MONTHLY EQUITY COMMENTARY - FEBRUARY

Strategy Feberuary 2007

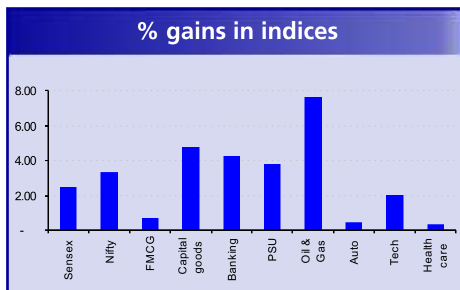
Benchmark indices hit their all-time high levels once again in January 2007. Good Q3FY07 results and a high growth in the index of industrial production (IIP) buoyed sentiments. The month saw higher interest and participation in the small and mid cap stocks, in line with our expectation. Select mid-caps with better-than-expected Q3FY07 performance outperformed in a significant manner.

A rebound in IIP, better-than-expected Q3FY07 results and reduced crude prices have provided a boost to the sentiments and increased confidence in FY08 earnings. While valuations are not undemanding and may invite corrections, we expect these positive factors to help sustain the markets at high levels in the medium term.

We maintain our recommendation of following a bottom-up approach of buying and owning select fundamentally sound mid-caps, which are still available at attractive valuations.

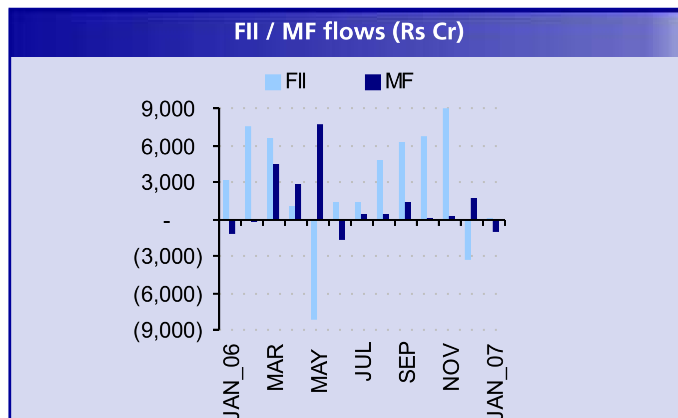
Benchmarks hit all-time highs…

Benchmark indices hit their all-time high levels before profit booking at these high levels restricted the gains during the month (till January 25) to 3.6% for the Sensex and 4.6% for the Nifty.



Source: Bloomberg

The markets were higher during the month despite the fact that FIIs did not put in monies on a net basis during the month. For January 2007, FIIs were net buyers (till January 24 2007) to the tune of only Rs.190 mn. This came on the back of an outflow of Rs.37 bn in December 2006. On the other hand, domestic mutual funds sold shares worth Rs.11 bn during the said period, on a net basis.



Source: Bloomberg

…but mid/small caps outperformed

The month saw higher interest and participation in small and mid cap stocks, in line with our expectation. Select stocks with better-than-expected Q3FY07 performance outperformed in a significant manner.

The interest in these stocks led to out-performance by the BSE mid-cap and small-cap indices. While the BSE small-cap index rose 10% during the month, BSE mid-cap index was 5% higher over the said period. The BSE madcap index as well as BSE small-cap index also hit their all-time highs during the month.

On a sectoral basis, metals, capital goods and oil sectors outperformed the broader indices. Capital goods stocks performed on the back of encouraging IIP figures. Oil companies, especially the OMCs, did well on continuing softness in the crude prices.

On the other hand, FMCG, auto and healthcare continued to under perform the benchmarks. The FMCG and auto sectors have under-performed mainly because of the severe pressure they have been witnessing on the raw material front and the consequent impact on margins.

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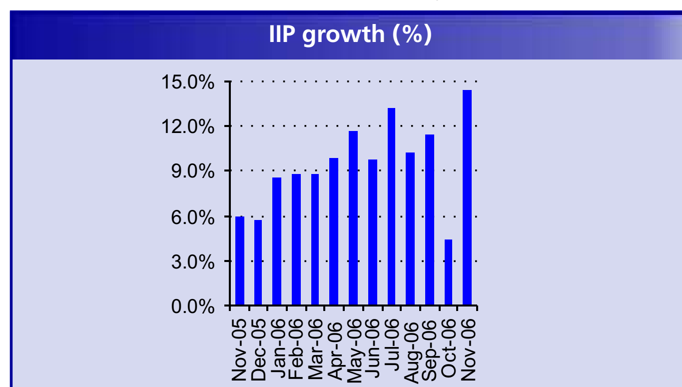
Industrial Growth rebounded

IIP rose 14.4 % for November 2006 compared to 6.0% in November 2005. This high growth boosted market sentiments especially coming on the back of a 6% (revised to 4.4%) growth in October 2006. The cumulative growth for the period April-November 2006-07 stands at 10.6% over the corresponding period of the pervious year. This is the fastest growth in the past 11 years buoyed by strong growth in manufacturing, mining and intermediate goods.

The manufacturing sector recorded 15.7% growth during this month, which is the fastest since June 1996. While the mining sector grew by 7.0% (YoY), the electricity sector grew 8.7% (YoY). In October 2006, consumer durables and non-durables had under performed. However, in November 2006, the consumer durables and consumer non-durables recorded growth of 11.4% and 12.1%, respectively, with the overall growth in consumer goods being 11.9%.

The industrial sector contributes slightly more than a quarter to the GDP. So, better performance in these seven months will definitely provide a cushion against any drop in contribution from agriculture or services to the GDP. On the flip side, this will also provide the central bank further reason to raise interest rates to curb inflation. Rising consumer spending may stoke up inflation (already at about 6% in January 2007), prompting the central bank to raise its 6% benchmark rate as soon as January 31, 2007.



Source: Bloomberg

MONTHLY EQUITY COMMENTARY - FEBRUARY

Q3FY07 results Corporate India continues to impress

Corporate India continued to post impressive performance in Q3FY07. According to a study carried out by Business Standard, the first set of about 800 companies have achieved a YoY revenue growth of about 35% and a corresponding rise of 67% in net profits. With several large corporates still to announce their results, the growth rates may vary.

What is more encouraging is that operating margins and net margins have improved over this period by 187 bps and 212 bps, respectively. This is despite the increasing competition and increase in raw material prices, mainly commodities. This indicates that most of the companies have been able to more than offset the cost pressures through initiatives like improving operating efficiencies, increasing realizations and controlling costs.

In the backdrop of a fast-growing economy and improving global competitiveness, we feel companies may be able to achieve high growth rates, at least in the foreseeable future. This is subject to any adverse unforeseen circumstances.

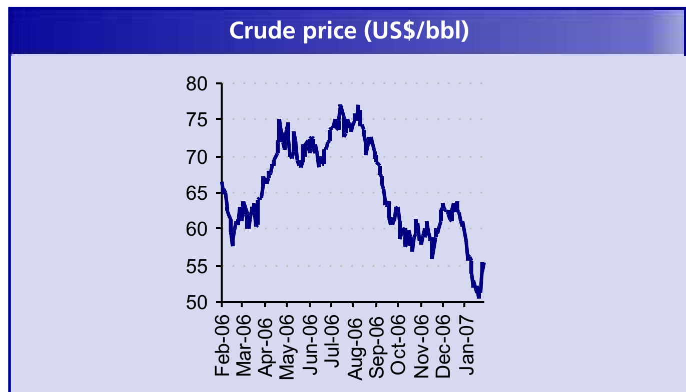
So far as valuations are concerned, we believe these results may lead to a higher degree of confidence about the sustainability of past growth rates and in FY08 earnings estimates. This, in turn, should make the market sustain and build on the high levels it is currently trading at.

Oil cooled down

Crude prices further declined during the month by 11% (to about $54 per barrel) on the back of a slowing US economy, a milder-than-expected winter and also rise in inventory levels in the US. In December 2006, crude prices had declined by 3%. Prices declined also due to the comments from Saudi Arabia that there was no need to further cut crude production.

While reduced crude prices are a positive for oil marketing companies, this benefit may be negated in case there is a further cut in the retail fuel prices. The Government is looking at ways and means of containing inflation, which crossed 6% in the first week of January 2007.

Crude price (US$/bbl)



Source: Bloomberg

Inflation

During the month, inflation (wholesale price index) shot up to breach the 6% mark for the week ended January 6, 2007. This is the first time in the past two years that inflation has breached the 6% mark. In the subsequent weeks, it came down to 5.95%. However, it is still way above the Government's target range of 5-5.5%. This is of concern, more so as it comes in the wake of softer crude prices.

The increase, which was partly due to a rise in the prices of manufactured goods and commodities, led the Government to take several steps to contain inflation. In case inflation continues to rise, it may impact the economic growth in the coming quarters.

Statutory liquidity ratio (SLR) initiative

The Government has indicated that the RBI will have more flexibility to cut SLR for banks from the current levels of 25%. This is with a view to curb any excess liquidity in the system. This step is aimed at containing the money flow and the consequent inflation, which topped 6% in early January 2007.

However, the greater flexibility on SLR available to the RBI does not mean that the RBI is going to cut the SLR anytime soon, especially in view of the most recent action of an expected hike in the cash reserve ratio announced in early December 2006.

Import duty cuts

Another move by the Government to contain inflation came in the form of a reduction in customs duties for a range of commodities. The Government cut customs levies on primary and semi-finished metals such as aluminum and copper to 5% from 7.5%, halved the duty on chemicals such as sulphur and sodium to 5% and removed the levy on portland cement. This was done with a view to reduce the cost of imports, in turn, restricting the prices in the domestic markets.

This step may restrict further price hikes of most of these commodities, especially cement. However, we see the impact on cement prices mainly in the coastal regions with minimal impact on interior parts of India, at least in the short-term. On the other hand, the import duty cut had an immediate impact on the stock prices of cement companies, which have since under-performed the broader markets.

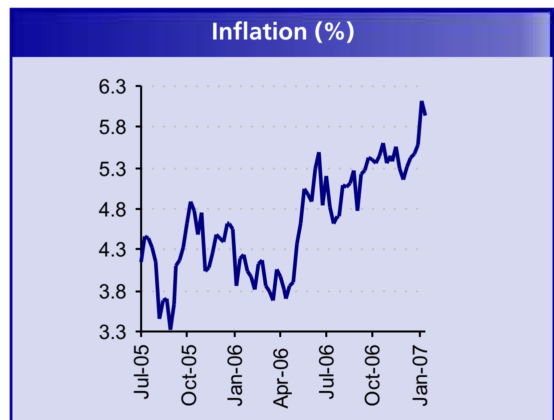
Recommendation

A rebound in IIP, better-than-expected Q3FY07 results and reduced crude prices have provided a boost to the sentiments and increased confidence in FY08 earnings. While valuations are not undemanding and may invite corrections, we expect these positive factors to help sustain the markets at high levels in the medium term.

We maintain our recommendation of following a bottom-up approach of buying and owning select fundamentally sound mid-caps, which are still available at attractive valuations. From within our universe of covered stocks, there are several stocks, which have the potential to offer significant returns from the current levels over a 12-month horizon.

The following are our preferred picks from among our universe of stocks:

Inflation (%)

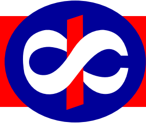


Source: Bloomberg

Top picks

Sector	Companies
Auto/Ancillaries	Maruti, Bajaj Auto, Tube Investments, Subros
Banks/FIs-	SBI, J&K Bank, Allahabad Bank, UTI Bank
Capital Goods, Engg	L&T, Kirloskar Oil Engines and Easun Reyrolle
Cement	Shree Cements and India Cements
Construction	IVRCL, Nagarjuna Constructions and Patel Engineering
FMCG/Food Processing Biols	REI Agro, Gujarat Ambuja Exports, Shree Riddhi Siddhi Gluco
IT/ITES	HCL Tech, Satyam, Infosys, Megasoft, NIIT
Logistics	Gateway Distriparks and Concor
Media	UTV, ENIL
Oil/Gas	Great Offshore, HPCL, BPCL, ONGC and GSPL
Pharmaceuticals	Panacea, Cipla, Jubilant and Alembic
Others	Everest Kanto, Murudeshwar Ceramics, JBF, Indraprastha Gas and GHCL

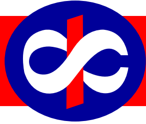
Source: Kotak Securities - Private Client Research



REPORTS

Report Date	Company Name	Recommendation	Report Date Price	Target price
26-Dec-06	Nagarjuna Construction	BUY	194	200
5-Jan-07	Allcargo Global Logistics (AGL)	BUY	1,223	1346
29-Dec-06	Gateway Distriparks	BUY	206	259
2-Jan-07	Aventis Pharma	BUY	1,350	1643
5-Jan-07	Entertainment Network (ENIL)	BUY	257	294
9-Jan-07	Everest Kanto Cylinder	BUY	766	924
12-Jan-07	Infosys Technologies	BUY	2,185	2460
15-Jan-07	UTI Bank	BUY	499	563
16-Jan-07	Tata Consultancy Services (TCS)	BUY	1,326	1453
16-Jan-07	HCL Technologies	BUY	630	772
19-Jan-07	Gujarat State Petronet	BUY	49	58
17-Jan-07	Patel Engineering	BUY	462	526
17-Jan-07	Container Corporation (Concor)	BUY	2075	2498
17-Jan-07	Gujarat Ambuja Exports	BUY	32	42
17-Jan-07	Aztec Software	BUY	149	173
18-Jan-07	NIIT Technologies	BUY	340	422
18-Jan-07	Alembic Ltd	BUY	67	93
18-Jan-07	Jubilant Organosys	BUY	268	334
18-Jan-07	AIA Engineering	BUY	1317	1510
19-Jan-07	Panacea Biotec	BUY	391	513
19-Jan-07	Riddhi Siddhi Gluco Biols	BUY	294	410
19-Jan-07	Shree Cement	BUY	1,515	1800
22-Jan-07	Great Offshore	BUY	746	878
22-Jan-07	Satyam Computers	BUY	487	556
22-Jan-07	NIIT LTD	BUY	570	672
22-Jan-07	Orchid Chemicals & Pharma	BUY	207	379
22-Jan-07	Exide industries	BUY	42	48.5

After the January Report we have released the above reports, out of which we are presenting you the following reports in detail. We request you to visit kotaksecurities.com or kotaksec.com to read the rest of the reports.



NAGARJUNA CONSTRUCTIONS

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 194** | **TARGET PRICE: Rs. 200**

26 December 2006

Teena Virmani

We recently met the management of Nagarjuna Constructions to get an insight into the progress of different projects and new developments regarding order inflows. We maintain our positive stance on the company.

Currently, we maintain our BUY recommendation on the stock since significant upsides are expected to come from the real estate division of the company within two to three years. We would revisit our target price of Rs.200 once the company finalizes its plans for real estate development.

Growing order book

Robust order book, strong order inflows and diversification across different segments have enabled the company to maintain its position in the infrastructure space. Nagarjuna's order book of Rs.70 bn is fairly diversified across roads (45%), buildings (25%), water (16%), irrigation (9%) and electrical projects (6%) with the road segment being the major contributor. It would also continue to remain focused on the road and water segment in the future.

Improving margins

Variable pricing clauses, diversification of order book across different segments and large ticket size orders are likely to result in improvement in the operating margins of the company over last year. We expect the company to achieve operating margins of 9.5% for the full year going forward as compared to 8.9% last year.

BOT projects - financially closed

NCC has achieved financial closure for the road BOT projects and financial closure for the hydropower project is likely by March 2007.

BOT projects

	Bangalore Maddur	Meerut Muzzafarnagar	Bangalore Elev. Corridor	Orai Bhognipur
Cost of project (Rs mn)	2500	5300	7640	5200
Debt (Rs mn)	1875	3975	5730	3900
Equity (Rs mn)	625	1325	1910	1300
Annuity (Rs mn - 6mntly)	297	Toll based	Toll based	448.2
Grant	-	1278	-	-
JV partner	Maytas, KMC const	Maytas, Gayatri Projects	Maytas, Soma Const	KMC constructions
Status	Operational	Financially closed	Financially closed	Financially closed
NCC's stake	33%	30%	33.50%	64%
Concession period	10years	20years	20years	17.5years

Source: Company

The company is likely to receive the first annuity payment for the Bangalore Maddur project and is also entitled to a bonus amount of Rs.297 mn for early completion of this project. Other projects are expected to start getting toll revenues or annuities from FY08/FY09 onwards. Based on the traffic projections, the company is expecting equity internal rate of return (IRR) of at least 16% from these projects.

Real estate development - a big jump expected

Nagarjuna's real estate division is expected to close this financial year with Rs.720 mn of revenues. The 'National Games housing complex' at Ranchi for the forthcoming National Games is also likely to clock approximately Rs.3 bn of revenues over two years. It has also signed an agreement with AP Housing board for the development of 85 acres of land in Vishakhapatnam at the project cost of Rs.4 bn and also carrying out the real estate projects in Bangalore, Cochin, Chennai and Hyderabad.

Along with this, the company would also be finalizing plans to develop the 130 acres of land bank that the company had acquired

at very low cost and another 270 acres of real estate developemnt. We believe significant upside is likely to come from the real estate projects over two to three years. We will factor in the revised estimates for real estate division once the company finalizes the plans for development.

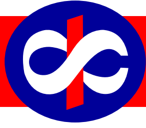
Valuations and recommendations

At the current price of Rs.194, the stock is trading at 22.8x and 16.3x P/E on FY07 and FY08 multiples. It is trading at 14.3x and 10.5x EV/EBITDA on FY07 and FY08 estimates. We maintain our BUY on the stock and will revisit our price target of Rs.200. At the current market price, the upside is very limited to our target price. However, further upgrades are likely due to higher value attributed by the real estate development going forward once the company finalizes its plans.

Summary table (Year end Mar)

(Rs mn)	FY06	FY07E	FY08E
Revenues	18,404	29,446	40,047
% change YoY	54.9	60.0	36.0
EBITDA	1,641	2,797	3,804.5
EBITDA margin (%)	8.9	9.5	9.5
Other Income	20.2	20.2	20.2
Depreciation	181.6	260.9	345.9
EBIT	1,479.3	2,556.7	3,478.8
% change YoY	74.7	72.8	36.1
Net interest	217.0	361.8	399.3
Profit before tax	1,262.3	2,194.9	3,079.5
% change YoY	80.3	74	40.3
Tax	223.3	439.0	615.9
As % of PBT	17.7	20.0	20.0
Net income	1,039.0	1,755.9	2,463.6
% change YoY	82.2	69	40.3
Shares outstanding (m)	103.3	206.6	206.6
EPS (reported) (Rs)	10.1	8.5	11.9
EV/ Sales	2.2	1.4	1.0
EV/EBITDA	25.0	14.3	10.5
P/E (x)	38.6	22.8	16.3
P/B	4.2	3.6	3.0

Source: Company & Kotak Securities - Private Client Research

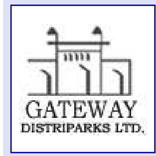


GATEWAY DISTRIPARKS LTD

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 206** | **TARGET PRICE: Rs. 259**

29 December 2006

Apurva Doshi



GDL has won the contract for operating and managing Punjab Conware CFS at JNPT. We maintain BUY with an upward revision in price target to Rs.259 (26% upside potential)

About Punjab Conware CFS

- Punjab Conware is the Punjab government owned container freight station (CFS) at JNPT, Mumbai. The CFS is located at Dronagiri node, Navi Mumbai and is about 7 km from JNPT.
- The CFS has a large container yard, covered storage area of 52500 sq m consisting of four warehouses. The facility is spread over 27.5 acres of land. The CFS commenced its operations in August 1999.
- The CFS has a capacity to handle 150,000 TEUs per annum. However, it has been operating at almost one-third its capacity. In FY06, it achieved throughput of 55,662 TEUs. The CFS has the infrastructure to handle approximately 75000 TEUs and a few years back it had handled approximately 70000 TEUs.
- Regarding financials, in FY06, the CFS recorded sales of Rs.260 mn and EBIDTA of Rs.138 mn, thereby giving EBIDTA margin of 53%.

Cost and accounting treatment

- The company has agreed to an upfront cash fee of Rs.350 mn, which is to be written off in the books over a period of 15 years. Thus, GDL will write off Rs.23.3 mn every year for the next 15 years. Assuming the company takes over the physical possession of the CFS facility in February 2007 the company will write off Rs.3.9 mn as one-time upfront fee in FY07E.
- GDL is also required to pay annual fees of Rs.100 mn with upward revision of 5% in the subsequent years. Assuming the company takes over the physical possession of the CFS facility in February 2007 GDL will be required to pay Rs.16.7 mn as annual fee in FY07E. There is also an escalation clause of 5% in the annual fees. Thus, GDL would pay Rs.105 mn as annual fees in FY08E. The annual fees would be written off in the respective year of payment.
- Thus, if we combine the above two fees, the company is expected to write off Rs.20.6 mn in FY07E and Rs.128.3 mn in FY08E.
- GDL has already raised Rs.3.8 bn from its GDR issue in January 2006. Out of the issue, approximately Rs.2 bn is still lying with the company pending investment in the business. Thus, we feel the company is well placed on the cash side to fund the acquisition.

The CFS contract is EBIDTA positive for GDL

- We expect the company to handle 9000 TEUs in FY07E (only two months of operation) and ramp up to 75,000 TEUs in FY08E. Further, the company would add infrastructure and ramp up the capacity to 150,000 TEUs per annum in two years.
- We expect an average realization of Rs.4750 per TEU in FY07E that will move up to Rs.5000 per TUE in FY08E. Currently, the CFS does more of export containers and warehousing and, thereby, earns lower ground rent. The company will gradually change the mix in favour of import containers to be able to earn higher ground rent.
- We expect the CFS to report revenues of Rs.43 mn and Rs.375 mn in FY07E and FY08E.
- We expect the CFS to earn EBIDTA of Rs.22.5 mn and Rs.187.5 mn in FY07E and FY08E. However, the company will write off Rs.20.6 mn and Rs.128.3 mn towards operating and maintenance charges according to the terms of the contract. Hence, the company will actually report EBIDTA of Rs.1.9 mn in FY07E and Rs.59.2 mn in FY08E.

Valuation and recommendation

- The operating and maintenance contract of Punjab Conware CFS provides the company with a well-established platform to explore the tremendous growth opportunities in the increasing traffic at the country's premier port that is JNPT, which handles more then 55% of the entire container traffic of the country.
- With the additional CFS facility, GDL will be able to cater to the business from the third terminal, which is expected to operate at full capacity within a year's time. Also, GDL will be ready to take advantage of the additional business from the fourth terminal at JNPT, which is expected to be operational in two to three years.
- The contract will substantially increase GDL's capabilities and range of services. It will also provide GDL significant operating leverage to rapidly raise its market share and customer base by accommodating more shipping lines and extend additional services to the shipping industry. Hence, we feel this would be the next major growth driver for the company.

Change in Estimates

(Rs mn)	Old		Revised	
	FY07E	FY08E	FY07E	FY08E
Revenues	1,925	2,547	1,967	2,602
EBIDTA	1,007	1,358	1,009	1,382
EBIDTA %	52.3	53.3	51.3	53.1
Profit	857	1,092	860	1,114
EPS - Rs.	9.3	11.8	9.3	12.1
CEPS - Rs.	11.0	14.3	11.0	14.5

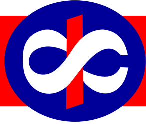
Source: Kotak Securities - Private Client Research

- We have factored in the revenues and profitability from the Punjab Conware CFS in our earnings estimates. We had already included additional 50000 TEUs at JNPT in our earlier estimates and hence the impact is limited in our earnings estimates. We expect the company to report higher sales of Rs.1.9 bn in FY07E and Rs.2.6 bn in FY08E.
- We expect the company to report an EPS of Rs.9.3 in FY07E, moving up to Rs.12.1 in FY08E.
- At the current market price of Rs.206, the stock trades at 3.0x for FY07E and 2.7x FY08E to book value.
- It discounts FY07E and FY08E earnings at 22.1x and 17.1x, respectively.
- It discounts FY07E and FY08E cash earnings at 18.7x and 14.2x respectively.
- We maintain our positive bias on the stock and continue to recommend a BUY with an upward revised price target of Rs.259, which provides 26% upside potential. Maintain BUY.

Consolidated Summary table

(Rs mn)	FY06	FY07E	FY08E
Sales	1,386	1,967	2,602
Growth (%)	45.0	42.0	32.3
EBITDA	836.6	1009.2	1382.1
EBITDA margin (%)	60.4	51.3	53.1
Net profit	722	860	1114
Net debt	(3,207)	(1,352)	(1,329)
EPS (Rs)	7.8	9.3	12.1
Growth (%)	108.8	19.0	29.6
DPS (Rs)	3.0	3.0	3.0
ROE (%)	12.6	13.7	15.7
ROCE (%)	13.8	16.0	18.2
EV/Sales (x)	11.4	9.0	6.8
EV/EBITDA (x)	18.9	17.5	12.8
P/E (x)	26.3	22.1	17.1
P/BV (x)	3.3	3.0	2.7

Source: Company & Kotak Securities - Private Client Research



AVENTIS PHARMA

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 1350** | **TARGET PRICE: Rs. 1643**

2 January 2007

Awadhesh Garg

Aventis' focus on its strategic brands, successful mapping with its parents' portfolio, strong presence in certain therapeutic areas, high brand recall among the medical fraternity and increasing outsourcing by parent, continue to be the key determinants for its future valuation.

The performance of the company is enviable in its strategic brands.

We expect earnings growth of 17% CAGR for the next two years. From 2008, Aventis is likely to launch patented drugs from its parent's portfolio. However, more clarity will come only in 2007. Aventis has about 60% of its total assets in liquid cash, which can be utilized for inorganic growth or acquisition of brands, we believe. We initiate our coverage with a BUY recommendation with 2007 DCF-based price target of Rs.1643. This implies an upside of 22% from the current level.

Key Investment Rationale

Strategic brands to remain key growth driver in domestic market

Aventis has identified certain brands as strategic, based on the parent's strength in R&D and marketing, which can be leveraged to improve sales growth and margins. In 2005, strategic brands as a group grew by 20% and made up 32% of domestic sales, led by Lantus (83%), Rabipur (22%), Frisium (18%), Amaryl (18%), Cardace (15%), Clexane (14%) and Targocid (8%). We expect these same brands to continue to drive growth. The company expects Lantus to be its largest brand in three to four years, the world's first and only once-daily twenty-four hour basal insulin. However, insulin is under price control, and this being an imported drug, we estimate gross margin of 15%.

Outsourcing by Parent to remain robust

Aventis has been catering to its parent's requirements in various markets for several years, supplying both formulations and APIs. Outsourcing from the parent and exports continue to be sustained growth drivers in the future and we expect it to grow by 20-25% in the coming years. In 2005, sourcing had a growth of 55% due to higher procurements of Daonil (Glibenclamide) by Germany. The company had started supplies of Daonil (anti-diabetic) formulations to the parent. It intends to gradually raise Daonil supplies and aims to meet about 80% of the parent's requirements (by volume) for the drug in the coming years.

Exports likely to resume at normal level in 4QCY06 after products relisted in Russia

Exports accounted for about 26% of total sales in CY05, growing by 9.1%. Most of the exports are to group companies (mainly to the CIS and EU countries), either formulations or intermediates. Exports to CIS countries grew 26% primarily resulting from the upsurge in demand from Russia as several products benefited from the Federal Reimbursement Scheme. However, in Q3CY06, exports dropped 6%, the fourth successive drop. Sales had earlier dipped owing to removal of two products from the reimbursement list in Russia. These were restored during the quarter and Aventis expects growth to resume soon. For the full year CY06, we expect a flat growth in exports followed by 10% growth in CY07E, contributing 23% to total sales in CY07E.

Parent's global R&D pipeline may benefit domestic entity

Sanofi Aventis globally has 127 new drug discovery projects in research and development pipeline. This pipeline includes about 45 drugs in pre-clinical development, 26 in phase-1, 38 in phase-II and 18 in late stage development, that is, phase-III. It plans to file about 11 ANDAs and seven vaccines by CY08E. Although clarity on the launch of these drugs will emerge only over a period of time, we believe some of these products could be relevant for the Indian markets and are likely to be launched in India with a time lag.

We expect revenue CAGR of 12.7% and earning CAGR of 20.5% over CY06-07E

Aventis has recorded a 10% growth in net sales in CY05 at Rs.8.08bn. Going forward, we expect net sales to grow by 12.3% and 13.1% to Rs.9.07bn and Rs.10.3bn in CY06E and CY07E, respectively. Operating margins are likely to remain between 27-28%. We expect net profit to grow by 27.5% in CY06E and 13.9% in CY07.

Valuation and recommendation

Aventis has posted an EPS of Rs.63 in CY05 and we expect EPS to grow by 27% and 14% to Rs.80.3 and Rs.91.4 in CY06E and CY07E, respectively. At the current market price of Rs.1350, the stock is trading at 16.8x CY06E and 14.8x CY07E expected earnings. The company has a cash of around 430 crores (Rs.188 per share) in its balance sheet at the end of the year CY06 which is around 65% of total assets. We initiate our coverage with a BUY recommendation with 2007 DCF-based one year target price of Rs.1643 per share.

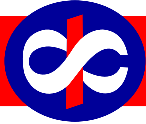
Key risks and concerns

- Possibility of new products being routed through Sanofi's unlisted Indian subsidiary, which would be a key risk. However, Aventis' inherent marketing strengths, in our view, make it the preferred vehicle for such launches.
- Risk of likely termination of Chiron Behring JV due to acquisition of Chiron Vaccines by Novartis.
- Slowdown or pricing pressure in domestic formulation market.

Summary table - Year end December

Rs mn	CY05	CY06E	CY07E
Sales	8,078	9,069	10,255
Growth (%)	9.9	12.3	13.1
EBITDA	2,241	2,449	2,820
EBITDA margin (%)	27.7	27.0	27.5
Net profit	1,451	1,850	2,106
Net Margin (%)	18.0	20.4	20.5
EPS (Rs)	63.0	80.3	91.4
Growth (%)	(2.3)	27.5	13.9
DPS (Rs)	4.0	16.0	16.0
RoE (%)	30.7	31.1	28.0
RoCE (%)	50.3	46.8	42.2
EV/Sales (x)	4.3	2.9	2.4
EV/EBITDA (x)	15.7	10.9	8.9
P/E (x)	26.3	16.8	14.8
P/BV (x)	7.3	4.7	3.7

Source: Company & Kotak Securities - Private Client Research



ENTERTAINMENT NETWORK INDIA LTD. (ENIL)

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 257** | **TARGET PRICE: Rs. 294**

5 January 2007

Saurabh Gurnurkar & Dipen Shah

Release of listenership data: Reinforces ENIL's strong competitive positioning in radio markets

According to the latest results of the Wave 2 '06 of the Indian Listenership Track (ILT), Radio Mirchi has consolidated its leadership position in Delhi and Mumbai while establishing itself as the dominant No.1 player in India's third largest metro - Kolkata. The Media Research Users Council (MRUC) released listenership data for Kolkata for the first time.

Radio Mirchi leads the competition by a distance...

The latest data released by the MRUC reaffirms the leadership status of ENIL in high ad spend locations like Delhi, Mumbai and Kolkata. As the accompanying table illustrates, ENIL has consolidated its market leadership in the radio markets of Delhi and Mumbai in addition to emerging as the No.1 player in the latest researched market of Kolkata.

According to the data released, ENIL has daily listenership that is more than double its nearest competitor in Delhi & NCR, Radio City. ENIL has listenership of close to 4.2 mn vis-à-vis the 2.094 mn and 2.048 mn reported by competitors Radio City and Red FM, respectively. ENIL also leads the closest competitor in Mumbai by close to 40% with daily listenership numbers of 2.629 mn. MRUC, for the first time, has also released listenership numbers for Kolkata market, wherein ENIL leads the market with daily listenership of close to 2.73 mn.

Daily Listenership (mn)

	Mumbai	Delhi & NCR	Kolkata
Radio Mirchi	2.629	4.201	2.731
Radio City	1.893	2.094	N/A
Red FM	1.658	2.048	0.764
Radio One	0.973	N/A	N/A
AIR FM2 100.7	0.71	1.222	0.246
AIR FM1 107.1	0.404	0.439	0.502
Aamar FM 106.2	N/A	N/A	0.582
Power FM 107.8	N/A	N/A	0.3056

Source: MRUC Survey, AC Nielsen, fieldwork September 2006 to November 2006.

Strong growth likely in radio industry; ENIL to be beneficiary...

The Ficci-PwC report on the Indian entertainment industry estimates the market for radio to grow to Rs.12 bn in FY10 from the Rs.3.4 bn reported in FY06. Within the radio industry, the private FM segment is expected to grow to Rs.10 bn in FY10 from the estimated Rs.2 bn in FY06. The balance is expected to accrue to the state-owned broadcaster All India Radio (AIR).

...on the back of strong growth being witnessed by advertising industries...

As sectors like retail, banking, finance and insurance, real estate, and media are displaying strong growth trends, radio should benefit accordingly as its viability is proved further.

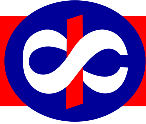
We believe ENIL's ability to dominate the market, coupled with its strong marketing backbone has enabled the company to be the leader in terms of revenues in the nascent radio industry. We opine that radio, as a medium, is unique on account of its low cost and higher user frequency due to which it could emerge as a critical component of an advertiser's strategy.

...aided by the Times Group lineage

The Times group, Bennett, Coleman and Company Ltd (BCCL), a prominent Indian media conglomerate directly, and through its 100% owned subsidiary TIML, owns about 71% of ENIL's current equity.

We believe the presence of Times group in other media industry segments like print, music, broadcasting and others has helped ENIL's radio and other nascent businesses like OoH and 360 to a significant extent. In our opinion, ENIL has had the advantage of tapping into the corporate relationships fostered by the various established businesses of the group. We believe advertisers would feel inclined to extend their relationship with the group and also look to ride on the inherent benefits radio has a medium.

We note that ENIL enjoys an advantage over peers due to this factor that could place it at an advantage even in terms of content procurement from cross-media entities from the group.



Projected healthy growth in consolidated financials: Economies of scale and low operating cost to drive margin expansion:

We expect healthy growth in the financials for ENIL over FY06-09 on the back of comfortable macro factors like rising income levels and the growth momentum we expect in the company's business segments. For ENIL, we expect:

(a) **Radio business to drive revenue growth:** We expect healthy growth in ENIL's radio business on the back of its network expansion, competitive positioning and expected robust demand from the user segments. We note that ENIL has hiked its ad rates on extant radio stations by an average of 10-25% depending on the station's maturity towards the end of Q2FY07.

We expect the full impact of these ad rate hikes to positively impact the radio business' financials, going ahead. We also expect the pan-India presence of ENIL, post its rollout, to improve its attractiveness to advertisers in the medium-term.

(b) **TIMPL, 100% owned subsidiary to start contributing:** We are optimistic about the growth prospects for ENIL's emerging businesses- OoH and event management, given the revenue visibility and expected growth potential in these businesses.

(c) **Emergence as a city-centric cross-media entity:** On the back of a strong positioning in radio, emerging presence in OoH and event management and a strong urban strategy we expect ENIL to emerge as a formidable cross-media entity, going forward. We believe ENIL, given its strong execution skills, management bandwidth and the Times pedigree has an advantage over peers and could consolidate its extant dominant position.

Future Prospects

For ENIL, we expect the radio revenues to grow robustly from the current Rs.1.17 bn in FY06 to Rs.2.35 bn in FY08. Further, it is slated to Rs.2.94 bn in FY09 on the back of growing traction from target markets, network expansion and also due to the ad rate hikes affected recently.

For TIMPL, we expect revenues to grow at a CAGR of 58% over FY06-09E to Rs.900 mn in FY08 and Rs.1.13 bn in FY09E. Overall, we expect consolidated revenues for ENIL to register a CAGR of 55% over FY06-08E. We expect consolidated revenues to grow to Rs.3.3 bn in FY08 and to Rs.4.07 bn in FY09 from the Rs.1.37 bn reported in FY06.

We expect ENIL to report consolidated revenues of Rs.2.3 bn in FY07 and a further Rs.3.3 bn in FY08 and net profits of Rs.309 mn in FY07 and Rs.408 mn in FY08. We expect net profits to further grow to Rs.509 mn in FY09. On an equity capital of Rs.467.5 mn, this would translate into an EPS of Rs.7 for FY07, Rs.8.6 in FY08 and Rs.11 in Fy09.

Network expansion, economies of scale and low operating cost to drive margin expansion…

Given the healthy revenue growth expected and on account of operating leverage showing through its various radio stations, we expect consolidated operating margins to expand to 22.45% in FY07 (standalone EBITDA percentage reported in H1FY07 is 18%) and further to 24% and 27.3% in FY08E and FY09E, resulting in healthy profit growth for ENIL. Radio margins in FY07 are expected to be subdued on account of continuing investments in the radio and OoH businesses that are in expansion mode.

The strong EBITDA percentage improvement registered by ENIL also demonstrates the low operating costs and consequent leverage on a growing revenue base typical of radio broadcasting services. We also expect improved revenue contribution from TIMPL to positively impact financials over the period.

Valuation and Recommendation:

We have valued ENIL using the DCF and sum-of-the-parts methodology and have arrived at a weighted average fair value of Rs.294 for the stock. For our DCF analysis, we have assumed a terminal growth rate of 4% and WACC of 12.5% that yields a fair value of Rs.310 over one year based on a rolling 12-month basis.

We have also valued ENIL using a sum-of-the-parts methodology assigning appropriate EV/EBITDA multiples to the different businesses. Radio business has been valued at 14x FY08 EV/EBITDA and the OoH and Live Entertainment businesses at 12x EV/EBITDA. This yields a fair value of Rs.278 for the stock on a 12-month horizon.

We prefer to use a simple average of both the methodologies to arrive at an estimated fair value for ENIL that works out to Rs.294 over a 12-month horizon. We continue to recommend a BUY on ENIL.

Key Concerns

Competition and possible irrational behavior of new entrants: It is expected that the 43 new players in this space are expected to roll out close to 245 stations over the fiscals of FY07 and FY08. We note that in an attempt to gain market share, new entrants could look to indulge in irrational pricing in certain key pockets and/or exert pressure on employee payouts.

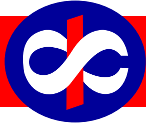
Royalty issues: Currently, radio broadcasters are required to pay a fixed Rs.5 mn in royalties per station per annum irrespective of the station's location. Both the parties - music providers and radio companies are in litigation on this issue with the music providers asking for a greater percentage of revenue share that radio companies are unwilling to part with. ENIL currently pays about Rs.300-1200/hr for the content played by it to the content owner and also the Phonographic Performance Society.

Any unfavorable developments for radio companies on this front could impact the profitability of players.

Summary table

Rs mn	FY06	FY07E	FY08E	FY09E
Sales	1,374	2,290	3,306	4,074
Growth (%)	83.3	66.6	44.4	23.2
EBITDA	381	513	795	1,110
EBITDA margin (%)	27.7	22.4	24	27.3
Net profit	217	309	408	510
Net cash (debt)	(17)	218	(105)	(1,106)
EPS (Rs)	4.6	6.5	8.6	10.7
Growth (%)	(526.0)	(0.5)	32.2	24.8
CEPS	9.2	7.7	11.2	14.0
DPS (Rs)	-	0.5	0.5	1.0
ROE (%)	20.7	11.0	12.5	12.6
ROCE (%)	16.9	11.5	13.8	16.7
EV/Sales (x)	9.1	5.5	3.7	2.8
EV/EBITDA (x)	32.1	24.1	15.5	10.5
P/E (x)	39.5	39.7	30.0	24.1
P/Cash Earnings	28.2	33.6	23.0	18.4
P/BV (x)	4.6	4.1	3.5	2.7

Source: Company & Kotak Securities - Private Client Research



ALLCARGO GLOBAL LOGISTICS LTD (AGL)

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 1223** | **TARGET PRICE: Rs. 1346**

5 January 2007

Apurva Doshi

AGL has approved the 100% acquisition of airfreight and logistics service provider Hindustan Cargo Ltd. Maintain BUY with upward revision in P/E based price target to Rs.1346 (10% upside potential).

The acquisition

- AGL has approved the acquisition of the entire paid-up capital of Rs.25 mn, comprising 250,000 equity shares of Rs.10 each in Hindustan Cargo Ltd from its holding company, that is, Thomas Cook India Ltd. The company would pay Rs.89.1 mn to acquire 100% stake in HCL.
- Hindustan Cargo (HCL) will become a wholly-owned subsidiary of the company with effect from the date of registration of physical transfer of equity shares in favour of the company. Hindustan Cargo is a niche player in the airfreight and logistic services business.

About HCL

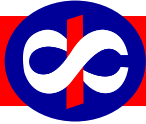
- Hindustan Cargo is a Chennai-based subsidiary of Thomas Cook India Ltd. Thomas Cook India established the operations in India in 1881. Cargo was one of the divisions of Thomas Cook India and in order to give thrust to the cargo business. In order to propel it to greater heights achieved by their travel and exchange divisions, the company established a wholly-owned subsidiary called HCL in 1994.
- The company has a global network across all continents and has worked with all major trade lines worldwide. The company enjoys well-established contacts with exporters and importers in most parts of the country.
- The company services some of the reputed companies like TVS Motors, Saint Gobain, Blue Star, Cadbury India, Viceroy Hotels, Taj group of Hotels, Hewlett Packard among others.
- During 2004-2005, the company was awarded and recognized by FFSI Worldwide Network, Hong Kong, as the second best agent in recognition of the exceptional sales performance for the most important Top-10 agents with the highest growth of more than 180%. The company also received the Quality Summit International Award for excellence and business prestige from Business Initiative Directions (BID) of Spain.

Services offered

- Hindustan Cargo Ltd provides innovative solutions for customer needs like cargo consultancy, general cargo, valuable cargo, reefer cargo, perishables, pharmaceuticals, garments, and IT-related products. The industries the company is servicing are all fast growing cargo industry, thereby offering huge growth potential.
- For import and export cargo the company provides air freight services like door-to-door services, consolidations, direct shipments, packing, crating and local transportation.
- The company also provides sea freight services like NVOCC operations, FCL and LCL services worldwide with door-to-door handling of cargo. The company also provides Customs Clearance for air and sea operations. The company has its own customs house agents (CHA) license and is experienced in providing speedy clearance at airports and seaports.
- The company also provides multi-modal logistics services using various modes of transport like air, sea and road to provide door-to-door services that is speedy and efficient and cost effective.

The contract is profit accretive for AGL

- The company has been making profits since 2001. In the financial year ended October 2005, the company recorded net sales of Rs.56.8 mn with EBIDTA of Rs.13.4 mn, thereby translating into EBIDTA margin of 23%. The net profit stood at Rs.7.9 mn.
- For the year ended October 2006, HCL reported revenues of Rs.320 mn and PBT of Rs.13 mn.
- Going by past financials and the synergies to be derived out of the acquisition we feel the acquisition would be EBIDTA and profit accretive for AGL. We expect HCL to report profits of Rs.250 mn in CY07E and Rs.500 mn in CY08E.



Valuation and recommendation

- The acquisition of HCL provides the company with a well-established platform to take advantage of the tremendous growth opportunities in the increasing airfreight cargo and door-to-door multi modal logistics services.
- The contract will increase AGL's range of services. It will also provide AGL access to its reputed clients and, thereby, extend additional logistics services to them. Hence, we feel this would be the next growth driver for the company.

Change in Estimates (Rs mn)

	Old		Revised	
	CY07E	CY08E	CY07E	CY08E
Revenues	19,080	21,292	19,752	22,468
EBIDTA	1,667	2,086	1,835	2,391
Profit	1,120	1,385	1,145	1,435
EPS	55.3	68.4	56.5	70.8
CEPS	66.5	82.9	67.7	85.4

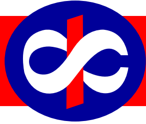
Source: Kotak Securities - Private Client Research

- We have factored in revenues and profitability from the acquisition into our estimates. Hence, we are increasing our EPS estimate from Rs.55.3 to Rs.56.5 for CY07E and from Rs.68.4 to Rs.70.8 for CY08E.
- The current market price of Rs.1223 discounts CY07E and CY08E earnings at 21.6x and 17.3x, respectively.
- It discounts CY07E and CY08E cash earnings at 18.1x and 14.3x, respectively.
- We maintain our positive bias for the stock and continue to recommend a BUY with upward revision in P/E based price target of Rs.1346, which provides 10% upside potential. We have derived our target price by according target P/E of 19x to CY08E EPS estimate of Rs.70.8. We maintain a BUY recommendation on the stock.

Summary table (consolidated)

Rs mn	FY06	CY06 (9M)	CY07E	CY08E
Sales	2,704	12,883	19,752	22,466
Growth (%)	19.4	376.4	26.7	13.7
EBITDA	582	1,005	1,835	2,391
EBITDA margin (%)	21.5	7.8	9.3	10.6
Net profit	494	696	1,145	1,435
Net debt	(183)	704	343	(703)
EPS (Rs)	27.2	34.4	56.5	70.8
Growth (%)	98.6	40.9	41.4	25.3
DPS (Rs)	5.5	3.5	4.0	4.5
ROE (%)	31.0	31.2	41.5	36.3
ROCE (%)	31.0	28.8	45.2	46.9
EV/Sales (x)	9.1	2.0	1.3	1.1
EV/EBITDA (x)	42.2	25.3	13.7	10.1
P/E (x)	45.0	35.6	21.6	17.3
P/BV (x)	15.5	11.1	7.5	5.4

Source: Company & Kotak Securities - Private Client Research



EVEREST KANTO CYLINDERS LTD (EKC)

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 766** | **TARGET PRICE: Rs. 924**

9 January 2007

Sanjeev Zarbade & Apurva Doshi

Reason for this report: Introduction of FY09E estimates and upward revision of price target to Rs.924. Upgrading the stock from HOLD to BUY with 21% upside potential.

Introduction of FY09E numbers

We recently met the management of EKC and are positive about the growth prospects of the company. We are introducing our FY09E estimates on increased earnings visibility due to successful ramp up of the Gandhidham plant. In FY09E, we expect EKC to report net sales of Rs.7.7 bn, EBIDTA margin of 28.3% and PAT of Rs.1.3 bn, thereby translating into an EPS of Rs.65.0 and CEPS of Rs.77.2.

Successful ramp up of the Gandhidham plant

The company commenced commercial production at the Gandhidham plant in December 2006. In FY06, the company produced 10510 cylinders. In the first half of FY07 the company produced approximately 40000 cylinders and in Q3FY07E the company is expected to have produced 35000 cylinders. The company is likely to end the year with 142800 cylinders moving up to 289000 cylinders in FY08E and further to 306000 cylinders in FY09E.

Potential expansion of China plant from 200,000 to 1.5 mn cylinders over next 4 years

The company is looking to ramp up the China plant from 200,000 to 1.5 mn cylinders per annum over a period of four years. The demand for CNG cylinders in China is expected to go up significantly due to the government mandating conversion of buses in certain cities to CNG and also aggressive ramp up of gas stations in China from current levels of 400 to approximately 2000 CNG stations in two to three years time.

EKC has already bought the land for the China plant and construction work is expected to start by the end of February 2007. The company has already placed the order and paid the advance for the machinery. They are likely to be delivered by July 2007. The plant is expected to commence commercial production by September 2007 with the first line with capacity of 200,000 cylinders per annum. This will ramped up to 400,000 cylinders per annum in FY09E. We expect the unit to produce 50,000 cylinders in FY08E and move up to 200,0000 cylinders in FY09E.

Unit II of Dubai plant to commence production by February 2007

EKC has already set up the unit II at Dubai with the capacity to produce 96,000 cylinders per annum. The plant is expected to commence commercial production by February 2007. The average realizations at Dubai are typically 25-30% higher, that is, average realization of US$230 per cylinder in Dubai as against US$180 in India. Thus, this unit is likely to significantly improve the overall profitability of the company, going forward. We expect the unit to produce 9,600 cylinders in FY07E moving up to 67,200 cylinders in FY08E and further rise to 76,800 units in FY09E.

Volume breakup - cylinders

Plant Location	FY06	FY07E	FY08E	FY09E
Aurangabad	127,600	93,500	99,000	104,500
Tarapur	130,400	144,000	148,000	152,000
Dubai	103,500	105,600	96,000	96,000
Gandhidham	0	142,800	289,000	306,000
Dubai - unit II	0	9,600	67,200	76,800
China	0	0	50,000	200,000
Total Production	361,500	495,500	749,200	935,300

Source: Company & Kotak Securities - Private Client Research

CNG cascades booming opportunity

The company supplied approximately 110 cascades in FY06, which is likely to move up to 250 cascades in FY07. Typically, cascades consist of 30 to 90 CNG cylinders per cascade and the company also puts it with the imported pipes and the valves. Hence, the customer, that is, the CNG filling stations have to simply connect it to their source of gas. There is a lot of value addition in this activity. With rising number of vehicles getting converted into CNG in India, and improving distribution infrastructure we expect this to be a substantial and, more importantly, high margin business for the company going forward.

Newer orders increase in capacity utilisation

The company is continuously developing some new high capacity special products for the aerospace and other high growth industries. We feel the company is likely to get new orders, which would further improve its capacity utilization and profit margins.

Improving margins

On the margin front, EKC is able to fully pass on the hike in raw material prices, thereby keeping its margins intact. The company is actually passing on higher price increases than the rise in prices of raw materials, thereby generating incremental operating margins. Also, higher capacity utilization is leading to greater operational efficiency leading to lower cost per unit and increasing profitability.

Change in Estimates

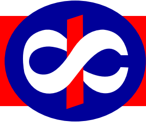
(Rs mn)	Old		Revised		
	FY07E	FY08E	FY07E	FY08E	FY09E
Net sales	3855	5724	4,088	6,181	7,716
EBIDTA (%)	26.4	26	26.8	27.8	28.3
PAT	550	801	594	997	1,269
EPS (Rs)	28.2	41.1	30.5	51.1	65.0
CEPS (Rs)	37.4	54.5	40.0	61.4	77.2

Source: Kotak Securities - Private Client Research

- We estimate the company to report higher net sales of Rs.4.1 bn in FY07E, as against our earlier estimate of Rs.3.8 bn and Rs.6.2 bn in FY08E as against our earlier estimate of Rs.5.7 bn due to a surge in final product prices led by a rise in raw material prices, heavy demand for CNG cylinders and some new products being developed for aerospace and other high growth industries.
- We expect the company to report higher EBIDTA margin of 26.8% in FY07E and 27.8% in FY08E, as against our earlier estimate of 26.4% and 26.0%, respectively, mainly due to the ability of the company to pass on the entire price hike in raw material to its customers. Also, going forward, we see strong growth in user industries, thereby keeping product prices strong.
- We expect the company to report higher PAT of Rs.594 mn in FY07E and Rs.997 mn in FY08E as against our earlier estimate of Rs.550 mn and Rs.801 mn, respectively.
- Accordingly, we are increasing the EPS estimate from Rs.28.2 to Rs.30.5 for FY07E and from Rs.41.1 to Rs.51.1 for FY08E.
- We estimate the revised CEPS at Rs.61.4 and Rs.77.2 for FY07E and FY08E, respectively, as against our earlier estimate of Rs.37.4 and Rs.54.5 respectively.

Valuation & Recommendation

- At Rs.766, the stock trades at 5.8x for FY07E, 4.3x FY08E and 3.2x FY09E to book value.
- It discounts FY07E, FY08E and FY09E earnings at 25.2x, 15.0x and 11.8x respectively.
- It discounts FY07E, FY08E and FY09E cash earnings at 19.1x, 12.5x and 9.9x, respectively.
- Based on the changes in earnings estimates and introduction of FY09E numbers we are revising our DCF-based price target upwards from Rs.670 to Rs.924.
- Accordingly, we are upgrading the stock from HOLD to BUY with a 21% upside potential from current levels.



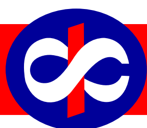
Key Risks

- Any delay in commencement of the expansion of Dubai and China plant would lead to flat or marginal growth for the company.
- Seamless steel is the main raw material for making the cylinders, thus, any increase in the prices, which the company is not able to pass on to its customers, or disruption in its availability could impact the profitability of the company.

Summary table - Consolidated

Rs mn	FY06	FY07E	FY08E	FY09E
Sales	2,355	4,088	6,181	7,716
Growth (%)	77.9	73.6	51.2	24.8
EBITDA	593	1,096	1,717	2,181
EBITDA margin (%)	25.2	26.8	27.8	28.3
Net profit	335	594	997	1,269
Net cash (debt)	(105)	1	(567)	(171)
EPS (Rs)	19.0	30.5	51.1	65.0
Growth (%)	134.6	77.5	67.8	27.2
CEPS	24.8	40.0	61.4	77.2
DPS (Rs)	1.4	4.0	4.0	4.0
ROE (%)	29.9	26.6	31.8	28.6
ROCE (%)	36.0	37.5	41.3	40.4
EV/Sales (x)	5.8	3.7	2.5	2.0
EV/EBITDA (x)	22.9	13.6	9.0	6.9
P/E (x)	40.3	25.2	15.0	11.8
P/Cash Earnings	30.9	19.1	12.5	9.9
P/BV (x)	10.1	5.8	4.3	3.2

Source: Company & Kotak Securities - Private Client Research



INFOSYS TECHNOLOGIES LTD

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 2185** | **TARGET PRICE: Rs. 2460**

12 January 2007

Dipen Shah & Saurabh Gurnurkar

Infosys' results for the quarter were marginally below our expectations. However, the increasing preference for offshoring from India (coupled with reduced fears of a recession in the US), strong volume growth of the company (third consecutive quarter of double-digit growth in US dollar terms) and ability to maintain EBIDTA margins (even in the backdrop of about 3.8% appreciation in the rupee v/s the US dollar) make us positive on the continuing growth for the company over the medium-to-long term.

The company has also communicated, in recent interactions, that none of the clients have indicated any change in their IT spending plans for CY2007. The clients have also reiterated that offshoring remains on top of their IT spending agenda. We see these as positive signals for Infosys in particular and the industry in general.

On the supply side, the company plans to become a total solutions provider by increasingly taking on more consulting/consulting-led assignments. It is training its employees in specific domains, in addition to the technical training provided to them. Each practice/service is focused on the industry dynamics, problems faced by those companies and how Infosys can help those companies - all ingredients of a consultative approach.

Q3FY07 results

(Rs. mn)	Q3FY07	Q2FY07	% Chg	Q3FY06	% Chg
Turnover	36,550	34,505	5.9	25,319	44.4
Expenditure	24,590	23,415		16,710	
EBIDTA	11,960	11,090	7.8	8,609	38.9
Depreciation	1,410	1,220		1,170	
EBIT	10,550	9,870	6.9	7,439	41.8
Other Income	590	660		-50	
PBT	11,140	10,530	5.8	7,389	50.8
Tax	1,300	1,230		830	
Minority interest	10	10		70	
PAT	9,830	9,290	5.8	6,489	51.5
PAT after EO items	9,830	9,290		6,489	
EPS (Rs)	17.8	16.8		11.8	
EBIDTA (%)	32.7	32.1		34.0	
EBIT (%)	28.9	28.6		29.4	
Net Profit (%)	26.9	26.9		25.6	

Source: Company

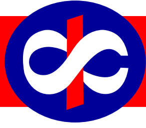
Recommendation

We have marginally increased our FY08 earnings estimates for the company in view of the better-that-expected scenario in user economies and better-than-anticipated margin performance in Q3FY07. We now expect the company to achieve a 36% rise in revenues for FY08 and a 31% rise in net profits.

Based on an EPS of Rs.88, we arrive at a price target of Rs.2460. At our price target, our FY08E EPS will be discounted at 28x. We are according higher valuation to FY08E earnings due to the increased confidence in our FY08 numbers in light of the receding fears of a US slowdown, a strong handle on margins in times of an appreciating rupee and higher probability of pricing increases.

We continue to recommend a BUY on the stock in view of the growing strategic importance of off-shoring from India and expected high growth over the medium to long term for Infosys. In view of the recent run-up in the stock price (20% in the past quarter), we expect the stock to remain range-bound in the short-term.

An accelerated slowdown or recession in major user economies or appreciation of the rupee (v/s US dollar) beyond our assumed levels of 43 per US dollar by FY08 end may provide a downward bias to our estimates and recommendation.



Revenue growth continues, though impacted by an unfavorable Re/$ in Q307...

- Revenues grew by 5.9% on the back of a rise in business volumes. In dollar terms, this was the third sequential quarter, which saw the company reporting revenue growth rates in excess of 10%. The 3.8% appreciation of the rupee during Q3 impacted revenue growth, limiting it to 5.9% in rupee terms.
- The company added 6,062 employees on a gross basis and 3,282 employees on a net basis. The employee utilization excluding trainees also reduced from 77.5% in the previous quarter to 75.8% in Q2FY07.

Growth in revenues of top clients

Rs. mn	Q3FY07	3QFY06	YoY gth (%)	2QFY07	QoQ grth (%)
Top client	2,521.95	1,139.34	121.35	2,277.33	10.74
Top 5 clients	6,907.95	4,456.07	55.02	7,246.05	-4.67
Top 10 clients	11,330.50	7,570.26	49.67	11,352.15	-0.19

Source: Company

Geographic growth

Rs. mn	Q3FY07	Q3FY06	YoY gth (%)	Q2FY07	QoQ gth (%)
North America	23,099.60	16,457.08	40.36	21,979.69	5.10
Europe	9,795.40	6,304.33	55.38	8,902.29	10.03
India	657.90	354.46	85.61	552.08	19.17
Rest of World	2,997.10	2,202.72	36.06	3,070.95	-2.40

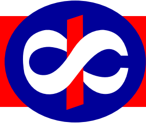
Source: Company

...but was helped by an upward bias in pricing

- The company's blended realization during the quarter went up about 1.4% with offshore realizations moving up 1.9% and on-site realizations by 1.7%. This up tick in pricing came about due to a change in business mix and also some service increases.
- The company continues to get new clients at 3-4% higher realizations (as compared to average). According to the management, existing clients are ready to give billing rate hikes in view of the higher costs for Infosys and the value provided by the company.
- We believe consistent hikes in average realizations will allow the company to restrict the impact of higher salary hikes and rupee appreciation, if any.

New services showing good traction...

- The new services and practices, which have been introduced by the company, are also gaining traction. We believe Infosys' focus on consulting and on a solutions approach will allow it to effectively compete for larger end-to-end projects with the global incumbents. This will allow Infosys to expand its services range in turn, increasing revenue productivity (new services normally have higher billing rates) and profitability.
- During the quarter, relatively new services like testing (9%), BPM (15%) and package implementation (12%) grew faster than the company average.
- The PI service now contributes to 17.9% of revenues as compared to the 17% of revenues in Q2FY07. The package implementation business added to the quarterly run-rate as the company received more orders for globalization, integration and standardization of different packages.
- The management has stated that this business has also not seen any signs of a slowdown. We opine that discretionary spending has not been impacted yet - as evidenced by the growth in PI, testing and consulting. PI, though, is not totally discretionary in nature.
- Consulting revenues were at about $12.2 mn (v/s $11.12 mn in Q2FY07) for the current quarter. Also, the downstream work generated out of the consulting projects is rising at a fair clip.
- This subsidiary currently employs about 200 plus consultants and is likely to break even in the next two to three quarters' time.
- In terms of client metrics, there was a sequential decline in revenues from the Top 5 clients that de-grew 4.7%. The company has said this is due to a change in the composition of Top 5 clients.



Impressive growth in BPO…

- Infosys BPO recorded a 20% QoQ rise in revenues and added new customers taking the total to 29 for this business. This healthy revenue growth comes on the back of the 23% growth reported in the previous quarter.
- The operating margins for Infosys BPO stood at 22%, which are among the highest in the industry.
- In this line of business, the company has focused on higher end business and during the quarter, knowledge management revenues grew well. This division now employs more than 300 consultants.

Attrition under control - more emphasis on mid-tier employees

Infosys, for the quarter, has reported LTM attrition of 13.5%. Of this, 1.3% is attributable to involuntary attrition. Negating this, the attrition rate is flattish QoQ at 12.2%.

However, the management has indicated its eagerness in retaining the middle management level employees and plans to place greater emphasis on this critical middle tier (three to five yrs experience) level. The company may consider wage hikes over and above the normal hike for select employees in this band going forward.

Higher margins: Lower G&A and benefits of scale

- The improvement in EBIDTA margins was a surprise to us. We had estimated EBITDA margins of 31.7% for the quarter.
- Margin improvement in Q3 came about in the background of a 3.8% appreciation in the rupee vis-à-vis the dollar, which impacted margins by 200 bps. An improvement in the per capita revenue (+80bps impact), lower G&A costs (+50bps) and higher license fee recognition in products (+80bps) helped Infosys report an improvement in the EBITDA margins.
- The China subsidiary and the consulting subsidiary continued to be in the red with losses during the quarter. The Australian subsidiary had profits of $4.2 mn whereas Infosys BPO reported margins of about 22% for the quarter.
- We believe a gradual improvement in profitability in new ventures like China and consulting (loss in Q3FY07 also), coupled with better operating efficiencies, should allow Infosys to restrict impact on margins arising from higher salaries and expected rupee appreciation in the future.
- The other income fell from previous quarter levels to Rs.590 mn in the current quarter. The appreciation of the rupee led to translation losses that impacted margins negatively by 160 bps. On the other hand, hedged positions improved margins by +100bps. The net effect of the rupee appreciation on net margins thus stood at -60 bps during the quarter.
- After providing for a lower 11.7% tax, profits grew about 6% to Rs.9.83 bn.

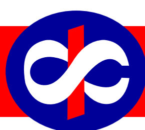
Future prospects

(Rs. mn)	FY06	FY07E	% Chg	FY08E	% Chg
Turnover	95,215	140,421	47.5	191,126	36.1
Expenditure	64,298	95,540		131,583	
EBIDTA	30,917	44,881	45.2	59,543	32.7
Depreciation	4,371	5,290		6,650	
EBIT	26,546	39,591	49.1	52,893	33.6
Other Income	1,386	3,280		4,100	
PBT	27,932	42,871	53.5	56,993	32.9
Tax	3,132	5,222		7,979	
Minority interest	200	90		0	
PAT	24,600	37,559	52.7	49,014	30.5
Provisions	1	0		0	
PAT after provisions	24,600	37,559		49,014	
EPS (Rs)	89.1	67.4		88.0	
EBIDTA (%)	32.5	32.0		31.2	
EBIT (%)	27.9	28.2		27.7	
Net Profit (%)	25.8	26.7		25.6	

Source: Company, Kotak Securities - Private Client Research

We expect Infosys to end FY07 with a 48% growth in revenues. While EBIDTA margins are likely to be slightly lower, the other income component is likely to be higher mainly due to forex gains.
For FY08, we expect revenues and PAT to grow YoY by 36% and 31%, respectively. While volumes are likely to grow 39%, we have assumed the rupee to appreciate to 43 per US dollar by FY08 end.

We believe on-site and offshore billing rates may rise about 2% between Q3FY07 and Q4FY08.
EBIDTA margins are likely to be lower YoY on the back of higher salaries and the expected rupee appreciation.
After considering higher taxation at 14% of PBT, we expect the PAT to rise by about 31%, leading to earnings of Rs.88 per share in Fy08.



UTI BANK

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 499** | **TARGET PRICE: Rs. 563**

15 January 2006

Saday Sinha

UTI Bank, the third-largest private sector bank in India, reported very strong growth in its net interest income (NII) and net profit for Q3FY07, on the back of strong growth in its core business accompanied by margin expansion.

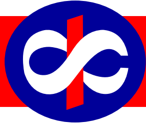
Key highlights

- Net interest income (NII) grew by a healthy 45% from Rs.2.87 bn to Rs.4.16 bn on the back of robust credit growth and margin expansion.
- Total advances grew 66% YoY and now stands at Rs.323.4 bn while total deposits grew 50% to Rs.509.2 bn. Commendably savings and current account grew 59% and 61%, respectively, taking the share of CASA deposits to 37%, an improvement of 240 bps (YoY).
- Retail assets continued to drive growth of the bank, which grew by 59% to Rs.92 bn. Its growth is primarily driven by mortgages, which now constitute around 43% of retail loans.
- Other income too has improved significantly by 61% from Rs.1.73 bn in Q3FY06 to Rs.2.8 bn in Q3FY07.
    - Fee Income grew 59% YoY to Rs.2.01 bn.
    - Trading profit grew by 68% YoY to Rs.0.79 bn.
- Operating expenses rose 64.6% mainly due to higher salaries and costs of new branches. The bank recruited 3300 new employees during nine months of FY07 to run the branches, which will be set up in H2FY07.
- Net profit rose 40% to Rs.1.85 bn from Rs.1.32 bn, primarily led by strong credit flow and net interest income along with the lower than expected provisions.
- NIMs rose to 3.0% in Q3FY07 from 2.94% in Q3FY06 and 2.92 % in Q2FY07. Although there was a slight pressure on the cost of funds, it was compensated by higher average yields. Now, the bank is also focusing on the corporate segment, which offers greater profitability. This would lead to further improvement in its margins.
- Net NPAs declined substantially to 0.68% compared to 0.95% in Q3FY07.
- Tier-I capital adequacy stands at 7%. To finance its balance sheet growth and improve its Tier-I ratio, the bank would further raise hybrid capital. It has already raised hybrid capital worth $150 mn and Rs.2 bn by way of upper Tier-II Bonds and $46 mn and Rs.2.1 bn by way of Tier-I Perpetual Debt during the nine months of FY07. This capital raising is a part of the US$700 mn capital raising announced by the bank some time ago in the form of hybrid Tier-I, Upper Tier-II and subordinated bonds during FY07.
- The bank added 12 branches & extension counters and 105 ATMs during this quarter.

Quarterly performance (Rs mn)

	Q3FY07	Q3FY06	% change
Interest on advances	7053.0	3931.9	79.4
Interest on investments	4572.8	3358.4	36.2
Int. on other advances	135.1	111.0	21.7
Other interest	135.3	65.7	105.9
Total interest earned	11896.2	7467.0	59.3
Other income	2797.4	1734.2	61.3
Total income	14693.6	9201.2	59.7
Employee expenses	1146.6	622.3	84.3
Selling & Administrative Expenses			
Other operating expenses	2222.9	1424.3	56.1
Interest expenses	7737.8	4592.6	68.5
Total operating expenses	11107.3	6639.2	67.3
Operating profit	3586.3	2562.0	40.0
Provisions	762.8	592.0	28.9
Tax provision	977.4	652.9	49.7
Net profit	1846.1	1317.1	40.2
EPS-Unit Curr	6.59	4.74	39.0
Net interest income	4158.4	2874.4	44.7

Source: Company



Valuation

We have decided to value UTI Bank on P/E rather than the P/BV-RoE methodology, which is more commonly used to arrive at the fair book value multiple. This methodology assumes steady growth to perpetuity. Therefore, this becomes unsuitable for private sector banks like UTI bank, which has grown by over 30% YoY in 26 out of the last 28 quarters.

We expect that net profit for FY07E and FY08E to be Rs.6.36 bn and Rs.8.73 bn, respectively resulting into an EPS of Rs.22.8 and Rs.31.3, respectively. The adjusted book value for FY07E and FY08E is forecasted at Rs.113.3 and Rs.138.1 respectively. The stock is now trading at 15.9x its FY08 earnings and 3.6x its FY08E adjusted book value.

We have arrived at the price target of Rs.563 based on a P/E ratio of 18x on FY08E earnings. The EPS is expected to grow at a CAGR of 34% during FY06-08E, which places the PEG ratio at around 0.53x.

Peer Group Comparison

	Year	HDFC Bank	ICICI Bank	UTI Bank
P/E (x)	FY07E	28.7	27.5	21.9
	FY08E	22.1	21.3	15.9
P/ABV (x)	FY07E	5.3	3.5	4.4
	FY08E	4.4	3.1	3.6
RoE (%)	FY07E	20.0	13.7	20.3
	FY08E	22.0	15.9	23.1
RoA (%)	FY07E	1.4	1.1	1.1
	FY08E	1.5	1.1	1.2
NIM (%)	FY07E	4.1	2.2	2.7
	FY08E	4.1	2.2	2.7

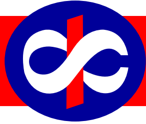
Source: Kotak Securities - Private Client Research

We recommend BUY on the stock with a price target of Rs.563, an upside of 13% from the current level.

Summary table

(Rs bn)	FY06	FY07E	FY08E
Interest income	28.89	43.98	56.08
Interest expense	18.11	29.36	36.91
Net interest income	10.78	14.62	19.17
Other income	7.3	9.73	12.65
Gross profit	9.94	13.2	16.9
Net profit	4.85	6.36	8.73
Gross NPA (%)	1.5	1.4	1.4
Net NPA (%)	1	0.7	0.7
Net interest margin (%)	2.6	2.7	2.7
RoE (%)	18.4	20.3	23.1
RoAA (%)	1.1	1.1	1.2
Dividend Yield (%)	0.8	0.8	0.8
EPS (Rs)	17.4	22.8	31.3
Adjusted BVPS (Rs)	96.1	113.3	138.1
P/E (x)	28.4	21.9	15.9
P/ABV (x)	5.2	4.4	3.6

Source: Company & Kotak Securities - Private Client Research



NICHOLAS PIRAMAL INDIA LTD.

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 258** | **TARGET PRICE: Rs. 300**

15 January 2006

Awadhesh Garg

New drug development collaboration with Eli Lilly & Company

- Eli Lilly has licensed to Nicholas a novel, patented, pre-clinical, drug candidate for development
- Nicholas will design and execute the global clinical development program, namely, IND-enabling non-clinical studies, human clinical trials up to Phase-III
- Agreement will serve as prototype for additional drug candidates across multiple therapeutic areas, accelerate the clinical trials and reduce to drug development costs significantly
- Nicholas would receive potential milestone payments of up to US$100 mn on successful completion of phase I & II and up on successful registration and launch by Eli Lilly, plus royalties on sales upon launch of the product and commercialization rights in select markets

Nicholas Piramal India Ltd and Eli Lilly and Co have signed a landmark new drug development agreement to develop and, in certain regions, commercialize a select group of Lilly's pre-clinical drug candidates that span multiple therapeutic areas.

The alliance seeks to increase productivity in drug development by synergizing the unique strengths of both companies and equitably sharing risk and reward. Nicholas will be responsible for the design and execution of the global clinical development program, including IND-enabling non-clinical studies and human clinical trials up to Phase-III.

The management has reiterated that the deal will have three revenue streams, namely, milestone payments, royalty income and sales revenue in certain geographies. The company would receive a call-back payment, and potential milestone payments of up to US$100 mn up on successful completion of phase I & II and up on successful registration and launch by Eli Lilly, plus royalties on sales upon successful launch of the first compound and commercialization rights in select markets.

The company expects phase-I to be completed by the end of 2007 or mid-2008 and phase-II by mid-2009 and phase-III by 2010. The product then will be returned to Eli Lilly after phase-III completion for registration and global launch. According to the terms of the agreement, Eli Lilly will have marketing rights in the US, Europe and Japanese markets and Nicholas will receive royalty on sale of product in these geographies, while Nicholas will have the marketing rights in the remaining markets.

Risk adjusted milestone cash flow

Year	FY09E	FY10E	FY11E
Molecule 1 (Metabolic Syndrome)			
Expected time to Complete Clinical Trials	Phase-I	Phase-II	Phase-III
Amount expected to be received (US$mn)	10	20	70
Rs./US$ Exchange Rate	44	44	44
Amount expected to be received (Rs. mn)	440	880	3080
Probability of Success in Clinical Trials	80%	50%	20%
Probable amt expected to received	352	440	616

Source: Kotak Securities - Private Client Research

The agreement, which will serve as a prototype for joint development of several pre-clinical drug candidates from Lilly in multiple therapeutic areas, will be a new paradigm for global alliances in drug discovery and development.

Valuations and recommendation

We expect the company to register a 28% and 63% consolidated revenues and earnings CAGR over FY06-08E, respectively, while improving return on equity (RoE) to 25.8% in FY08E. In our estimates, we have considered potential milestones payments (based on probability) from this Eli Lilly deal in discounted cash flow valuation. However, we have not considered royalty and sales revenues from the product in our estimates.

The company has posted EPS of Rs6 in FY06 and we expect EPS to grow by 83% and 45% to Rs10.9 and Rs15.8 in FY07E and FY08E, respectively. At the current market price Rs.258, the stock is trading at 23.6x FY07E and 16.3x FY08E earnings and 10.7x FY08E EV/EBITDA. We are raising our DCF-based target price to Rs300 per share. Maintain BUY.

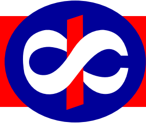
Key risks

- Price cut in domestic market
- Integration risk of acquisitions
- Delay in execution of contracts
- Risk of break-up of association or termination of contracts

Summary table

(Rs mn)	FY06	FY07E	FY08E
Sales	15,984	22,568	25,886
Growth (%)	21.5	41.2	14.7
EBITDA	2,136	3,611	4,789
EBITDA margin (%)	13.4	16.0	18.5
Net profit	1,246	2,282	3,302
Net Margin (%)	7.8	10.1	12.8
EPS diluted (Rs)	6.0	10.9	15.8
Growth (%)	(31.1)	83.2	44.6
DPS (Rs)	3.0	3.0	3.0
RoE (%)	15.9	21.1	25.8
RoCE (%)	13.8	18.2	21.6
EV/Sales (x)	3.4	2.4	2.0
EV/EBITDA (x)	25.3	15.0	10.7
P/E (x)	41.9	23.6	16.3
P/BV (x)	5.4	4.8	3.9

Source: Company & Kotak Securities - Private Client Research



TATA CONSULTANCY SERVICES LTD (TCS)

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 1326** | **TARGET PRICE: Rs. 1453**

16 January 2007

Dipen Shah & Saurabh Gurnurkar

Tata Consultancy Services

TCS' results for 3QFY07 came in above our estimates. While revenues grew by 8% QoQ (v/s our expectations of an 4.6% rise), profits were higher by 11% over the previous quarter mainly due to the higher revenues and better-than-expected EBIDTA margins.

In 2QFY07, EBIDTA margins were helped by a one-time net write back of provisions to the tune of Rs.340mn and lower provision for debts to the tune of about Rs.220mn. Despite this and the rupee appreciation, the company was able to improve profitability by about 90bps at the EBIDTA levels.

The macro scenario remains good for the Indian IT services vendors with the US economy not showing signs of a recession and off-shoring becoming more strategic. The full services model operated by TCS through its Global Network Delivery Model (GNDM) is finding increasing acceptance in the form of large contracts bagged by the company in the recent quarters. This is expected to lead to continued growth in the future.

We have revised our earnings estimates for FY07 and FY08 to accommodate the positive comments about the macro environment and the 3QFY07 results. We expect TCS to report revenues of about Rs.186bn in FY07 and Rs.248bn in FY08. We have assumed the rupee to appreciate to Rs.43 per USD by FY08-end. PAT is expected to grow to Rs.41bn in FY07 and further to Rs.53.5bn in FY08, resulting into an EPS of Rs.42 and Rs.55, respectively. The current price discounts our FY07E earnings by 32x and FY08E earnings by 24x.

At the current levels, we believe that our FY07E earnings are fairly priced in. Based on FY08E earnings estimates, we continue to recommend a BUY with a price target of Rs.1453. At the target price, our FY08E earnings will be discounted by 26.5x, which is at a marginal discount to our assumed valuations for Infosys based on FY08 earnings.

A faster-than-expected slowdown / recession in the major user economies and a higher than expected rupee depreciation provide the key downside risks to our estimates.

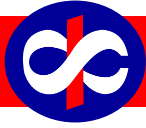
3QFY07 results

(Rs mn)	2QFY07	3QFY07	QoQ %	3QFY06	YoY %
Turnover	44821	48605	8.4	34527	40.8
Expenditure	32527	34852		24760	
EBIDTA	12294	13753	11.9	9767	40.8
Depreciation	958	1080		738	
EBIT	11336	12673		9029	
Interest	0	0		0	
Other Income	77	300		-154	
PBT	11413	12972	13.7	8875	46.2
Tax	1447	1828		1319	
PAT	9967	11144	11.8	7556	47.5
Minority interest	59	115		48	
Share of profit	8	17		-3	
Adjusted PAT	9915	11047	11.4	7505	47.2
EO items	0	0		3	
EPS (Rs)	10.1	11.3		7.7	
EBIDTA (%)	27.4	28.3		28.3	
Net Profit (%)	22.2	22.9		21.9	

Source: Company

Revenues

- The company reported a growth of 8% in revenues driven largely by a similar rise in the volumes. This is as compared to an 11% rise in volumes in 2QFY07. In the international business, growth came about despite a 170bps shift in favor of offshore and GDC revenues to 45.7%. The company was able to transition large contracts to off-shore and GDC locations. This shift impacted the revenues growth by 1.6% in 3QFY07.
- In all the large accounts, which the company has received, the scale ups are along expected lines and the off-shoring of business is happening at the desired pace. These initiatives should lead to better profitability in the future. We believe that, timely shifting of work to off-shore locations would gradually lead to normalized margins over the life of the contract.



- The company has been able to secure large deals in diverse areas like financial services, transportation and retail areas, including others, which has helped the volume growth. During the quarter, TCS bagged two $100mn deals and three $50mn deals.
- The revenue growth was also helped by the productivity improvement in the fixed priced contracts, which formed 41% of the quarter's revenues. Asset-based solutions also helped and contributed 2.8% of revenues compared to 2.5% in the previous quarter. The company bagged large orders for FNS and in areas like treasury and depository solutions.
- TCS has been able to get better rates from existing as well as new clients. According to the management, existing clients are giving 3% - 5% increases at the time of renegotiations. On the other hand, the company is getting new clients at 5% - 10% higher rates. Revenues grew by 2% due to the higher average realizations v/s a 1.17% rise in 2QFY07. The rupee appreciation impacted the overall growth rate of revenues by 2.46% for the quarter.
- The revenue growth was led by emerging verticals like Retail and Life Sciences in addition to Telecom and BFSI. New services like Assurance services, Consulting and Asset Leveraged solutions continued to grow well.
- In the BPO segment, the UK based BPO subsidiary, Diligenta, continued the transformation process and is expected to gradually transition the platform. However, the process is expected to take time and marketing to new clients is expected to start post the completion of the transformation process. The subsidiary, which mainly services Pearl's clients continued to incur losses.

Margins

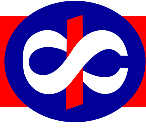
- EBIDTA margins during the quarter improved by about 90bps due to higher realizations (1.74%), increased productivity (0.14%) and higher off-shore revenues (0.28%). On the other hand, margins were negatively impacted due to forex fluctuations (1.37%).
- The margin improvement is encouraging especially as it came in the backdrop of a nearly 3.5% appreciation in rupee and exceptional gains in the previous quarter (about 0.76% margin gain in 2QFY07).
- The management has indicated that a further move towards off-shore (target 45% of revenues), better utilization of GDCs and better leverage of SG&A expenses (target 19% of revenues) provide the levers for potential margin improvement in the future.
- The other income component grew from Rs.77mn in 2QFY07 to Rs.300mn in 3QFY07, on the back of forex gains.

Future prospects

(Rs mn)	FY06E	FY07E	YoY %	FY08E	YoY %
ITurnover	132550	185850	40.2	247562	33.2
Expenditure	95543	135284		181063	
EBIDTA	37008	50566	36.6	66499	31.5
Depreciation	2806	3989		5000	
EBIT	34202	46578		61499	
Interest	0	0		0	
Other Income	257	1395		1550	
PBT	34459	47972	39.2	63049	31.4
Tax	4984	6424		9142	
PAT	29475	41548	41.0	53907	29.7
Minority interest	280	384		555	
Share of profit	16	60		120	
Adjusted PAT	29211	41225	41.1	53472	29.7
EO items	243	0		0	
EPS (Rs)	29.6	42.1		54.6	
EBIDTA (%)	27.9	27.2		26.9	
Net Profit (%)	22.2	22.4		21.8	

Source: Company, Kotak Securities - Private Client Research

We have made appropriate changes our FY07E and FY08E estimates post the 3QFY07 results and the favourable comments made by the management on future volume growth and pricing.
We have assumed the rupee to appreciate to Rs.43 per USD by FY08 end. We expect the company to achieve revenues of Rs.185bn in FY07 and Rs.248bn in FY08.
The EBIDTA margins for are expected to be marginally lower despite salary hikes and the expected rupee appreciation. A shift to off-shore (about 43.5% of revenues by 4QFY08) and additional leverage on costs, along with marginal price increases, are expected to restrict the impact on margins.
Consolidated PAT is expected to grow to Rs.41bn in FY07E and further to Rs.53.5bn in FY08E. The EPS works out to Rs.42 in FY07E and to Rs.55 in FY08E.



HCL TECHNOLOGIES LTD (HCLT)

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 630** | **TARGET PRICE: Rs. 772**

16 January 2007

Dipen Shah & Saurabh Gurnurka

HCLT's 2QFY07 results were broadly in line with our estimates. Revenue growth of 6.2% QoQ was spurred by healthy growth in the Infrastructure (IMS) & software services business. A higher than expected other income coupled with a lower tax incidence resulted in profits of Rs.2862mn that were above our estimates.

We like HCLT because of its focus on integrated services, which allows it to increase profitability by improving productivity. The company's investments in new services like IMS and BPO have started yielding results in the form of the recent large deal wins.

Over the recent quarters, HCLT has won large contracts like Teradyne, Autodesk, DSG Intl. and Skandia, with most of these being multi service and multi year deals in BPO, Infrastructure Services and software services. These are expected to help the company in achieving sustained growth in the quarters to come.

We have fine-tuned our earnings estimates to accommodate the Q2FY07 results. We expect HCLT to report net profit of Rs.10.9bn in FY07 and further grow to Rs.12.4bn in FY08. These will translate into earnings of Rs.33.7 and Rs.38.4 for FY07 and FY08 respectively. At the current price levels our FY08E earnings are discounted by 16x.

Given the relatively lower profitability of the company, we have accorded valuations that are at a discount to larger peers. At our revised target price of Rs.772 our FY08 earnings will be discounted by 20.2x and provides an upside of 23% from the current levels. We recommend a BUY on HCL Technologies.

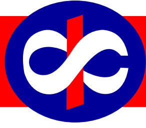
2QFY07 results

(Rs mn)	1QFY07	2QFY07	% chg	2QFY06	% chg
Turnover	13796	14651	6.2	10542	39.0
Expenditure	10807	11410		8165	
Operating Profit	2989	3241	8.4	2377	36.3
Depreciation	556	623		493	
Gross Profit	2433	2618	7.6	1884	39.0
Other Income	290	481		143	
PBT	2723	3099	13.8	2027	52.9
Tax	221	206		203	
PAT	2502	2893	15.6	1824	58.6
Share of income	4	-23		-7	
Minority interest	5	7		6	
Adj. PAT	2501	2863	14.5	1811	58.1
PAT after EO prov	2501	2863		1811	
EPS (Rs)	7.8	9.0		5.7	
OPM (%)	21.7	22.1		22.5	
GPM (%)	17.6	17.9		17.9	
NPM (%)	18.1	19.7		17.3	

Source: Company

Revenues

HCLT's Q2FY07 revenues grew by 6.2% QoQ to Rs.13.8bn. This was brought about by BPO services and IM services where revenues grew by 6% and 12%, respectively. Software services revenues on the other hand grew by 5% during the quarter.



Software Services

We believe that, revenues in the software services business grew on the back of higher volumes and also an improvement in the average realizations (largely due to a change in the business mix). While volumes were higher, we believe that average realizations have also improved for the company that aided revenue growth. This coupled with higher onsite utilization rates helped offset the impact of rupee appreciation during the quarter.

Revenues grew on the back of increased business from its non-Top 20 clients that have grown at a higher than company rate , indicative of traction in new accounts and the mega deals won by the company over the past two quarters. HCLT has indicated that it is actively pursuing business from clients which are not necessarily in the Fortune 500 list. According to the management Fortune 500 companies are either working with other Indian majors or are not in looking at total business transformation services.

In the software segment HCLT has added about 580 employees in 2QFY07 with the gross lateral employee addition at 1553. The margins for this business increased by about 50 bps to 22.8%; positively impacted by benefits of scale, higher utilization rates and beneficial impact of pricing improvements.

BPO Revenues

BPO revenues during the quarter grew by 6% to Rs.1.86bn (13% of revenues). This business also added 1069 employees on a net basis, continuing with the high additions in the previous two quarters taking the total strength in this segment to 12,181 employees. The large employee addition witnessed in this space is to service the large clients acquired recently and this indicates the visibility of revenues going forward.

Margins increased sequentially in 2QFY07 by 60bps to 23.1% on account of the higher utilization levels and also better non-voice mix in business.. The proportion of non-voice business in this space was close to 35%. The company aims to scale up the non-voice component to 40% in the near term. An increase in proportion of non-voice business is expected to favorably impact margins for the BPO segment.

HCLT is increasingly looking at output based pricing in new deals which would allow it to maintain and improve profitability through better productivity. Also, the company is targeting increased revenues in back office processing to improve its capacity utilization rates from this segment.

Infrastructure Services

The infrastructure services business continued with its healthy growth during the quarter with revenues growing by 12% QoQ. Once again, growth in the current quarter was brought about by the multi year and multi service integrated deals from large customers.

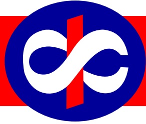
The company is among the few that have built up a strong practice in this area having been one of the early starters in this line of business and is rated among the strong global players in IM by Forrester and IDC. This business continued to witness significant migration of contracts from traditional global outsourcers to offshore outsourcers like HCLT.

Operating margins in this business declined marginally to about 17.5% (-10bps). We believe this is on account of higher marketing spends this quarter. Increased revenues from higher margin businesses and greater leverage from the SG&A spends, in our opinion have helped the company mitigate the negative effect of the rupee appreciation during the quarter.

Margins

EBDITA margins for the quarter were close to 40bps up from the previous quarter at 22.1% from the 21.7% reported in the previous quarter. The improvement in margins came about due to greater utilization rates in the software services business coupled with the beneficial impact of pricing up ticks. In our opinion the impact of the rupee appreciation on the gross margins was compensated to an extent by the increased contribution from geographies like Europe and also the productivity increases registered in the BPO segment.

The management has indicated that any improvement in margins will be utilized to spend on sales and marketing, in order to sustain and improve on the current growth rates. Going forward, on an annual basis, we expect the margins to remain stable at around 2QFY07 levels keeping in mind the proposed increase in sales and support spend/investments.



Future Prospects

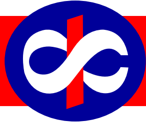
(Rs mn)	FY06	FY07E	% chg	FY08E	% chg
Turnover	43938	59737	36.0	72978	22.2
Expenditure	34159	46647		56766	
EBIDTA	9779	13091	33.9	16213	23.8
Depreciation	2033	2529		3133	
EBIT	7746	10562	36.4	13080	23.8
Other Income	579	1728		1665	
PBT	8325	12290	47.6	14745	20.0
Tax	626	994		1588	
Adj. PAT	7698	11296	46.7	13157	16.5
Share of income	-6	-4		22	
ESOP	0	362		765	
Minority interest	25	22		20	
PAT	7667	10908	42.3	12394	13.6
PAT after EO prov	7667	10908		12394	
EPS (Rs)	24.0	33.7		38.3	
EBIDTA (%)	22.3	21.9		22.2	
EBIT (%)	17.6	17.7		17.9	
PAT (%)	17.5	18.9		18.0	

Source: Company, Kotak Securities - Private Client Research

We have fine-tuned our FY07E & FY08E earnings estimates to accommodate 2QFY07. We now expect the company to report revenues of Rs.60bn and Rs.74bn in FY07 and FY08, respectively. While IM revenues are expected to grow at a CAGR of 44% over FY06-08, IT services revenues are expected to rise by a CAGR of 25% and BPO revenues by 37% over FY06-08.

EBIDTA margins are expected to be maintained despite salary hikes and the expected rupee appreciation due to increasing leverage in the multi-service accounts and cost control initiatives. The faster growth in BPO revenues, which enjoy slightly higher margins, should also positively impact the profitability.

After assuming higher tax at about 11% of PBT in FY08E, PAT is expected to grow to Rs.10.9bn and a further Rs.12.4bn in FY08, translating into an EPS of Rs.33.7 and Rs.38.3 respectively in FY07 and FY08 respectively. Our earnings estimates for the fiscals also incorporate an ESOP charge, applicable from the next quarter. Management has guided towards charges of Rs.362mn & Rs.765mn on account of ESOP's over FY07 & Fy08.



PATEL ENGINEERING LTD

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 462** | **TARGET PRICE: Rs. 526**

17 January 2007

Teena Virmani

Patel Engineering reported a good set of numbers with revenues registering a YoY growth of 29%, operating margins of 19.2% and a decent YoY growth of 16% in net profits ahead of our estimates. The revenue growth was below our estimates but with very good operating profit margins, company has been able to achieve 16% YoY growth in net profits.

Key highlights of the results - standalone

(Rs mn)	Q3FY07	Q3FY06	YoY (%)
Net Sales	2184	1696.8	29
Expenditure	1765	1335	
Cost of construction	1580	1216	
As a % of net sales	72.3	71.7	
General and Admin expenses	185	119	
As a % of net sales	8.5	7.0	
EBITDA	419	361	16
EBITDA margin	19.2	21.3	
Depreciation	70	72	
EBIT	349	289	
Interest	24	60	
EBT(exc other income)	325	229	
Other Income	11	46	
EBT	335	276	22
Tax	44	25	
Tax %	13.0	9.1	
PAT	292	251	16
Extraordinary Items	0	0	
Net profit	292	251	16
NPM (%)	13.4	14.8	
Equity Capital	60	49	
EPS (Rs)	5	5	

Source: Company

Performance of the company in Q3FY07

The company reported a decent revenue growth of 29% for Q3FY07 as compared to Q3FY06. By December 2006, Patel Engineering had an order book of Rs.50 bn, thereby providing a visibility for the next three years. Hydropower projects constitute 50%, irrigation projects constitute 28% and transportation projects form 22% of the total order book of Rs.50 bn.

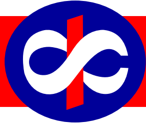
Operating margins of the company in the current quarter were very good due to higher margin projects executed in the current quarter. However, they are lower by 200 bps than in Q3FY06. Patel Engineering has also retired high cost contractee advances that have resulted in a fall in the interest cost of the company. This has resulted in overall net profit growth of 16% for the current quarter, resulting in net profit margins of 13.4%.

Land development plans

The company has formed five wholly-owned subsidiary companies to exploit the existing land of the company. We interacted with the management regarding their land development plans. Patel has a total land of approximately 430 acres spread in prime cities like Mumbai, Hyderabad, Bangalore, Chennai, Mysore as well as in Panvel and Karjat.

The company plans to commercially develop 0.7 mn sq ft of land in Jogeshwari, Mumbai. In Hyderabad, Patel has land of approximately 250 acres, located in Gachibowli and Shamshabad area. In Bangalore, Chennai and Mysore they have land of approximately 100 acres. The remaining 60 acres is spread in Panvel and Karjat.

The company is in the initial stages of finalizing plans for developing this land bank. We have arrived at the approximate NPV for each area based on prevailing prices and upon discounting it to the present value after taking into account the average development time of two to two and a half years from now.



Land valuation table

City	Approx Valuation (Rs mn)	Per share value (Rs)
Mumbai	1,336	22
Hyderabad	4,463	75
Bangalore	464	8
Chennai, Mysore, Panvel, Karjat	1,785	30
Total	8,048	135

Source: Company

Valuations and recommendation

At the current market price of Rs.462, the stock is trading at 19.8x and 16.5x on P/E multiples and 13.3x and 10.9x on EV/EBITDA multiples on FY08 and FY09 estimates.

We are incorporating FY09 estimates for the company on a standalone basis. We expect Patel Engineering to maintain the operating margins in the range of 12-13% for the full year. This is despite higher margins reported in the current quarter since hydropower projects carry higher margins while transportation projects have lower margins. We are revising our price target from Rs.360 after incorporating the land valuation.

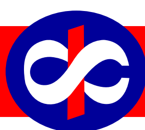
Our one-year forward price target of Rs.526 is the sum of the core business valuation on DCF, subsidiary valuation on peer valuation multiples and land bank valuation.

We are quite positive on the long-term prospects of the company. Once real estate plans get finalized and company starts getting the returns from those projects, there would be a significant value unlocking for the company. Our one-year forward target price provides an upside of 14% from the current levels and we recommend a BUY on the stock.

Summary table (Rs mn) - standalone

Year end March	FY07E	FY08E	FY09E
Revenues	11,374	14,951	17,920
% change YoY	42	31	20
EBITDA	1,458	1,909	2,300
% change YoY	38	31	21
Other Income	200	200	200
Depreciation	326	393	450
EBIT	1,332	1,716	2,051
% change YoY	34.0	29.0	19.0
Net interest	188	150	174
Profit before tax	1,144	1,566	1877
% change YoY	45	37	20
Tax	126	172	206
as % of PBT	11	11	11
Net income	1,018	1,394	1670
% change YoY	45	37	20
Shares outstanding (m)	60	60	60
EPS (reported) (Rs)	17	23	28
CEPS (Rs)	23	30	36
DPS (Rs)	1	1	1
EV/ Sales	2.2	1.7	1.41
EV/EBITDA	17.1	13.3	10.9
Price to earnings (P/E)	27.1	19.8	16.5

Source: Company & Kotak Securities - Private Client Research



CONTAINER CORPORATION OF INDIA (CONCOR)

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 2075** | **TARGET PRICE: Rs. 2498**

17 January 2007

Apurva Doshi

Results were below expectations. However, we continue to recommend BUY with unchanged price target of Rs.2498 (21% upside).

- Net sales for Q3FY07 were Rs.7.5 bn as against Rs.6.3 bn in Q3FY06, thereby registering a YoY growth of 17.5%. However, it slipped 2.9% on QoQ basis due to lower volume growth in the export import segment and, consequently, lower income from ground rent. The growth in sales on a YoY basis is primarily due to buoyant 28.9% growth in the domestic movement of containers by rail.
- The company recorded an EBIDTA margin of 29.8% for Q3FY07, 200 bps higher on YoY and 300 bps lower on a QoQ basis. The lower EBIDTA margin was primarily due to some discounts extended by the company and also the rise in haulage charges, which was passed on to the customers with a lag.
- Depreciation during Q3FY07 was higher by 17% YoY and 4% QoQ to Rs.241.7 mn. This was due to the rise in provisioning of depreciation due to acquisition of wagons and setting up of infrastructure related to the terminals.
- PBT for the Q3FY07 was at Rs.2.2 bn up 28.3% YoY and down 11% on a sequential basis.
- PAT for Q3FY07 was up 21.1% YoY and down 12.6% on sequential basis to Rs.1.6 bn translating into a quarterly EPS of Rs.25.5 and quarterly CEPS of Rs.29.2.

Quarterly performance

Rs mn	Q3FY07	Q3FY06	YoY (%)	Q2FY07	QoQ (%)	9MFY07
Net Sales	7,472	6,358	17.5	7,693	(2.9)	22,379
Staff cost	83	75	11.5	86	(3.5)	252
Rail freight	4,226	3,273	29.1	4,239	(0.3)	12,549
Other exp.	939	1,245	(24.6)	846	11.0	2,671
Total exp.	5,248	4,592	14.3	5,171	1.5	15,472
EBIDTA	2,224	1,765	26.0	2,522	(11.8)	6,907
Other income	205	146	40.4	169	21.7	536
Depreciation	242	207	17.0	232	4.0	697
EBIT	2,187	1,705	28.3	2,458	(11.0)	6,746
Interest	-	0	(100.0)	-	-	-
PBT	2,187	1,705	28.3	2,458	(11.0)	6,746
Extraordinary loss/(gain)	(1)	1	-	-	-	3
Tax & deferred tax	530	336	58.0	563	(5.9)	1,530
PAT	1,656	1,368	21.1	1,895	(12.6)	5,213
Equity shares o/s (mn)	65	65		65		65
Ratios						
Operting profit margin (%)	29.8	27.8	+200 bps	32.8	-300 bps	30.9
Rail Freight / Sales (%)	56.56	51.48		55.09		56.08
Other Exp / Sales (%)	12.56	19.58		11.00		11.94
EPS (Rs)	25.5	21.1		29.2		80.2
CEPS (Rs)	29.2	24.2		32.7		90.9
Tax / PBT (%)	24.2	19.7		22.9		22.7

Source: Company

Segmental Revenue

Rs mn	Q3FY07	Q3FY06	YoY (%)	Q2FY07	QoQ%
International	5,809	5,038	15.3	6,400	(9.2)
Domestic	1,663	1,290	28.9	1,293	28.6

Source: Company

Segmental profits

Rs mn	Q3FY07	Q3FY06	YoY (%)	Q2FY07	QoQ%
International	1,673	1,467	14.0	2,172	(23.0)
Domestic	383	247	55.3	187	104.5

Source: Company

Segmental margins

(%)	Q3FY07	Q3FY06	YoY (%)	Q2FY07	QoQ (%)
International	28.8	29.1	(1.1)	33.9	(15.2)
Domestic	23.0	19.1	20.5	14.5	59.0

Source: Company

Change in FY07E estimates

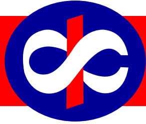
- Accommodating the Q3FY07 results, we estimate the company to report lower net sales of Rs.30.5 bn in FY07E as against our earlier estimate of Rs.31.5 bn.
- We estimate the company to report lower PAT of Rs.7.0 bn in FY07E as against our earlier estimate of Rs.7.3 bn.
- Accordingly, we expect the company to report an EPS of Rs.108.4 in FY07E as against our earlier estimate of Rs.112.6.
- However, we maintain our FY08E estimates and expect the company to report EPS of Rs.126.7.

Model concession agreement signed. Yet, Concor to remain No.1 player

- Indian Railways has finally signed the model concession agreement with 14 private players to run their own container trains. According to the agreement, companies would buy wagons from manufacturers, build inland container depots and find customers, while the railways would run the goods trains.
- Concor has added 12 rakes of 45 wagons each in the first half of FY07 as against 11 rakes of 45 wagons each in the entire last year, that is, FY06. This clearly proves that when other private players are not able to procure the wagons Concor's wagon acquisition plan is moving according to the schedule. This clearly proves the superior ability of Concor to build up the required infrastructure for handling the expected growth in transportation of containers by rail.
- The signing of MCA indicates the end of Concor's monopoly. However, we feel Concor has a tremendous advantage in terms of its scale of operations consisting of volume of traffic, network of terminals across the country, strong base of low cost assets like high-speed wagons and containers, which would ensure its No.1 position in India in the visible future for transportation of containers through rail.

Recommendation and Valuation

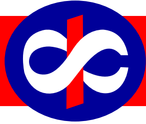
- At Rs.2075, the stock trades at 5.1x for FY07E and 4.0x FY08E to book value.
- It discounts FY07E and FY08E earnings at 19.1x and 16.4x, respectively.
- It discounts FY07E and FY08E cash earnings at 16.9x and 14.4x, respectively.
- We remain positive and reiterate our BUY on Concor with unchanged price target of Rs.2498, which provides an upside potential of 21% from the current level. We recommend a BUY.



Summary table

(Rs mn)	FY06	FY07E	FY08E
Sales	24,332	30,490	38,349
Growth (%)	22.0	25.3	25.8
EBITDA	6,976	9,417	11,622
EBITDA margin (%)	28.7	30.9	30.3
Net profit	5,258	7,043	8,233
Net debt	(6,763)	(8,096)	(10,902)
EPS (Rs)	80.9	108.4	126.7
Growth (%)	22.7	34.0	16.9
DPS (Rs)	18.0	19.0	20.0
ROE (%)	27.7	29.7	27.5
ROCE (%)	35.3	38.5	36.7
EV/Sales (x)	5.3	4.2	3.2
EV/EBITDA (x)	18.4	13.5	10.7
P/E (x)	25.6	19.1	16.4
P/BV (x)	6.4	5.1	4.0

Source: Company & Kotak Securities - Private Client Research

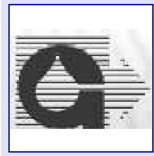


GUJARAT AMBUJA EXPORTS LTD (GAEL)

RECOMMENDATION: BUY **REPORT DATE PRICE: Rs. 32** **TARGET PRICE: Rs. 42**

17 January 2007

Apurva Doshi



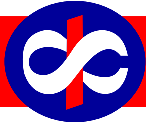
Result above expectations. We continue to recommend BUY with a revised price target of Rs. 42 (32% upside).

- Net Sales for Q3 FY07 was at Rs 3.9 bn up by 14.5% yoy and up 10% on sequential basis largely due capacity addition in the maize processing and cotton yarn business, which grew by 40.7% and 36.5% respectively.
- EBIDTA margin during Q3 FY07 was up by 230 bps at 8.4% on yoy basis and also up 80 bps on sequential basis. This was primarily due to strong demand for the maize based starch derivatives and cotton yarn thereby leading to better price realizations for the company. Also the raw material to sales ratio declined from 79.2% in Q3FY06 to 75.1% in Q3FY07 mainly due to higher price realizations and better capacity utilisation of the plants.
- EBIDTA for the Q3 FY07 was at Rs 332 mn up by 57.1% yoy and up 22.6% qoq. Major contribution is made by Maize processing segment where 40.7% yoy growth in revenues has led to 415.8% yoy growth in profits and the cotton yarn business where 36.5% yoy growth in revenues has led to 75.9% yoy growth in profits.
- Depreciation during Q3 FY07 was higher by 15.0% yoy and 2.5% qoq to Rs. 77.4 mn. This was due to the increase in the provisioning of depreciation due to the expansion of maize crushing capacity from 325 TPD to 500 TPD and also due to modernisation in the textiles plant.
- Interest cost increase substantially by 45.4% yoy and 73.3% on qoq basis to Rs. 40.8 mn in Q3 FY07 due to the loans taken by the company to fund the expansion plans of the company in maize processing and textiles business.
- PBT for the Q3 FY07 was at Rs. 214.9 mn up 84.6% yoy up 23.3% on qoq basis.
- PAT for the Q3 FY07 was up by 84.4% yoy and 23.3% on qoq basis to Rs 142.1 mn translating into a quarterly EPS of Rs. 1.0 and quarterly CEPS of Rs. 1.6.

Quarterly performance

(Rs mn)	Q3FY07	Q3FY06	YoY (%)	Q2FY07	QoQ (%)	9MFY07
Net Sales	3,939	3,439	14.5	3,581	10.0	10,540
Increase / decrease in stock	(285)	9	(3,303.9)	27	(1,152.9)	(233)
Raw materials	3,241	2,716	19.3	2,816	15.1	8,416
Staff cost	57	55	4.5	51	12.8	154
Other exp.	594	448	32.4	417	42.3	1,364
Total exp.	3,607	3,228	11.7	3,311	8.9	9,701
EBIDTA	332	211	57.1	271	22.6	840
Other income	1	0	140.6	2	(52.8)	4
Depreciation	77	67	15.0	76	2.5	227
EBIT	256	144	77.0	198	29.3	617
Interest	41	28	45.4	24	73.3	85
PBT	215	116	84.6	174	23.3	532
Extraordinary loss/ (gain)	-	-	-	-	-	-
Tax & deferred tax	73	39	84.8	59	23.3	180
PAT	142	77	84.4	115	23.3	352
Equity Rs. mn	279	279		279		279
Ratios						
Operting profit margin (%)	8.4	6.1	+230 bps	7.6	+80 bps	8.0
Raw Materials / Sales (%)	75.04	79.23		79.37		77.63
Staff cost / Sales (%)	1.46	1.60		1.42		1.46
Other Exp. / Sales (%)	15.07	13.03		11.65		12.94
EPS (Rs)	1.0	0.6		0.8		2.5
CEPS (Rs)	1.6	1.0		1.4		4.2

Source: Company



Segmental Revenue

Rs mn	Q3FY07	Q3FY06	YoY (%)
Cotton Yarn	450.8	330.3	36.5
Maize Processing	345.4	245.5	40.7
Other Agro Processing	3,134.0	2,861.1	9.5
Wind mill	8.4	2.2	284.6

Source: Company

Segmental PBIT

(Rs mn)	Q3FY07	Q3FY06	YoY (%)
Cotton Yarn	64.0	36.4	75.9
Maize Processing	72.8	14.1	415.8
Other Agro Processing	123.9	116.2	6.6
Wind mill	3.5	0.7	383.6

Source: Company

Segmental Margins

(%)	Q3FY07	Q3FY06	YoY (%)
Cotton Yarn	14.2	11.0	28.9
Maize Processing	21.1	5.7	266.6
Other Agro Processing	4.0	4.1	(2.7)
Wind mill	40.9	32.5	25.7

Source: Company

Buy back of shares at Rs. 38/- per share

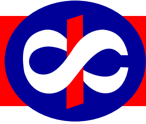
GAEL has approved the buy back of Equity shares of Rs 2/- each to the aggregate level of 10% of paid up capital and free reserves of the Company. The total equity and reserves of the company as on March 2006 is Rs. 2.6 bn and hence the company could buyback upto 10% of Rs. 2.6 bn that is Rs. 262.6 mn. At a maximum price of Rs. 38 per share the company could buy back upto 6.9 mn shares, which constitutes 4.9% of the total outstanding shares of the company as on today. We view this step as positive, as buy back of shares may result in higher EPS for the company.

Good growth in Agro processing segment

The Company has been exporting Soyabean De-oiled Cakes, Rapeseed De-oiled Cakes & Castor De-oiled cakes to various countries like Japan, Indonesia, Malaysia, Philippines, Vietnam, Korea, Taiwan, Singapore, Slovak & Australia. In Q3FY07, the total exports of De-Oiled cakes aggregated to 156300 Tons as against 96301 Tons of the corresponding period last year, thereby registering a growth of 62% on YoY basis. The exports of Agro Processing segment other than Maize processed products and Cotton Yarn was at 157096 Tons as against 96460 Tons of the corresponding period last year, thereby registering a YoY growth of 63%. The company also exported Soya Lecithin & Soya Flour. Thus we see that this segment where the company has significant capacities of 3300 tons per day for Soyabean crushing could be the next major growth driver for the company.

Expansion plans on track

- The company is setting up a 31,400 spindles cotton yarn-spinning mill adjacent to the existing 73,000 spindles cotton yarn mill at Himmatnagar, Gujarat. The project is expected to commence commercial production by September 2007.
- The company is setting up a 500 TPD maize crushing capacity plant in Uttaranchal. The company has already bought the land for the project and construction of the building has also started. The first phase of the plant is expected to commence commercial operations by April 2007 and is expected to achieve full scale of operations in the second half of FY08.
- The company is also setting up a 500 TPD maize crushing capacity plant at Nashik with facilities to make ethanol and ENA. The company has already bought the land for the project and the civil construction work has also started at the site. The first phase of the project is expected to start commercial production by September 2007.



Change in Estimates

	Old		Revised	
	FY07E	FY08E	FY07E	FY08E
Net sales	14608	18139	15,011	18,538
EBIDTA %	6.9	8.6	7.7	9.1
PAT	388	656	479	728
EPS (Rs)	2.8	4.7	3.4	5.2
CEPS (Rs)	4.9	7.5	5.6	8.1

Source: Kotak Securities - Private Client Research

- Accommodating Q3FY07 results we are revising our earnings estimates. We estimate the company to report higher net sales of Rs. 15.0 bn and Rs. 18.5 bn in FY07E and FY08E, as against our earlier estimate of Rs. 14.6 bn and Rs. 18.1 bn respectively due to expected higher utilisation of the seed crushing, solvent extraction and rising prices of the maize processing business of the company.
- We estimate the company to report higher EBIDTA margin of 7.7% and 9.1% in FY070E and FY08E as against our earlier estimate of 6.9% and 8.6% respectively. This is primarily due to higher price realizations in the maize processing and textiles business of the company. Also, going forward we see strong growth in the user industries thereby keeping the product prices strong.
- We expect the company to report higher PAT of Rs. 479 mn and Rs. 728 mn in FY07E and FY08E as against our earlier estimate of Rs. 388 mn and Rs. 656 mn respectively.
- Accordingly we are increasing the EPS estimate of the company from Rs. 2.8 to Rs. 3.4 in FY07E and from Rs. 4.7 to Rs. 5.2 in FY08E.
- We estimate the revised CEPS at Rs. 5.6 and Rs. 8.1 for FY07E and FY08E as against our earlier estimate of Rs. 4.9 and Rs. 7.5 respectively.

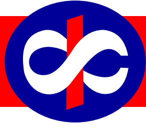
Recommendation and Valuation

- At Rs. 32, the stock trades at 1.5x for FY07E and 1.2x FY08E to book value.
- It discounts FY07E and FY08E earnings at 9.3x and 6.1x, respectively.
- The stock looks very attractive on cash earnings basis. It discounts FY07E and FY08E cash earnings at 5.7x and just 4.0x, respectively.
- We remain positive and reiterate our BUY on GAEL with a increased price target of Rs. 42, which provides upside potential of 32% form the current level. We recommend BUY.

Summary table

(Rs mn)	FY06	FY07E	FY08E
Sales	12,932	15,011	18,538
Growth (%)	15.8	16.1	23.5
EBITDA	762	1,152	1,681
EBITDA margin (%)	5.9	7.7	9.1
Net profit	303	479	728
Net debt	2,074	3,249	4,726
EPS (Rs)	2.2	3.4	5.2
Growth (%)	12.6	58.0	52.1
DPS (Rs)	0.2	0.2	0.2
ROE (%)	12.2	16.8	21.3
ROCE (%)	12.8	15.1	17.1
EV/Sales (x)	0.5	0.5	0.5
EV/EBITDA (x)	8.6	6.7	5.5
P/E (x)	14.7	9.3	6.1
P/BV (x)	1.7	1.5	1.2

Source: Company & Kotak Securities - Private Client Research



ALEMBIC LTD

RECOMMENDATION: BUY | **REPORT DATE PRICE: Rs. 67** | **TARGET PRICE: Rs. 93**

18 January 2007

Awadhesh Garg

Q2FY07 Results highlights

- Alembic has announced its results for Q3FY07, which is slightly below our expectations at both revenue and net profit level. However, our estimates for the full year FY07E remain unchanged. We hope the company will achieve our earning estimates comfortably. For 9MFY07, net profit on pre-exceptional basis has grown 22% to Rs.750 mn, which is in line with our expectation.
- Net sales have risen 8.8% YoY to Rs.1.86 bn mainly driven by 3% growth in domestic formulation sales and a sharp 85% jump in exports formulation sales. API business (domestic + exports) grew 8% to Rs.417 mn.
- Profit after tax grew only 5% to Rs.251 mn. Lower growth was mainly due to lower other income.
- The company has reported an EPS of Rs.4.3 for 9MFY07. We maintain our EPS estimates of Rs.6.2 and Rs.8.4 for FY07E and FY08E, respectively.

Moderate sales growth in Q3 driven by strong growth in export formulation sales

Alembic has reported an 8.8% rise in net sales to Rs.1.86 bn in Q3FY07 as compared to Rs.1.71 bn in last year for the same period, which is slightly below our expectation. The domestic formulations business has registered a lower growth of 3% at Rs.1.3 bn against Rs.1.25 bn while the export formulation business has clocked a strong growth of 85% at Rs.178 mn from Rs.96 mn.

Factors, which may have impacted domestic formulation growth are: 1) VAT implementation in Tamil Nadu where the company lost around Rs.50 mn sales, 2) Alembic went slowly on OTC products; and 3) Lower sales realization on some products due to voluntary price reduction. The company has entered the Russian market from this quarter where it has received a good initial response. This led to sharp growth in export formulation sales. The company has got OTC status for Glycodin (cough and cold) in Russia, which is the key growth driver in exports sales.

The API business (both domestic and export) has registered a satisfactory growth of 8% to Rs.417 mn against Rs.386 mn mainly due to the change in product mix and also markets.

Sales break-up

Particulars	Q3FY07	Q3FY06	% Chg	Fy06
I. Formulations	1,476	1,352	9.2	5,018
Domestic	1,299	1,255	3.4	4,564
Exports	178	96	84.5	454
II. Bulk/API	417	386	8.1	1,476
Domestic	220	203	8.2	703
Exports	198	183	8.0	773
III. Export Incentives &				
R&D Income	20	34	-41.4	166
Total Income (I+II+III)	1,913	1,771	8.0	6,659
Less: Excise Duty	55	63	-12.2	271
Net Income	1,858	1,708	8.8	6,389

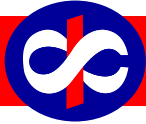
Source: Company

EBITDA margin back to normal level of 18% in Q3

In 9MFY07 the EBITDA margin has improved to 17% due to continuous rise in margin in last two quarters. We expect further improvement in margins to 18% in FY07E due to increasing share of formulation in total sales, higher export growth and change in API mix and some new product launches.

Valuations and recommendation

For FY06, the company has posted an EPS of Rs.5.7. Going forward, we expect it to report an EPS of Rs.6.2 and Rs.8.4 for FY07E and FY08E, respectively. At a CMP of Rs.67, the stock is trading at 11x FY07E and 8x FY08E earnings. We maintain BUY with a one-year price target of Rs.93 providing an upside of 39% from the current levels.



Quarterly Performance (Q3-FY07)

(Rs mn)	Q3FY07	Q3FY06	YoY (%)	Q2FY07	QoQ (%)	FY06
Net Income	1,858	1,708	8.8	2,039	-8.9	6,389
Expenditure	1,524	1,412		1,648		5,306
EBIDTA	334	296	12.8	391	-14.4	1,083
Depreciation	75	70		73		288
EBIT	259	226	14.6	318	-18.4	795
Interest	30	32		15		87
Other Income	16	55		41		126
PBT	244	249	-1.9	344	-28.9	835
Extra-Ordinary Items	(1)	-		(153)		-
Tax	(8)	10		28		50
Reported PAT	251	239	5.0	163	54.3	785
Equity Shares (Mn)	138	138		138		138
EPS (Rs)	1.8	1.7	5.0	1	54.3	5.7
EBIDTA Margin (%)	18.0	17.3		19.2		17.0
PAT Margin (%)	13.5	14.0		8.0		12.3

Source: Company

Summary table

(Rs mn)	FY06	FY07E	FY08E
Revenues	6,309	7,380	8,437
Growth (%)	21.3	17.0	14.3
EBITDA	1,083	1,352	1,626
EBITDA margin (%)	17.2	18.3	19.3
Net profit	785	853	1,168
Net Margin (%)	12.4	11.6	13.8
EPS diluted (Rs)	5.7	6.2	8.4
Growth (%)	50.9	8.6	36.9
DPS (Rs)	1.0	1.0	1.0
RoE (%)	25.7	23.0	25.6
RoCE (%)	17.2	17.9	21.2
EV/Sales (x)	1.8	1.5	1.2
EV/EBITDA (x)	10.7	8.0	6.4
P/E (x)	12.8	10.9	7.9
P/BV (x)	3.0	2.3	1.8

Source: Company & Kotak Securities - Private Client Research

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