investor's eye

Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Balaji Tele	9-July-07	231	**264**	303
Crompton	19-Aug-05	88	**271**	280
HDFC Bank	23-Dec-03	358	**1221**	1355
Lupin	06-Jan-06	403	**679**	840
M&M	1-Apr-04	232	**823**	913

Unichem Laboratories

Apple Green

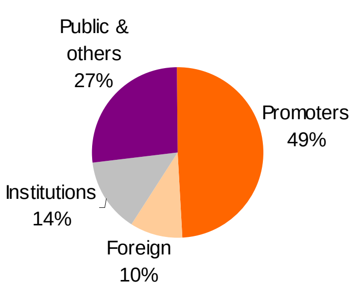
Stock Update

Exports take a hit, core earnings in line

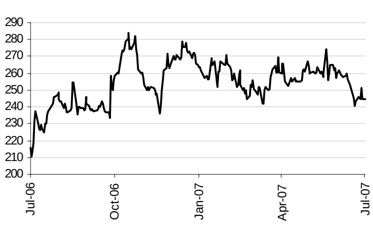
Buy; CMP: Rs245

Company details	
Price target:	Rs360
Market cap:	Rs883 cr
52 week high/low:	Rs302/207
NSE volume: (No of shares)	17,263
BSE code:	506690
NSE code:	UNICHEMLAB
Sharekhan code:	UNICHEM
Free float: (No of shares)	1.9 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-6.8	-5.8	-5.9	13.2
Relative to Sensex	-13.8	-16.3	-15.0	-25.7

Result highlights

- For Q1FY2008 Unichem Laboratories (Unichem) has reported a sales growth of 12.1% to Rs153.5 crore, which is lower than our expectation of Rs165 crore. The growth was subdued largely due to a sharp 18.8% decline in the company's exports on account of the appreciation of the rupee.
- On account of the rising rupee, the management did not push its exports during the quarter. Instead, it chose to re-negotiate the pricing terms with its key clients. The negotiation process is currently on and the management is hopeful of improving its export realisations in the future quarters.
- Unichem's strong brand building efforts, the continued momentum in its power brands and therapy focused marketing initiatives have caused the domestic formulation business to perform in the quarter. The revenues from this segment grew by an impressive 20.9% to Rs126.8 crore—way above the industry growth rate of 11-12% witnessed during the quarter. However, the management has also indicated that such a high growth rate for this business might not be sustainable going forward. The company expects the growth to moderate in Q2FY2008, due to the Drug Price Control Order (DPCO) related price cuts imposed on its largest brand, Ampoxin, towards the end of Q1FY2008.
- Within its domestic formulation business it has recently launched a new marketing division by the name of "Unikare". This division will focus on marketing dermatology products. With the launch of this division, the company is hopeful of participating in this fast growing Rs1,500-crore dermatology market in India.

Result table Rs (cr)

Particulars	Q1FY2008	Q1FY2007	% yoy chg
Net sales	153.5	136.9	12.1
Expenditure	119.1	107.4	10.9
Operating profit	34.4	29.6	16.3
Other income	-2.4	2.3	-205.8
EBIDTA	32.0	31.9	0.3
Interest	0.4	0.4	-3.4
Depreciation	3.3	2.9	16.9
PBT	28.2	28.6	-1.3
Taxes	6.0	4.6	29.4
Reported PAT	22.2	24.0	-7.3
Extraordinary items	0.0	1.2	-100.5
Prior period items	-0.3	0.0	-8131.4
Adjusted PAT	22.5	25.2	-10.6
Net forex impact	-3.0	1.0	-400.0
PAT excluding forex impact	25.2	23.0	9.8
OPM (%)	22.4	21.6	
EBIDTA margin (%)	20.8	23.3	
Net profit margin (%)	14.5	17.5	
EPS (Rs)	6.2	6.7	-7.3

- Unichem's operating profit margin (OPM) expanded by 80 basis points to 22.4% in the quarter. The margin expansion was driven by a decline in the raw material cost, despite the decline in export realisations. On the other hand, the rising research and development (R&D) cost (on account of product development expenses incurred for abbreviated new drug application [ANDA] filings) and an increase in the staff cost adversely affected the margin. The operating profit grew by 16.3% to Rs34.4 crore in the quarter.
- Unichem's reported net profit declined by 7.3% to Rs22.2 crore in Q1FY2008. The decline was largely due to a foreign exchange (forex) loss of Rs3 crore incurred on the receivables due to the appreciating rupee and an increase in deferred taxes (due to a large capital expenditure [capex] plan in FY2008E). On excluding the impact of the forex fluctuations, the net profit showed an improvement of 9.8% to Rs25.2 crore.
- At the current market price of Rs245, Unichem is trading at 8.6x its estimated FY2008 earnings. In view of the positive outlook for the company, we maintain our Buy recommendation on Unichem with a price target of Rs360.

Exports take a hit; revenue growth lower than expected

The steep appreciation in the Indian rupee vis-à-vis the US Dollar took a toll on Unichem's exports, which declined by 18.8% year on year (yoy) to Rs24.6 in Q1FY2008. The sharp decline in the exports was also partly due to some clients rescheduling delivery orders. However, as per the management, these will be recovered in the future quarters. On account of the rising rupee, the management did not push its exports during the quarter. Instead, it chose to re-negotiate pricing terms with its key clients. The negotiation process is currently on and the management is hopeful of improving its export realisations in the future quarters. The hit on the exports caused Unichem's top line to grow by only 12.1% in Q1FY2008 to Rs153.5 crore as against our expectation of Rs165 crore.

Domestic formulation business grows by an impressive 20.9%; surpasses industry growth

Unichem's strong brand building efforts, the continued momentum in its power brands and therapy focused marketing initiatives resulted in the domestic formulation business performing very well during the quarter. The revenues from this segment grew to Rs126.8 crore at an impressive rate of 20.9%, which was way above the industry growth rate of 11-12% witnessed during the quarter.

The company continues to maintain its thrust on this business, which forms over 70% of its total sales. Within its domestic formulation business it has recently launched a new marketing division by the name of Unikare. This division will focus on marketing dermatology products, specifically creams ointments, gels and lotions. Until now, Unichem has had a negligible presence in dermatology. With the launch of this division, the company is hopeful of participating in this fast growing Rs1,500-crore dermatology market in India.

However, the management has also indicated that such a high growth rate for this business might not be sustainable going forward. The company expects the growth to moderate in Q2FY2008, due to DPCO-related price cuts imposed on its largest brand Ampoxin towards the end of Q1FY2008. However, we have modelled a conservative 11.5% growth in this business in FY2008E and we remain optimistic about the company's ability to beat our estimates.

Revenue break-up

Particulars	Q1FY2008	Q1FY2007	% yoy chg
Domestic	131.9	111.4	18.4
Formulations	126.8	104.9	20.9
Bulk	5.6	7.1	-20.5
Exports	24.6	30.3	-18.8
Formulations	15.7	19.8	-21.1
Bulk	8.5	9.9	-14.8
Other operating income	0.0	1.4	-100.0
Total	156.5	143.1	9.3

OPM expands by 80 basis points to 22.4%

Unichem's OPM expanded by 80 basis points to 22.4% in the quarter. The margin expansion was driven by a decline in the raw material cost. The raw material cost comprised 41.9% of sales in Q1FY2008 as compared with 46.5% of sales in the corresponding quarter of the previous year. The decline in the raw material cost indicates that the company has been able to control its raw material costs despite the decline in exports (which usually generate higher realisations). This is largely on account of a greater captive use of active pharmaceutical ingredients (APIs) in the manufacture of formulations as well as excise benefits being derived from the company's formulation manufacturing facility in Baddi, Himachal Pradesh.

On the other hand, the 16% rise in the staff cost and the 22% rise in the other expenditure adversely affected the margin. The staff cost was higher due to an overall increase in salary levels along with the induction of 100 new employees in the company's newly launched Unikare division. The other expenditure was higher primarily due to the rising R&D cost, which formed 2.3% of sales in Q1FY2008 as compared with only 1.6% in the corresponding quarter of the previous year. The R&D cost is largely on the product development cost relating to ANDA filings for the US market. Going forward, the R&D cost is expected to escalate as Unichem plans to file at least two ANDAs per quarter.

The margin expansion caused the company's operating profit to grow by 16.3% to Rs34.4 crore.

Cost analysis

Particulars	Q1FY2008	Q1FY2007	% yoy chg
Adjusted material cost	64.3	59.2	8.5
% of net sales	*41.9*	*43.2*	
Staff cost	17.8	15.4	16.1
% of net sales	*11.6*	*11.2*	
Other expenditure	40.0	32.8	22.1
% of net sales	*26.1*	*23.9*	

Forex loss, rising deferred taxes cause reported net profit to decline by 7.3%

Unichem's reported net profit declined by 7.3% to Rs22.2 crore in Q1FY2008. The decline was largely due to a forex loss of Rs3 crore incurred on receivables due to the appreciating rupee as compared with a gain of Rs1 crore in the corresponding quarter of the previous year. Further, due to large expansions to the tune of Rs80-890 crore being carried out in the Baddi, Pithampur, Goa and Rohana plants, the company has made large provisions for its deferred tax during the quarter. In Baddi, the company is setting up a new antibiotics unit at a cost of Rs40-50 crore. This has caused the company's tax incidence to shoot up from 16.2% in Q1FY2007 to 21.2% in Q1FY2008.

If we exclude the impact of forex the gains and losses, the company's net profit actually showed an increase of 9.8% to Rs25.2 crore during the quarter.

Valuation and view

Unichem's Q1FY2008 results have been below expectations, primarily due to the impact of the rising rupee, which took a toll on the company's exports. The domestic business, however, continues to perform well. We expect exports to pick up in the next few quarters, as the company manages to renegotiate higher pricing terms with its key clients. The company's capex plans to upgrade its facilities at Pithampur, Goa and Rohana as well as to set up a new antibiotic formulation plants at Baddi, Himachal Pradesh are indicative of the company's future growth.

At the current market price of Rs245, Unichem is trading at 8.6x its estimated FY2008 earnings. In view of the positive outlook for the company, we maintain our Buy recommendation on Unichem, with a price target of Rs360.

Valuation table (standalone)

Particulars	FY2005	FY2006	FY2007	FY2008E
Net sales	393.5	455.8	545.6	638.9
Net profit	44.7	70.0	89.0	102.5
Shares in issue (cr)	3.4	3.6	3.6	3.6
EPS (Rs)	13.1	19.5	24.7	28.5
% y-o-y growth	*17.5*	*48.4*	*27.0*	*19.7*
PER (x)	18.7	12.6	9.9	8.6
EV	878.9	866.8	899.8	894.4
EV/EBIDTA (x)	14.1	9.5	8.3	6.8
Book value (Rs/share)	53.5	83.5	103.1	124.3
P/BV (x)	4.6	2.9	2.4	2.0
Mcap/sales	2.1	1.9	1.6	1.4
RoCE (%)	26.0	23.8	25.3	27.1
RoNW (%)	24.5	23.3	24.0	25.2

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

ICICI Bank

Apple Green

Stock Update

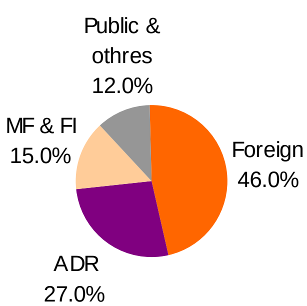
Higher non-interest income drives profits

Buy; CMP: Rs970

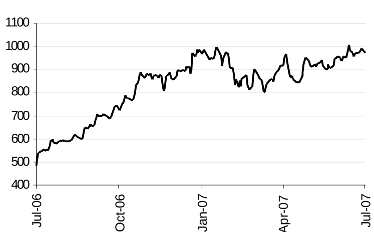
Company details

Price target:	Rs1,173
Market cap:	Rs86,775 cr
52 week high/low:	Rs1,007/440
NSE volume: (No of shares)	14.5 lakh
BSE code:	532174
NSE code:	ICICIBANK
Sharekhan code:	ICICIBANK
Free float: (No of shares)	65.2 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.9	8.9	1.1	102.4
Relative to Sensex	-3.9	-3.2	-8.7	33.0

Result highlights

- ICICI Bank's Q1FY2008 results have been higher than expectations with its profit after tax (PAT) growing by 25.1% year on year (yoy) to Rs774.8 crore compared with our estimate of Rs704 crore. The numbers are higher mainly on account of a very high growth of 69.7% yoy in the non-interest income category. The core operating performance in terms of the net interest income (NII) has been lower than expectations though.
- During the quarter under review the bank's NII grew by 16.2% to Rs1,714.3 crore compared with our estimate of Rs1,854.2 crore. The bank's reported net interest margin (NIM) declined by 20 basis points yoy and by 36 basis points quarter on quarter (qoq). The absence of interest on the cash reserve ratio (CRR) balances coupled with a higher increase in the cost of funds compared with the yield on the assets led to the decline in the NIM.
- The non-interest income was up 69.7% yoy to Rs1,715 crore, much above our expectations of Rs1,405 crore, mainly driven by a higher treasury gain of Rs195 crore compared with Rs18 crore in Q4FY2007, a fee income of Rs1,428 crore (up 35.4% yoy), and a lease and dividend income of Rs327 crore (up 59.8% yoy).
- Although the bank's total advances grew by 34.7% yoy, yet the growth in the retail advances moderated to 29% yoy from 39% in Q4FY2007 as the bank sold off Rs3,850 crore of loans during the quarter adjusted for which the retail growth would remain at 32.9% yoy. The deposit growth also moderated to 26% yoy from 39.6% in Q4FY2007. The total assets of the bank grew by 34.1% yoy and 3.6% qoq.
- The operating profit was up 58% yoy; but the core operating profit growth was lower at 28.9% yoy.

Result table Rs (cr)

Particulars	Q1FY08	Q1FY07	% yoy	% qoq
Net interest income	1,714.3	1,475.3	16.2	-6.1
Non-interest income	1,715.0	1,010.6	69.7	-6.5
Treasury income	195.0	18.0	-	-56.3
Fee	1,428.0	1,055.0	35.4	0.1
Lease & dividends	327.0	204.6	59.8	44.1
Amortisation	-235.0	-267.0	-12.0	-11.7
Net income	3,429.3	2,485.9	37.9	-8.4
Operating expenses	1,905.3	1,521.5	25.2	-0.8
Operating profit	1,523.9	964.4	58.0	-16.4
Core operating profit (excluding treasury)	1,563.9	1,213.4	28.9	13.6
Provisions & contingencies	552.3	216.0	155.7	-37.0
PBT	971.7	748.1	29.9	-2.5
Provision for taxes	196.9	128.6	53.1	127.3
Current tax	327.6	167.1	96.1	20.6
Deferred tax	-130.7	-38.5	239.5	-29.3
Net profit	774.8	619.5	25.1	-6.1

- The asset quality deteriorated with the gross non-performing asset (GNPA) going up by Rs1,193 crore on a sequential basis and the net NPA (NNPA) rising to 1.38% compared with 0.98% in Q4FY2007. The increase in the NPAs was mainly a result of higher defaults witnessed in the non-collateralised segments, which include credit cards and personal loans.
- We feel the core operating performance should improve with the NIM likely to stabilise or show marginal improvement going forward. The non-interest income growth is expected to remain steady. The only concern is the uptick in the NPAs which need to be watched going forward. At the current market price of Rs970, the stock is quoting at 21.2x its FY2009E earnings per share (EPS), 10.4x its pre-provision profit (PPP) and 2.2x FY2009E book value (BV). We maintain our Buy recommendation on the stock with the price target of Rs1,173.

NIM under pressure due to higher cost of funds

The NII was up by 16.2% to Rs1,714.3 crore with the reported NIM down by 20 basis points yoy and by 36 basis points qoq. The absence of interest on the higher CRR balances coupled with a higher increase in the cost of funds compared with the yield on the assets led to the decline in the NIM.

ICICI Bank's low cost deposit base with a CASA ratio of 22% is much lower than the industry average of 30-35%. So when the bulk deposit rates move up the bank faces higher pressure on its NIM as compared with its peers. In Q4FY2007 the deposit rates offered on bulk deposits of 6-12-month tenure were in the region of 11-12% the full cost of which was reflected in this quarter. The same shot up the cost of funds by 80 basis points qoq. The savings account deposit balance grew by 32.6% yoy and by 11.4% qoq. The growth was higher than the total deposit growth of 26.1% yoy and 0.1% qoq, and a positive for the bank in the face of a significant rise in its cost of funds.

NIM likely to stabilise or show marginal improvement

Although the bulk deposit rates have come off by 200 basis points from their peaks in March 2007, yet a lot of repricing gains are not expected soon as the major portion of the bulk deposits raised by the bank would mature only in Q3FY2008 and Q4FY2008. However the recently concluded follow-on public offer of around Rs20,000 crore would provide the bank with a huge pool of float funds from Q2FY2008 onwards which would provide the bank interest-free income. Hence we feel the NIM should stabilise at these levels and show a marginal improvement going forward.

Yield analysis (%)

Particulars	Q1FY08	Q1FY07	Q4FY07	yoy chg in bps	qoq chg in bps
Yield on assets	10.1	8.7	9.7	140	44
Cost of funds	7.8	6.2	7.0	160	80
NIM - reported	2.3	2.5	2.7	-20	-36
NIM - adjusted	2.3	2.5	2.6**	-20	-43

Source: Company, Sharekhan Research

** NIM adjusted for the one-time CRR interest of around Rs 50 crore earned during Q4FY2007.

Retail loan growth moderates to 29% yoy

Although the bank's total advances grew by 34.7% yoy, yet the growth in the retail advances moderated to 29% yoy from 39% in Q4FY2007 as the bank sold off Rs3,850 crore of loans during the quarter adjusted for which the retail growth would remain at 32.9% yoy. However, retail disbursals slowed sharply, declining by 15% yoy and 35% qoq, driven by a slowdown in home loan disbursements (home loan disbursements declined by 29% yoy and 42% qoq) due to higher interest rates and property prices.

Retail loans table

Retail loans (Rs crore)	Q1FY2008	% yoy chg	% qoq chg
2-wheelers	2,600.0	23.8	11.7
Cars	19,000.0	-1.0	-0.9
CV	17,000.0	46.6	-15.9
Personal loans	11,200.0	60.0	-10.1
Credit cards	6,100.0	74.3	0.4
Mortgages	65,500.0	32.3	2.6
Others + LAS	6,016.0	2.5	16.5
Total	127,416.0	29.0	-1.4
Non-collateralised portfolio	17,300.0	64.8	-6.7

Non-interest income much above expectations

The non-interest income was up 69.7% yoy to Rs1,715 crore, driven by a higher treasury gain of Rs195 crore compared with Rs18 crore in Q4FY2007, a fee income of Rs1,428 crore (up 35.4% yoy), and a lease and dividend income of Rs327 crore (up 59.8% yoy).

Fee income component to show steady growth going forward

The fee income continued to report a robust growth with the contribution from the retail business at 55%. The contribution from the international and corporate business stood at around 42% of which almost 8% was derived from the international business and the remaining 3% from other businesses. The international business is expected to see the highest growth in the medium term, though the NIM is lower whereas the fee income generated from this business is much higher. Hence we expect the fee income component to show a steady growth going forward.

Gains on principal investments in venture funds lead to higher treasury income

Treasury gains in Q1FY2007 were much lower at Rs18 crore due to a meltdown in the equity market in May 2006. The bank booked around Rs80-90 crore of capital gains on its principal investments in the venture funds managed by its venture fund subsidiary; this augmented the overall trading income for the quarter.

Non-interest income composition

Particulars	Q1FY08	Q1FY07	% yoy	% qoq
Non-interest income	1,715.0	1,010.6	69.7	-6.5
Treasury	195.0	18.0	-	-56.3
Fee income	1,428.0	1,055.0	35.4	0.1
Lease income & dividends	327.0	204.6	59.8	44.1
Amortisation	-235.0	-267.0	-12.0	-11.7
Non-interest income (adjusted for treasury & amotrtisation)	1,755.0	1,259.6	39.3	6.1

Source: Company

Core operating profit growth lower at 28.9% yoy

The operating expenses increased by 25.2% yoy to Rs1,905.3 crore; of this the staff expense grew by 46.3% yoy and 18.4% qoq, mainly due to a higher staff count and the impact of the annual increment in the salaries from the current quarter. Direct marketing agency costs declined in line with the retail advances while higher rentals and set-up costs of new branches contributed to the 29.3% year-n-year growth in the other expenses. The operating profit was up 58% yoy to Rs1,523.9 crore; but the core operating profit growth was lower at 28.9% yoy.

Operating expenses break-up

Particulars	Q1FY08	Q1FY07	% yoy	% qoq
Staff	521.8	356.8	46.3	18.4
DMA	382.7	390.8	-2.1	-9.5
Others	1,000.8	773.9	29.3	-5.3
Total	**1,905.3**	**1,521.5**	**25.2**	**-0.8**

Sequential growth in provisions remains stable, provision coverage declines

Provisions showed an increase of 155.7% yoy, however it's better if we compare the sequential growth in provisions. The provisions have declined by 37% qoq but that is due to a one-time higher provision on standard assets for Rs310 crore. Adjusting for the same the provisions have declined by only 2.5%. The NPA provisions were up 19.4% qoq at 102 basis points in Q1FY2008. The average advances increased from 91 basis points despite the fact that the asset quality deteriorated with the NNPA in percentage terms standing at 1.38% compared with 0.98% in Q4FY2007. The provision coverage also decreased from 58% in Q4FY2007 to 55% sequentially.

Provisions and contingencies break-up

Particulars	Q1FY08	Q1FY07	% yoy	% qoq
NPA	500.3	169.0	196.0	19.4
General & others	52.0	47.0	10.6	-64.6
Total	552.3	216.0	155.7	-37.0
Total - adjusted	552.3	216.0	155.7	-2.5

Asset quality deteriorates due to higher retail GNPAs

The sequential increase of Rs1,193 crore in the GNPA comprises primarily retail GNPAs of Rs777 crore (ie a 65% increase) of which non-collateralised defaults comprise 35%. Around Rs100 crore of NPAs were added due the Sangli Bank merger. Defaults on the home loan portfolio remain marginal.

Particulars	Q1FY2008	Q4FY2007	qoq chng
GNPA (in Rs)	6,043.0	4850.0	1,193.0
Retail GNPAs of which:	3,867.0	3090.0	777.0
Non-collateralised defaults	2,088.2	1668.6	419.6
NPA (in Rs)	2,742.0	2019.0	723.0
Retail NNPAs of which:	1,943.0	1512.0	431.0
Non-collateralised defaults	893.8	710.6	183.1
NPA (as %)	1.38	0.98	40 (bps)
Provision Cover (%)	55	58	

Margins not reflecting the contribution expected from high yielding non-collateralised portfolio

The default rates on non-collateralised retail loan products like credit cards and personal loans are high and the higher lending rates on these products factor in such defaults. However, the higher yields are not reflecting in the margins as the increase in the cost is outpacing the increase in the yields.

GNPAs growing at a much faster pace than advances

ICICI Bank's GNPAs have gone up by 25% qoq, which is significantly higher than the 1.2% sequential growth seen in its advances. Again in the non-collateralised portfolio, we have witnessed a 6.7% decline in the loan growth while GNPAs in this portfolio have grown by 25.1% qoq. We have factored in higher NPA provisions during FY2008, hence we would like to wait for another quarter before changing our estimates as the current provisions are marginally higher than our estimates and could get normalised going forward in a more benign interest rate regime. The interest rates are likely to have peaked out and the central bank's monetary policy is expected to ease with inflation down below 4.5%.

Performance of subsidiaries

- ICICI Lombard General Insurance achieved a profit after tax (PAT) of Rs45 crore in Q1FY2008 compared with that of Rs15 crore for Q1FY2007. Along with a higher premium income the investment income also increased during the quarter which resulted in profits jumping three folds.

- The losses for ICICI Prudential Life Insurance were higher at Rs242 crore compared with Rs52 crore in Q1FY2007. However the new business achieved profit (NBAP) stood at Rs165 crore for Q1FY2008 compared with that of Rs186 crore in Q1FY2007. The decline in the NBAP has been a surprise but the same has is a result of the very high growth witnessed in Q1FY2007 for the unit linked products (ULIP) before new guidelines came into effect. After the new guidelines came into effect the margins declined slightly from above 20% to 19% levels. The first quarter normally is a low growth quarter for insurance companies. However Q1FY2007 was an aberration due to the effect of the change in the ULIP guidelines. Hence we would like to see the performance of the life insurance business in Q2FY2007 before revisiting our estimates.

- ICICI Bank UK's unaudited PAT for Q1FY2008 stood at approximately Rs75 crore (US$18.9 million).

Sangli Bank merger process complete

Sangli Bank merged with ICICI Bank with effect from April 19, 2007. There has been hardly any impact on the balance sheet after the merger, as the balance sheet size of Sangli Bank was 0.5% of ICICI Bank's balance sheet as in March 2007. The merger valuation accounting resulted in Rs344 crore of goodwill paid for by ICICI Bank and the same was adjusted through ICICI Bank's share premium account.

Update on the follow-on offer

The bank has successfully raised Rs8,750 crore from the domestic market. The greenshoe option has not yet been exercised in the domestic market. In the foreign market the bank raised Rs9,923.6 crore including the greenshoe option. The bank's current capital adequacy ratio stood at 11% with the Tier-I capital adequacy ratio at 7.1%, which is expected to improve to 13-14% with the new Tier-I equity capital raised by the bank in July 2007.

Valuation and view

We feel the bank's core operating performance should improve with the NIM likely to stabilise or show marginal improvement going forward and the non-interest income growth expected to remain steady. The only concern is the uptick in the NPAs which need to be watched going forward. At the current market price of Rs970, the stock is quoting at 21.2x its FY2009E EPS, 10.4x its PPP and 2.2x FY2009E BV. We maintain our Buy recommendation on the stock with the price target of Rs1,173.

Earnings table

Particulars	FY05	FY06	FY07E	FY08E	FY09E
Net profit (Rs cr)	2005.2	2539.9	3110.4	4015.7	5120.8
Shares in issue (cr)	73.7	89.0	89.9	112.1	112.1
EPS (Rs)	27.2	28.5	34.6	35.8	45.7
EPS growth (%)	2.5	4.9	21.2	3.6	27.5
PE (x)	35.6	34.0	28.0	27.1	21.2
P/PPP (x)	24.2	22.2	14.9	13.4	10.4
Book value (Rs/share)	170.3	249.6	270.3	419.9	450.0
P/BV (x)	5.7	3.9	3.6	2.3	2.2
Adjusted book value (Rs/share)	149.9	237.7	247.9	392.9	412.5
P/ABV (x)	6.5	4.1	3.9	2.5	2.4
RONW (%)	18.1	13.6	13.3	10.4	10.5

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

Orchid Chemicals & Pharmaceuticals

Emerging Star

Stock Update

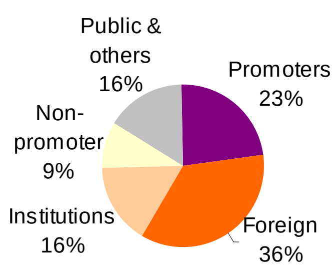
Core earnings exceed expectations

Buy; CMP: Rs234

Company details

Price target:	Rs375
Market cap:	Rs1,538 cr
52 week high/low:	Rs285/165
NSE volume: (No of shares)	3.3 lakh
BSE code:	524372
NSE code:	ORCHIDCHEM
Sharekhan code:	ORCHID
Free float: (No of shares)	5.0 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-7.1	-10.2	15.9	39.8
Relative to Sensex	-14.1	-20.2	4.7	-8.2

Result highlights

- Orchid's top line grew by 18.1% year on year (yoy) to Rs238.2 crore in Q1FY2008. The top line growth was above our estimates of Rs223.2 crore and was driven by new launches including the launch of Cefepime injections in the USA.
- The company maintained its performance in its major market, the USA. Its key products—Ceftriaoxne and Cefproxil—continued to enjoy a healthy market share in excess of 20-25%. Further, being the sole generic supplier of Cefoxitin and Cefazolin in the USA, Orchid maintains its high market share for these products.
- Driven by the improvement in the raw material costs, Orchid's operating profit margin (OPM) expanded by 110 basis points to 29.9% in Q1FY2008. On the other hand, the rising R&D costs (due to FTF filings) and increasing staff costs adversely impacted the margins. On a like-to-like basis (excluding the Rs10 crore incremental cost incurred on FTF filings), the margin expansion would have been even more robust at 530 basis points to 34.1%. Consequently, the operating profit grew by 22.8% to Rs71.2 crore in Q1FY2008.
- The reported net profit jumped up by 251.7% to Rs51.3 crore, largely due to the foreign exchange (forex) gains recorded during the quarter and the reduction in the interest expense. On the other hand, the net profit was adversely impacted by the increased tax outgo due to the imposition of minimum alternative tax (MAT). On adjusting for the forex gains, losses and the associated tax implications, the adjusted net profit rose by 81.8% to Rs26.5 crore.
- On a consolidated basis, Orchid's revenues grew by 18.4% yoy to Rs251.8 crore in Q1FY2008. The company's OPM shrank by 190 basis points to 24.1% in the quarter, causing the operating profit to rise by only 9.8% to Rs60.7 crore. The net profit rose by a robust 348.6% to Rs48.6 crore due to a large marked-to-market gain recorded on the outstanding foreign currency convertible bond (FCCB) loans of the company and a 25.1% lower interest expense.

Result table (stand-alone) Rs (cr)

Particulars	Q1FY08	Q1FY07	% yoy change
Net sales	238.2	201.7	18.1
Expenditure	167.0	143.7	16.2
Operating profit	71.2	58.0	22.8
Other Income	53.2	0.8	6707.0
EBIDTA	115.4	58.8	96.2
Interest	16.5	22.0	-25.2
Depreciation	23.0	19.3	19.0
PBT	75.9	17.4	335.3
Taxes	24.6	2.9	763.5
Reported net profit	51.3	14.6	251.6
Net forex impact	24.8	0.0	-
Adjusted net profit (excluding forex impact)	26.5	14.6	81.8
OPM (%)	29.9	28.8	110 bps
Adjusted net profit margin (%)	11.1	7.2	390 bps
EPS (Rs)	7.8	2.2	251.5

- Orchid has just received approval for Cefdinir tablets and suspension from the US Food and Drug Administration (USFDA). The product, with a market size of $850 million in the USA, will be launched immediately by Orchid. We estimate Orchid to generate approximately $19 million and $25.5 million in revenues in FY2008 and FY2009 respectively.
- At the current market price of Rs234, Orchid trades at 9.9x its estimated FY2009 earnings, on a fully diluted basis. In view of the company's strong growth prospects ahead, we retain our positive outlook on the stock and maintain our Buy call with a price target of Rs375.

Orchid reported a strong 18.1% yoy increase in its net sales to Rs238.2 crore in Q1FY2008. The sales growth was above our expectations. The company's OPM dipped by 270 basis points to 26.1% in the quarter, driven by a sharp rise of 54.9% in the other expenses. The OPM reported by the company was below our estimates. Consequently, Orchid's operating profit rose by a meager 7.2% to Rs62.2 crore in Q1FY2008. Owing to a sharp reduction in the interest expense and a substantial forex gain of Rs52.8 crore recorded during the quarter, the net profit jumped up 251.6% to Rs51.3crore in the quarter. The reported profit growth was way above our estimates.

On consolidated basis, Orchid's revenues grew by 18.4% year on year (yoy) to Rs251.8 crore in Q1FY2008. The company's OPM shrank by 190 basis points to 24.1% in the quarter, causing the operating profit to rise by only 9.8% to Rs60.7 crore. The net profit rose by a robust 348.6% to Rs48.6 crore due to a large marked-to-market gain recorded on the outstanding FCCB loans of the company and a 25.1% lower interest expense. The consolidated profits were lower than the stand-alone profits on account of a Rs4-5-crore write-off of the costs associated with Bexel Pharmaceuticals and Orchid Research Laboratories.

US business maintains momentum despite no new launches

Orchid's sales grew by a robust 18.1% yoy to Rs238.2 crore during the quarter, but declined sequentially by 4%. The sequential decline was due to a seasonal reduction of antibiotics during the summer season in the USA. The year-on-year (y-o-y) growth was, however, robust and largely powered by the ten days of sales of Cefepime injections, which were launched on June 21. Although Cefipime injections have an annual market size of only $190 million in the USA, we believe Orchid gained handsomely from this opportunity since it is the only generic player in the market. We believe Orchid could have captured a market share of almost 50%. Further, Orchid's key products—Ceftriaxone and Cefprozil, launched in FY2006—have maintained their sales momentum and retained their respective market shares of over 20% each in the US market. Further, being the sole generic supplier of Cefoxitin and Cefazolin in the USA, Orchid continues to maintain its high market share for these products.

The quarter also marked Orchid's foray into non-antibiotic space, with the launch of Terbinafine tablets. Going forward, Orchid expects to launch nine new products in the remaining part of FY2008 in the USA. Of these, five will be in the Cephalosporin space and four in the non-antibiotic space. The approval for Tazobactum piperacillin is expected shortly, once the results of the microbiology studies have been reviewed by the USFDA. Orchid hopes to launch the product immediately upon receipt of approval

Filings for FTF opportunities and forex losses exert pressure on margins

Orchid's OPM expanded by 110 basis points to 29.9% in the quarter. The margin expansion was led by a 3% reduction in the company's raw material cost. The material cost, which constituted 35.5% of sales in Q1FY2007, formed only 29.1% of sales in Q1FY2008. The sharp drop in the material cost was on account of an improved product and geographical mix, as the company continued to derive an increasing share of its revenues from the high-margin formulation exports to the regulated markets.

On the other hand the rising R&D costs adversely impacted the margins. Orchid incurred Rs15 crore on ANDA filings and development during the quarter as compared with only Rs9 crore incurred in the corresponding quarter of the previous year. The increase in the R&D cost was largely due to three filings made for FTF opportunitites, which usually cost more than the normal Para III filings. On a like-to-like basis (excluding the costs incurred for FTF filings), the OPM showed an even more robust expansion of 530 basis points to 34.1% in the quarter.

The margins were also adveresly impacted by the 29.7% increase in the staff cost. This was due to the addition of employees in the company's R&D division.

The resultant expansion in the margins caused the company's operating profit to grow by a 22.8% to Rs71.2 crore in Q1FY2008.

Cost analysis Rs (cr)

Particulars	Q1FY08	Q1FY07	% yoy chng
Adjusted material cost	69.4	71.6	-3
% of sales	*29.1*	*35.5*	
Staff cost	22.3	17.2	29.7
% of sales	*9.4*	*8.5*	
Other expenditure	75.3	54.9	37
% of sales	*31.6*	*27.2*	

Forex gains and reduced interest expenses boost net profit

Orchid's reported net profit increased by a massive 251.6% to Rs51.3 crore. The steep rise was largely due to an over 6.5x rise in the other income, which rose steeply because of a Rs52.8 crore marked-to-market gain recorded on the company's outstanding FCCB loans due to the appreciation of the rupee vis-à-vis the US Dollar. Further, the company's interest expense also declined by 25.1% to Rs16.5 crore during the quarter as it had repaid a large part of its debt towards the end of March 2007 from the proceeds of the recent FCCB issue. Further, the debt level as on June 30, 2007 remains at the same level as on March 31, 2007.

On the other hand, the company's tax outgo increased substantially, with the imposition of MAT in the FY2008 Union Budget. Excluding the impact of the taxes paid on the forex gain, the company's effective tax rate rose to 24% in Q1FY2008 as compared with only 16% in Q1FY2007. The resultant reported net profit grew by a strong 251.6% to Rs51.3 crore. However, on excluding the net forex impact (the impact of the forex gain of Rs52.8 crore, the associated tax implication of Rs19.1 crore and the forex loss of Rs9 crore incurred on outstanding receivables), the adjusted net profit of the company (derived solely from operations) stood at Rs26.5 crore, up by 81.8% yoy.

Cefdinir approval received from the US FDA

Orchid has just announced that it has received approval from the USFDA for its ANDAs for Cefdinir for capsules 300 mg and Cefdinir for oral suspension 125 mg/5 ml and 250 mg/5 ml. Cefdinir, the generic version of Abbot's Omnicef, is an antibiotic used to treat a variety of infections. The product just lost patent protection in May 2007 in the USA, with the branded product having a market size of approximately $850 million.

The Cefdinir market already has four players—Abbot (the innovator) along with leading generic companies like Teva, Lupin and Sandoz. The management has indicated that Cefdinir is currently available at a 70% discount to the innovator's price. Being the fifth player entering the market, we believe Orchid will be able to capture at least 15% of the market and generate revenues of approximately $19 million and $25.5 million from the product in FY2008 and FY2009 respectively.

Accelerated pace of regulatory filings continues

Orchid has maintained its pace of regulatory filings in Q4FY2007. The company's cumulative filings stands at 45 DMFs and 40 ANDAs till date in the USA. Of the DMFs filed, 26 pertain to the Cephalosporin product range, 17 to the non-Penicillin, non-Cephalosporin (NPNC) range, and two to the Penicillin product space. Among the ANDAs filed till date, 27 are in the Cephalosporin segment, 11 in the NPNC space and two in the Penicillin product segment. Further, the management has also indicated that some of its filings in the current quarter have been for potential FTF opportunities. As of date, Orchid has received approvals from the USFDA for 20 ANDAs.

Even though the company's increased focus on regulatory filings has led to an increase in its expenses, we believe that Orchid is laying down the foundations for its future growth. With this pace of filings, the company is expected to have a cumulative filing count of 71 ANDAs in the USA and an equal number in Europe by FY2008. This robust product pipeline will result in an accelerated pace of new launches and lead to stronger growth.

Valuation & view

With FY2007 over, Orchid's lean phase seems to be over. Orchid has been investing steadily in building its product pipeline to expand its presence in the regulated markets of the USA and Europe. Going forward, especially from FY2008 onwards, we believe the company will grow by leaps and bounds, with its big launches in the USA and an entry into Europe. With the new FCCB issue, the company has also cleaned up its balance sheet, which was a huge cause of concern for investors in the past. The reduced debt level will generate substantial savings in interest costs, which is already evident in this quarter and which will boost Orchid's bottom line in the future. Further, with an improved product and geographical mix, Orchid's margins will also show substantial expansion. With a strong top line growth, robust margins and a clean balance sheet, Orchid's future seems very bright.

At the current market price of Rs234, Orchid is quoting at 9.9x its estimated FY2009 earnings, on a fully diluted basis. In view of the bright prospects for the company, we retain our positive stance on the stock and maintain our Buy call with a price target of Rs375.

Valuation table Rs (cr)

Paticulars	FY05	FY06	FY07	FY08E	FY09E
Total operating income	677.7	873.5	912.9	1044.3	1193.9
Net profit	31.0	82.9	96.6	156.4	224.5
% y-o-y change	-0.1	167.3	16.6	61.8	43.6
Shares in issue (cr)	3.4	6.5	6.6	9.1	9.6
EPS (Rs)	9.1	12.8	14.7	17.3	23.5
PER (x)	25.7	18.2	15.9	13.5	9.9
Cash EPS (Rs)	27.2	25.7	27.2	29.3	35.1
Cash PER (x)	8.6	9.1	8.6	8.0	6.7
EV	966.4	1017.0	1519.7	577.0	429.0
EV/Ebidta (x)	6.0	3.9	5.2	1.6	1.0
Book value (Rs/share)	138.1	121.5	76.2	160.1	182.3
P/BV (x)	1.7	1.9	3.1	1.5	1.3
Mcap/sales	1.2	1.7	1.7	2.0	1.9
RoCE (%)	6.6	9.4	9.4	11.2	13.0
RoNW (%)	6.6	10.6	19.3	10.8	12.9

Cipla

Cannonball

Stock Update

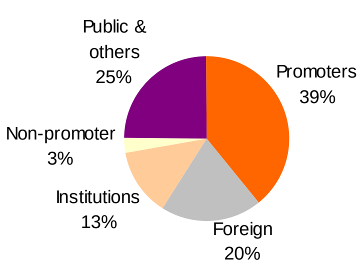
Book profit

Book Profit; CMP: Rs191

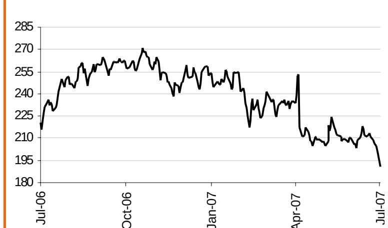
Company details

Market cap:	Rs14,874 cr
52 week high/low:	Rs280/180
NSE volume: (No of shares)	31.4 lakh
BSE code:	500087
NSE code:	CIPLA
Sharekhan code:	CIPLA
Free float: (No of shares)	47.1 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-4.4	-14.5	-20.5	-7.0
Relative to Sensex	-11.6	-24.1	-28.1	-38.9

Result highlights

- Cipla reported much lower than expected results for Q1FY2008 with a net profit of Rs119.8 crore against the expectation of Rs176.8 crore. The earnings have been lower due to the disappointing performance of the export business and a significant contraction in the operating profit margin (OPM).
- The revenues were marginally higher by 4.4% to Rs901.8 crore. The sales growth was lower basically due to the lower-than-expected performance of the export business, which grew by a marginal 2.1%. The disappointing exports could partly be justified by the decline in the export realisations caused by the rupee appreciation. The low growth in the exports was also partly attributed to the high base in Q1FY2007 when the company had gained hugely from the Finasteride exclusivity in the USA. Going forward, the high growth rate seen in the previous quarters seems even more difficult to sustain on the high base of the previous year. Thus, in order to factor in the above, we are moderating our formulation export growth estimates for FY2008 and FY2009 to 20% each from the earlier estimates of 30% and 25% respectively.
- Cipla's domestic business grew by just 6.9% during the quarter, which was way below the industry growth of 10-12%. This was mainly on account of lower stocking of certain older brands of products at the primary level.
- The OPM witnessed a sharp 870-basis-point decline to 17.8% in the quarter due to the higher contribution of low-margin anti-retrovirals (ARVs) and the decline in the export realisation due to rupee appreciation. Further, rising staff and manufacturing expenses also affected the margin. Consequently, the operating profit stood at Rs160.7 crore, down by 29.8%. Going forward also, Cipla's margin will continue to be affected by the increased contribution from the low-margin ARV sales. Hence, we are revising down our OPM estimates for FY2008 and FY2009 to 19% (from 21.5%) and 20.5% (from 22%) respectively.

Result table Rs (cr)

Particulars	Q1FY2008	Q1FY2007	% Change
Net sales	901.8	863.6	4.4
Total expenditure	741.1	634.7	16.8
Operating profit	160.7	228.9	-29.8
OPM (%)	17.8	26.5	-870bps
Other income	18.54	22.0	-15.5
EBIDTA	179.2	250.8	-28.5
EBITDA margin (%)	19.9	29.0	-910bps
Interest	0.8	2.8	-70.6
Depreciation	30.25	26.0	16.3
PBT	148.2	222.0	-33.3
Taxes	28.4	51.6	-45.0
PAT (after extraordinary)	119.8	170.4	-29.7
PAT margin (%)	13.3	19.7	-640bps

- With the 15.5% fall in the other income and a 16.3% rise in the depreciation cost, the net profit declined by 29.7% to Rs119.8 crore in Q1FY2008.
- Cipla's performance continued to be disappointing in Q1FY2008, largely due to the lower than expected performance of the export business and the decline in the OPM. Hence, we are revising down our FY2008 and FY2009 earnings estimates by 18.1% and 15.7% respectively.
- At the current price of Rs191, the stock trades at 21.4x and 17.7x its FY2008E and FY2009E earnings respectively. At this level, we feel the stock is richly valued, considering the limited scalability of formulation exports and the company's inability to effect margin improvements, which leaves limited room for upside for the investors. **The stock has yielded a return of 88.7% since our recommendation and we advise investors to book profits on Cipla.**

Disappointing exports affect performance

Cipla reported a marginal revenue growth of 4.4% to Rs901.8 crore in Q1FY2008; the same was lower than our expectations of Rs972.3 crore. The sales growth was lower basically due to lower than expected performance of the exports, which grew by a marginal 2.1%. The disappointing exports could partly be justified by the decline in the export realisations caused by rupee appreciation. If we discount the rupee fluctuation factor, Cipla's exports grew by just 12.8% during the quarter.

The domestic performance was also not satisfactory at 6.9% growth, which was below the industry growth of about 10-12%.

Revenue break-up Rs (cr)

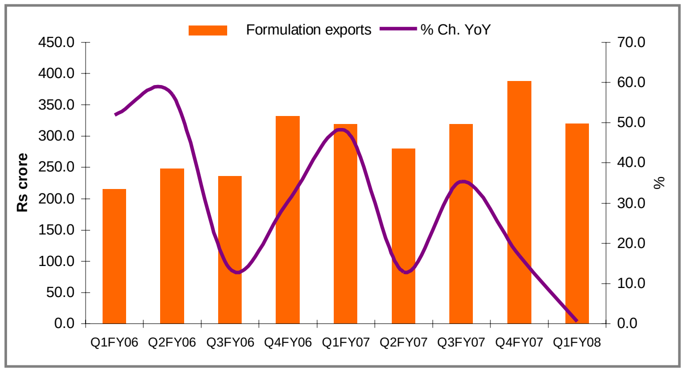
Particulars	Q1FY08	Q1FY07	% yoy chnge
Domestic	505.4	472.9	6.9
% of total sales	*55.7*	*54.6*	
Exports	401.9	393.8	2.1
% of total sales	*44.3*	*45.4*	
Formulation exports	320.3	318.7	0.5
% of total sales	*35.3*	*36.8*	
API exports	81.58	75.2	8.5
% of total sales	*9.0*	*8.7*	
Total sales	907.3	866.7	4.7

Formulation export growth tapering off

Cipla reported flat formulation exports at Rs320.3 crore during the quarter (against Rs318.7 crore during Q1FY2007), partly due to the declining rupee realisation from exports and partly due to the high base of Q1FY2007 when the company had booked huge revenues from the Finasteride exclusivity. On discounting the impact of foreign exchange (forex) fluctuation, the company delivered just 11.1% growth on a year-on-year basis, which was lower compared to the earlier quarters. This indicates that the growth momentum in the formulation export segment has slowed down.

Cipla holds supply pacts with global leaders for US and European markets which can catapult the formulation export revenues. But, unless and until Cipla converts its supply pacts into reality, it cannot scale up the formulation export business substantially.

Formulation export growth moderates



Cipla has one of the strongest pipelines of 160 generic products (comprising plain generics, patent challenges and first-to-file products) for regulated markets, to be marketed through its allied partners. These products are at various stages of development. On the ARV front, the up-coming tenders worth $600 million in the South African market may provide a big opportunity to Cipla, given its lowest cost manufacturing capability for ARVs.

Further, Cipla, the second largest manufacturer of inhalers in the World, is well placed to exploit the upcoming generic opportunity in Europe for CFC-free inhalers. Also, Glaxo Plc, the global leader in inhalers, is contemplating outsourcing the manufacturing of inhalers to Cipla. Any development on this front can boost the export earnings.

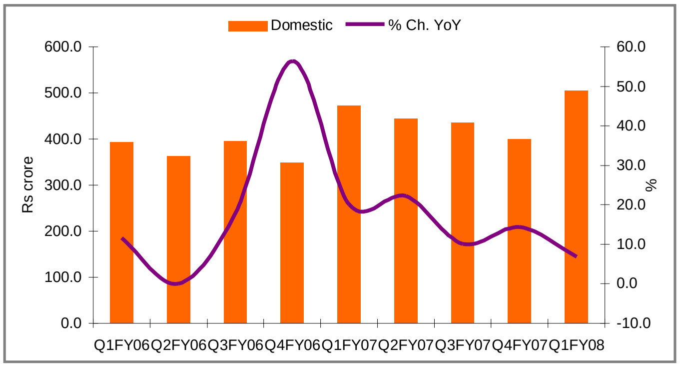
However, with the delay in materialisation of the generic supply pacts into supply orders, the formulation export growth has moderated in recent quarters. The high growth rate seen in the previous quarters seems even more difficult to sustain on the high base of the previous year. Thus, in order to factor in the above, we are moderating our formulation exports growth estimates for FY2008 and FY2009 to 20% each from the earlier estimates of 30% and 25% respectively.

During the quarter, the active pharmaceutical ingredient (API) exports saw a 8.5% growth yoy but a 42.3% decline sequentially. However, considering the lumpy business cycle in the API business and lack of clear visibility for API supply under exclusivity of innovative players, we continue to model a marginal 5% compounded annual growth rate (CAGR) for FY2007-09.

Domestic formulations showed weakness

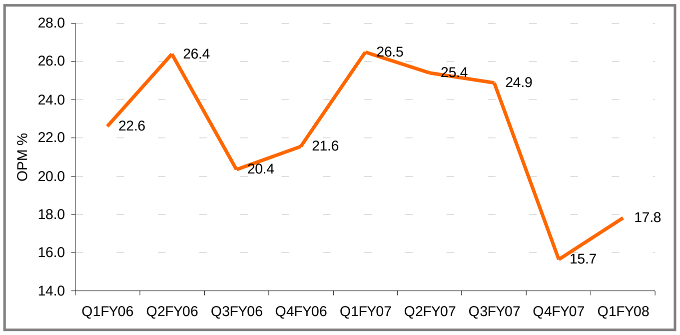
The domestic formulation business reported a 6.9% growth to Rs505.35 crore, which was lower than the industry growth of about 10-12%. This was lower than estimates mainly on account of lower stocking of certain older brands of products at the primary level. We believe the company would deliver 15% and 13% growth for FY2008 and FY2009 respectively on the back of regular introduction of products and increased penetration into the rural markets.

Growth in domestic formulations slows down



Deteriorating product mix and rising rupee affect the margins

Cipla's OPM witnessed an 870-basis-point decline to 17.8% in the quarter. The contraction in the margin was due to a change in the product mix (higher volume of ARVs where the margins are low) and a decline in the export realisation due to rupee appreciation. Also, a higher other expenditure and staff cost subdued the OPM in Q1FY2008. In fact, the other expenses increased by 240 basis points due to the new Patalganga export oriented unit, which is fully functional. The staff cost also saw a 130-basis-point increase on account of annual increments and overall increase in manpower. Consequently, the operating profit stood at Rs147.0 crore, down by 22.8%.



The increasing proportion of the low-margin ARVs in Cipla's revenue mix and the non-materialisation of supply pacts into business orders are causes for concern for Cipla, as a result of which the OPM has witnessed a sharp decline in the recent quarters (the trend is visible from the chart). Going forward also, Cipla's margins will continue to be affected by the increased contribution from the low-margin ARV sales. Hence, we are revising down our OPM estimates for FY2008 and FY2009 to 19% (from 21.5%) and 20.5% (from 22%) respectively.

Net profit slips by 30%; lower than estimates

With the other income declining by 15.5% and depreciation rising by 16.3%, the net profit stood at Rs119.8 crore, which was much lesser than our estimate of Rs176.8 crore.

Revising downwards FY2008 and FY2009 estimates

Cipla once again reported disappointing quarterly numbers, the Q1FY2008 numbers were disappointing largely due to the lower than expected performance of the export business and the decline in the OPM. Considering the delay in the materialisation of supply pacts with global players, consequent rising contribution from the low-margin business of ARVs and the deteriorating margin performance, we are revising down our FY2008 and FY009 earnings estimates by 18.1% and 15.4% respectively. As per our revised estimates, the EPS for FY2008 and FY2009 stands at Rs8.9 and Rs10.8 per share respectively.

	Revised Estimates		Old Estimates		% revision	
	FY08E	FY09E	FY08E	FY09E	FY08E	FY09E
Net sales	3887.9	4539.6	4100.5	4795.5	-5.2	-5.3
Net profit	694.2	841.7	847.2	998.0	-18.1	-15.7
EPS	8.9	10.8	10.9	12.8	-18.1	-15.4

Book profits

The continuous disappointing performance both on the export and the margin front in recent quarters has diminished the earnings visibility for the company. Also it is believed that Cipla has geared up its ARV business (margins are low here) in order to capitalise on the upcoming opportunity in global markets (particularly the African countries). The emergence of the ARV business as a growth contributor would in turn hit the operating profitability of the company.

At the current price of Rs191, the stock trades at 21.4x and 17.7x its FY2008E and FY2009E earnings respectively. At this level, we feel the stock is richly valued, considering the limited scalability of the formulation exports and the inability of the company to effect margin improvements, which leaves limited room for upside for the investors. **The stock has yielded a return of 88.7% since our recommendation and we advise investors to book profits on Cipla.**

Valuation table Rs (cr)

Particulars	FY05	FY06	FY07	FY08E	FY09E
Net sales	2181.3	2891.4	3438.1	3887.9	4539.6
Net profit	411.9	607.6	660.8	694.2	841.7
Shares in issue (cr)	77.7	77.7	77.7	77.7	77.7
EPS (Rs)	5.3	7.8	8.5	8.9	10.8
PER (x)	36.1	24.5	22.5	21.4	17.7

Hindustan Unilever

Apple Green

Stock Update

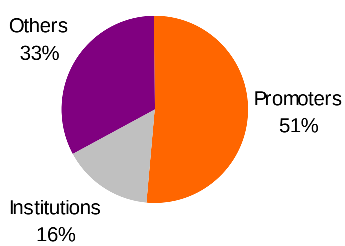
Buyback of shares

Buy; CMP: Rs204

Company details

Price target:	Rs280
Market cap:	Rs44,900 cr
52 week high/low:	Rs262/166
NSE volume: (No of shares)	30.8 lakh
BSE code:	500696
NSE code:	HINDLEVER
Sharekhan code:	HLL
Free float: (No of shares)	107.8 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	3.1	-5.5	-11.2	-13.6
Relative to Sensex	-4.7	-16.0	-19.7	-43.3

Event

Hindustan Unilever Ltd (HUL) has announced a plan to buy back its shares. It will seek the approval of its shareholders for the proposed move at its board meeting on July 29, 2007. The exact details, especially the price at which the company will buy back, will be announced only after the board approves the plan.

Effect on the share capital

According to the regulations of the Securities and Exchange Board of India for a buyback, HUL can buy back the equivalent of 25% of its net worth (maximum permissible) of Rs2,723 crore, ie Rs680 crore. The buyback will reduce its equity capital by around 1.46% (depending on the buyback price) that is 3.2 crore shares. Hence we don't expect the buyback to be significant though this act of the company will evoke positive sentiment for the stock.

Outlook

With a cash pile of Rs416 crore, investments of Rs2,400 crore and cash of Rs1,800 crore being generated from operations, the company's buyback proposal will have a positive effect on its return on capital employed (RoCE), which had slightly dipped in CY2006. The RoCE had gone down from 68.7% in CY2005 to 67% in CY2006. Further we believe, the impact of the buyback on the earnings would be neutral.

Additionally, with this announcement we believe that HUL has sent a signal to its investors that it believes its shares are undervalued.

At the current market price of Rs204, the stock is quoting at 23.9x its CY2007E earnings per share (EPS) of Rs8.5 and 21.3X its CY2008E EPS of Rs9.6. We maintain our Buy recommendation on the stock with a price target of Rs280.

Earnings Table Rs (cr)

Particulars	CY2005	CY2006	CY2007E	CY2008E
Net profit (Rs crore)	1,310.7	1,539.7	1,883.9	2,111.8
% y-o-y growth	*10.8*	*17.5*	*22.4*	*12.1*
Shares in issue (crore)	220.1	220.7	220.7	220.7
EPS (Rs)	6.0	7.0	8.5	9.6
PER (x)	34.3	29.2	23.9	21.3
Book value (Rs)	10.5	12.3	14.9	18.5
P/BV (Rs)	19.5	16.5	13.7	11.1
EV/EBIDTA (x)	29.5	25.6	22.0	18.9
RoCE (%)	68.7	67.0	67.7	61.3
RoNW (%)	56.8	56.5	57.4	51.9

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

Deepak Fertilisers & Petrochemicals Corporation

Ugly Duckling

Stock Update

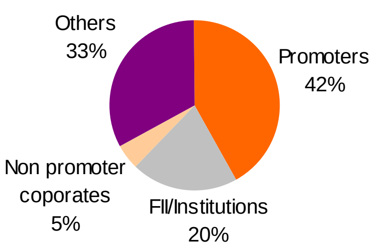
Gas to improve overall capacity utilisation

Buy; CMP: Rs103

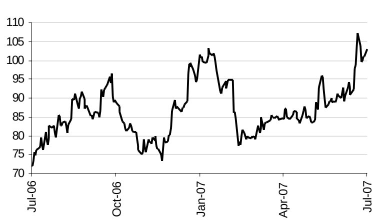
Company details

Price target:	Rs126
Market cap:	Rs910 cr
52 week high/low:	Rs110/69
NSE volume: (No of shares)	1.3 lakh
BSE code:	500645
NSE code:	DEEPAKFERT
Sharekhan code:	DPKFERT
Free float: (No of shares)	5.1 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	15.8	23.3	9.9	44.7
Relative to Sensex	7.1	9.6	-0.7	-5.0

We attended the conference call of Deepak Fertilisers and Petrochemicals Ltd (DFPL) to discuss the future prospects of the company. We present below the key takeaways from the call.

- The net sales for Q1FY2008 increased by 32% year on year to Rs219.8 crore. However, the net profit was down by 9% to Rs22.6 crore because of higher raw material cost and higher interest expenditure.
- The revenue grew mainly because of contributions of Rs63.7 crore from the isopropyl alcohol (IPA) plant and Rs152 crore from the chemical segment (a 38% growth).
- The production of IPA in Q1FY2008 was around 12,000 tonne and the company managed to get an average realisation of Rs50,000 per tonne. Generally, IPA realisation is in the range of Rs45,000 to Rs60,000 per tonne. The IPA utilisation level is to remain around 60% to 65% in FY2008. The cost of propylene, a key raw material, is close to around Rs30,000 per tonne.
- In Q1FY2008, the company enjoyed a 20% profit margin in the IPA business where the profit margin generally varies from 15% to 20%.
- The company expects to receive the gas from Dahej-Uran pipeline in the next four weeks at the price of US$8.0 to US$8.5 per million British thermal unit (mBtu). The company has not signed any long-term contract for the gas, as it believes the gas prices would come down and stabilise around US$4-6 per mBtu in some years, once the Krishna-Godavari basin starts operating.
- During Q1FY2008, the company shut its ammonia manufacturing capacity for 41 days to augment the current capacities. The production capacity of ammonia now stands at 390 metric tonne (MT) per annum from the earlier 272MT.
- The company does not sell ammonia, but uses it for captive consumption to manufacture other products. The company expects the cost of ammonia to come down, as manufacturing the chemical is cheaper compared with importing ammonia or buying the same from the local market. The company expects that the plant will operate at full capacity utilisation once there is proper availability of the gas.

Earnings table Rs (cr)

Particulars	FY2006	FY2007	FY2008E	FY2009E
Net sales	562.9	833.1	1114.5	1259.1
Net profit	67.0	94.4	114.9	150.8
EPS	7.6	10.7	13.0	17.1
PER (x)	11.0	9.5	7.6	5.8
Book value	65.0	72.0	81.6	95.3
P/BV (x)	1.5	1.4	1.2	1.0
EV/EBITDA	8.8	8.3	6.1	4.8
RoCE (%)	11.4	11.1	12.1	14.0

- Around 76% of the total area of 550,000 square feet of "Ishanya" mall has already been leased out at an average price of Rs46-47 per square foot. The company expects the mall to start operations from Diwali (ie around October 2007).
- The company expects 80% capacity utilisation for the fertiliser segment once there is proper availability of the gas.
- As of June 2007, the company has a debt of Rs32 crore. The management also expects interest expenses of around Rs7 crore for Q2FY2008.

Outlook and valuation

The outlook for the company remains positive with the gas from the Dahej-Uran pipeline being made available in the next four weeks. The company will also witness full capacity utilisation of the products that are manufactured from ammonia on the back of the augmented ammonia of capacity 390MT per annum. The IPA plant has now stabilised with around 60-65% capacity utilisation and the "Ishanya" mall is expected to start operating from October 2007.

At the current market price, the stock is trading at 5.8x its FY2009E earnings and an enterprise value/earnings before interest, depreciation, tax and amortisation of 4.8x. The increased capacity of ammonia from 272MT per annum to 390MT per annum and the proper availability of gas have increased the utilisation of concentrated nitric acid and methanol. Due to this, we have marginally revised our FY2009 estimates upwards. The IPA plant (DFPL is the only producer of IPA in the country) has now stabilised. The Dahej-Uran pipeline is expected to start providing gas in the coming weeks. All these factors would benefit the company by increasing the capacity utilisation of different products. We maintain our Buy recommendation on the stock with price target of Rs126.

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

Shree Cement

Cannonball

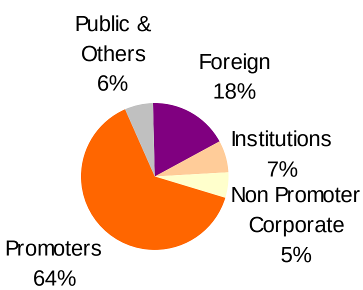
Stock Update

Price target revised to Rs1,625

Buy; CMP: Rs1,440

Company details	
Price target:	Rs1,625
Market cap:	Rs5,011 cr
52 week high/low:	Rs1,592/795
NSE volume: (No of shares)	22,441
BSE code:	532349
NSE code:	SHREECEM
Sharekhan code:	SHREECEM
Free float: (No of shares)	1.3 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	22.9	41.7	-1.6	66.8
Relative to Sensex	13.6	25.9	-11.0	9.5

Result highlights

- In Q1FY2008 Shree Cement's revenue grew by a healthy 37.6% year on year (yoy) to Rs425 crore on the back of a 25% growth in volumes and a 10% increase in realisations.
- The company's operating expenditure increased by 41.7% yoy to Rs243.5 crore, thanks to higher power & fuel and freight costs. On a per tonne basis, the total cost increased by 13% yoy to Rs1,726 which translated into a sequential decline of 4%.
- On the back of a higher growth in the operating expenditure, the operating profit grew at a slower rate of 32.6% yoy to Rs182 crore whereas the operating profit margin (OPM) dropped by 160 basis points to 42.8%.
- On account of a higher volume growth, the earnings before interest, tax, depreciation and amortisation (EBITDA) per tonne improved by 6% yoy and by 8% quarter on quarter (qoq) to Rs1,294.
- The interest cost declined by 27.5% yoy to Rs3.9 crore on account of the repayment of debt whereas the depreciation provision increased by 35.8% yoy to Rs35.7 crore as a fall-out of the increase in the gross block.
- Thanks to the higher other income component of Rs12.6 crore as well as the lower interest cost, the net profit grew by a healthy 29.5% yoy to Rs117 crore, in line with our expectations.
- Shree Cement is augmenting its cement capacity by 4 million metric tonne (MMT) over the next couple of years. Unit V, which is a 1.5MMT clinkerisation unit, is expected to come up by September 2007 whereas the integrated unit VI is expected to come up by September 2008. The 3.5MMT grinding unit at Khushkera is expected to come up in two phases, ie 2MMT by September 2007 and 1.5MMT by December 2007. Considering the timely implementation of the capital expenditure (capex) plan, we are assuming the volumes would grow by 33% yoy in FY2008 and by 20% yoy in FY2009.

Result table Rs (cr)

Particulars	Q1FY08	Q1FY07	% yoy	Q4FY07	% qoq
Net sales	**425.8**	**309.4**	**37.6**	**378.3**	**13.0**
Total expenditure	243.5	171.9	41.7	227.0	7.0
Operating profit	**182.3**	**137.5**	**32.6**	**151.3**	**20.0**
Other income	12.6	3.0	317.2	9.1	38.0
EBIDTA	194.9	140.5	38.7	160.4	21.0
Interest	3.9	5.4	-27.5	1.6	138.0
PBDT	191.0	135.1	41.4	158.8	20.0
Depreciation	35.7	26.3	35.8	134.7	-73.0
PBT	**155.3**	**108.8**	**42.7**	**24.1**	**544.0**
Tax	38.3	18.5	107.6	0.3	12140.0
Profit after tax	**117.0**	**90.4**	**29.5**	**23.8**	**392.0**

- Taking cognisance of the change in the pricing scenario, we are also assuming the prices would increase by Rs5 per bag in the second half of the year but keeping our assumption of a Rs5 drop per bag in FY2009 unchanged.
- Keeping in view the change in the price and volume assumptions and the higher income earned by the company on surplus cash, we are upgrading our earnings per share (EPS) estimates for FY2008 and FY2009 by 26% to Rs156 and by 20% to Rs162 respectively. At the current market price, the stock is trading at a price/ earnings ratio (PER) of 8.9x FY2009E EPS and 4.7x FY2009E enterprise value (EV)/EBITDA. Considering the attractive valuations of the stock, we are maintaining our Buy recommendation on Shree Cement with an upgraded price target of Rs1,625 per share.

A robust volume growth boosts top line by 37.6% yoy

Shree Cement's volume grew by 25% yoy to 1.41MMT as the Unit IV at Ras commissioned in March started contributing to the volumes. As we had expected the realisations at Rs3,019 were flat on a sequential basis since the prices were more or less unchanged in the quarter. On a year-on-year (y-o-y) basis, the realisation growth stood at 10% which led the top line to grow by 37.6% yoy to Rs425 crore, in line with our expectations.

Particulars	Q1FY08	Q1FY07	% yoy	Q4FY07	% qoq
Volumes	1410000	1124000	25.4	1261810	11.7
Realisations	3019.9	2752	9.7	2997.8	0.7
Top line	425.8	309.38	37.6	378.27	12.6

Source: Sharekhan

Operating cost jumps by 41.7% yoy…

The company's operating expenditure increased by 41.7% yoy to Rs243.5 crore, thanks to higher power & fuel and freight costs. The power & fuel cost jumped by 75% yoy on account of higher volumes as well as higher pet coke prices whereas the freight cost increased by 43% yoy to Rs61.9 crore. On a per tonne basis, the fuel cost jumped by 39% yoy to Rs583 whereas the freight cost was higher by 14% yoy to Rs439. The total cost per tonne at Rs1,726 was 13% higher on a y-o-y basis whereas on a sequential basis the same was lower by 4%, thanks to the volume growth.

Per tonne analysis	Q1FY08	Q1FY07	% yoy	Q4FY07	% qoq
Raw material	366.6	315	16	376.0	-2
Stocks	-53.1	49	-209	-45.5	17
Employee	109.1	101	8	166.7	-35
Power and fuel	583.8	420	39	571.9	2
Freight	439.4	386	14	423.8	4
Other exp	280.1	259	8	305.9	-8
Total cost per tonne	1726.0	1529	13	1798.8	-4

….leading to a margin contraction of 160 basis points

On the back of a higher growth in the operating expenditure, the operating profit grew at a slower rate of 32.6% yoy to Rs182 crore whereas the OPM dropped by 160 basis points to 42.8%. On account of a higher volume growth, the EBITDA per tonne improved by 6% yoy and by 8% qoq to Rs1,294.

Particulars	Q1FY08	Q1FY07	% yoy	Q1FY07	% qoq
Total cost per tonne	1726.0	1529	13	1798.8	-4
Realisation	3019.9	2752	10	2997.8	1
EBIDTA	1293.9	1223	6	1199.1	8

Source: Sharekhan

Higher other income and lower interest cost boost PAT by 29.5% yoy

The company's other income increased from Rs3 crore in the last year to Rs12.6 crore in Q1FY2008 as the company earned a higher treasury income on the surplus cash whereas the interest cost declined by 27.5% yoy to Rs3.9 crore on account of the repayment of debt. The depreciation provision increased by 35.8% yoy to Rs35.7 crore as a fall-out of the increase in the gross block. Thanks to the higher other income component as well as the lower interest cost, the net profit recorded a healthy growth of 29.5% yoy to Rs117 crore, in line with our expectations.

Capacity hike to aid the volume to grow at CAGR of 22.1% yoy

Shree Cement's unit IV of 1.5MMT was commissioned ahead of schedule in March 2007, effectively making it available for the full fiscal. As mentioned in our earlier update, Shree Cement is augmenting its capacity to 10MMT in the next couple of years at a cost Rs700 crore. The company's capex programme is running on schedule (refer table). We expect the volume to grow by 33% in FY2008 and then by 20% in FY2009.

Capex Schedule	Capacity	Timeline
Unit V	1.5	Sep-07
Grinding Unit	2.0	Sep-07
Grinding Unit	1.5	Dec-07
Unit VI	1.5	Sep-08

Source: Sharekhan

Assuming a price increase of Rs5 per bag

Earlier we had assumed the realisations would remain flat for this year on account of the price freeze imposed by the government. But now with the government officially removing the price freeze, we have assumed prices would increase by Rs5 per bag in the second half of the fiscal. We have maintained our assumption of a Rs5-per-bag drop in FY2009.

Upgrading price target to Rs1,625

In view of the change in the price assumptions and the higher income earned by the company on surplus cash, we are upgrading our EPS estimates for FY2008 and FY2009 by 26% and 20% to Rs156 and Rs162 respectively. At the current market price, the stock is trading at a PER of 8.9x FY2009 EPS and 4.7x FY2009 EV/EBITDA. Considering the attractive valuations, we are maintaining our Buy recommendation with an upgraded price target of Rs1,625 per share.

Valuation table

Year ended March 31	FY05	FY06E	FY07E	FY08E	FY09E
Net profit (Rs cr)	109.6	152.6	356.7	544.6	564.7
% y-o-y growth	-	*39*	*134*	*53*	*4*
Shares in issue (cr)	3.48	3.48	3.48	3.48	3.48
EPS (Rs)	31.5	43.8	102.4	156.3	162.1
% y-o-y growth	-	*39*	*134*	*53*	*4*
PER (x)	45.8	32.9	14.1	9.2	8.9
P/BV (Rs)	19.7	19.2	14.1	4.5	3.0
EV/EBIDTA (x)	30.8	23.5	8.6	5.5	4.7
RoCE (%)	21.2	26.5	42.6	58.7	43.5
RoNW (%)	45.3	51.5	56.0	46.9	33.2

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

Bajaj Auto

Apple Green

Stock Update

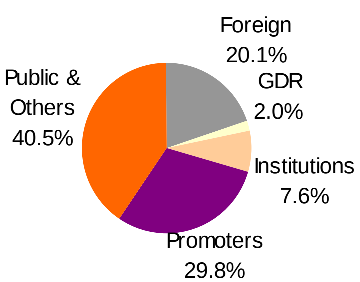
Price target revised to Rs2,470

Hold; CMP: Rs2,423

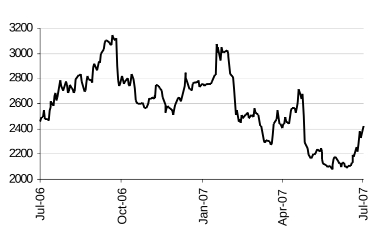
Company details

Price target:	Rs2,470
Market cap:	Rs24,527 cr
52 week high/low:	Rs3,175/2,063
NSE volume: (No of shares)	3.2 lakh
BSE code:	500490
NSE code:	BAJAJAUTO
Sharekhan code:	BAJAJ
Free float: (No of shares)	6.9 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	9.7	-2.9	-13.1	-5.1
Relative to Sensex	1.4	-13.7	-21.5	-37.7

Bajaj Auto Ltd (BAL) has recently disclosed its new business achieved profits (NBAP) in a presentation. The company has stated the NBAP at Rs703.6 crore for FY2007. The NBAP has been calculated by ascertaining the present value of all future profits (net of tax) arising from the sale of new contracts during the reporting period, on best estimate assumptions, after allowing for the cost of capital.

In FY2007, the company's gross premium income had grown by 71% to Rs5,310 crore. Its new business had risen by 57% to Rs4,270 crore in FY2007. The new business growth was driven by a sharp rise of 156% in the non-single premium to Rs3,085 crore in the same period. The margin on the new business works out to 21.97%, which is higher than that of the other leading players.

For the first two months of this fiscal, the non-single premium for BAL had grown by 115% to Rs372.5 crore. We are raising our growth estimates for the regular new business premium of Bajaj Allianz Life Insurance Co Ltd to 50% in FY2008 and 40% in FY2009. We expect the single premium to grow marginally going forward.

We have valued the insurance business of BAL on NBAP methodology. Taking into account the above-mentioned disclosures, we are raising our valuation of the life insurance business of BAL from Rs330 per share to Rs522 per share. Consequently, we are raising our price target for BAL to Rs2,470.

Value of life insurance business

		Earlier			Revised	
	FY07	FY08	FY09	FY07	FY08	FY09
Total New Business Premium (Rs cr)	4269.8	5218.9	6245.6	4269.8	5835.9	7710.9
% growth		*22.2*	*19.7*		*36.7*	*32.1*
NBAP (Rs crore)	640.7	826.2	1027.2	703.6	1044.6	1452.3
% growth		*29.0*	*24.3*		*48.5*	*39.0*
Value of Bajaj's 26% stake (20x NBAP)						7551.9
Per share value for Bajaj (Rs)						**522.0**

At the current market price of Rs2,423, the stock quotes at FY2009E price/earnings ratio of 18.8x and at an enterprise value (EV)/earnings before interest, depreciation, tax and amortisation (EBIDTA) of 12x. We maintain our Hold recommendation on the stock with a revised price target of Rs2,470.

Sum of parts valuation	(Rs)
Bajaj Auto (New)	1,009
Bajaj Finserv	642
Bajaj Holding & Investments Ltd	819
Price target	**2,470**

Earnings table Rs (cr)

Particulars	FY2005	FY2006	FY2007	FY2008E	FY2009E
Net profit	627.2	999.5	997.9	1,140.3	1,306.7
EPS (Rs)	62.0	98.8	98.6	112.7	129.1
% y-o-y change	*-0.5*	*59.4*	*-0.2*	*14.3*	*14.6*
PER	39.1	24.5	24.6	21.5	18.8
P/B	5.9	5.1	4.4	3.9	3.5
EV/EBIDTA	29.7	17.2	16.6	14.7	12.0
RoCE (%)	18.8	25.5	22.3	21.4	22.5
RoNW (%)	15.2	20.9	18.0	18.4	18.7

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
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
Balaji Telefilms
Cadila Healthcare
Federal-Mogul Goetze (India)
KSB Pumps
Marksans Pharma
Navneet Publications (India)
Network 18 Fincap
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
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

Esab India
Orient Paper and Industries
WS Industries India