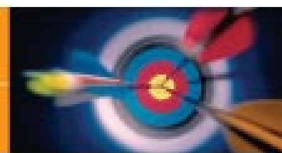
investor's eye



Index

- Stock Update >> Associated Cement Companies
- Stock Update >> Ashok Leyland
- Stock Update >> Reliance Industries
- Stock Update >> NIIT Technologies
- Stock Update >> Thermax
- Stock Update >> SKF India
- Viewpoint >> Sona Koyo Steering Systems
- Sector Update >> Information technology

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Aban Loyd	03-Mar-05	330	**920**	1,760
Bajaj Auto	15-Nov-05	1,873	**2,500**	3,500
BHEL	11-Nov-05	1,203	**1,812**	2,650
Esab India	21-May-04	60	**290**	575
Infosys	30-Dec-03	689	**1,648**	1,865

For Private Circulation only

Associated Cement Companies

Apple Green

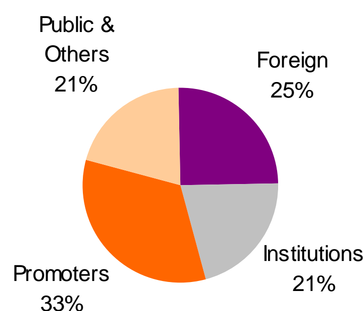
Stock Update

A whopper performance

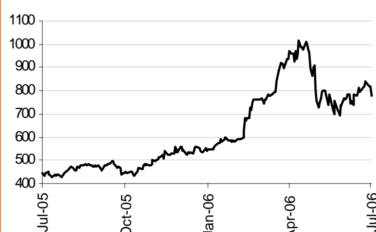
Buy; CMP: Rs780

Company details	
Price target:	Rs1,050
Market cap:	Rs14,555 cr
52 week high/low:	Rs1,061/425
NSE volume: (No of shares)	1.2 lakh
BSE code:	500410
NSE code:	ACC
Sharekhan code:	ACC
Free float: (No of shares)	12.5 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	11.4	-12.7	52.9	93.8
Relative to Sensex	7.2	0.0	36.7	37.0

Result highlights

- At Rs291 crore ACC's Q2CY2006 pre-exceptional net profit is above our expectation primarily because of a higher-than-expected improvement in the cement realisation.
- The net sales for the quarter grew by a healthy 32% driven by a 5.2% growth in the cement volume and a whopping 33.8% year-on-year (y-o-y) growth in the cement realisation.
- The growth in the cement realisation has been higher than the average rise of 20-22% in cement prices on account of two reasons. One, ACC's higher exposure to the southern region, where cement price hikes have been higher and two, higher dispatches from ACC's Gagal unit in Himachal Pradesh, which is an excise-free zone. Further on an overall basis also the excise duty as 5% of sales has fallen to 9.7% from 11.8% last year.
- The company's operating profit margin (OPM) for the quarter improved by a staggering 1,190 basis points to 31.2%, driven by the sharp increase in the cement realisation.

Result table Rs (cr)

Particulars	Q2CY06	Q2CY05	% yoy chg	H106	H105	% yoy chg
Net sales	1,462.0	1,107.2	32.0	2,789.5	2,220.6	26.0
Total expenditure	1,006.5	893.9	12.6	2,018.9	1,842.2	10.0
Operating profit	455.5	213.3	113.6	770.6	378.5	104.0
Other income	15.5	32.7	-52.7	60.1	60.9	-1.0
PBIDT	471.0	246.0	91.4	830.7	439.3	89.0
Interest	14.7	21.9	-32.9	34.1	42.3	-19.0
PBDT	456.3	224.1	103.6	796.7	397.0	101.0
Depreciation	57.9	48.0	20.8	117.3	95.3	23.0
PBT	398.4	176.1	126.2	679.4	301.8	125.0
Tax	107.3	45.5	135.6	141.2	19.2	637.0
PAT before extraordinary item	291.1	130.6	122.9	538.2	282.6	90.0
Extraordinary items	146.3	8.8		123.4	22.3	
Tax on extraordinary item	-32.0			-20.6	0.0	
Reported	405.4	139.4	190.9	641.0	304.9	110.0
EPS	15.5	7.3	113.3			-
EPS after extraordinaries	21.7	7.8				
Margins (%)						
OPMs (%)	31.2	19.3		27.6	17.0	
EBIDTA (%)	31.9	21.6		29.2	55.7	
PBT(%)	27.0	15.5		23.8	38.2	
PAT (%)	19.7	11.5		18.9	35.8	

Note 1: The Q2CY2006 results of ACC include the numbers of Bargarh Cement and Damodar Cement, the two companies that were merged with ACC. The results also do not include the revenues of the refractory business, which was divested in September 2005. Hence the numbers for the period are not strictly comparable with those of the previous year.

Note 2: The reported net profit includes a profit of Rs146.2 crore on the gains from the sale of land in Delhi and the sale of the Mancherial unit. We have treated the same as extraordinary items and accounted for them below the line.

- With a 32% growth in the revenues and a 1,190-basis-point improvement in the OPM, the operating profit for the quarter jumped by a steep 113.6% to Rs455 crore.
- On a like-to-like basis, cement revenues have grown by 39.6% and cement earnings before interest and tax (EBIT) have grown by 123%.
- On the cost front, despite a 34% increase in the staff cost, a 12% increase in the freight cost and a 9.8% increase in the power and fuel cost per tonne, the total cost per tonne increased by just 7%.
- With a strong cash flow from the operations, the company was able to repay its debts and hence the interest cost declined by 33% in the quarter. The pre-exceptional net profit for the quarter jumped by a handsome 123% to Rs291 crore. The reported net profit, which includes the gains from the sale of land and the Mancherial unit (which have been treated as extraordinary items by us including the tax of Rs32 on the same) stood at Rs405 crore, up 191%.

ACC's pre-exceptional net profit grew by 123% to Rs291 crore. The growth was way ahead of our expectation primarily because of a higher-than-expected improvement in the cement realisation. Further the company is planning to expand Bargarh Cement's capacity from 0.96 million tonne per annum (MTPA) to 2.14MTPA and set up a 30-megawatt (MW) captive power plant at the cost of Rs537 crore. In the view of the continued strong cement prices and the new capital expenditure (capex) plan as mentioned above, we are upgrading our estimates for ACC's earnings for CY2006 and CY2007 by 19.6% and 8.5% respectively. Our revised earnings per share (EPS) estimates are Rs47.8 and Rs56.2 for CY2006 and CY2007 respectively.

In our earlier reports we had mentioned that with Holcim assuming charge of ACC's operations, the Indian cement company would benefit from the Swiss company's operational and management expertise. This is clearly evident, as in the last one year ACC has sold its non-core businesses and assets, and realised a sum in excess of Rs500 crore from the exercise. The proceeds have been utilised to repay debt and fund expansion plans. With the continued focus on cement operations and sale of more non-core assets, ACC could become a debt-free company in the next two years.

At the current market price of Rs780, the stock is discounting its CY2007E earnings by 13.9x and earnings before interest, depreciation, tax and amortisation (EBIDTA) by 7.9x. On enterprise value (EV)/tonne basis, the stock is trading at an attractive valuation of US$141.9 per tonne of cement. Given the continued momentum in the earnings growth and the sharp improvement in the return ratios, the stock is attractively valued. We maintain our Buy recommendation on the stock with the price target of Rs1,050.

Sharp improvement of 33.8% in cement realisation

During the half year January-June 2006, cement consumption grew by 12% as compared with a 10% growth in the corresponding period of the previous year. This caused the cement manufactures to work at over 90% capacity utilisation, which coupled with the Supreme Court's ban on the overloading of trucks resulted in a surge in cement prices in the last three to four months. Being a leading cement producer, ACC has gained immensely as during the quarter its cement revenues grew by a very healthy 41% yoy. This stupendous growth was driven by a sharp rise in the cement volume and realisation yoy. The cement realisation rose by 33.8% to Rs2,985 per tonne whereas the cement volume grew by 5.2% to 4.63 million tonne. The growth in the cement realisation has been higher than the average rise of 20-22% in the cement prices on account of two reasons. One, ACC's higher exposure to the southern region, where cement price hikes have been higher and two, the higher dispatches from ACC's Gagal unit in Himachal Pradesh, which is an excise-free zone. Further on an overall basis also, the excise duty as 5% of sales has fallen to 9.7% from 11.8% last year. The net sales for the quarter grew by 32% to Rs1,462 crore.

Higher realisation boosts operating profit by a staggering 113.6%

Driven by the sharp improvement in the cement realisation, ACC's OPM improved by a whopping 1,190 basis points to 31.2%. Consequently, the operating profit for the quarter grew by a staggering 113.6% to Rs455 crore. On the cost front, despite a 34% increase in the staff cost, a 12% rise in the freight cost (because of the ban on the overloading of trucks) and a 9.8% surge in power and fuel cost per tonne, the total cost per tonne increased by just 7%. Hence ACC's EBIDTA per tonne jumped up significantly from Rs450 per tonne to Rs950 per tone during Q2CY2006.

Per-tonne analysis

Rs per tonne	Q2CY2006	Q2CY2005	% chg
Cement volumes (million tonne)	4.63	4.4	5.2
Realisation per tonne	2985.0	2230.0	33.8
Cement sales (Rs crore)	1382.0	981.4	40.8
Cost per tonne			
Raw material	363.4	346.0	5.0
Stock adjustment	-110.1	-67.3	
Staff cost	178.2	132.9	34.1
Power & Fuel	551.6	502.2	9.8
Cost of traded cement	3830.0	3039.3	26.0
Freight	474.9	423.8	12.1
Other expenses	702.4	553.1	27.0
Total cost per tonne	2173.9	2031.7	7.0
EBIDTA per tonne	950.0	450.0	111

The Q2CY2006 results of ACC include the numbers of Bargarh Cement and Damodar Cement, the two companies that were merged with ACC. Also the quarter does not include the revenues of the refractory business, which was divested in September 2005. Hence we have compared the consolidated cement revenues and EBIT to know the like-to-like performance. On a like-to-like basis, the cement revenues and EBIT have grown by 39.6% and 123% respectively.

Consolidated results (Rs crore)

Particulars	Q2CY2006	Q2CY2005	% chg
Revenue	1382.2	990.0	39.6
EBIT	425.8	190.7	123.2

Pre-exceptional net profit up 98%

With strong cash flows, the company was able to repay its debts and hence its interest cost declined by 33% during the quarter. On the other hand, the depreciation cost increased by 20% yoy as ACC commissioned its Gagal unit in April 2006 and Chaibassa plant in September 2005. Further the merged capacities of Bargarh Cement and Damodar Cement added to the depreciation during the quarter. The pre-exceptional net profit for the quarter grew by a handsome 98.4% to Rs259 crore. The reported net profit, which includes the gains from the sale of land and the Mancherial unit (which have been treated as extraordinary items by us) stood at Rs405, up 191%.

Upgrading earnings

ACC's pre-exceptional net profit grew by 98.4% to Rs259 crore. The growth was higher than our expectation primarily because of the higher-than-expected improvement in the cement realisation. In view of the continued strong cement prices, we are upgrading our estimates for the company's earnings for CY2006 and CY2007 by 19.6% and 8.5% respectively. Our EPS estimates now stand at Rs47.8 and Rs56.2 for CY2006 and CY2007 respectively.

ACC benefiting from Holcim's focus on core cement business

In our earlier reports we had mentioned that with Holcim in charge, ACC would benefit from the Swiss company's operational and management expertise. The same is clearly evident, as in the last one year ACC has sold its non-core businesses and assets, and realised a sum in excess of Rs500 crore from the exercise. The proceeds have been utilised to repay debts and fund expansion plans. With the continued focus on the cement operations and the sale of more non-core assets, ACC could become a debt-free company in the next two years.

Outlook remains positive, maintain Buy with price target Rs1,050

The growth in cement consumption continues unabated—t grew by 12% in H1CY2006 as compared with a 10% growth in H1CY2005. As a result cement prices have grown at a faster clip of 20-22%. ACC is benefiting from the rising cement prices, increasing cement volumes and strong focus on efficiency improvement. We remain bullish on the cement sector and ACC remains one of our top cement picks, as we are gradually witnessing the company's transformation into a very efficient cement producer. The management has maintained its focus on efficiency by announcing the 30MW captive power plant for Bargarh Cement. This is in addition to the 25MW captive power plant for the Lakheri unit that will be commissioned in Q4CY2006. All the factors shall maintain the momentum in ACC's earnings, which are expected to grow at a compounded annual growth rate of 85% over CY2005-07.

At the current market price of Rs780, the stock is discounting its CY2007E earnings by 13.9x and EBIDTA by 7.9x. On an EV/tonne basis, the stock is trading at an attractive valuation of US$141.9 per tonne of cement. We maintain our Buy recommendation on the stock with the price target of Rs1,050.

Q2CY2006 developments

Lakheri plant expansion in progress, new capex plan announced

ACC is expanding the capacity at the Lakheri plant by 1 million tonne to 1.5 million tonne at a cost of Rs60 crore. The company is also putting up a captive thermal power plant of 25MW at Lakheri at a total cost of Rs100 crore. The power plant would be operational by the middle of 2007. This capex programme is progressing as per schedule. Further the company is planning to expand Bargarh Cement's capacity from 0.96MTPA to 2.14MIPA and set up a 30MW captive power plant at a cost of Rs537 crore. The expansion it expected to be complete by the end of CY2007. The total capacity of ACC at the end of the capacity expansions will be 22 million tonne.

Earnings table

Particulars	FY04	FY05	CY05	CY06E	CY07E
Net profit (Rs cr)	200.2	378.2	310.5	899.8	1058.6
Share in issue (cr)	17.7	17.9	18.5	18.8	18.8
EPS (Rs)	11.3	21.2	16.8	47.8	56.2
% y-o-y growth	*93.0*	*87.0*	*-21.0*	*184.0*	*18.0*
PER (x)	72.4	36.9	46.4	16.3	13.9
P/BV (x)	10.2	8.7	6.7	4.6	3.6
EV/EBIDTA (x)	39.8	24.4	30.1	9.7	7.9
EV/tonne (US $)	204.2	199.3	177.4	157.5	141.9
Dividend yield (%)	0.5	0.5	1.0	1.0	1.0
ROCE (%)	12.5	16.8	12.0	31.1	33.6
RONW (%)	14.8	23.7	14.5	28.3	25.9

*Includes only nine-month results as the accounting year was changed

Ashok Leyland

Ugly Duckling

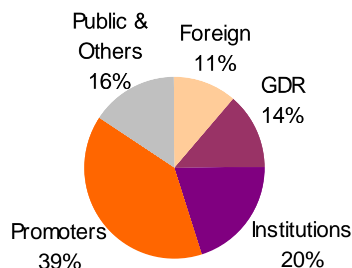
Stock Update

Acquisition positive

Buy; CMP: Rs31

Company details	
Price target:	Rs53
Market cap:	Rs4,192 cr
52 week high/low:	Rs53/25
NSE volume: (No of shares)	74.7 lakh
BSE code:	500477
NSE code:	ASHOKLEY
Sharekhan code:	ASHOKLEY
Free float: (No of shares)	61.7 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-10.0	-25.1	3.4	15.0
Relative to Sensex	-10.5	-11.7	-3.3	-16.9

Ashok Leyland Ltd (ALL) has signed a framework agreement to acquire the truck business of the Czech truck maker, Avia. We view the acquisition in positive light since it would aid ALL to gain a foothold in some of the European markets. The acquisition would also give ALL access to the superior technological and designing capabilities of Avia and may also boost the revenues from its auto component business in the future. Further, Avia has some strong brands in the light commercial vehicle (LCV) category which can be launched in India by ALL. The acquisition is expected to get completed by August 2006 and the company has not yet disclosed the cost of the acquisition.

In another development, the Hindujas have bought out Iveco's 30% stake in the holding company, Land Rover Leyland International Holding (LRLIH). LRLIH holds a 49.53% stake in ALL and hence Iveco indirectly controls a 15% stake in ALL. The transaction is believed to have been struck at close to Rs600 crore. Since Iveco was not adding any value to the company, we view this as a positive development.

Background of Avia

Avia was originally formed as an aircraft and engine manufacturer in 1919. In 1995, it was taken over by Daewoo Corporation, which acquired a 50.2% stake in the company. With the bankruptcy of Daewoo Corporation, Avia was taken over in 2005 by an investment company called Odien Capital Partners, which has attempted to turn it around. ALL is however acquiring just the truck unit of Avia, which we gather performs about 60% of its total operations.

Avia manufactures 6-12-tonne trucks and has the capacity to manufacture up to 20,000 vehicles a year. It also has a state-of-the-art paint shop, and a research and development (R&D) facility. The company has good presence in the European markets and the countries like the Czech Republic, Hungary, the UK, Ireland, Slovakia, Italy and Spain. It manufactures a popular D-series trucks (consisting of 6-tonne, 7.5-tonne and 9-tonne models), which has built good brand equity in the European markets. It is currently a loss-making company and its total annual sales are estimated to be around Rs113 crore. Also, ALL is only taking over one division of Avia, ie the truck divsion, and the deal involves the take-over of only the assets and not debt.

Impact on ALL

We believe the acquisition would have positive implications for ALL. It is part of the company's inorganic growth strategy to enter new markets and would give it a foothold in the European markets. ALL is also expected to launch some of the LCV models of Avia in India. As of now, ALL's presence in the LCV segment is quite miniscule and some of the strong brands like the D-series trucks of Avia should help to change this situation. Further, we also believe that the company would look to market some of its own products in the European markets. The management has also indicated that it would be marketing Avia products in the markets like the Middle East, south-east Asia, Russia and Ukraine.

The acquisition would also help ALL to benefit from the technological and designing capabilities of Avia. Going forward, we think that the acquisition would also boost ALL's auto component revenues as the parts may be outsourced due to cost advantages.

Outlook

With buoyancy in the sector, we believe that the acquisition has come at the right time, and should lead to a strong growth in the company's export sales, boost its LCV sales in India and increase its auto component revenues. At the current market price of Rs31, the stock is quoting at 8.2x its FY2008E earnings and an FY2008 enterprise value/ earnings before interest, depreciation, tax and amortisation of 4.5x. We maintain our Buy recommendation on the stock with the price target of Rs53.

Earnings table

Year ended Mar 31	FY2005	FY2006	FY2007E	FY2008E
Net profit (Rs cr)	281.0	305.6	406.7	503.5
% y-o-y growth	-	*9.0*	*33.0*	*24.0*
Shares in issue (cr)	118.9	122.2	133.2	133.2
EPS (Rs)	2.4	2.5	3.1	3.8
% y-o-y growth	-	*9.0*	*33.0*	*24.0*
PER (x)	13.1	12.4	10.2	8.2
Book value (Rs)	9.6	11.4	15.0	15.6
P/BV (Rs)	3.2	2.7	2.1	2.0
EV/EBIDTA (x)	8.9	7.2	5.6	4.5
Dividend yield (%)	3.2	4.2	3.9	3.9
RoCE (%)	20.7	21.8	25.9	28.8
RoNW (%)	23.7	23.6	20.4	24.2

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

Reliance Industries

Evergreen

Stock Update

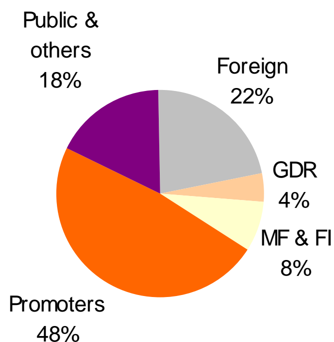
Results in line with expectations

Buy; CMP: Rs996

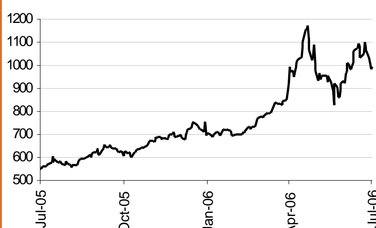
Company details

Price target:	Rs1,200
Market cap:	Rs138,842 cr
52 week high/low:	Rs1,195/666
NSE volume: (No of shares)	65.1 lakh
BSE code:	500325
NSE code:	RIL
Sharekhan code:	RIL
Free float: (No of shares)	66.5 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	5.2	7.8	41.0	94.1
Relative to Sensex	4.7	27.0	31.8	40.3

Result highlights

- The Q1FY2007 net profit of Reliance Industries Ltd (RIL) grew by 10.6% year on year (yoy) to Rs2,547 crore in line with our expectation. The growth could have been higher but for the partial shut-down of its refinery and some petrochemical units.
- The refining & marketing (R&M) business witnessed another quarter of strong performance with its sales growing at 29.6% yoy despite a lower capacity utilisation. The company achieved the highest ever gross refining margin (GRM) of $12.4 per barrel (bbl) during the quarter.
- The profit before interest and tax (PBIT) in the R&M business grew by 13.8% yoy despite the facts that the company had to bear high losses on retailing of the products and its capacity utilisation was lower than last year's.
- The petrochemical business also saw a strong momentum with the revenue growing by 46.7% yoy. However, the PBIT grew by a slower 23.2% yoy. The PBIT margin declined by 211 basis points due to higher input cost and the partial shut-down of some cracking units.
- The overall operating profit grew by 18.8% yoy. The operating profit margin (OPM) declined by 277 basis points.
- RIL has identified organised retailing, and oil exploration and production (E&P) activities as the future growth drivers. While we have factored the value of the oil E&P activities in our price target (Rs362 per share), we believe that the organised retailing business could add anything between Rs100 and Rs160 to the stock's value. However we have not factored the same in our price target.
- We are reiterating our Buy recommendation on the stock with a revised price target of Rs1,200 based on the sum-of-parts valuation method.

Revenue grows by 37.9% yoy

The revenue for Q1FY2007 grew by a strong 37.9% yoy on the back of the strong performance of the R&M and petrochemical businesses. The revenue from the R&M business grew by 29.6% yoy whereas that from the petrochemical business grew by 46.7% during the same period.

Result table Rs (cr)

Particulars	Q1FY2007	Q1FY2006	% yoy chg
Net sales	24,522.6	17,784.0	37.9
Other income	44.0	194.0	-77.3
Total income	24,566.6	17,978.0	36.6
Total expenditure	20,285.0	14,218.0	42.7
Operating profit	4,237.6	3,566.0	18.8
Interest	266.0	237.0	12.2
Depreciation	907.0	791.0	14.7
Profit before tax	3,108.6	2,732.0	13.8
Tax	561.0	422.0	32.9
Profit after tax	2,547.6	2,310.0	10.3
OPM (%)	17.3	20.1	-277 bps

Segment results (Rs crore)

	Q1FY2007	Q1FY2006	% yoy chg
Revenues (Rs crore)			
Petrochemicals	9,787.0	6,670.0	46.7
Refining	20,862.0	16,095.0	29.6
Others	530.0	413.0	28.3
PBIT (Rs crore)			
Petrochemicals	1,087.0	882.0	23.2
Refining	2,035.0	1,788.0	13.8
Others	284.0	219.0	29.7
PBIT margins (%)			
Petrochemicals	11.1	13.2	-212 bps
Refining	9.8	11.1	-135 bps
Others	53.6	53.0	56 bps

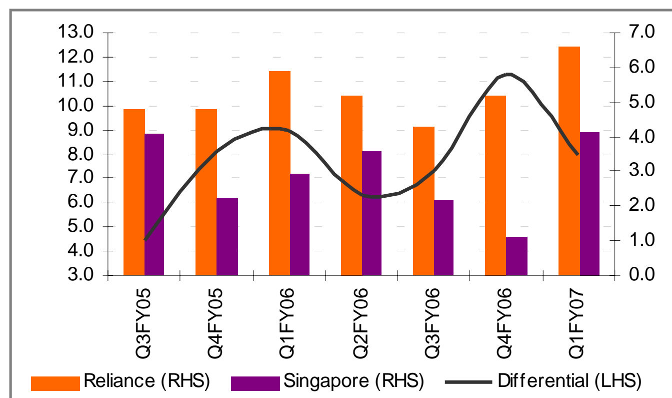
The growth in the revenues was achieved despite the partial shut-down of the refinery and some cracking units during the quarter, and consequently the crude throughput in the R&M business and production of petrochemicals were lower compared with that in the last year.

Refining business: Strong GRM drives revenues

The R&M business reported a strong growth of 29.6% in its revenue for the quarter to Rs20,862 crore. The growth was achieved on the back of better price realisation even as the capacity utilisation during the quarter was lower at 91% compared with 96% in Q1FY2006.

During the quarter the GRM remained strong at $12.4 per bbl (net of under recoveries in the retailing of the products), outpacing the Singapore GRM by a margin of $3.5/bbl.

GRM remains strong ($/bbl)



Source: Company, Sharekhan research

However, the PBIT of the R&M business grew by only 13.8% as the company incurred huge losses on retailing of the petroleum products. The PBIT margin declined by 135 basis points during the quarter.

We believe that the growth in the PBIT and margins was still encouraging, given the fact that the capacity utilisation was lower during the quarter. Also on a quarter-on-quarter basis, the PBIT margin expanded by 143 basis points as the retailing losses are coming down.

Supplies from refinery to	Q1FY06	Q4FY06	Q1FY07
OMC	1.9	1.1	0.7
Captive use	1.6	1.8	1.7
Retailing	0.6	1.1	0.9
Others	1.3	1.2	1.1
Exports	2.5	3.2	3.5
Total	7.9	8.4	7.9

We believe that in the coming quarters some of the following measures would further help the company in improving its profitability in this business.

- Lower sales through own retail outlets and slower ramp-up in the retail outlet network.
- Lower supplies to the public sector oil marketing companies (OMC).
- Increases in petrol (Rs4 per litre) and diesel (Rs2 per litre) prices effected by the company in June 2006.

Petrochemical/polyester business: Prices drive revenues and profits

The petrochemical business reported a strong growth of 46.7% in its revenue to Rs9,787.0 crore. The production of polymers was lower by 8.6% yoy due to the shut-down of some of the cracking units.

The production of polyester products was up by 3.2% as the company commissioned its polyester fibre and filament yarn capacities during the quarter. RIL is likely to commence its 630,000-metric-tonne-per-annum capacity of pure terephthalic acid in July 2006 which shall help it to maintain the volume growth.

Oil & gas business: Progressing smoothly

Crude oil production from the Panna-Mukta oil field improved by 6.0% yoy whereas gas production from the Panna-Mukta-Tapti oil field remained flat during the quarter.

Production volumes

In tonne	Q1FY2007	Q1FY2006	% yoy chg
Crude Panna-Mukta	381,997	360,288	6.0
Gas MSCM	869	873	-0.5
From Panna-Mukta	*347*	*333*	*4.2*
From Tapti	*522*	*540*	*-3.3*

MSCM - Million standard cubic meters

As for the blocks under exploration and development, the company had already mentioned its estimates earlier. The KG D6 block has 14 trillion cubic feet (tcf) of reserves and is likely to begin commercial production in FY2009; it is expected to produce 40MSCMD of gas initially. The NEC-25 block in Orissa has 2.2tcf of gas which has been approved by authorities. However, the upside could possibly go up to 8.2tcf. The field is likely to start the commercial production

in FY2010. The coal bed methane (CBM) blocks are expected to have 3.65tcf of gas.

During Q1FY2007, RIL made two more crude oil discoveries in the KG basin. The potential of these discoveries is currently being evaluated.

The oil block in Yemen is producing 2,000 barrels per day (bpd) and RIL has plans to increase the production to 20,000bpd by the end of CY2006. RIL also owns a block in Oman which is in the exploration stage.

Net profit grows by 10.6% yoy

The operating profit for Q1FY2007 grew by 18.8% yoy to Rs4,237.6 crore as the OPM contracted by 277 basis points. The reasons for the same were higher input cost, lower capacity utilisation and losses on retailing, as mentioned above.

The net profit grew at a slower rate of 10.6% yoy as during the quarter the company invested in Reliance Petroleum shares which reduced the surplus funds for investments. As a result the other income declined to Rs44 crore from Rs194 crore in Q1FY2006.

Retailing to be next major growth area

Organised retail is the new theme for growth and expansion at RIL. Through Reliance Retail Ltd (RRL), its 100% subsidiary, (not considering stock options which might be given later on to the employees), RIL has embarked upon a Rs25,000-crore expansion plan in the organised retail space. This would entail an equity investment of Rs10,000 crore in RRL by RIL; the balance investment would be in the form of equity.

The focus will be on food, grocery and farm inputs, and the company plans back-to-back integration of the same by establishing direct procurement system and food processing zones. RIL will also focus on other verticals like apparels and consumer goods wherein it will bring world-class brands to India.

We expect the retailing venture to begin full-fledged operations by FY2009, when it would become profitable and be valued at anything between Rs100 and Rs160 per share of RIL.

Also venturing into SEZs

RIL is also planning to venture into the construction of special economic zones (SEZs). The company has planned three SEZs, one each at Jamnagar in Gujarat (where its new refinery is coming up), Navi Mumbai and Haryana. These SEZs can also add significantly to the stock's value.

Valuation and view

We believe that with its strong capital expansion plans and ability to fund the same from the strong internal cash flows, RIL is all set to create long-term value for its shareholders. We are revising our price target to Rs1,200 based on the sum-of-parts valuation method. However, the same does not include any upside expected from the foray in retailing and SEZ construction.

Derivation of price target*

	Per share	Basis
R&M	429.5	5.5x FY2008E EV/EBIDTA
Petrochemicals	365.0	5.5x FY2008E EV/EBIDTA
Upstream oil and gas equivalent	362.0	$3.5 per barrel of oil and oil
IPCL	22.0	Based on market price
RPL	167.0	Based on market price
Total	1,365.1	
Debt	-147.0	
Fair value	1,208.0	

* We have excluded the value of treasury stock for the purpose of our calculations.

Valuation table

Year ended March 31	2005	2006	2007E	2008E
Net profit	7,572.0	9,069.0	9,699.7	9,734.8
Shares in issue (cr)	139.6	139.6	139.6	139.6
EPS (Rs)	54.2	65.0	69.5	69.7
% y-o-y chg	*42.9*	*19.8*	*7.0*	*0.4*
PER (x)	18.1	15.1	14.1	14.1
Book value (Rs)	295.0	351.5	412.4	473.7
P/BV (x)	3.3	2.8	2.4	2.1

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

NIIT Technologies

Ugly Duckling

Stock Update

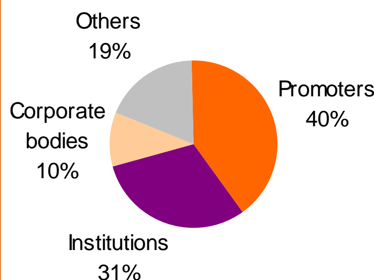
Results in line with expectations

Buy; CMP: Rs181

Company details

Price target:	Rs296
Market cap:	Rs700 cr
52 week high/low:	Rs242/131
NSE volume: (No of shares)	1.5 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	16.1	-22.1	-2.3	0.3
Relative to Sensex	15.5	-8.3	-8.7	-27.5

Result highlights

- NIIT Technologies reported a growth of 14.9% quarter on quarter (qoq) and of 39.9% year on year (yoy) in its consolidated revenues to Rs191 crore during the first quarter. The sequential growth was driven by a 4.5% sequential growth in the organic business. The incremental revenues (of around Rs17.4 crore) from the acquisition of the UK-based Room Solutions (RM) accounted for an 11.4% growth on a sequential basis.
- The operating profit margin (OPM) improved by 20 basis points as compared with that in Q1FY2006 but slipped by 100 basis points qoq to 19%. The sequential decline was caused by the adverse impact of the annual wage hikes (17% average hike to the offshore employees and around 5% hike to the onsite employees) and the relatively low margin of RM. The adverse impact was partially mitigated by the depreciation of the rupee and the decline in the selling, general and administration (SG&A) expenses (from 22% to 20%) as a percentage of sales.
- The other income component was boosted by the foreign exchange fluctuation gains of Rs1.7 crore and stood at Rs3.5 crore, up from Rs1.1 crore in Q4FY2006 and a negative other income of Rs0.1 crore reported in Q1FY2006. Thus, despite the higher-than-expected tax rate and minority interest, the earnings growth of 13.4% qoq and of 55.7% yoy to Rs21.8 crore was higher than our estimate.
- In terms of the outlook, the growth in the organic business is likely to accelerate on the back of healthy fresh order intake of $38 million in Q1 and the consequent jump in the pending order backlog to $90 million (up from $76 million in Q4) executable over the next one year. The margins are likely to get dented in Q2 due to one-time charges related to the integration of RM but the same would get normal in the following quarters.
- At the current market price the stock trades at 8.3x FY2007 and 6.6x FY2008 estimated earnings. We maintain our Buy call on it with the price target of Rs296.

Result table Rs (cr)

Particulars	Q1FY07	Q1FY06	Q4FY06	% yoy chg	% qoq chg
Net revenue	191.0	136.5	166.2	39.9	14.9
Operating expenses	154.7	110.8	133.0	39.6	16.3
Operating profit	36.3	25.7	33.2	41.2	9.3
Other income	3.5	-0.1	1.1	-	218.2
Depreciation	12.0	9.3	11.0	29.0	9.1
Profit before tax	27.8	16.3	23.3	70.6	19.2
Tax	4.5	2	4	-	25.0
Net profit	23.3	14.1	19.7	65.2	18.2
Minority share	1.5	0.1	0.5	1400.0	200.0
RPAT	21.8	14.0	19.2	55.7	13.4
Equity capital	38.7	38.7	38.7		
EPS (Rs)	5.6	3.6	5.0		
Margins (%)					
OPM	19.0	18.8	20.0		
NPM	11.4	10.3	11.6		

Organic growth to pick up

The healthy sequential growth of 14.9% in the revenues was largely driven by the incremental revenues from the integration of RM. The organic business grew at a lower-than-expected rate of 4.5% in rupee terms, despite the favourable impact of the depreciation in the rupee. It is the third consecutive quarter of a decline in the sequential growth rate of the organic business.

However, the growth rate is expected to pick up in the following quarter on the back of the healthy growth in the pending order book position. The pending order backlog stood at $90 million, up from $76 million in Q4FY2006. Second, the company expects to secure some business that was outsourced by RM to the other information technology service vendors. Third, the management indicated that the business of business process outsourcing (BPO) is likely to grow at a faster rate (as compared to the 4.3% sequential growth in Q1).

Margins to dip in Q2

The OPM improved by 20 basis points as compared with that in Q1FY2006 but slipped by 100 basis points qoq to 19%. The sequential decline was contributed by the adverse impact of the annual wage hikes (17% average hike to the offshore employees and around 5% hike to the onsite employees) and the relatively low margin of RM. The adverse impact was partially mitigated by the depreciation of the rupee and the decline in the SG&A expenses (from 22% to 20%) as a percentage of sales.

However, the margins are expected to decline sharply in Q2 due to one-time charges related to the integration of RM. The margins are likely to normalise in the second half and move in the range of 19-20%. The two key levers of margin improvement would be the enhanced profitability of RM owing to the shifting of the development work and support staff cost to India and improvement in the contribution of the offshore revenues (offshore revenues contributed just 37% of the revenues in Q1).

Other highlights

The net employee addition was healthy at 305 associates, amounting to a growth of 8.6% over the base at the end of the previous quarter. The software service business added 266 employees while 39 associates joined the BPO business during the quarter. At around 18% the attrition rate was also manageable.

The company added four new clients during the quarter, including a large client in the transportation vertical from Europe. The revenues from the Top 20 clients grew at 21.9% on a sequential basis.

Valuation

At the current market price the stock trades at 8.3x FY2007 and 6.6x FY2008 estimated earnings. We maintain our Buy call on it with the price target of Rs296.

Earnings table

Particulars	FY2005	FY2006	FY2007E	FY2008E
Net sales (Rs cr)	543.2	607.5	779.8	927.4
Net profit (Rs cr)	58.6	66.3	84.7	106.1
No of shares (cr)	3.9	3.9	3.9	3.9
EPS (Rs)	15.2	17.2	21.9	27.5
% y-o-y chg	-	*13.2*	*27.8*	*25.3*
PER (x)	11.9	10.6	8.3	6.6
Price/BV (x)	3.0	2.4	2.0	1.6
EV/EBIDTA(x)	6.4	4.8	3.9	2.8
Dividend yield (%)	3.0	3.3	3.9	4.4
RoCE (%)	21.9	23.4	26.2	26.6
RoNW (%)	32.7	28.6	29.0	27.8

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

Thermax

Emerging Star

Stock Update

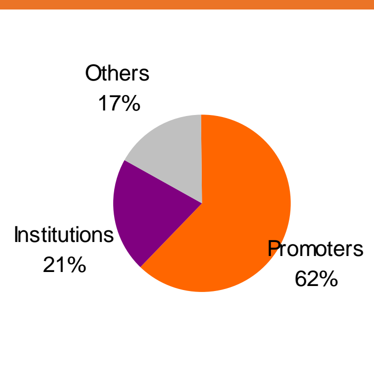
Q1FY2007 results—first cut analysis

Buy; CMP: Rs245

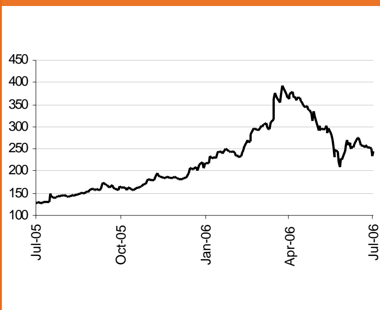
Company details

Price target:	Rs340
Market cap:	Rs584 cr
52 week high/low:	Rs410/125
NSE volume: (No of shares)	58,108
BSE code:	500411
NSE code:	THERMAX
Sharekhan code:	THERMAX
Free float: (No of shares)	90.6 lakh

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-1.0	-35.0	11.1	85.6
Relative to Sensex	-1.5	-23.4	3.9	34.1

Result highlights

- Thermax' consolidated revenues grew by 23.7% year on year (yoy) to Rs355.2 crore in Q1FY2007, in line with our expectations. The energy segment grew by a robust 21.9% yoy to Rs281.2 crore while the environment segment grew by 26.1% yoy to Rs112.5 crore.
- The company's operating profit margin (OPM) grew by 400 basis points yoy to 10.4% in the quarter, beating our expectations. The robust margin expansion was on the back of the fall in the raw material cost, which as a percentage of sales declined from 63.9% in Q1FY2006 to 58.0% Q1FY2007. The operating profit grew by 101.3% yoy to Rs37.0 crore, ahead of our expectations.
- The energy segment saw a sharp increase in the profit before interest and tax (PBIT) margins, which ballooned by 620 basis points to 11.5%. The environment segment had a lower PBIT of 6.5%.
- The net profit grew by 202.6% yoy to Rs25.9 crore in Q1FY2007, way ahead of our expectation. The robust margin expansion, higher other income and lower effective tax rate are attributable to the massive upward swing in the net profit.
- The stand-alone profit after tax (PAT) stood at Rs27.5 crore for Q1FY2007. The difference between the consolidated and the stand-alone PAT is attributable to the Rs1.5 crore loss of ME Engineering, UK, Thermax' wholly-owned subsidiary.
- The consolidated order backlog stood at Rs 2,666 crore in Q1FY2007 as against Rs1,730 crore in Q4FY2006, a strong growth of 54.1% quarter on quarter (qoq) and a growth of 131.8% yoy.

Result table Rs (cr)

Particulars	Q1FY2007	Q1FY2006	% yoy chg
Net sales	355.2	287.2	23.7
Expenditure	318.2	268.8	18.4
Operating profit	37.0	18.4	101.3
Other income	6.6	3.3	99.7
PBIDT	43.6	21.7	101.0
Interest	0.1	0.3	-70.0
Depreciation	3.9	3.5	12.0
PBT	39.6	17.9	121.3
Tax	13.6	9.3	46.5
PAT	25.9	8.6	202.6
EPS (Rs/Share)	2.2	0.7	202.6
OPM (%)	10.4	6.4	400.0 bps
PBTM (%)	11.1	6.2	490.0 bps
PATM (%)	7.3	3.0	430.0 bps

- The stock is trading at a price/earnings ratio (PER) of 12.8x FY2008E consolidated earnings and enterprise value (EV)/earnings before interest, depreciation, tax and amortisation (EBIDTA) of 7.0x FY2008E. We continue to remain bullish on the company and maintain a BUY on Thermax with a price target of Rs340.

We also attended the annual general meeting (AGM) of the company. A detailed analysis of the AGM and the quarterly results will follow soon.

Earnings table

Particulars	FY2005	FY2006	FY2007E	FY2008E
Net profit (Rs cr)	70.3	100.9	156.7	227.5
Share in issue (cr)	11.9	11.9	11.9	11.9
EPS (Rs)	5.9	8.5	13.2	19.1
% y-o-y growth	*15.8*	*43.6*	*55.3*	*45.2*
PER (x)	41.6	29.0	18.6	12.8
Book value (Rs)	30.7	32.4	42.6	58.7
P/BV (x)	8.0	7.6	5.8	4.2
EV/Ebidta (x)	22.0	13.1	10.0	7.0
Dividend yield (%)	4.9	1.4	1.2	1.2
ROCE (%)	24.0	37.2	45.1	46.9
RONW (%)	15.0	22.3	27.0	29.5

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

SKF India

Apple Green

Stock Update

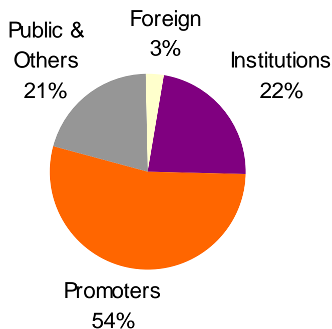
Impressive performance

Buy; CMP: Rs280

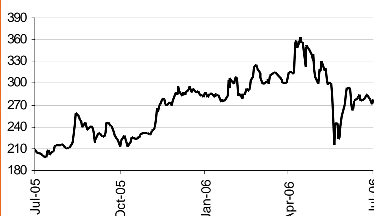
Company details

Price target:	Rs406
Market cap:	Rs1,476 cr
52 week high/low:	Rs376/198
NSE volume: (No of shares)	53,255
BSE code:	500472
NSE code:	SKFINDIA
Sharekhan code:	SKFBEAR
Free float: (No of shares)	2.4 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	2.3	-12.5	-4.2	31.4
Relative to Sensex	1.8	3.0	-10.5	-5.0

Result highlights

- SKF India's Q2CY2006 net profit at Rs25.3 crore grew by 29.2% year on year (yoy).
- The net sales for the quarter stood at Rs328 crore marking a growth of 84.5%. The steep growth in the revenues has come from the indenting business, which hitherto was conducted on a commission basis.
- On a like-to-like basis the operating profit margins (OPMs) have shown an improvement of 130 basis points to 13% yoy. The reported OPMs for the quarter were down 3.1% as the indenting business, which has a lower margin of close to 4%, brought down the overall OPMs.
- The operating profit for the quarter has shown a significant improvement of 49% and the same stood at Rs42.6 crore.
- The stock trades at compelling valuations of 8.3x CY2007 earnings.

With a strong growth in the volumes for the automobile sector and the continued uptrend in India's industrial activity (both higher production and new industrial investments), the outlook for SKF's portfolio of complete bearing solutions remains positive. This coupled with a higher share of the high-margin services business, growth through new ventures like increasing the supply to Indian railways, and the continued growth in the exports to its parent, add icing to the cake. Further at the current market price (CMP) of Rs280 the stock is discounting its CY2007 earnings by 8.3x and its earnings before interest, depreciation, tax and amortisation (EBIDTA) by 4.2x. This is pretty much the valuation that the stock used to command when we initiated our coverage at the price of Rs140. We believe the valuations are compelling, given SKF India's earnings' compounded annual growth rate (CAGR) of a strong 37% over CY2005-07E, which could go up further if the parent's plans of making SKF India a manufacturing hub for sourcing bearings solutions materialises in a big way. We maintain our Buy recommendation on the stock with a price target of Rs406.

Result table Rs (cr)

Particulars	Q2CY06	Q2CY05	% chg	H12006	H12005	% chg
Net sales	327.9	177.7	84.5	623.8	347.6	79.5
Total expenditure	285.3	149.1	91.3	544.7	298.7	82.4
Operating profits	42.6	28.6	49.0	79.1	48.9	61.7
Other income	2.0	7.1	-71.8	4.2	15.1	-72.2
EBIDTA	44.6	35.7	25.0	83.3	64.0	30.2
Interest	-0.8	-1.1	-26.6	-2.0	-2.2	-8.3
PBDT	45.4	36.8	23.4	85.3	66.2	28.9
Depreciation	6.8	6.4	5.8	13.7	13.0	5.5
PBT	38.6	30.4	27.1	71.6	53.2	34.6
Tax	13.3	11.6	14.3	23.7	20.4	16.2
Profit after tax	25.3	19.6	29.2	47.9	33.6	42.4
EPS	4.8	3.7		9.1	6.4	
OPM (%)	13.0	16.1		12.7	14.1	
EBIDTA (%)	13.6	20.1		13.4	18.4	
PATM (%)	7.7	11.0		7.7	9.7	

Change in the treatment of indenting business buoys revenues

The net revenues for Q2CY2006 grew by 84.5% yoy to Rs328 crore. However the revenues are not strictly comparable as the Q2CY2006 revenues include the revenues from the indenting business (IB), which hitherto was conducted on a commission basis. Earlier the domestic customers used to place their orders with the Singapore arm of SKF AB and SKF India used to get a commission on such sales made through Singapore. This is what is known as indenting business or direct customer delivery (DCD). However from September 2005, the IB is being routed through the books of SKF India itself. Due to this change in the treatment of the IB, the revenues from the same are included in the net sales and the corresponding costs are included in the total expenditure. The commission earned on the IB, which was included in the other income earlier, is no longer there. Hence we see a significant jump in the revenues and a significant drop in the other income (down 72% yoy).

Reported OPMs are down, but the like-to-like OPMs have improved

On a like-to-like basis the operating profit margins (OPMs) have shown an improvement of 130 basis points to 13% yoy. The reported OPMs for the quarter were down 3.1% as the indenting business, which has a lower margin of close to 4%, brought down the overall OPMs.

Like-to-like figures

	Q2CY06	Q2CY05	% chg
Revenue	327.9	277.7	18.0
Operating profit	42.6	32.6	31.0
Margin (%)	13.0	11.7	+130 Bps

Source: Sharekhan research

The operating profit for the quarter has shown a significant improvement of 49% and the same stood at Rs42.6 crore. On a like-to-like basis ie if we add the indenting commission earned last year to the operating profit of last year, the operating profit has grown by a healthy 31%.

Capex plan on schedule

The capital expenditure (capex) plan, which includes expanding its ball bearing capacity to 100 million units per year from the existing 74 million units per year and increasing its taper roller bearing capacity to 8.5 million units per year from the existing 6 million units per year is progressing as per schedule and is likely to be completed in the middle of Q3CY2006. The expansion shall contribute to the top line substantially in Q4CY2006, once the operation stabilises. Further the new cylindrical roller bearing (CRB) plant has commenced commercial production during the quarter and will contribute to the top line in Q3CY2006. The expansion would meet both the growing domestic demand and exports and consequently maintain the momentum in the company's earnings growth.

Parent to increase sourcing products from SKF India

As India is one of the focus areas for SKF Sweden, SKF India expects the exports to its parent to grow to 20% of the total sales. The exports constituted about 8% of the total sales of Rs775 crore of SKF India in CY2005. SKF Sweden wants to make India the primary hub to make several types of small ball, roller bearings and customised products that demand manual craft. SKF India hopes to ride on the increased sourcing from its parent for its export push and plans to achieve the above target in three to five years. About half of the earlier mentioned expansion at SKF's Pune manufacturing facility would be used to meet the parent SKF's sourcing needs.

Compelling valuations—maintain buy with a price target of Rs406

With a strong growth in the volumes of the automobile sector and the continued uptrend in India's industrial activity (both higher production and new industrial investments), the outlook for SKF's portfolio of complete bearing solutions remains positive. This coupled with the higher share of the high-margin services business, growth through new ventures like increasing supply to the Indian railways, and the continued growth in the exports to its parent, add icing to the cake. Further at CMP of Rs280 the stock is discounting its CY2007 earnings by 8.3x and its EBIDTA by 4.2x. This is pretty much the valuation that the stock used to command when we initiated our coverage at the price of Rs140. We believe the valuations are compelling, given SKF India's earnings CAGR of a strong 37% over CY2005-07E, which could go up further if the parent's plans of making SKF India a manufacturing hub for sourcing bearings solutions materialises in a big way. We maintain our Buy recommendation on the stock with a price target of Rs406.

Earnings table

Particulars	CY04	CY05E	CY06E	CY07E
Net profit (Rs cr)	50.1	84.7	120.2	158.2
% y-o-y growth	*56.0*	*69.0*	*42.0*	*32.0*
Shares in issue (cr)	4.53	5.27	5.27	5.27
EPS (Rs)	11.1	16.1	22.8	30.0
% y-o-y growth	*56.0*	*45.0*	*42.0*	*32.0*
PER (x)	25.3	17.4	11.0	8.3
Book value (Rs)	56.7	65.9	83.0	105.5
P/BV (Rs)	4.9	4.3	3.0	2.4
EV/EBIDTA (x)	11.3	10.0	5.7	4.2
Dividend yield (%)	1.0	1.4	2.3	3.0
RoCE (%)	32.8	40.9	45.7	47.5
RoNW (%)	19.5	24.4	27.5	28.4

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

Sona Koyo Steering Systems

Viewpoint

Steering to high-growth zone

CMP: Rs81

Result highlights

- The net sales of Sona Koyo Steering Systems (Sona Koyo) increased by an impressive 50.3% to Rs115.6 crore during Q1FY2007. The sales were higher because the company began to supply electronic power steering (EPS) systems to Maruti Udyog during the quarter. Currently, Sona Koyo is the only company in India to manufacture EPS systems.
- The operating profit margin (OPM) improved by 148 basis points due to the savings on account of lower employee cost and other expenditure. Consequently, the operating profit rose by 75.5% to Rs11.95 crore. The sharp rise in the raw material cost (up from 69.1% of sales in Q1FY2006 to 73.4% in Q1FY2007) restricted the profit growth.
- The company incurred a loss of Rs1 crore on account of foreign currency loan translation. The interest cost was higher due to the additional loans taken to fund the capital expenditure (capex) and increased working capital requirements.
- As a result, the net profit for the quarter rose by 31.5% to Rs3.67 crore.
- The rising exports and a strong demand for EPS systems should bolster Sona Koyo's growth in the next few years whereas a higher localisation of components should help the company to expand its margins. New client addition and commencement of supplies to Fuji Autotech would also drive the revenue growth for the company. For the current fiscal, the company is targeting exports of Rs80 crore and revenues of Rs475 crore. At the current market price of Rs81, the stock quotes at 21.6x its FY2006 earnings and 10.9x its enterprise value (EV)/ earnings before interest, depreciation, tax and amortisation (EBIDTA).

Result table Rs (cr)

Rs in crs	Q1FY2007	Q1FY2006	% yoy chg
Net sales	115.60	76.91	50.3
Total expenditure	103.65	70.10	47.9
Operating profits	11.95	6.81	75.5
Other income	0.52	0.97	-46.4
Interest	3.24	1.01	220.8
Depreciation	3.58	2.49	43.8
PBT	5.65	4.28	32.0
Tax	1.98	1.83	8.2
Deferred tax	0.00	-0.34	-100.0
Adjusted PAT	3.67	2.79	31.5
OPM (%)	10.34	8.85	
EPS	0.84	0.63	

Launch of EPS systems drives the top line growth

Sona Koyo's net sales for Q1FY2007 marked an impressive growth of 50% year on year (yoy) to Rs115.6 crore. The growth was achieved on the back of a rise of 55.6% in the domestic sales, which grew to Rs103.42 crore driven by the commencement of supplies of EPS systems to Maruti Udyog for its *Alto*, *WagonR* and *Versa* models. As of now, Sona Koyo is the only domestic manufacturer of EPS systems. During the year, the company hopes to bag new orders from Maruti Udyog, Nissan and Toyota for its EPS systems. An EPS system is superior to a hydraulic steering in terms of technology and leads to 3% higher fuel efficiency in comparison. During the quarter the company sold about 50,000 units of EPS systems. It plans to raise the annual sales of EPS systems gradually to 500,000 units in the next three years.

The growth on the exports front was disappointing due to the postponement of an order. The export revenue grew by 16.8% to Rs12.2 crore during the quarter. The company's export target for this fiscal stands at Rs75-80 crore.

Margin growth restricted by higher input costs

The OPM improved by 148 basis points yoy to 10.3% during the quarter. However, the growth in the profit was restricted due to a very high growth in the raw material cost, which rose from 69.1% (as a percentage of sales) in Q1FY2006 to 73.4% in Q1FY2007. The raw material cost rose sharply because of higher import content in the EPS systems. The operating profit for the quarter rose by 75.5% to Rs11.95 crore.

The interest cost of the company rose to Rs3.24 crore as a result of the additional borrowings for capex and increased working capital requirements. Further the company suffered a foreign exchange loss of Rs1.06 crore during the year. Consequently, the net profit for the quarter rose by 31.5% to Rs3.7 crore.

Other highlights

- During the quarter, new capacities of 250,000 units per annum for steering columns and manual steering gears became operational at its Gurgaon plant.
- Sona Koyo is setting up a new plant at Dharuhera in Haryana to localise the sourcing of components of EPS and manufacture hydraulic power steering. This plant is likely to become operational in Q4FY2007. Overall, the company has lined up a capex of Rs100 crore for FY2007 and of Rs130 crore for FY2008.

- The supplies to Fuji Autotech, France commenced from July 2006 onwards. In the next three to five years, the company hopes to raise the exports to the French company to $30 million while the target for the current year is $1.5 million.
- The company would look to infuse more equity and pay off some of its debts to reduce its interest cost. However, no concrete plan relating to the same has been formed yet.
- The company has been selected for manufacturing the steering systems needed for the world truck and small car being developed by Tata Motors.

Outlook and valuations

Higher exports and a strong demand for EPS systems should boost Sona Koyo's growth in the next few years whereas higher localisation of components should help it to expand its margins. New client addition and the commencement of supplies to Fuji Autotech would also drive the revenue growth for the company. For the current fiscal, the export target for the company stands at Rs80 crore while the overall revenue target for the year is Rs475 crore. At the current market price of Rs81, the stock quotes at 21.6x its FY2006 earnings and 10.9x its EV/EBIDTA.

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

Information technology

Sector Update

Infosys ahead of its peers

IT sector, robust growth

On an overall basis, the performance of the front-line information technology (IT) companies in Q1FY2007 has been ahead of expectations. The volume growth was robust and the demand environment continues to be favourable. The billing rates were largely stable with the new business coming in at higher than average billing rates. Also some of the existing businesses were getting renegotiated at higher billing rates. However, the positive impact was partially mitigated by the volume discounts offered to the large clients (with an annual revenue run rate of over $10 million dollars).

On the supply side, the wage inflation continues to be the key concern. What's more worrying is that the attrition rate has inched up (partially due to the seasonal factor as some employees opt for higher studies during this period) for most of the companies. On the positive side, the domestic majors have certain operational levers to cushion the impact of the cost pressures, like higher contribution from the offshore business, lower selling, general and administration (SG&A) cost as a percentage of sales, better performance of their subsidiaries and higher proportion of fixed price contracts that could boost the overall employee productivity. The depreciation of the rupee should also have a favourable impact on the margins.

Operational metrics - Q1 results

	Infosys	TCS	Wipro
Volume growth			
- % chg qoq	8.5	8.1	5.5
Billing rates			
- Onsite (% chg qoq)	1.1	0.0	-0.1
- Offshore (% chg qoq)	0.2	0.0	-0.2
Recruitment			
- Net employee addition	5694	4698	2841
- % increase on base	10.8	7.1	5.0
Attrition rate			
- IT services (%)	11.9	10.6	17.0
Salary hikes	Taken in Q1	Taken in Q1	In Sept
Operating margin			
- Absolute (%)	29.5	24.2	24.1
- Basis points chg qoq	-230	-220	-60
- Outlook	Improve	Improve	Decline
Exchange rate impact			
- % q-o-q revenue growth	3.2	3.2	1.7
- Non-operating income (Rs cr)	52.0	40.0	-3.7

Pls note Wipro figures pertain to its Global IT Services business

Infosys, ahead of the pack

Infosys is way ahead of its peers in terms of the volume growth (purely organic and higher than the others), profitability and the outlook (both the revenue growth and margin improvement) for the coming quarters.

On the supply side, the recruitment was quite healthy and the management aims to maintain the momentum. The annual salary hikes have been given in Q1. The company has also invested aggressively in its sales and marketing infrastructure and visas in the first quarter. Thus, the margins are likely to improve in the coming quarters and the company should be able to maintain the margins in the range of 32-33% in FY2007 also.

Tata Consultancy Services (TCS)--all negatives factored in already

TCS has been able to maintain its sequential volume growth in the range of 7-8% for the past three consecutive quarters. The volume growth is likely to remain robust in the coming quarters also, on the back of the ramp-up of business in the large deals.

In terms of profitability, the margins witnessed an adverse impact of the salary hikes, start-up costs related to the large deals and the investment made in building capacities in some of its global delivery centres (GDC) like Brasil, resulting in a 220-basis-point sequential decline in the operating margins to 24.2%. On the brighter side, most of the negatives have now already been factored in the margins that would result in an improvement in its profitability over the coming quarters. The relatively lower proportion of the offshore business (41.3% including GDCs) leaves scope for considerable improvement in one of the levers against cost pressures.

Wipro, integration pangs

Wipro has lagged behind its peers in terms of the volume growth of 5.5% (including acquisition) in the first quarter. The company has given a revenue growth guidance of 7% in dollar terms to $577 million in Q2 for its global IT services. The guidance appears to be cautious and below expectations as it includes a revenue growth of 2% from the incremental revenues accrued from the acquisitions made in Q1. Thus, the organic growth would be around 5%.

In terms of the margins, the global IT services business reported a 60-basis-point decline in the operating margins, largely due to the Rs13 crore operating losses reported by the acquired entities cumulatively. Unlike its peers, Wipro would provide annual salary hikes from September onwards that is likely to put pressure on the margins in the coming quarters. Second, the additional expenses related to the restricted stock options (around Rs17 crore per quarter) would also depress the margins.

Some of the key levers to cushion against the margin pressure are the improvement in the profitability of the acquired entities and its business process outsourcing (BPO) business. There is also enough scope to improve the utilisation rate as the net employee utilisation stood at 72% as compared to 76% for Infosys and 80% in the case of TCS. However, the company is still likely to report a sequential decline in the margins in the coming quarters.

Valuation

Given the robust demand environment, stable billing rates and the ability to cushion against cost pressures, we continue to maintain our bullish stand on the sector. Among the front-line companies, Infosys is our top pick.

Peer comparison

	EPS (Rs)		P/E	
	FY07	FY08	FY07	FY08
Infosys	65.8	81.0	25.1	20.4
TCS	78.6	98.7	23.1	18.4
Wipro	18.2	23.0	25.8	20.4

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

Sharekhan Stock Ideas

Evergreen

HDFC Bank
Infosys Technologies
Reliance Industries
Tata Consultancy Services

Apple Green

Aditya Birla Nuvo
Associated Cement Companies
Bajaj Auto
Balrampur Chini Mills
Bharat Bijlee
Bharat Heavy Electricals
Corporation Bank
Crompton Greaves
Godrej Consumer Products
Elder Pharmaceuticals
Grasim Industries
Hindustan Lever
Hyderabad Industries
ICICI Bank
Indian Hotel Company
ITC
Mahindra & Mahindra
Marico Industries
Maruti Udyog
MRO-TEK
Lupin
Nicholas Piramal India
Omax Auto
Ranbaxy Laboratories
Satyam Computer Services
Sintex Industries
SKF India
State Bank of India
Sundaram Clayton
Tata Motors
Tata Tea
Unichem Laboratories
Wipro

Cannonball

Cipla
Gateway Distriparks
International Combustion (India)
JK Cements
Madras Cement
Shree Cement
Transport Corporation of India

Emerging Star

3i Infotech
Aarvee Denims and Exports
Aban Loyd Chiles Offshore
Alok Industries
Alphageo India
Cadila Healthcare
KSB Pumps
Marksans Pharma
Navneet Publications (India)
New Delhi Television
Orchid Chemicals & Pharmaceuticals
ORG Informatics
Solectron Centum Electronics
Television Eighteen India
Thermax
Tube Investments of India
TVS Motor Company
UTI Bank
Welspun Gujarat Stahl Rohren
Welspun India

Ugly Duckling

Ashok Leyland
Deepak Fertilisers & Petrochemicals Corporation
Genus Overseas Electronics
HCL Technologies
ICI India
Jaiprakash Associates
JM Financial
KEI Industries
NIIT Technologies
Punjab National Bank
Ratnamani Metals and Tubes
Sanghvi Movers
Saregama India
Selan Exploration Technology
Subros
Sun Pharmaceutical Industries
Surya Pharmaceuticals
UltraTech Cement
Union Bank of India
Universal Cables
Wockhardt

Vulture's Pick

Esab India
Nelco
Orient Paper and Industries
WS Industries India

Home

Disclaimer

"This document has been prepared by Sharekhan Ltd.(SHAREKHAN) This Document is subject to changes without prior notice and is intended only for the person or entity to which it is addressed to and may contain confidential and/or privileged material and is not for any type of circulation. Any review, retransmission, or any other use is prohibited. Kindly note that this document does not constitute an offer or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction.

Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is from publicly available data or other sources believed to be reliable. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. We do not represent that information contained herein is accurate or complete and it should not be relied upon as such. This document is prepared for assistance only and is not intended to be and must not alone betaken as the basis for an investment decision. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

SHAREKHAN & affiliates may have used the information set forth herein before publication and may have positions in, may from time to time purchase or sell or may be materially interested in any of the securities mentioned or related securities. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind. Any comments or statements made herein are those of the analyst and do not necessarily reflect those of SHAREKHAN."