investor's eye

Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Aban Loyd	03-Mar-05	330	**1,201**	1,760
BHEL	11-Nov-05	1,203	**2,268**	2,650
ICICI Bank	23-Dec-03	284	**591**	750
Infosys	30-Dec-03	689	**1,758**	1,870
Orient Paper	30-Aug-05	214	**432**	675

Mahindra & Mahindra

Apple Green

Stock Update

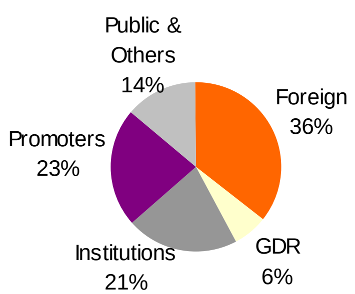
Expansion to drive future growth

Buy; CMP: Rs638

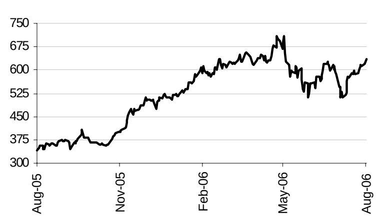
Company details

Price target:	Rs700
Market cap:	Rs15,418 cr
52 week high/low:	Rs719/337
NSE volume: (No of shares)	9.1 lakh
BSE code:	500520
NSE code:	M&M
Sharekhan code:	M&M
Free float: (No of shares)	17.1 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8.3	-5.3	5.3	89.4
Relative to Sensex	0.8	-2.8	-7.9	26.7

Mahindra & Mahindra (M&M) has announced the location for setting up its new multi-purpose vehicle (MPV) platform code named *Ingenio*. For the same, it has inked a memorandum of understanding (MoU) with the government of Maharashtra to set up the facility at Nashik at an investment of Rs550 crore. The production of the new vehicle is expected to commence by the year 2008. With this additional investment the production capacity at the existing plant at Nashik will increase to 150,000 vehicles per annum from the current 80,000 vehicles per annum.

The total planned vehicle-production capacity of 150,000 a year at Nashik will be divided between its *Scorpio*, *Logan* and *Ingenio* models. With this capacity addition at Nashik, M&M's total vehicle capacity at its four manufacturing locations in the country is expected to increase to about 300,000 units a year. The company plans to increase its capacity further to 350,000 vehicles per annum by 2009.

Engine capacity to increase to 800 units per day

The company is also investing Rs200 crore to raise its engine making capacity at Igatpuri in Maharashtra to 800 engines per day from about 450 engines per day currently in order to match the expected increase in the vehicle-production capacity. This is expected to be operational by Q1FY2008.

Logan launch on track

The company's plan to launch the low-cost car *Logan* in a joint venture with Renault is also believed to be on schedule. *Logan* is likely to be launched in the first half of 2007. *Logan* would be positioned in the upper-B segment and would come in both the petrol and diesel varieties. The initial capacity for *Logan* is expected to be 50,000 units per annum.

Capex plans

M&M had earlier announced its capital expenditure (capex) plans for FY2007 at Rs650 crore. Considering the above mentioned developments the capex will be higher in the current year. M&M is sitting on sufficient surplus funds of approximately Rs700-800 crore and $200 million. However, the funding for a higher capex is not expected to have an impact on the cash flows of the company.

In addition, M&M will invest Rs1,000 crore in the Pune special economic zone (SEZ), Rs200 crore in the Thane SEZ, and Rs400 crore in the expansion of its information technology (IT) arm Tech Mahindra. On the whole, the group will invest nearly Rs2,500 crore in the next 2-3 years.

Launch of mini bus by Mahindra International

Mahindra International, a joint venture between Mahindra and Mahindra and International Truck and Engines Corporation for the manufacture of commercial vehicles has launched its first mini-bus with the CRDe technology. The mini-bus incorporated with CRDe has a turbo-charged NEF 2609 cc engine.

Outlook and valuation

The company is able to increase its capacity with a very nominal investment, and the capacity expansion plans are well in line with its growth plans and overall strategy. Even amid the rising raw material cost scenario, the company has been able to increase its operating margins owing to its rising efficiencies and cost saving measures. We expect the company to maintain its margins going forward.

M&M is the first Indian auto manufacturer to launch the CRDe technology in *Scorpio*. The company is getting repositioned as a well diversified conglomerate expanding to new markets, with new products and a new business model. M&M's success in the utility vehicle segment with strong brands like *Scorpio* and *Bolero*, entry into light commercial vehicles, successful launch of its new three-wheeler *Champion Alfa* and the proposed launch of *Logan* will create a highly strengthened and diversified product portfolio.

At the current market price of Rs638, the stock quotes at 10.3x its FY2007E and 9x its consolidated earnings. We maintain our Buy recommendation on the stock with a price target of Rs700.

Earnings table

Particulars	FY2005	FY2006	FY2007E	FY2008E
Stand-alone				
Net sales (Rs cr)	6511.0	7977.2	9524.5	10899.8
y-o-y change (%)	*33.6*	*22.5*	*19.4*	*14.4*
Net profit (Rs cr)	499.5	647.9	711.5	804.7
Shares in issue (cr)	23.34	23.34	23.34	23.34
EPS (Rs)	21.4	27.8	30.5	34.5
y-o-y change (%)	*54.9*	*29.7*	*9.8*	*13.1*
PER (x)	26.8	20.7	18.8	16.6
Consolidated				
Net profit (Rs cr)	711.0	1136.2	1300.9	1496.1
y-o-y change (%)	*78.5*	*59.8*	*14.5*	*15.0*
Shares in issue (cr)	23.34	23.34	23.34	23.34
EPS (Rs)	30.5	48.7	55.7	64.1
y-o-y change (%)	*78.5*	*59.8*	*14.5*	*15.0*
PER (x)	18.8	11.8	10.3	9.0

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

Tube Investments of India

Emerging Star

Stock Update

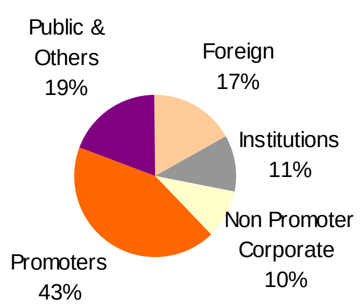
Book profit

Book Profit; CMP: Rs82

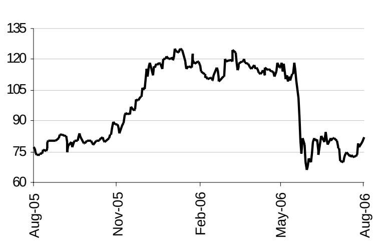
Company details

Price target:	Book Profit
Market cap:	Rs1,515 cr
52 week high/low:	Rs132/63
NSE volume: (No of shares)	40,725
BSE code:	504973
NSE code:	TUBEINVEST
Sharekhan code:	TUBEINVT
Free float: (No of shares)	10.6 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	0.9	-28.0	-26.7	10.9
Relative to Sensex	-6.1	-26.1	-35.9	-25.8

Result highlights

- When we initiated coverage on Tube Investments of India (TII) our primary argument was that the company's focus on its high-margin tubes business and the stable growing metal-form business would result in a substantial improvement in its margins.
- The improvement in the metal-form business is in line with our expectation. However the business environment for the other businesses has been gradually deteriorating and this is expected to hurt TII's performance going forward till FY2008.
- First, TII's cycle business is still bleeding with the profitability being severely affected. Second, its strips business is severely hampered by stiff competition in the domestic and export markets. Third its capital expenditure (capex) plan for the high-margin tubes division is delayed by 6-9 months on account of some environmental clearance problems. The additional capacity is now expected to go on stream only in Q3FY2007 as against Q1FY2007 expected by us. This further raises the question about the start and completion of the second phase of the capex, which was earlier expected to be commissioned in March 2007.
- On account of these developments, we are downgrading our FY2007 earnings estimates by 34% to Rs5.8 per share. We are introducing our FY2008 earnings estimates for TII, which stand at Rs8.7 per share. On account of these developments, the earnings growth will gather momentum only in H1FY2008.

Result table Rs (cr)

Particulars	Q1FY2007	Q1FY2006	% yoy chg
Net sales	381.5	378.19	0.9
Total expenditure	338.55	333.54	1.5
Consumption of raw material	220.3	230.23	
Staff cost	28.65	22.96	
Other exp	89.6	80.35	
Operating profit	43.0	44.65	-3.8
Other income	1.2	1.03	16.5
Interest	3.07	3.11	-1.3
Depreciation	13.73	11.43	20.1
EBT	27.4	31.14	-12.1
Tax	9.19	7.73	18.9
EAT	18.2	23.41	-22.3
Extraordinary items	71.2	0	
Adjusted profit after extraordinary item	89.4	23.41	281.8
Margins			
OPMs (%)	11.3	11.8	
EBT (%)	7.2	8.2	
EAT (%)	4.8	6.2	

Note: The extraordinary item for the quarter includes Rs71.2 crore from the sale of investments. This has been treated as an extraordinary item and has been accounted below the line.

- At the current market price (CMP) of Rs82, the stock is discounting its FY2007 earnings by 14x and FY2008 earnings by 9.5x, and we believe the stock is fairly valued given the earnings multiple commanded by its peers. In the wake of the deteriorating conditions for the mainstay engineering business and the uncertainty over the completion of the capex we see no significant upside in the company's earnings for the next 3-4 quarters. We suggest that investors should book profit at these levels. However given the strong balance sheet and significant value that is likely to be unlocked from the company's strategic and non-strategic investments, long term investors with a time horizon of 2-3 years can stay invested.
- The deteriorating business environment for TII is clearly visible in its Q1FY2007 performance. The revenue for the quarter stood flat at Rs381.5 crore as the sales of steel strips fell sharply due to the company facing stiff competition in the export and domestic markets. Even the exports of tubes registered lower revenue as the company faced some raw material procurement problems. The cycle division's sales also declined by 3.4%.
- The operating profit for the quarter declined by 3.8% to Rs43 crore, as the operating profit margins (OPMs) declined by 50 basis points to 11.3%. With an 18.9% increase in the depreciation and a higher tax rate, the pre-exceptional net profit for the quarter declined by 22.3% to Rs18.2 crore. The reported net profit, which includes extraordinary other income of Rs71.2 crore registered a 281.8% growth and stood at Rs89.4 crore.

Poor show by engineering and cycles businesses drags performance

TII's Q1FY2007 performance has been impacted due to the poor show by its mainstay engineering and cycles businesses. Under the engineering division, the revenues of steel strips fell sharply as the company faced stiff competition from the low-cost Chinese strips manufacturers in the exports market and from the integrated strips manufacturers in the domestic market. Even its mainstay high-margin tubes division did not deliver an impressive performance. The exports of tubes registered lower revenue as the company faced some raw material procurement problems. Further continuing its poor run, the cycle division's sales declined by 3.4%. However, the metal-form division continued its impressive performance as the division reported a smart 19.7% growth in its revenue and a 29% growth in its earnings before interest and tax (EBIT).

Segmental results Rs (cr)

Particulars	Q1FY07	Q1FY06	% yoy chg
Cycles	124.59	128.97	-3.4
Engineering	191.51	199.56	-4.0
Metal forming	75.06	62.69	19.7
EBIT			
Cycles	3.02	3.6	-16.1
Engineering	22.55	25.66	-12.1
Metal forming	12.35	9.56	29.2
EBIT margins (%)			
Cycles	2.4	2.8	-0.4
Engineering	11.8	12.9	-1.1
Metal forming	16.5	15.2	1.2

...so does operating and net profit

The poor show at the top line level coupled with the cost pressures impacted TII's profitability. The OPMs for the quarter declined by 50 basis points to 11.3% and hence the operating profit for the quarter declined by 3.8% to Rs43.0 crore. The EBIT margins of the cycle division took a hit of 40 basis points and stood at a meagre 2.4%. The EBIT margins of the engineering division also declined by 110 basis points to 11.8% because of the lacklustre performance of the tube business and a sharp fall in the exports of strips. With an 18.9% increase in the depreciation and a higher tax rate, the pre-exceptional net profit for the quarter declined by 22.3% to Rs18.2 crore. The reported net profit, which includes extraordinary other income of Rs71.2 crore registered a 281.8% growth to Rs89.4 crore.

Deteriorating business environment for strips and cycles businesses

When we initiated coverage on TII our primary argument was that the company's focus on its high-margin tubes business and the stable growing metal-form business would result in a substantial improvement in its margins and lead to a significant earnings growth. The improvement in the metal-form business is in line with our expectation. However there are three developments that are deteriorating the business environment and hence are likely to hurt TII's performance going forward.

1) *Cycles business continuing trend of poor performance*
   We expected the cycle division to deliver a stable performance. Contrary to our expectations, the division is still bleeding with profitability being severely affected. The division has registered a decline in its operating profit for the last three quarters.

2) Strips business facing stiff competition

Under the engineering division, TII's strips business has been severely hampered by stiff competition from the Chinese strips manufacturers in the exports market and from the integrated strips manufacturers in the domestic market. For FY2006 the domestic business for strips was flat and the exports business declined by a huge 53%. In Q1FY2007, even the domestic strips business has shown a decline. This business of TII has not shown any improvement in the last 9-12 months. Further the exports of tubes registered lower revenue as the company faced some raw material procurement problems.

3) First phase of capex delayed on account of environment clearance

TII's capex for the high-margin tubes division has been delayed by 6-9 months on account of some environmental clearance problems. The additional capacity is now expected to go on stream only in Q3FY2007 as against Q1FY2007 expected by us. This further raises the question about the start and completion of the second phase of the capex, which was earlier expected to be commissioned by March 2007.

Downgrading earnings

As mentioned above, these developments are likely to impact TII's performance significantly going forward. On account of these developments, we are downgrading our FY2007 estimates by 34% to Rs5.8 per share. We are introducing our FY2008 earnings estimates for TII, which stand at Rs8.7 per share. We have fully factored TII's capex binge, which includes a new CDW tubes facility in China and the new doorframes plant for Tata Motors.

Current price fully values FY2008 earnings

At CMP of Rs82, the stock is discounting its FY2007 earnings by 14x and FY2008 earnings by 9.5x, and we believe the stock is fairly valued given the earnings multiple commanded by its peers. In the wake of the deteriorating conditions for the mainstay engineering business and the uncertainty over the completion of the capex, we see no significant upside in the company's earnings for the next 3-4 quarters. We suggest that investors should book profit at these levels.

Comparative valuations

Particulars	FY2007	FY2008	FY2007	FY2008
	PER		EV/EBIDTA	
Tube Investments	14.0	9.5	7.9	4.7
SKF	13.8	10.5	7.4	5.5
Sundaram Fasteners	13.9	11.4	6.5	5.5
Amtek India	6.2	4.8	5.0	4.2
Amtek Auto	9.1	7.5	5.0	4.0
Talbros Automotive Components	6.8	5.0	4.5	3.1
Clutch Auto Ltd	9.1	6.2	6.1	4.4
Sundaram Clayton	13.3	9.8	11.3	7.9
Average	10.8	8.1	6.7	4.9

Source: Shrarekhan Research and Consensus estimates

Significant value on the balance sheet

TII has a very strong balance sheet and its strategic and non-strategic investments leave significant value to be unlocked. We have valued its investments in MS General Insurance Company at book value and its other strategic and non-strategic investments at a 50% discount to their current values. Further even after funding its capex through internal accruals TII will be left with significant cash on its books. TII has a very good track record as far as the dividend payout is concerned. TII's dividend payout ratio stands at an average of 32% for the last 5 years, which is very impressive. Hence we have assumed that 50% of the free cash could be distributed as dividend to reward the shareholders. This gives us a value of Rs8 per share (or Rs4 every year) over the next two years. Hence adding all the values, we have arrived at a fair value of Rs107, which means an additional Rs20 per share. Hence given the strong balance sheet and the significant value that could be unlocked from the strategic and non-strategic investments, long term investors with a time horizon of 2-3 years can stay invested.

Earnings table

Particulars	FY04	FY05	FY06	FY07E	FY08E
Net profit (Rs cr)	82.5	99.4	101.3	107.8	159.9
Shares in issue (cr)	18.47	18.47	18.47	18.47	18.47
EPS (Rs)	8.9	5.4	5.5	5.8	8.7
% y-o-y growth	-	*-39.7*	*1.9*	*6.5*	*48.3*
PER (x)	18.4	15.2	15.0	14.0	9.5
P/BV (Rs)	1.9	3.4	2.8	2.2	1.8
EV/EBIDTA (x)	11.0	9.9	9.0	7.9	4.7
Dividend yield (%)	2.4	1.7	5.7	1.5	1.5
RoCE (%)	19.5	22.2	21.5	18.8	23.6
RoNW (%)	20.9	22.2	19.0	15.7	19.4

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

Nelco

Vulture's Pick

Stock Update

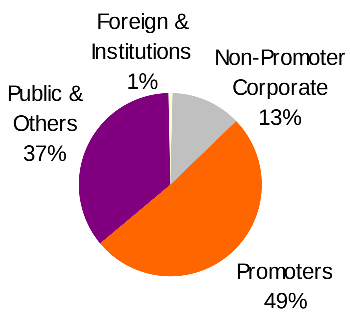
Book out

Book Out; CMP: Rs89

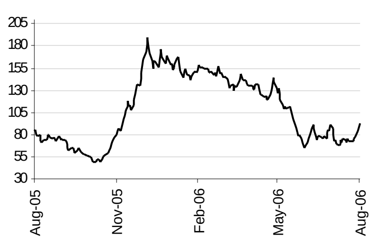
Company details

Price target:	Book Out
Market cap:	Rs203 cr
52 week high/low:	Rs199/46
NSE volume: (No of shares)	28,679
BSE code:	504112
NSE code:	NELCO
Sharekhan code:	NELCO
Free float: (No of shares)	1.2 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.1	-26.8	-41.8	9.0
Relative to Sensex	-5.8	-24.9	-49.1	-27.1

Nelco's recent performance has been much below our expectations due to the delay in the orders from the Indian armed forces and the little progress in the proposed additional development at its existing property in Mumbai. The concerns were highlighted in the stock update dated July 18, 2006 wherein we had downgraded the stock to a Hold recommendation.

The long-term re-rating triggers, though delayed and uncertain, were still intact at that time. We were hopeful that an important re-rating trigger (such as a move to strengthen its relations with the key foreign collaborator like Thales through a joint venture or the sale of a strategic stake) would eventually play out. The French major Thales is aggressively looking at expanding its footprint in India with a focus on catering to the needs of the Indian defence and security forces. And Nelco could have been an ideal partner given its strong parentage with an established presence as a supplier to the Indian armed forces.

However, the recent announcement of a joint venture between Rolta India and Thales would considerably limit the extent of the latter's engagement with Nelco. Though the joint venture would initially focus on the development of information systems and solutions, Rolta's management indicated that the relationship could grow and also encompass implementation, customisation and integration of Thales' products (and solutions) in India.

In the absence of any meaningful re-rating triggers, we advise booking out of the stock. We had recommended the stock on January 31, 2006 at the price of Rs144.

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

Sharekhan Stock Ideas

Evergreen

HDFC Bank
Infosys Technologies
Reliance Industries
Tata Consultancy Services

Apple Green

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

Cannonball

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

Emerging Star

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

Ugly Duckling

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

Vulture's Pick

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Orient Paper and Industries
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