investor's eye

Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Aurobindo	28-May-07	684	**809**	914
Crompton	19-Aug-05	88	**253**	280
HDFC Bank	23-Dec-03	358	**1,144**	1355
JP Associates	30-Dec-03	125	**741**	850
Zensar Tech	18-Jun-07	342	**331**	484

Tata Tea

Apple Green

Stock Update

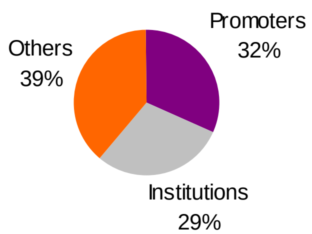
Eyeing *Snapple*

Buy; CMP: Rs853

Company details

Price target:	Under review
Market cap:	Rs5,282 cr
52 week high/low:	Rs990/558
NSE volume: (No of shares)	1.8 lakh
BSE code:	500800
NSE code:	TATATEA
Sharekhan code:	TATATEA
Free float: (No of shares)	4.2 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-10.4	36.1	14.9	14.0
Relative to Sensex	-11.4	20.4	8.9	-21.6

Key points

- As per media reports Tata Tea is bidding for the *Snapple* range of fruit drinks, diet drinks and iced tea coming from the portfolio of Cadbury Schweppes.
- Cadbury Schweppes, which makes a range of soft drinks and confectionary including *Dairy Milk* chocolate, *Trident* chewing gum and *Snapple* juice drinks, is in the process of spinning off its US beverage unit.
- If Tata Tea is successful in acquiring *Snapple*, the brand would stimulate growth in its stagnating black tea business.
- Till further clarity emerges on the revenue potential and profitability of *Snapple* as well as the structure of the Tata Tea-Cadbury Schweppes deal, it is difficult to form an opinion on how this deal may affect the performance of Tata Tea's stock price.

Event

As per the media reports Tata Tea is bidding for the *Snapple* range of fruit drinks, diet drinks and iced tea coming from the portfolio of Cadbury Schweppes.

Background

Cadbury Schweppes, which makes a range of soft drinks and confectionary including *Dairy Milk* chocolate, *Trident* chewing gum and *Snapple* juice drinks, is in the process of spinning off its US beverage unit.

Cadburys Schweppes had bought *Snapple* from Nelson Peltz in 2000 at an enterprise value of 1.028 billion pounds. During the year ended 1999 Snapple Beverage Group had made earnings before interest, tax, depreciation and amortisation (EBIDTA) of US$111 million on a turnover of US$772 million with *Snapple* contributing 70% of the revenue. The performance of *Snapple* in 2006 was flat as a whole with a better second half following the launch of a range of *Snapple* super premium teas and improved distribution.

Earnings table

Particulars	FY2005	FY2006	FY2007E	FY2008E*
Net profit (Rs crore)	243.4	293.9	353.5	380.0
Shares in issue (crore)	5.6	5.6	5.9	6.2
EPS (Rs)	43.4	52.5	60.0	61.5
EPS Growth (%)		20.8	14.3	2.5
P/E (x)	19.6	16.2	14.2	13.9
Book Value (Rs)	271.1	280.1	361.6	496.8
P/BV (x)	3.1	3.0	2.4	1.7
EV/Sales (x)	2.0	1.9	1.6	1.5
EV/EBITDA (x)	11.1	10.8	9.3	8.8
RoNW (%)	14.0	13.9	12.3	9.5
RoCE (%)	17.0	19.0	19.1	14.6

*Under revision

In its annual report for 2006 Cadburys Schweppes had identified the *Snapple* range of teas as a fast growing platform. It had further mentioned that it would try to expand the availability of these brands in those channels where they are currently under represented. Hence the rationale behind hiving off this business is still not clear.

As per media reports, Cadburys Schweppes announced that it planed to spin off the businees shortly after the news of the acquisition of a stake in the company by Nelson Peltz emerged in March. Nelson Peltz had bought a 3% share of Cadbury Schweppes and this may have influenced the spin-off of Cadbury Schweppes Americas Beverages from the Cadbury Schweppes Confectionary Group. Nelson Peltz has a history of building stakes in companies with a view to forcing change in the mangement of companies.

Implications

In our opinion, *Snapple* is not being sold because it is making losses or has growth concerns. We believe some other factors are compelling Cadburys Schweppes to hive off this business. Hence if Tata Tea acquires *Snapple*, the brand would stimulate growth in its stagnating black tea business. The Tata Tea management had earlier said that it would be increasing its focus on the other areas of non-carbonated drinks like green tea, red tea, herbal tea etc.

Cadburys Schweppes had bought *Snapple* from Nelson Peltz in 2000 for a considerarion of 1.028 billion pounds and had made efforts to increase the brand's geographical presence. We believe that for Tata Tea the acquisition cost would be anyway higher than Cadbury Schweppes' acquisition cost for *Snapple*. The bidding price is expected to move up since The Coca Cola Company is also expected to be in the race.

In 2001, after the acquisition of *Snapple*, the Cadbury Schweppes American Beverage segment had reported a turnover of 2.168 billion pounds with *Snapple* contributing 25% of it. This business has grown at a compounded annual growth rate of 3.45% in the last five years to 2.566 billion pounds. Assuming the contribution to be constant, the revenue flow from *Snapple* is expected to be around 640 million pounds in 2006. We expect *Snapple*'s EBIDTA margin to be around 14% and applying an enterprise value/EBITDA multiple of 13, the Tata Tea-Cadbury Schweppes deal size works out to around US$2.3 billion.

Tata Tea is in talks with private equity players who are showing interest in the business of beverages. Tata Tea recently earned US$1.2 billion from the sale of its 30% stake in Glaceau. But its management had earlier mentioned that the funds would be partially used to retire debt from Tetley's Balance Sheet. Now it remains to be seen how the Tata Tea-Cadbury Schweppes deal is structured. If the Glaceau proceeds are fully utilised for this acquisition then the gearing ratio that was expected to come down with the Glaceau stake sale will not take place and a high interest outgo would continue to drag Tata Tea's profits.

Till further clarity emerges on the revenue potential and profitability of *Snapple* and the structure of the Tata Tea-Cadbury Schweppes deal it is difficult to form an opinion on how this deal would affect the performance of Tata Tea's stock price.

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

State Bank of India

Apple Green

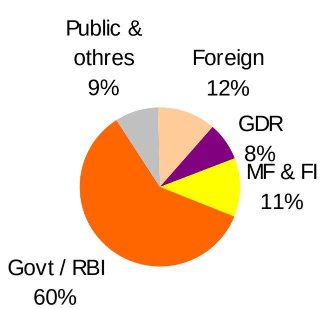
Stock Update

Price target revised to Rs1,780

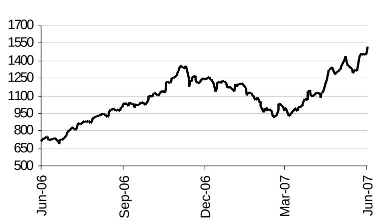
Buy; CMP: Rs1,525

Company details	
Price target:	Rs1,780
Market cap:	Rs80,261 cr
52 week high/low:	Rs1,531/684
NSE volume: (No of shares)	13.7 lakh
BSE code:	500112
NSE code:	SBIN
Sharekhan code:	SBI
Free float: (No of shares)	17.0 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	13.8	52.6	20.2	107.9
Relative to Sensex	12.5	34.9	14.0	43.0

Key points

- The Reserve Bank of India (RBI) has announced that it is going to transfer its 59.7% holding in State Bank of India (SBI) to the government for Rs35,530 crore on June 29, 2007. The transaction is revenue neutral for the government, as the RBI would declare a special dividend of a similar amount to replace the amount paid by the government for the stake sale.
- The SBI management has said that the bank will require to raise Rs15,000 crore of capital in FY2008; of this Rs6,000 crore is likely to be in the form of equity and the balance as debt.
- The current guidelines restrict SBI from diluting the promoter's stake below 55% and this would hinder the bank's capital raising plans. Hence the management is of the view that the follow-on offer would take place after the amendment to the SBI Act, most probably in December 2007.
- SBI has plans to consolidate its insurance and asset management businesses into a separate non-banking financial company (NBFC). It also plans to sell a 10% stake in the NBFC to three to four investors and intends to list the arm in FY2009. All these would be significant value drivers going forward. The chairman of the bank has stated that he expects the valuation of the life insurance business to be around Rs28,700 crore ($7 billion) while we have valued the same business at Rs23,800 crore ($5.8 billion). Our valuation is lower considering the roadblocks that the bank is likely to face while unlocking the value in these investments, just as ICICI Bank is facing now.
- After providing for the AS-15 impact (Rs900 crore of extra provision per year from FY2008-12) our earnings estimates for FY2008 and FY2009 have reduced by 4% each. We have also introduced our FY2009 estimates. Based on the current market price of Rs1,525 the stock is currently trading at 13.9x FY2009E earnings

Earnings table

Particulars	FY2005	FY2006	FY2007E	FY2008E	FY2009E
Net profit (Rs cr)	4304.5	4406.7	4541.3	5164.7	6267.4
Shares in issue (cr)	52.6	52.6	52.6	57.1	57.1
EPS (Rs)	81.8	83.7	86.3	90.4	109.7
% y-o-y change	*16.9*	*2.4*	*3.1*	*4.8*	*21.4*
PE (x)	18.6	18.2	17.7	16.9	13.9
P/PPP (x)	7.3	7.1	7.0	6.6	5.7
Book value (Rs/share)	457.4	525.3	595.6	728.5	813.0
P/BV (x)	3.3	2.9	2.6	2.1	1.9
Adjusted book value (Rs/share)	355.8	432.0	495.7	642.4	692.6
P/ABV (x)	4.3	3.5	3.1	2.4	2.2
RONW (%)	19.4	17.0	15.4	13.7	13.5
Consolidated book value (Rs)	618.9	707.4	802.0	944.2	1061.0
P/CBV (x)	2.5	2.2	1.9	1.6	1.4

per share (EPS), 1.9x FY2009E stand-alone book value of Rs813 and 1.4x FY2009E consolidated book value of Rs1,061. The stock has run up 54% in a span of the past three months. Hence in the near term there could be some profit booking and consolidation. However, we believe the bank has entered a sweet spot as a host of policy changes in the banking sector and for SBI could unlock significant value in the stock in the medium term. We maintain our Buy recommendation on the stock with a revised twelve-month price target of Rs1,780.

Significant capital raising plans undertaken by SBI

SBI plans to raise Rs15,000 crore in FY2008. Of this Rs6,000 crore is likely to be raised in the form of equity and the balance as debt. The current guidelines restrict the bank from diluting the promoter's stake in it below 55% and would hinder its capital raising plans. Hence the management is of the view that the follow-on offer would take place only after the amendment to the SBI Act, most probably in December 2007. The bank would need Rs5,000 crore for Basel II compliance. As per the management the associate banks will need around Rs8,000 crore by 2009. The insurance business would also require significant injection of capital as SBI aims for robust growth for its life insurance venture.

Alternate instruments to be preferred

Currently the holding of foreign institutional investors in the bank has reached the maximum ceiling. In order to get better valuations from the foreign investors the bank has requested the government to consider the issue of non-voting shares. Again guidelines on the issue of preference shares are awaited. Since SBI's current capital adequacy ratio (CAR) is at 12.3% with Tier-I CAR at 8%, the bank prefers to wait and then decide on the instruments for the capital raising exercise. Some of the mid-sized public sector banks have already reached the 51% government threshold holding limit, hence some developments on alternate capital raising plans are expected which would trigger a re-rating in the public sector banking stocks.

Host of new businesses targeted

SBI plans to enter seven to eight new businesses of which pension fund management, private equity, general insurance tie-up and wealth management are on the top of the wish-list. These businesses would significantly contribute to its fee income component going forward.

Change in assumptions for the bank's follow-on offer

We had earlier factored in a dilution of 4.5 crore equity shares at the follow-on offer price of Rs1,000 per share. But looking at the growth plans of the bank, the prospects for the banking sector and the fact that the SBI issue is scheduled for December 2007 we have increased our follow-on offer price estimate to Rs1,350 per share which would help the bank to raise the desired Rs6,000 crore by diluting the government's stake till 55%. The revision has increased our FY2008E book value per share by Rs24. We expect the Tier-I CAR for the bank to increase to 9% after the issue and its return on equity to decline to around 14% from the current 15.5% levels. Other public sector banks are trading at 1-1.5 their FY2009E book values but have a higher return on equity compared with SBI. But SBI should also be given a premium valuation for its size and reach, especially since the banking sector appears to be in a sweet spot. Hence we feel a 1.35x valuation on the price-to-book parameter is justifiable.

Details of the SOTP valuation

We have valued the stand-alone banking business at 1.35x book value and the associate banks at 1.44x book value. For the non-banking subsidiaries, we have valued the life insurance business at 19x FY2009E new business adjusted profit (NBAP). The bank's chairman has stated that he expects the valuation of the life insurance business to be around Rs28,700 crore ($7 billion) while we have valued the same business at Rs23,800 crore ($5.8 billion). Our valuation is lower considering the roadblocks that the bank is likely to face while unlocking the value in these investments, just as ICICI Bank is facing now. The total valuation of the non-banking subsidiaries adds up to Rs317 per share after a holding company discount of 15%.

Other investments provide a cushion

We have not considered the valuations of its primary dealership, factoring business and other investments in the National Stock Exchange, ICRA, Reliance Petroleum etc. That would add up to another Rs20-25 per share for SBI and could act as the margin of safety for the stock.

Sum-of-the-parts valuation

Business	Basis	Period	Multiple	Stake	Value share
Stand-alone core banking	x BV	FY09E	1.36	-	1,107
SBI (associate banks)	x BV	FY09E	1.44	-	357
SBI life	NBAP	FY09E	19	74%	262
SBI Mutual Fund	6% of AUM	FY09E	6%	63%	15
SBI Capital Market	P/E	FY09E	13	86%	23
SBI Cards	P/E	FY09E	15	60%	17
Total					**1,780**

AS-15 impact expected to be spread over five years

We have also assumed that SBI would be allowed to write off a Rs4,500-crore estimated shortfall in its pension liability corpus over a period of five years (ie Rs900 crore per year) instead of the one-time write-off that was expected as per the AS-15 guidelines. This has reduced our FY2008 and FY2009 profit after tax estimates by 4% each.

Valuation and view

We have also introduced our FY2009 estimates. Based on the current market price of Rs1,525 the stock is currently trading at 13.9x FY2009E EPS, 1.9x FY2009E stand-alone book value of Rs813 and 1.4x FY2009E consolidated book value of Rs1,061. The stock has run up 54% in a span of the past three months. Hence in the near term there could be some profit booking and consolidation. However, we believe the bank has entered a sweet spot as a host of policy changes in the banking sector and for SBI could unlock significant value in the medium term. We maintain our Buy recommendation on the stock with a revised twelve-month price target of Rs1,780.

Sharekhan Stock Ideas

Evergreen

HDFC Bank
Infosys Technologies
Reliance Industries
Tata Consultancy Services

Apple Green

Aditya Birla Nuvo
ACC
Apollo Tyres
Bajaj Auto
Bank of Baroda
Bank of India
Bharat Bijlee
Bharat Electronics
Bharat Heavy Electricals
Bharti Airtel
Canara Bank
Corporation Bank
Crompton Greaves
Elder Pharmaceuticals
Grasim Industries
HCL Technologies
Hindustan Unilever
ICICI Bank
Indian Hotels Company
ITC
Mahindra & Mahindra
Marico
Maruti Udyog
Lupin
Nicholas Piramal India
Omax Autos
Ranbaxy Laboratories
Satyam Computer Services
SKF India
State Bank of India
Sundaram Clayton
Tata Motors
Tata Tea
Unichem Laboratories
Wipro

Cannonball

Allahabad Bank
Andhra Bank
Cipla
Gateway Distriparks
International Combustion (India)
JK Cement
Madras Cement
Shree Cement
Tourism Finance Corporation of India
Transport Corporation of India

Emerging Star

3i Infotech
Aban Offshore
Alphageo India
Cadila Healthcare
Federal-Mogul Goetze (India)
KSB Pumps
Marksans Pharma
Navneet Publications (India)
Network 18 Fincap
New Delhi Television
Nucleus Software Exports
Orchid Chemicals & Pharmaceuticals
ORG Informatics
Tata Elxsi
Television Eighteen India
Thermax
UTI Bank

Ugly Duckling

Ahmednagar Forgings
Ashok Leyland
Aurobindo Pharma
BASF India
Ceat
Deepak Fertilisers & Petrochemicals Corporation
Fem Care Pharma
Genus Power Infrastructures
Hexaware Technologies
ICI India
India Cements
Indo Tech Transformers
Jaiprakash Associates
JM Financial
KEI Industries
NIIT Technologies
Punjab National Bank
Ratnamani Metals and Tubes
Sanghvi Movers
Saregama India
Selan Exploration Technology
South East Asia Marine Engineering & Construction
Subros
Sun Pharmaceutical Industries
Surya Pharmaceuticals
UltraTech Cement
Union Bank of India
Universal Cables
Wockhardt
Zensar Technologies

Vulture's Pick

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