investor's eye

Index

Bajaj Auto

Apple Green

Stock Update

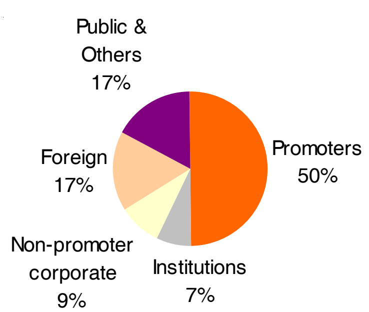
Back on track

Hold; CMP: Rs1,210

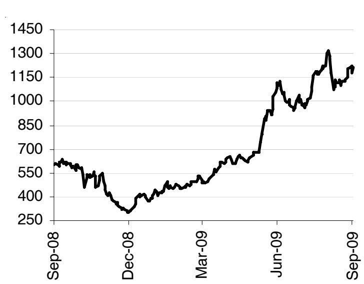
Company details

Price target:	Rs1,290
Market cap:	Rs17,506 cr
52 week high/low:	Rs1,356/295
NSE volume: (No of shares)	2.3 lakh
BSE code:	532977
NSE code:	BAJAJ-AUTO
Sharekhan code:	BAJAJAUTO
Free float: (No of shares)	7.3 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-3.7	11.0	137.6	99.4
Relative to Sensex	-2.6	5.9	31.1	91.8

Key points

- Bajaj Auto announced its monthly sales number for August 2009, which came into positive territory on year-on-year (y-o-y) basis for the first time after a long period of decline. For August 2009, the total sales volume grew by 6% year on year (yoy) to 213,072 units, wherein the motorcycle segment registered 4.1% y-o-y growth after a long period of decline on the back of strong performance by *Pulsar* and the newly-launched *Discover 100cc*. The newly-launched *Discover 100cc* has been received well in the market and has registered sales of 48,000 units.

- Three wheeler sales registered a growth of 23.4% yoy to 30,021 units. Overall exports for the month also grew by healthy 6% yoy to 75,164 units. The management is confident of maintaining the growth momentum in exports with the same run-rate as witnessed in August 2009.

- Further commenting on the future performance, the management is confident of maintaining its margins at around 19.5% for FY2010 (as was seen in Q1FY2010) as it is now aligning its portfolio towards its two major products—*Discover* and *Pulsar*—which are more towards high-end bikes. However we do not see any risk, as we have already factored in higher margins on account of strong volumes coming from these high-end bikes.

- The management also indicated that the company will continue the production of *Platina* and *XCD* till there is healthy demand for these brands. But in longer term, the company's focus will be on its high-end bikes—*Discover* and *Pulsar*—as these brands augur more volumes and better margins.

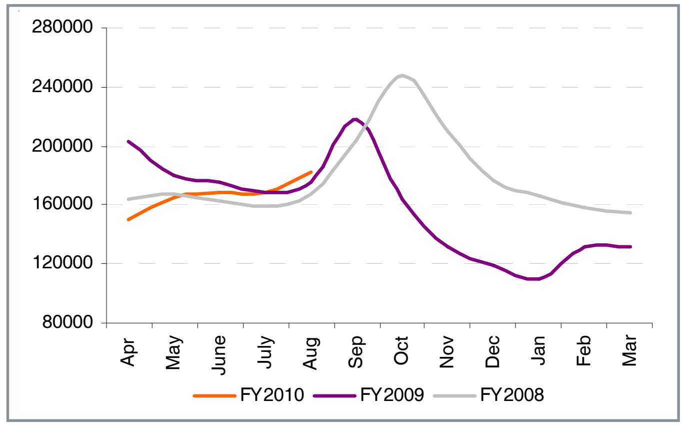
- The management does not see any impact of weaker monsoon on its sales on the fact that the company has been gaining its lost market share on the back of strong performance by *Discover* and *Pulsar*. These brands are into high-end bikes and cater to the demand in urban areas, thereby suppressing any risk form the below-normal monsoon. Also these two brands constitute approximately 50-55% of the total monthly sales of the company.

Valuation table

Particular	FY2007	FY2008	FY2009	FY2010E	FY2011E
Net sales (Rs cr)	9,317.5	8,663.3	8,436.9	9,533.1	10,862.0
Net profit (Rs cr)	997.9	756.0	823.5	1,196.3	1,332.4
EPS (Rs)	69.0	52.3	56.9	82.7	92.1
% yoy growth	*-0.2*	*-24.2*	*8.9*	*45.3*	*11.4*
PER (x)	17.5	23.2	21.3	14.6	13.1
P/B (x)	2.2	11.0	9.4	11.0	9.4
EV/EBIDTA (x)	6.2	18.5	20.6	11.4	9.7
RoCE (%)	22.3	24.2	36.0	44.2	39.9
RoNW (%)	18.0	52.7	44.0	44.3	36.3

- We believe that the performance of its new launches is the key to its future growth and would also help the company to gain its lost market share. Also the three-wheeler launches slated in the end of FY2010 and the healthy performance of its newly-launched motorcycles will drive further growth for the company. At the current market price, the stock is trading at 13.1x its FY2011E earnings of Rs92.1 and enterprise value (EV)/earnings before interest, tax, depreciation and amortisation (EBITDA) of 9.7x. We maintain our Hold recommendation on the stock with price target of Rs1,290.

Total motorcycle sales



Sales volumes for August 2009

Segment	Aug 2009	Aug 2008	% yoy	% mom	YTD FY10	YTD FY09	% yoy
Motorcycles	182,441	175,274	4.1	8.5	833,331	902,743	-7.7
Total two wheelers	183,051	176,631	3.6	8.5	836,202	908,579	-8.0
Three wheelers	30,021	24,324	23.4	24.5	117,367	106,175	10.5
Grand total	**213,072**	**200,955**	**6.0**	**10.5**	**953,569**	**1,014,754**	**-6.0**
Exports (out of the above)	75,164	71,105	5.7	9.6	322,044	337,075	-4.5

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

Insurance

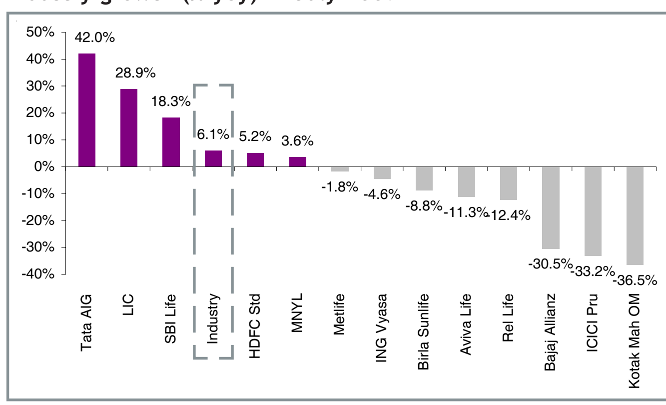
Sector Update

LIC grows its pie, contraction moderates for private players

Driven by strong performance by Life Insurance Corporation (LIC) of India, the life insurance industry recorded 6.1% year-on-year (y-o-y) growth in its annualised premium equivalent (APE) in July 2009, breaking the trend of negative growth in the past two months. Though private players continued to witness contraction in their APE, the pace of decline has moderated as compared with the previous month. On year-to-date (YTD) basis, the industry APE is now marginally lower by 3% year on year (yoy).

- In July 2009, the industry registered 6.1% y-o-y growth in its APE driven by some pick-up seen in the business volumes coupled with the lower base effect of the previous year, reversing the trend of negative growth in the past two months. On month-on-month (m-o-m) basis, the industry APE grew by 16.7%, higher compared with 9.0% growth seen in the previous month (June 2009).
- The APE for private players continued to contract for the third consecutive month, as it dipped by 9% yoy in July 2009. Importantly, the pace of decline has moderated and was lower compared with 25.3% y-o-y decline seen in June 2009. Despite 9% m-o-m growth in the APE for private players, an over 30% y-o-y decline in the APE for major industry players like Bajaj Allianz, ICICI Prudential and Kotak Mahindra OM pulled down the overall growth for private players.
- Notably, LIC continued the increasing trend in its APE by posting healthy 28.9% y-o-y and 25.9% m-o-m increase in its APE in July 2009, driven partially by higher sales during the month and partially due to low base effect of the previous year.
- Major private players continued to record negative growth during the month. Bajaj Allianz registered 30.5% y-o-y decline in its APE marking a year full of negative growth (the company registered growth last in July 2008). Moreover, ICICI Prudential too recorded decline (33.2% yoy) in its APE, straight for the tenth consecutive month.
- In terms of market share, LIC's pie increased to 48.4% in July 2009 from 44.9% in June 2009 driven by healthy

Industry growth (% yoy) in July 2009



Insurer (Rs cr)	July 2009	July 2008	% y-o-y	% m-o-m	FY10 FY10	FY09 FY09	% y-o-y
Tata AIG	96	67	42.0	28.6	284	305	-6.7
SBI Life	284	240	18.3	11.9	1,265	1,213	4.3
HDFC Standard	193	183	5.2	17.1	559	626	-10.7
Max New York Life	127	123	3.6	-10.9	516	560	-7.8
Metlife	70	71	-1.8	-3.7	208	247	-15.7
ING Vyasa	53	56	-4.6	13.3	173	205	-15.5
Birla Sunlife	183	200	-8.8	-6.2	613	692	-11.5
Aviva Life	52	59	-11.3	15.6	165	220	-25.1
Reliance Life	212	242	-12.4	-4.9	661	662	-0.2
Bajaj Allianz	234	337	-30.5	12.4	758	1,101	-31.2
ICICI Prudential	376	563	-33.2	26.9	1,108	2,019	-45.1
Kotak Mahindra OM	67	105	-36.5	7.9	203	327	-38.0
Private Total	**2,114**	**2,323**	**-9.0**	**9.2**	**7,056**	**8,361**	**-15.6**
LIC	**1,984**	**1,540**	**28.9**	**25.9**	**6,013**	**5,114**	**17.6**
Industry	**4,098**	**3,863**	**6.1**	**16.7**	**13,069**	**13,475**	**-3.0**

* APE = 10% of single premium received + 100% of non-single premium received

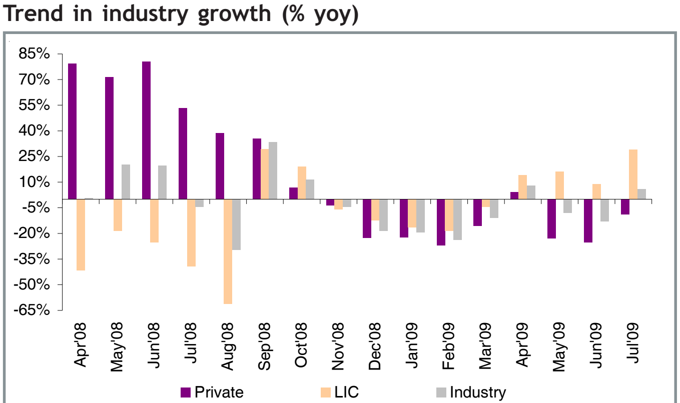
performance during the month. Meanwhile, among private players ICICI Prudential garnered significant (248-basis-point increase) market share sequentially, whereas Reliance Life, Birla Sunlife and Max New York Life lost market share to the tune of 148 basis points, 142 basis points and 136 basis points respectively during the month.

- In a recent development, the Insurance Regulatory Authority of India (IRDA) gave clarification regarding inclusion/exclusion of certain charges from cap on unit-linked insurance plan (ULIP) charges. We believe the decision to exclude mortality and morbidity charges will benefit the insurance companies and the investor, as it would not discourage life insurance companies from underwriting policies for old-age individuals. Besides, the decision to cap fund management charges at 135 basis points irrespective of policy tenure, intending to lower product cost for the investor, is a move in the right direction from longer-term perspective. However this would adversely affect the business volumes and margins in the near term, as the insurance companies will have to re-design their products and re-work their distribution strategies to maintain the business growth momentum while protecting their margins.

LIC leads the way

Driven by healthy performance by LIC in July 2009, the life insurance industry logged 6.1% y-o-y increase in its APE after declining in the past two months. On m-o-m basis, the industry grew by 16.7%, higher compared with 9% growth registered in June 2009. LIC maintained its positive growth trend in the current fiscal by registering healthy 28.9% y-o-y and 25.9% m-o-m increase in its APE in July 2009. Despite 9.2% sequential increase, the APE for private players dipped by 9% yoy. The fall was led by continued decline in the APE of major industry players such as Bajaj Allianz and ICICI Prudential.

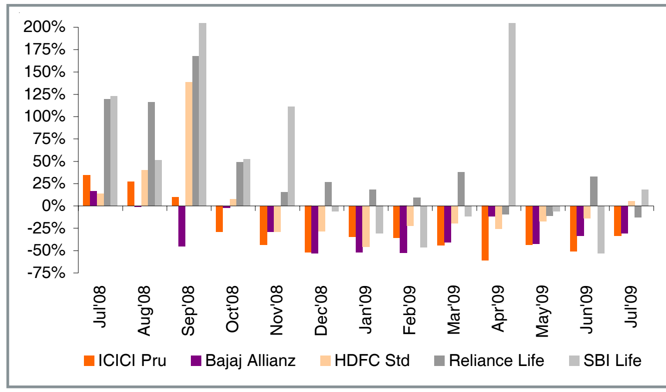
Trend in industry growth (% yoy)



SBI Life outperforms peers

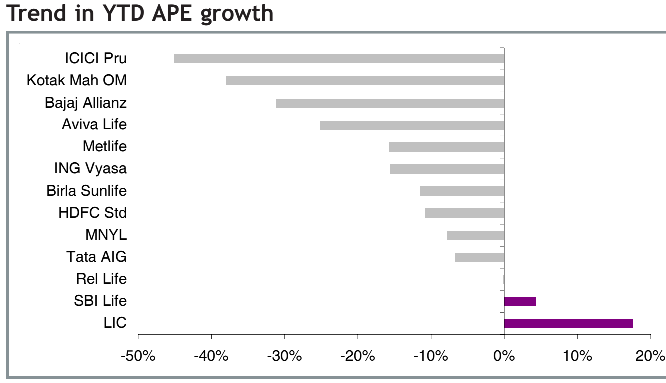
The declining trend in APE for industry majors continued through July 2009. Bajaj Allianz posted 30.5% y-o-y decline in its APE, marking one full year of negative growth, whereas ICICI Prudential too witnessed 33.2% y-o-y decline in its APE, posting tenth consecutive monthly decline in its APE.

Trend in APE growth of major private players



However, Tata AIG and SBI Life recorded robust 42% and 18.3% y-o-y increase in their APE during the month. Meanwhile, HDFC Standard and Max New York Life registered marginal 5.2% and 3.6% y-o-y increase in their APE during the month.

Trend in YTD APE growth

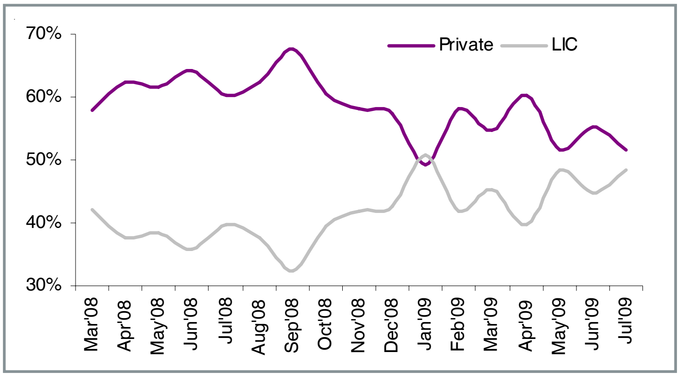


On YTD basis, LIC maintained positive growth trend in its APE in the current fiscal and has achieved 17.6% y-o-y growth. Meanwhile, SBI Life is the only large private player to achieve positive growth in its APE during the current fiscal—recording 4.3% y-o-y increase. Whereas the APE for ICICI Prudential, Kotak Mahindra OM and Bajaj Allianz fell sharply by 45%, 38% and 31% yoy respectively on y-o-y basis.

LIC garners market share

In July 2009 LIC's market share increased to 48.4%, much higher than 44.9% in June 2009 and 39.9% in July 2008. The sharp 25.9% sequential increase in its APE helped LIC to garner additional market share during the month.

Trend in market share



SBI Life continues to lead

In July 2009, ICICI Prudential gained significant market share of 248 basis points on account of healthy 26.9% sequential increase in its APE. Besides players like Reliance Life, Birla Sunlife and Max New York Life lost market share to the tune of 148 basis points, 142basis points and 136 basis points respectively. However, on YTD basis SBI life continues to lead the private pack with market share of 17.9% in July 2009 as compared with 14.5% during the year-ago period. Meanwhile, industry majors like ICICI Prudential and Bajaj Allianz have seen significant market share erosion on account of sharp decline in their APE in the current fiscal.

IRDA caps ULIP charges

Post IRDA's meeting with life insurers regarding its circular to cap ULIP charges and discussion over concerns raised by the industry, IRDA has come out with following clarifications:

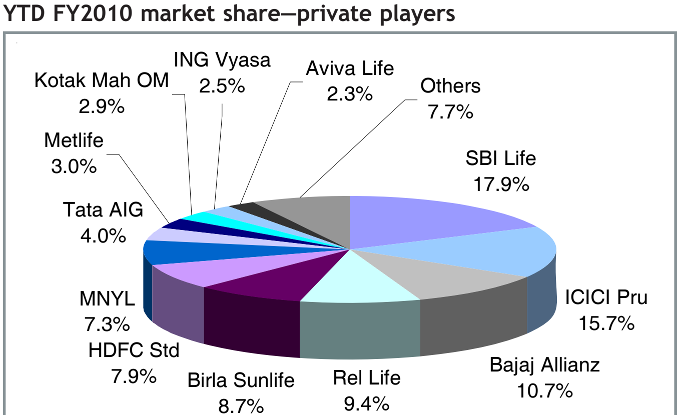
- Mortality and morbidity charges may be excluded while calculating the net yield.
- Within the overall cap, the fund management charges shall not exceed 135 basis points irrespective of the tenure of the contract.
- No surrender charge can be levied by an insurer for policies surrendered from the fifth policy year and thereafter. Consequently the policyholder will be entitled to receive the full fund value on such surrender.

Exclusion of mortality charges is likely to be positive for life insurers, as this would have significantly dented their margins and discouraged the companies from underwriting risk for old-age individuals. Moreover, the decision to cap fund management charges at 135 basis points irrespective of the policy tenure, intending to lower product cost for an investor, is a move in the right direction from longer-term perspective. However this would adversely affect the business volumes and margins in the near term, as insurance companies will have to re-design their products and re-work their distribution strategies to maintain business growth momentum while protecting their margins. Lastly, the surrender charges levied by the insurers are generally higher towards the initial years of the policy and thereby the decision of no surrender charges from the fifth policy year should not have any significant impact on the profitability of the insurance company.

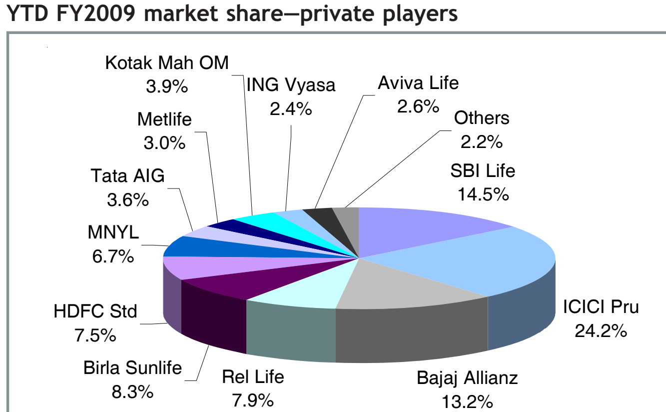
Outlook

After lacklustre Q1FY2010, business volumes seem to have picked up in July 2009. This could be partly due to the recent ban on the entry load on mutual funds, which makes ULIPs more attractive from distributor's perspective. Going forward, we believe the recent cap on ULIP charges announced by IRDA coupled with ongoing buoyancy in equity markets will make ULIPs more attractive investment option. However, these measures are likely to keep the margins and volumes under pressure in the near term till the insurers redefine their product and distribution strategies.

YTD FY2010 market share—private players



YTD FY2009 market share—private players



Pharmaceuticals

Sector Update

Opportunities lurk in mid-cap pharma space

Key points

- In line with our expectations, mid-cap pharmaceutical stocks have been re-rated in the past few weeks. And rightly so, as some of these companies have healthy growth outlook and as the huge valuation gap between mid-cap and large-cap pharmaceutical stocks was unjustified.
- Post the recent sharp re-rating of mid-cap pharmaceutical stocks the valuation gap has narrowed down considerably and it is time to be very selective now. From our universe, we prefer Cadila Healthcare (Cadila), Ipca Laboratories (Ipca) and Torrent Pharmaceuticals (Torrent).
- Notwithstanding the recent run up, we believe that these three mid-cap pharmaceutical stocks have upside triggers and scope for further re-rating from current level. The current volatility should be used to accumulate these mid-cap pharmaceutical stocks for meaningful upside over the next 6-12 month period.

Ipca Laboratories: Steady growth, compelling valuations

- *Earnings visibility:* With very-strong product pipelines across geographies, we expect 16% compounded annual growth rate (CAGR) in Ipca's earnings over FY2009-11E. The growth is backed by enhanced focus on the domestic formulation business that is expected to grow at 18% CAGR over FY2009-11E. Driven by aggressive brand promotion in emerging economies, revival in European business and scale-up in the US business, the formulation exports are projected to show CAGR of 21.1% over FY2009-11E. With strong growth in its branded portfolio and low-cost operating structure, we expect Ipca's margins to remain on an up-trend.
- *Shareholder value creation:* The return ratios are expected to stand strong, with the return on net worth (RONW) at 25.3% and the return on capital employed (ROCE) at 21.8% in FY2011E. The operating margin of 19%+ over the next two years is due to focus on niche segments.
- *Future event triggers:* Going forward, we expect the next leg of the growth for the company to come from its export division, as it leverages its API capabilities to create healthy business in USA and the emerging formulations market, commissioning of Indore special economic zone (SEZ) and significant scale-up in the business of Tonira Pharmaceuticals (its Japanese subsidiary). It is looking at developing four to five NDDS products targeting CVS and CNS segments, which would unlock its research and development (R&D) pipeline value in the medium term.
- *Compelling valuations:* Ipca has traditionally been getting PE multiple in low teens. But with enhanced growth visibility from the US and European markets, sustained growth in domestic business and healthy return ratios, we believe the stock should command higher valuations. At 9.1x FY2010E and 7.5x FY2011E earnings, valuations seem to be absolutely compelling when viewed in context of the strong growth potential that awaits the company. We therefore increase our target multiple to 9x and maintain our Buy recommendation on the stock with revised price target of Rs770.

Torrent Pharmaceuticals: Multi-faceted focus

- *Earnings visibility:* We expect Torrent's earnings to post CAGR of 14.2% over FY2009-11E on the back of 12.6% growth in revenues on account of strong revenue traction from the domestic formulation business. With the completion of investment phase, robust field presence and new product introductions, we expect Torrent's emerging markets (Brazil, Russia and Europe) to post strong CAGR of 20.5% over FY2009-11E. The management has guided towards revenue of Rs40-60 crore for FY2010 from its US business, although we feel this is conservative given the growth rate the US business has achieved in the first quarter itself.
- *Shareholder value creation:* The return ratios are expected to stand strong with the RONW at 27% and ROCE at 20% in FY2011E. The operating margin of 17%+ over the next two years is due to focus on niche segments.
- *Future event triggers:* The earnings visibility would improve further once the operating environment in

Germany turns favourable (Torrent has turned from a fixed-cost model to a variable-cost model in the German market with reduced promotional spend and manufacturing cost by shifting products to India [30-35 % of total sales shifted to India]. The strong presence in the US market would act as strong growth driver (on a low base) in the coming years. Torrent is steadily ramping up its product development activity with a 70:30 spend ratio towards product development and discovery research. The monetisation of its drug discovery pipeline (7 NCE in diabetes and related ailments) is expected to happen in the next two-three years as the molecules are currently in phase-1 and pre-clinical stages.

- *Compelling valuations:* At the current market price of Rs273, Torrent is discounting its FY2010E earnings by 11.2x and its FY2011E earnings by 9.2x. In lieu of the current re-rating in the stock, we upgrade our target multiple to 11x and maintain our Buy recommendation with revised price target of Rs328. We expect the company to report earnings per share (EPS) of Rs24.3 in FY2010 and that of Rs29.8 in FY2011E.

Cadila Healthcare: Poised for big league

- *Earnings visibility:* With strong and steady domestic formulation business and key value addition from its subsidiaries in the emerging and regulated markets, we expect Cadila's sales and earnings to register CAGR of 12.9% and 15.4% during FY2009-11E respectively. The already started joint venture (JV) Hospira would further add to the growth momentum.

- *Future event triggers:* Cadila has an ongoing investment in newer portfolios worth $180mn related to niche therapeutics and biogenerics. Cadila has 7 molecules at various stages of clinical trails in collaboration with research partners Eli Lily and Karo Bio. The monetisation of NCE R&D pipeline in FY2011-12 will improve the earnings visibility going forward.

- *Shareholder value creation:* We expect Cadila to post ROCE of 19.5% and RONW of 22.2% in FY2011E. Currently Cadila is leveraged with a net gearing ratio of 1.0x. However with strong revenue growth, we expect the D/E ratio to come down to 0.5x in FY2011E.

- *Buy with revised price target of Rs511:* Cadila is now spreading its wings to be a research-based pharmaceutical company by 2020. It has set up a vision to achieve sales of $1 billion by 2010 and that of $3 billion by 2015. The strong traction in the domestic, French and US businesses, and the increasing visibility of business from Hospira JV, reinforce our view on Cadila's continued growth prospects. Although the Nycomed JV continues to face challenges (due to genericisation of Pantaprazole in July 2010), we believe the losses would be offset by the impending revenues from JV Hospira. We maintain our positive stance on Cadila and maintain our Buy recommendation on the stock with revised price target of Rs511.

Valuation table

Company	CMP	Price		EPS (Rs)		EPS		P/E (x)			EV/EBITDA (x)		RoE (%)
	(Rs)	target	FY09	FY10E	FY11E	CAGR (%)	FY09	FY10E	FY11E	FY09	FY10E	FY11E	FY11E
Ipca	687	770	40.3	70.9	85.5	45.7	17.0	9.7	8.0	7.3	6.2	5.3	25.3
Torrent	273	328	21.8	24.3	29.8	16.9	12.5	11.2	9.2	8.9	6.9	5.9	27.2
Cadila	492	511	24.0	27.2	31.9	15.3	20.5	18.1	15.4	10.5	9.3	7.7	22.2

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

Sharekhan Stock Ideas

Evergreen

Housing Development Finance Corporation
HDFC Bank
Infosys Technologies
Larsen & Toubro
Reliance Industries
Tata Consultancy Services

Apple Green

Aditya Birla Nuvo
Apollo Tyres
Bajaj Auto
Bajaj Finserv
Bajaj Holdings & Investment
Bank of Baroda
Bank of India
Bharat Electronics
Bharat Heavy Electricals
Bharti Airtel
Corporation Bank
Crompton Greaves
Glenmark Pharmaceuticals
Godrej Consumer Products
Grasim Industries
HCL Technologies
Hindustan Unilever
ICICI Bank
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ITC
Mahindra & Mahindra
Marico
Maruti Suzuki India
Lupin
Piramal Healthcare (Nicholas Piramal India)
Punj Lloyd
Sintex Industries
State Bank of India
Tata Tea
Wipro

Cannonball

Allahabad Bank
Andhra Bank
IDBI Bank
Madras Cements
Phillips Carbon Black
Shree Cement
Tourism Finance Corporation of India

Emerging Star

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Alphageo India
Allied Digital Services
Axis Bank (UTI Bank)
Balrampur Chini Mills
Cadila Healthcare
Emco
Navneet Publications (India)
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Opto Circuits India
Orchid Chemicals & Pharmaceuticals
Patels Airtemp India
Thermax
Zee News

Ugly Duckling

BASF India
Deepak Fertilisers & Petrochemicals Corporation
Genus Power Infrastructures
ICI India
India Cements
Ipca Laboratories
Jaiprakash Associates
Mold-Tek Technologies
Orbit Corporation
Punjab National Bank
Ratnamani Metals and Tubes
Selan Exploration Technology
SEAMEC
Shiv-Vani Oil & Gas Exploration Services
Subros
Sun Pharmaceutical Industries
Torrent Pharmaceuticals
UltraTech Cement
Union Bank of India
United Phosphorus
Zensar Technologies

Vulture's Pick

Esab India
Mahindra Lifespace Developers
Orient Paper and Industries
Unity Infraprojects
Tata Chemicals
WS Industries India