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Take Five

Scrip	Reco Date	Reco Price	CMP	Target
♦ BHEL	11-Nov-05	1,203	2,255	2,650
♦ Cadila Healthcare	21-Mar-06	297	326	425
♦ Deepak Fertilisers	17-Mar-05	50.6	83	126
♦ ICICI Bank	23-Dec-03	284	876	1,240
♦ TCS	06-Mar-06	852	1,261	1,508

Bharat Heavy Electricals

Apple Green

Stock Update

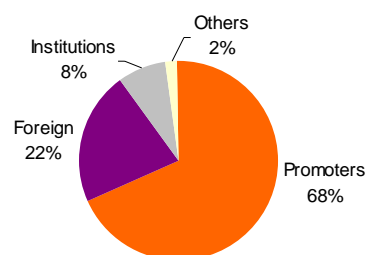
Foray into defence equipment space

Buy; CMP: Rs2,255

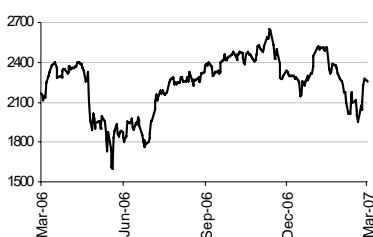
Company details

Price target:	Rs2,650
Market cap:	Rs55,805 cr
52 week high/low:	Rs2,668/1,531
BSE volume: (No of shares)	493,712
BSE code:	500103
NSE code:	BHEL
Sharekhan code:	BHEL
Free float: (No of shares)	7.8 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	0.0	-0.4	-0.9	4.4
Relative to Sensex	2.5	0.7	-9.1	-16.1

Bharat Heavy Electricals Ltd (BHEL) is planning to produce defence equipment, including weapons. It has already applied for a licence to produce defence products. It is likely to manufacture all types of guns, including field guns, air defence guns, and mortars for the Indian defence sector and para-military forces. It has also firmed up plans to produce underwater weapon systems, weapon control solutions and their components.

Fierce competition but huge opportunity

In the defence space, BHEL will have to compete with leading private players such as Larsen & Toubro, Tata Power, Mahindra & Mahindra, Godrej Industries, Kirloskar Brothers, Ashok Leyland, Jindal, Max Aerospace & Aviation and Ramoss India. But the size of the opportunity is also huge. According to India's newly introduced offsets policy, overseas players bagging Indian defence contracts will have to source 30% of their defence requirements through Indian companies. This is likely to bring in USD10 billion during the 11th Five-Year Plan period (2007-11).

Also the defence production is turning lucrative as the defence sector is augmenting its weapon infrastructure. BHEL has plans to enter defence avionics by manufacturing all types of components for unmanned air vehicles, aerostats and unmanned aerial combat vehicles. The company is also looking at a range of other defence items such as rocket launchers, defence electronics, torpedoes, and components of armoured and combat vehicles.

BHEL will be manufacturing defence products within its existing facilities, however the investment for the proposed defence foray has not been disclosed.

Valuation and view

BHEL's Q3FY2007 results were sharply above our and the street's expectations, primarily because of a sharp jump in the margins. The order backlog grew by 38.2% year on year to Rs46,700 crore. Going forward, huge orders from generation companies like National Thermal Power Corporation and Reliance Energy, and the company's planned foray into defence products would drive the company's order book and earnings. At the current levels, the stock is trading at 18.0x its FY2008E earnings and 10.7x its FY2008E earnings before interest, depreciation, tax and amortisation. Given the expectations of continued growth in its order book and a strong earnings growth (at a compounded annual growth rate of 35.1%), we believe the valuations are attractive. We maintain our Buy recommendation on the stock with a price target of Rs2,650.

Year ended March 31	FY04	FY05	FY06E	FY07E	FY08E
Net profit (Rs cr)	658.1	955.0	1679.3	2416.8	3066.0
% y-o-y growth	6.2	22.6	74.0	43.9	26.9
Shares in issue (Cr)	24.5	24.5	24.5	24.5	24.5
EPS (Rs)	26.9	39.0	68.6	98.7	125.3
% y-o-y growth	6.2	22.6	74.0	43.9	26.9
PER (x)	83.9	57.8	32.9	22.8	18.0
Book value (Rs)	216.4	246.2	298.3	376.3	475.3
P/BV (Rs)	10.4	9.2	7.6	6.0	4.7
EV/EBIDTA (x)	58.8	36.7	20.8	14.7	10.7
Dividend yield (%)	0.3	0.4	0.6	0.9	1.2
RoCE (%)	19.2	26.8	36.4	42.3	44.3
RoNW (%)	12.4	15.8	23.0	26.2	26.4

ABC Bearings

Viewpoint

Expansion to drive growth

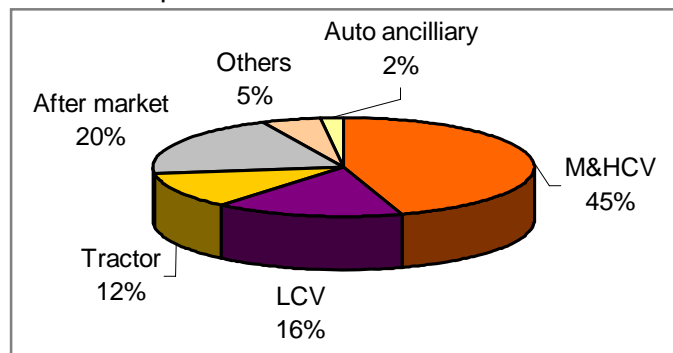
CMP: Rs141

We recently attended the analyst meet of ABC Bearings (ABC), held to discuss the company's future plans as well as newly formed joint venture with NSK. We present an update below.

About ABC Bearings

ABC is one of the leading manufacturers of taper and cylindrical bearings. Established in 1961, ABC has a technological tie-up with NSK of Japan. NSK is a \$6-billion company and the world's number three bearing manufacturer. Through this tie-up ABC receives constant technological assistance that make its products in line with international standards. ABC basically caters to the bearing requirements of the commercial vehicles, multi-utility vehicles and the tractor segment, with an impressive clientele including Tata Motors, Ashok Leyland, Toyota, Punjab Tractors, Carraro, Mahindra and Mahindra and Escorts. Its plant in Bharuch is equipped with the latest bearing technology and has already received international certifications such as QS-9000 and ISO/TS 16949.

Sales break-up



ABC manufactures a wide range of tapered roller bearings, ranging from 15mm to 200mm in diameter and also cylindrical roller bearings, ranging from 12mm to 110mm in diameter. It has a dominant market share of 27% in the taper bearing segment in the country.

Consolidated manufacturing operations

In October 2005, ABC decided to close its Lonavala manufacturing unit and shifted its operations to a single location in Bharuch, in an effort to rationalise its production costs and achieve economies of scale. This led to better

profitability and a strong improvement in its operational performance. The company has also been able to rationalise its workforce by reducing the manpower from 1,800 to about 320 in the past two years.

Financial performance

ABC's performance till FY2002 was affected due to the mounting interest cost, slackness in demand and low capacity utilisation. In the last three years its (FY2004-2006) sales have grown at a compounded annual growth rate of 28%. On the other hand, the profit after tax (PAT) has more than doubled from Rs6.2 crore in FY2004 to Rs15.6 crore in FY2006. For the nine months ended December 2006, its sales have seen a growth of 23% to Rs136.78 crore whereas the PAT has reported a growth of 44% to Rs15.38 crore.

Expanding capacity

The bearing industry is expected to grow at a rapid pace of about 15-20% going forward. ABC is expected to keep pace with the industry. To cater to the strong demand, the company is expanding its capacity from the current 6.5 million units to about 8.0 million units by October 2007. The company would be able to do this at a minimal capital expenditure. With technological inputs from NSK it would be able to make all its lines "universal", capable of producing both taper as well as cylindrical bearings. At present, the company is operating at 100% utilisation.

Entering into a joint venture with NSK

ABC and its collaborator NSK have formed a 25:75 joint venture company to manufacture ball bearings for the automotive industry. This new joint venture will set up its manufacturing facility near Sriperumbudur in Tamil Nadu at an investment of Rs50 crore. The products manufactured here would be complementary to ABC's product range. For example, it would cater to the two-wheeler and the passenger car segment. It would also supply to NSK Japan's transplant customers. The operations are expected to start by early 2008. ABC would be transferring its transmission bearing business to the joint venture company and will get adequate compensation for the same. At present, the contribution of this business is marginal. The unit is expected to generate revenues of about Rs50 crore in two years' time.

Since, ABC would be a minority shareholder in the venture, it would not be able to consolidate the accounts and hence we do not see any positive impact of the joint venture on the company's earnings. However, the joint venture reinforces the relationship between ABC and NSK, and ABC would benefit from the constant technological support from its partner which is of prime importance in the bearing industry.

Entering the rail bearing market

ABC is planning to venture into the rail bearing market. It would receive the technology for the same from its partner NSK. The market for rail bearings is Rs100-crore big and at present is largely dominated by Timken. Timken and NBC enjoy a dominant position in this segment. ABC would find it difficult to make inroads into this new segment as a couple of more players are also eyeing to enter this market.

Valuations

The demand for bearings in the automotive segment is buoyant. The export or outsourcing potential appears to be very low, considering that NSK has formed a separate

joint venture with a majority holding in it. At the current market price the stock trades at 8.1x on its estimated earnings per share of Rs17.7 for FY2007 and 7.1x on FY2008 rough earnings estimate. Considering the substantial discount to industry leaders such as SKF India and FAG bearings, there could be room for some upside from the current levels.

Earnings table

Particulars	FY2003	FY2004	FY2005	FY2006
Net sales	83.9	110.1	149.2	176.1
<i>% y-o-y growth</i>		31.2	35.5	18.1
Net profit	1.4	6.2	11.8	15.6
EPS	1.2	5.4	10.2	13.5
<i>% y-o-y growth</i>		329.2	90.8	32.0
PER	113.1	26.4	13.8	10.5
Cash PER	23.6	12.6	9.0	7.3
P/B	6.4	5.5	4.4	3.4
EV/EBIDTA	18.0	10.8	7.6	7.4
ROCE (%)	11.7	19.9	34.3	35.0
RONW (%)	5.6	20.8	31.6	32.6

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

Evergreen

HDFC Bank
Infosys Technologies
Reliance Industries
Tata Consultancy Services

Apple Green

Aditya Birla Nuvo
ACC
Apollo Tyres
Bajaj Auto
Balrampur Chini Mills
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
Hindustan Lever
Hyderabad Industries
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Ugly Duckling

Ahmednagar Forgings
Ashok Leyland
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Ceat
Deepak Fertilisers & Petrochemicals Corporation
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Vulture's Pick

Esab India
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