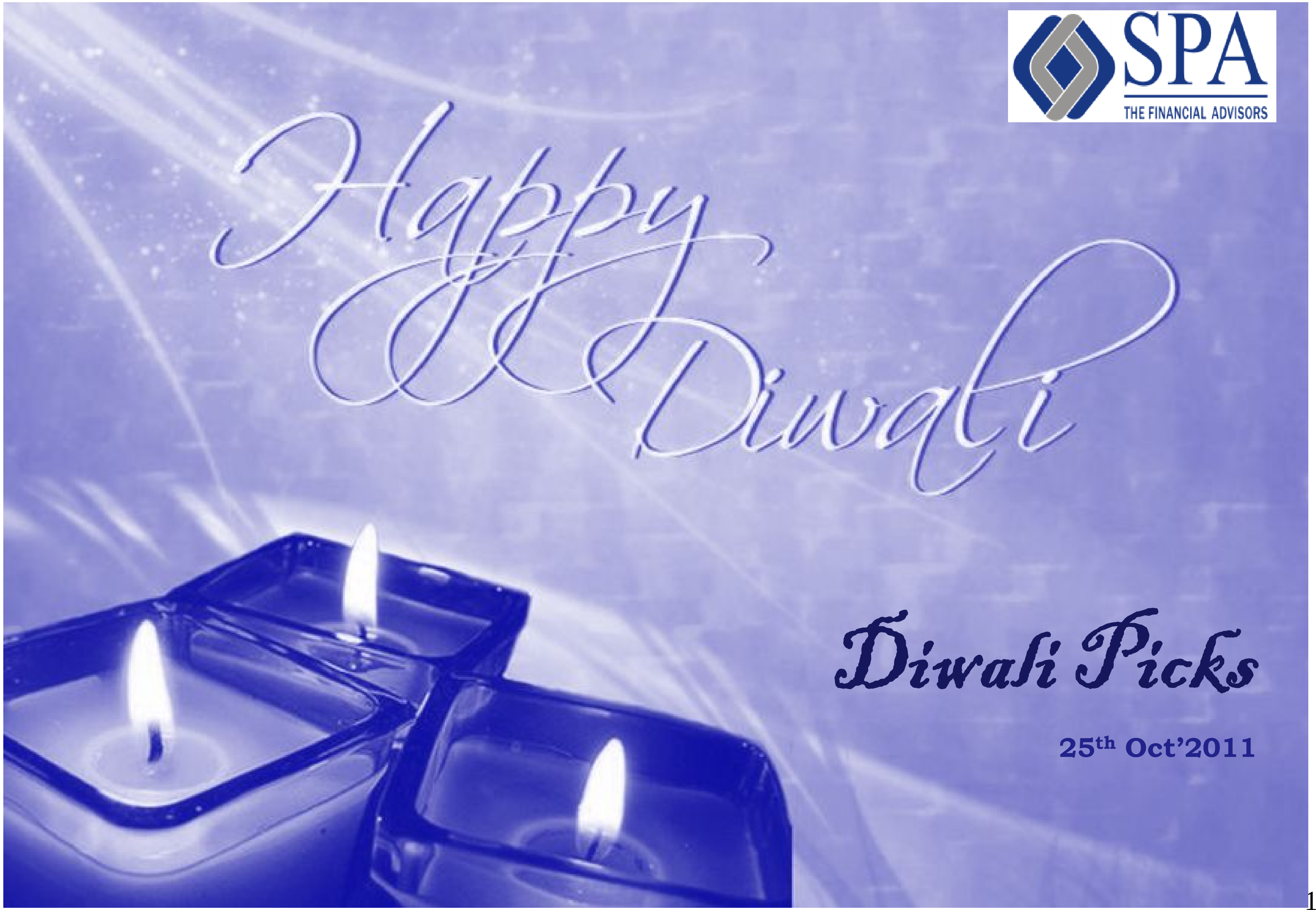


# Diwali Picks

**25th Oct'2011**

# *Now is the season of lights…*

*Things are on a lower pitch this Diwali - be it the economy, the stock market or just sentiment. However the big question now remains - is the worst over? It may be pre-mature to jump to any firm conclusion as yet. The direction of equities will hinge on the pace of global recovery and policy actions from Indian government.*

*Developed economies are doing all they can to breathe life into their subdued economies. However they are still far from any major recovery. Thing to be watched is - will the lowering of global growth expectations become tailwinds for the Indian Equity market, from current levels?*

*We believe the risks are more on the upside, than the downside. Global jitters withstanding, Nifty at 5100 levels is trading at 18x its TTM EPS, which is at a discount to its long term average. Earnings are expected to grow at ~15% CAGR over the next two years.*

*India as an economy and market has had its share of worries for a while now. This has been a combination of a) structurally high inflation and the ensuing rise in interest rates and tight monetary stance by the RBI, b) Risks to economic and earnings growth and c) Policy and execution paralysis at the governmental level.*

*However we believe each of these concerns could now be near to its peak: a) Inflation should ease with lower Oil/Commodity prices; Interest rates are at a higher end of the cycle and RBI's tight monetary stance should ease; b) Earnings and GDP growth downgrades are already done, c) off late government has been acting proactively and visible actions are under way. Moreover lower global growth and declining commodity prices will act as a blessing in disguise for the Indian Market.*

*While the market may correct in the short-term, outlook for the long term continues to remain optimistic. Even though the aftermath of the global crisis is still with us, we believe that India will continue to remain a favoured investment destination due to its sheer potential.*

*In this report, we at SPA Securities have presented a bouquet of seventeen stocks with a minimum 1-2 year horizon, which will reap good results going forward.*

*We would like to wish all of you a very "Happy Diwali and a prosperous New Year filled with peace, success, happiness and wealth". We hope it also brings cheer to the markets.*

# Bajaj Electricals CMP: INR 195 Target: INR 231

**Bajaj Electricals Ltd (BJE) is a 72 year old company with diversified business interest in consumer durables, lighting and engineering & projects (E&P). Company is a dominant player in small appliances, second largest player in luminaire and third largest in fans. The company has been growing strongly at a CAGR of 26% in last four years backed by robust growth in consumer segment and steady growth in other divisions.**

## Key Data

| | |
|---|---|
| BSE Code | 500031 |
| Bloomberg Code | BJE IN |
| Reuters Code | BJEL.BO |
| Shares Outstanding (mn) | 99.5 |
| Face Value | 2 |
| Mcap (INR bn) | 19.4 |
| 52 Week H/L | 332/160 |
| 2W Avg. Vol, BSE | 32,527 |
| Free Float (INR bn) | 7.71 |
| Beta | 0.61 |

| Shareholding (%) | Jun-11 |
|---|---|
| Promoters | 64.78% |
| FIIs | 9.04% |
| DIIS | 11.2% |
| Others | 14.98% |

## Key Investment Rationales

**Consumer Segment-Strong and steady:** Consumer segment which consists of Small Appliances & Fans business units (BUs) has been growing strongly at a 4 year CAGR of 30%. The segment recorded sales of INR 12,768.6mn & contributed ~47% to FY11 revenues. Strong demand generated from high disposable income complemented by company's strong distribution reach, new products and preference for branded products would lead consumer segment to grow at a 2 year CAGR of 22.3% to INR 19,104.2mn by FY13E.

**Margins to expand:** Among the 3 segments, consumer segment is the fastest growing segment with EBIDTA margins at 10-12% which is higher than 6- 7% for lighting & 9-10% for E&P. The share of consumer segment to total revenues is expected to increase from 46.6% in FY11 to 49.4% by FY13E. This along with recent fall in key raw materials like copper and aluminum would led to expansion in margins from 9.4% in FY11 to 9.7% in FY13E.

**Reducing quarterly volatility in E&P:** E&P division has grown at a 4 year CAGR of 26% to INR 8,314.2mn in FY11 on back of strong order inflows due to massive investment in power sector. Management is expected to cut down average number of projects at a time from current 60 to 30-35 projects thus re-aligning the business for effective monitoring, time bound completion of projects and therefore reducing the quarterly volatility in revenues.

**Strong competitive strength:** BJE has a strong distribution network with over 1,000 distributors, 4,000 authorised dealers, more than 450,000 retail outlets and 282 customer care centers across India. This ensures wider penetration and better after sales services to the consumers and hence providing it an edge over Chinese and other players. Company leverages its strong distribution network to market premium brand products of international brands like Morphy Richards, Walt Disney & Trilux.

| Y/E March (INR mn) | FY10 | FY11 | FY12E | FY13E |
|---|---|---|---|---|
| Net Sales | 22,286 | 27,407 | 32,476 | 38,681 |
| *Growth (%)* | *26.22%* | *22.98%* | *18.49%* | *19.11%* |
| EBIDTA | 2,427 | 2,580 | 3,140 | 3,767 |
| *EBIDTAM (%)* | *10.89%* | *9.41%* | *9.56%* | *9.74%* |
| Adj. PAT | 1,222 | 1,415 | 1,703 | 2,117 |
| *Growth (%)* | *36.72%* | *15.88%* | *20.32%* | *24.28%* |
| Adj. EPS (INR) | 12.52 | 14.32 | 17.06 | 20.96 |
| P/E (x) | 17.69 | 16.93 | 11.43 | 9.30 |

## Valuation & Outlook

BJE is expected to report revenue and profit CAGR of 18.8% and 22.3% respectively in next two years backed by strong growth in consumer and steady growth in other segments. Strong brand, wide distribution reach and good products offering by the company have been complementing the high consumption demand resulting in strong growth. **Based on increasing share of consumer segment, higher cash flows and strong growth prospects, we value the company at 11x FY13E EPS and arrive at a target price of INR 231.**

# eClerx CMP: INR 731 Target: INR 910

**eClerx Services Limited (ESL) is a niche player in the back-to-mid office service offerings in the Finance and Sales & Marketing verticals. The company has reported revenue of $76mn in FY11, growing at a revenue CAGR of more the 45% and a profit CAGR of 32% over the last four years. Its EBIT Margins are the highest among its peers at 30%+. We expect the company to grow at 26% CAGR FY11-13E based on its strong market positioning, niche knowledge domain and expanding earning opportunities**

| Key Data | |
|---|---|
| BSE Code | 532927.0 |
| NSE Code | ECLERX |
| Bloomberg Code | ECLX IN |
| Reuters Code | ECLE.NS |
| No.of Shares,mn | 29.0 |
| Face Value | 10.0 |
| Mcap, INR mn | 21,19.2 |
| 52 week H/L | 874.0 / 580.0 |
| 2 Week Avg. Qty. BSE | 12,000 |
| Free Float | 45.16% |
| Beta | 0.50 |

| Shareholding-Sep'11 | % Holding |
|---|---|
| Promoter | 54.8 |
| FIIs | 24.5 |
| DIIs | 9.5 |
| Others | 11.2 |

## Key Investment Rationales

**Niche Positioning:** The Company provides a niche set of services in the Financial Services and Sales & Marketing verticals. Its target services hover around end-to-end transaction processing in BFSI vertical and web based services, a fast growing segment with Web 2.0 and e-commerce/e-distribution channels.

**Strong Top/Mid management:** ESL ramped up its top/mid management from 150 in FY09 to 280 in FY11. It has hired 25 highly experienced professionals in its sales team to strengthen its top-mid level. These professionals have extensive domain knowledge as they are hired from various client or client-competitor companies. With this the company is able to explore revenue opportunities not only with new clients but also cross-selling into existing clients. Its Top 5 client revenue has grown at a LTM-CAGR of 46%.

**Future growth prospects:** ESL currently has over 200 client engagements; majority of which comes from its Top 5 clients. With over 45 clients, 28 of which are Fortune 500 companies, ESL has considerable head room to extend these services to its next 6-20 clients, which in the 2QFY12 have grown faster than the top-5 clients. We believe this would enable the company to clock a revenue target of $110mn by FY13E.

**Strong Financials:** ESL has shown a revenue CAGR of 45% FY08-11 much ahead of its peers. Its mid-30's EBIT Margins are unmatched. The company has a 90% offshoring model, almost 80% of which is annuity based. The company is debt free and has Cash to the tune of Rs. 1.2bn, which will help it in its inorganic growth plans. Thus, it is better placed than most of its peers.

| YE Mar (INR Mn) | FY10 | FY11 | FY12E | FY13E |
|---|---|---|---|---|
| Revenue | 2,570.2 | 3,421.0 | 4,378.9 | 5,473.6 |
| *Growth %* | *30.3%* | *33.1%* | *28.0%* | *25.0%* |
| EBIDTA | 843.9 | 1,346.0 | 1,680.2 | 2,171.9 |
| Net Income | 735.3 | 1,224.8 | 1,600.8 | 1,795.0 |
| Adj. EPS | 37.1 | 40.7 | 54.1 | 60.7 |
| *Growth %* | *14.3%* | *50.7%* | *33.0%* | *12.1%* |
| P/E | 19.67 | 17.95 | 13.50 | 12.04 |
| ROE | 40.2% | 55.9% | 59.4% | 51.4% |
| PEG | 1.38 | 0.35 | 0.41 | 0.99 |
| EV/EBIDTA | 16.6 | 14.9 | 11.8 | 8.9 |

## Valuation & Outlook

eClerx has consistently performed well and have grown at c.8.8%. CQGR for the last 10 quarters with stable margin performance. We expect this performance to continue due to 7.4% growth outlook in Indian KPO market (NASSCOM) and lack of niche offshore competition. We expect the company to report FY11-13E CAGR of 26.5%/27%/22.1% in terms of INR revenue/EBIDTA/EPS. The possible risk to our estimate is the inorganic growth route company is planning to pursue and INR depreciation. The company is aggressively pursuing 2-3 deals in the USD 10-25mn category. **We thus continue to recommend a BUY on the stock with a price of INR 910 based on 15x FY13E earnings of INR 60.7**

THE FINANCIAL ADVISORS

# Escorts CMP: INR 81 Target: INR 170

**Escorts is among India's leading agri machinery companies with 13% market share in tractors placing it at a number 3 position in India. It is also present in construction & material handling equipment, railway equipment and auto components businesses. The tractor business is the mainstay for the company accounting for 74% of consolidated revenues.**

| Key Data | |
|---|---|
| BSE Code | 500495 |
| NSE Symbol | ESCORTS |
| Bloomberg Code | ESC IN |
| Reuters Code | ESCO.BO |
| Shares Outstanding (mn) | 105.61 |
| Face Value | 10 |
| Mcap (INR bn) | 8.58 |
| 52 Week H/L | 245.9/63.6 |
| 2W Avg. Vol, NSE ('000) | 1659 |
| Free Float (INR bn) | 6.28 |
| Beta | 1.55 |

| Shareholding (%) | Jun-11 |
|---|---|
| Promoters | 26.77% |
| FIIs | 29.66% |
| DIIs | 15.85% |
| Others | 27.72% |

| Y/E March (INR mn) | FY10 | FY11E | FY12E | FY13E |
|---|---|---|---|---|
| Net Sales | 33515 | 40597 | 45803 | 49925 |
| Growth (%) | 27.28% | 21.13% | 12.82% | 9.00% |
| EBIDTA | 2132 | 2273 | 3160 | 3844 |
| EBIDTAM (%) | 6.36% | 5.60% | 6.90% | 7.70% |
| Adj. PAT | 1263 | 1232 | 1724 | 2242 |
| *Growth (%)* | 121.16% | -2.44% | 39.94% | 30.05% |
| Adj. EPS (INR) | 11.96 | 11.67 | 16.32 | 21.23 |
| P/E (x) | 18.04 | 6.96 | 4.98 | 3.83 |

## Key Investment Rationales

**Signed an agreement with Ingeteam Traction:** It has signed an exclusive agreement with Spanish firm "Ingeteam Traction" to provide traction systems to Indian Railways. Ingeteam Traction designs and supplies complete traction, control and auxiliary systems for trams, EMUs, locomotives and high-speed trains. The agreement with Ingeteam enables Escorts to foray in the niche domain of rail traction systems. Ingeteam is a market leader specializing in electrical engineering and serves key sectors like rail traction, marine.

**Agri-machinery business (74% revenue contribution):** Demand momentum in tractors is expected to be continued, led by strong rural economy and rising demand from non-agri sectors. It is looking to gain market share in the coming years led by new innovative product launches, improving its presence in South India and ramping up its sales force. The company has increased its market share in 13 of the 19 regions in which it operates and more particularly in South India (from 2.6% to ~5.5%). It has launched 4-5 variants over the past few quarters including a new series of high end tractors called 'Jai Kisan' in March 2011. Revenue in this segment is expected to grow at a CAGR of 14% over FY10-FY13E (Sept. year ending).

**Construction Equipment business (17% of revenues):** Escorts Construction Equipment (ECEL), the company's wholly owned subsidiary, has built its leadership in the niche segment of Pick 'n' carry cranes having market share of ~50%. ECEL is now focusing on front/backend loaders and with recent launch of newer products, we expect it to achieve significant scale, via 16% revenue CAGR over FY10-13E period and double EBITDA margin to 6%.

**Balance sheet no longer a concern:** Escorts has restructured its entire business by divesting its stake in all its loss making businesses (telecom, healthcare, etc.) and using the proceeds to repay the huge debt accumulated for the same thereby deleveraging its balance sheet. Its consolidated debt has reduced from INR 15420 mn in FY03 to INR 4050 mn in FY10. Escorts is expected to become net cash positive by FY12E.

## Valuation & Outlook

Escorts is the third largest tractor company in India. We expect the company to improve its core tractor business significantly on account of strong demand and improving utilization. We also believe its secondary operations (railway equipment, auto parts) will be less of a drag, and that its construction equipment division will unlock value over the longer term. We expect Escorts to gain market share over the next two years led by innovative product launches, improving presence in South India and reinforcing its sales force. **We recommend a "BUY" with a target Price of INR 170 in 18 months, at 8x FY13E earnings, implying an upside potential of ~ 106.6%.**

SPA THE FINANCIAL ADVISORS

# Hindustan Zinc CMP: INR 121 Target: INR 134

**Hindustan Zinc is India's largest zinc-lead producer and exporter accounting for more than 80% of the country's supply. The company is also among the world's lowest cost producers because of its integrated operations. HZ is ramping up its silver production to expand its bottomline. We believe bottoming of zinc-lead prices and increasing silver prices augur well for the company. MMDR bill will drag the company's financials if it is passed in its current form.**

## Key Data

| | |
|---|---|
| BSE Code | 500188 |
| NSE Code | HINDZINC |
| Bloomberg Code | HZ IN |
| Reuters Code | HZNC.BO |
| Shares Outstanding (mn) | 4,225.32 |
| Face Value | 2.00 |
| Mcap (INR mn) | 512,531 |
| 52 Week H/L | 155.25/108.62 |
| 2W Avg. Qty, BSE/ NSE | 182,429 |
| Free Float (%) | 35.08 |
| Beta | 0.95 |

| Shareholding (%) | Sep-11 |
|---|---|
| Promoters | 64.92 |
| FIIs | 1.31 |
| DIIs | 1.76 |
| Others | 32.01 |

| Y/E March (INR mn) | FY10 | FY11 | FY12E | FY13E |
|---|---|---|---|---|
| Net Sales | 80,170 | 99,121 | 119,087 | 133,690 |
| EBIDTA | 46,701 | 54,859 | 58,331 | 67,329 |
| EBIDTAM | *58.25%* | *55.35%* | *48.98%* | *50.36%* |
| Adj. PAT | 40,414 | 49,005 | 52,520 | 59,641 |
| *Growth (%)* | *48.17%* | *21.26%* | *7.17%* | *13.56%* |
| Adj. EPS (INR) | 9.56 | 11.60 | 12.41 | 14.12 |
| P/E (x) | 12.69 | 10.46 | 9.77 | 8.59 |

## Key Investment Rationales

**Largest producer and exporter in India:** HZ is the largest integrated producer and exporter of zinc and lead in India, accounting for more than 80% of the domestic share. The company is also one of the lowest cost producers of zinc and lead in the world, with an average cost of production at INR 50,200/t (USD 1,110/t) in FY11. HZ's Rampura Agucha Mine (contributing c.75% of total zinc production) is the largest opencast low cost producing mine.

**Silver business driving EBIDTA:** HZ is expanding its silver capacity to 500tpa by FY13. During this period the silver output will increase to 400t from 148t in FY11, on the back of ramping up production in the silver rich Sindesar Khurd mine. Sale of silver metal directly adds up to the company's EBIDTA as it is a byproduct of zinc-lead smelting.

**Zinc-Lead prices bottomed out:** Zinc-Lead prices have fallen by c.22% YTD to USD 1,925/t and USD 2,061/t respectively on the back of concerns in the global economy. We expect downside in zinc prices to be limited as below USD 1,800-2,000/t, China (c.40% of global zinc production) will have to cut back its production as rising inflation, lower grades and power costs will make it unfeasible to produce more zinc. Zinc also has a favourable demand-supply scenario over long term as China is set to increase its galvanizing capacities. We expect lead demand to outpace supply on the back of lower planned capacities and closure of old mines.

**Cash Rich company:** As on 1HFY12, the company has cash reserves of INR 59,698mn (INR 14/share) apart from investments worth INR 103,262mn . The company is contemplating to utilize these reserves for organic and inorganic growth.

## Valuation & Outlook

Favourable zinc-lead demand-supply scenario augurs well for the company. HZ being the lowest cost producer is also relatively insulated from the fall in global zinc-lead prices. Increase in production of silver will help expand the bottomline of the company. MMDR Bill if passed on an as-is basis will hamper the company’s EPS by 11.81% in FY12E and by 11.69% in FY13E to INR 12.41 and INR 14.12 respectively. **At the CMP of INR 121.30, the stock is available at a P/E multiple of 8.59x based on post MMDR FY13E EPS of INR 14.12. We expect Hindustan Zinc to outperform and arrive at a target price of INR 134.00 based on P/E multiple of 9.50x.**

**ICICI Bank is second-largest bank in India and the largest private bank. With a network of 2,533 branches and a presence in 19 countries it offers a wide range of banking products and financial services to corporate and retail customers. ICICI has various areas of business presence across investment banking, life and non-life insurance, venture capital and asset management.**

| Key Data | |
|---|---|
| BSE Code | 532174 |
| NSE Code | ICICIBANK |
| Bloomberg Code | ICICIBC IN |
| Reuters Code | ICBK.BO |
| No of Shares (Mn.) | 1152.4 |
| Face Value | 10 |
| Mcap (INR Bn.) | 1001.8 |
| 52 week H/L | 1277/762 |
| 2 week Avg Qty NSE | 3,196,570 |
| CMP (INR) | 869.3 |

| Shareholding (%) | Jun-11 |
|---|---|
| Promoters | 0% |
| FIIs | 38.17% |
| DIIS | 25.24% |
| Others | 36.59% |

## Key Investment Rationales

**Stable Balance Sheet to anchor growth:** ICICI has consciously consolidated on its liability as well as asset mix last two years and now has a cleaner and leaner balance sheet to take care of its growing business. ICICI has reduced its retail portfolio and has de-grown by 11.5% CAGR while a growing focus to improve Corporate portfolio – a + CAGR growth of ~33%. With a higher focus on core fee income and corporate mix improving in total liability profile, we expect ICICI's NIMs to improve to 2.7% in FY13E. A healthy CAR of 19% + will support the growth of this bank over next 2 years without the need of any fresh infusion.

**Cautious Bad Loan recovery – improved asset quality:** ICICI has been patient in recovering its sticky loans over past two years and also shedding off its severe pain point assets i.e. retail assets. Improved delinquencies has lead to better asset quality – it reported GNPA & NNPAS of 3.89% and 0.91% in Q1FY12, as compared to 4.64% and 0.94% as on FY11. We expect the asset quality to remain stable in this range over next 2 years.

**Improved Liability Profile:** ICICI had embarked on a branch expansion plan with a target to improve its CASA base that was fledgling at 27% in FY07. Currently, the CASA stands at 40% in Q1FY12 and has hugely benefitted ICICI with an improved margin profile as well as a stable liability profile. With interest rates likely to remain high for sometime now, we believe a higher base CASA will be much more than helpful in anchoring its profitability as well as net margins.

**Paced up for growth:** ICICI had registered as growth of 19.4% and 11.7% growth in its total advances and deposits in FY11, much lower than industry average, however on the base of improved profile. IN Q1FY12, it registered a healthy growth of 19.7% and 14.8% in its total advances and deposits on the back of its continued 5C strategy for growth. We expect a CAGR growth of 18% and 17% respectively in its total advances and deposits over FY13E.

| Y/E March (INR mn) | FY10 | FY11 | FY12E | FY13E |
|---|---|---|---|---|
| NII | 81,144 | 90,169 | 103,772 | 119,443 |
| *Growth (%)* | *-3.0%* | *11.1%* | *15.1%* | *15.1%* |
| Operating Expenses | 58,598 | 66,172 | 75,696 | 86,273 |
| PAT | 40,250 | 51,514 | 60,178 | 72,166 |
| *Growth (%)* | *7.1%* | *28.0%* | *16.8%* | *27.1%* |
| ABV (INR) | 386.0 | 399.0 | 437.5 | 481.0 |
| P/ABV (x) | 2.3 | 2.2 | 2.0 | 1.8 |
| RoA (%) | 8.0% | 9.7% | 10.5% | 11.6% |

## Valuation & Outlook

With a better mix of balance sheet and a robust CAR, ICICI is set for a steady growth over next 2 years. At CMP, it trades at 1.8x its FY13E ABV of INR 481. With a good business blend of standalone business as well as subsidiaries, we value ICICI Banks on a SOTP methodology. The cumulative value of subsidiaries i.e. Broking, Investment Banking, Life Insurance, general insurance, home finance as well as AMC is INR 272. **We value the standalone business at 1.9x FY13E ABV giving a target price of INR 1186, an upside of ~26%.**

**IMFA** **CMP: INR 220** **Target: INR 424**

**IMFA, India's largest backward integrated ferro chrome producer is currently struggling with high power generation costs and awaiting the environmental nod for its coal mine from the ministry. JV with Posco and timely commissioning of its coal block will drive the topline and bottomline going forward.**

| Key Data | |
|---|---|
| BSE Code | 533047 |
| NSE Code | IMFA |
| Bloomberg Code | IMFA IN |
| Reuters Code | IMFA.BO |
| Shares Outstanding (mn) | 25 |
| Face Value | 10 |
| Mcap (INR bn) | 8.31 |
| 52 Week H/L | 830/278 |
| 2W Avg. Qty, BSE/ NSE | 69381 |
| Free Float (%) | 36.79 |
| Beta | 0.68 |

| Shareholding (%) | Aug-11 |
|---|---|
| Promoters | 55.72 |
| FIIs | 0.10 |
| DIIs | 11.14 |
| Others | 33.04 |

| Y/E March (INR mn) | FY10 | FY11 | FY12E | FY13E |
|---|---|---|---|---|
| Net Sales | 5,926 | 10,405 | 12,300 | 15,086 |
| EBIDTA | 1,126 | 3,120 | 1,515 | 3,668 |
| EBIDTAM | *18.99%* | *29.99%* | 12.32% | 24.31% |
| Adj. PAT | 410 | 1,654 | 769 | 2,755 |
| *Growth (%)* | *-84.27%* | *303.40%* | -53.50% | 258.17% |
| Adj. EPS (INR) | 15.58 | 62.84 | 29.61 | 106.07 |
| P/E (x) | 20.54 | 5.09 | 10.80 | 3.02 |

## Key Investment Rationales

**Utkal Coal Block - the key trigger :** Utkal C coal block with recorded reserves of 196mnt has been allotted to IMFA's subsidiary Utkal Coal Ltd. The company has received Stage I clearance and has completed the formalities for Stage II clearance. The management is expecting the Stage II clearance will be received by this fiscal. The production in first year is expected to be 1.2mntpa and the company has the approval to ramp it up to 3.6mntpa. With the commissioning of capitive coal mine, the power costs are expected to be INR ~2.5/unit, which will expand the EBITDA margins by 15 percentage points over FY13-14.

**JV with Posco by next quarter:** IMFA has entered into JV with Posco in the ratio of 76:24. The existing furnace with capacity of 35,000t will be bought by Posco and will be leased back to IMFA. As per the agreement, Posco will buy the entire production of ferro chrome from the furnace for 25 years, of which the prices would be fixed quarterly.

**Indonesia coal mine acquisition:** IMFA through its step down subsidiary in Singapore has acquired 70% stake in an Indonesian coal block for USD 8.75mn and invested an additional USD 2mn in the current quarter. This block is expected to be commissioned by FY14. IMFA aims to use this coal block to for coal trading activities and secure its fuel supplies. The company is expected to infuse more funds on completion of its detailed assessment of the mine.

**Power Plans:** The company is also working on another 120MW thermal power plant which is expected to be commissioned by the end of 4QFY12. Of the 120MW, 60MW is expected to be utilized for captive consumption and the remaining 60MW would be for sale on merchant basis. For the next phase of growth, IMFA has plans to setup 1,320MW (2x660MW) power plant in Orissa with an investment of INR 66bn. This project is expected to be commissioned over next 3-4 years.

## Valuation & Outlook

Rising coal costs are the major dampener on the company's financials, as the power costs have shot up by more than 35% over the past two-three quarters. IMFA's captive coal mine is the key trigger, as sourcing coal from the mine will lead to huge cost savings and margin expansion. Further, JV with Posco will further guarantee higher off-take leading to topline growth. Any delays in acquiring coal block will prove to be an upside risk to our estimates. **At the CMP of INR 319.95, the stock is trading at P/E multiple of 3.02x based on FY13E EPS of INR 106.07. We recommend Buy with a target price of INR 424.**

# Mcnally Bharat CMP: INR119 Target : INR 210

**McNally Bharat Eng. Co. Ltd. is India's leading EPC player engaged in providing turnkey solutions to host of different sectors like Power, Steel, Aluminium, Material Handling, Mineral Processing etc and has technical collaborations with some of the world's leading firms for each of its activities. MBE manufactures a wide range of products required for its various projects through its subsidiary company McNally Sayaji (87% stake), to whom it provides the requisite technology and design to manufacture the products. MBE through its subsidiary MBE Mineral Technology Pte Ltd, acquired the Coal & Mineral Technology division of KHD Humboldt Wedag, a global leader in coal and mineral processing in 2009. MBE also has a third subsidiary EWB, Hungary.**

## Key Data

| Key Data | |
|---|---|
| BSE Code | 532629 |
| NSE Code | MBECL |
| Bloomberg Code | MCNA IN |
| Reuters Code | MCNL.BO |
| Shares Outstanding (mn) | 31.09 |
| Face Value | 10 |
| Mcap (INR bn) | 3.71 |
| 52 Week H/L | 274/110 |
| 2W Avg. Qty, NSE | 2299 |
| Free Float (INR bn) | 2.51 |
| Beta | 0.81 |

| Shareholding (%) | Sep-11 |
|---|---|
| Promoters | 32.28 |
| FIIs | 16.41 |
| DIIS | 14.25 |
| Others | 37.07 |

| Y/E March (INR mn) | FY10 | FY11 | FY12E | FY13E |
|---|---|---|---|---|
| Net Sales | 18055 | 22434 | 24685 | 26310 |
| *Growth (%)* | 61.94% | 24.25% | 10.04% | 6.58% |
| EBIDTA | 1584 | 1763 | 1958 | 2089 |
| EBIDTAM (%) | 8.77% | 7.86% | *7.93%* | *7.94%* |
| Adj. PAT | 567 | 673 | 765 | 816 |
| *Growth (%)* | 6.54% | 18.73% | 13.76% | 6.58% |
| Adj. EPS (INR) | 15.92 | 20.38 | 24.61 | 26.23 |
| P/E (x) | 18.43 | 10.72 | 4.84 | 4.54 |

## Key Investment Rationales

**Strong order book position:** Mcnally bagged orders worth INR 5900 mn in Q1FY12. MBE has a strong standalone order book of INR 35000 mn as on June 2011 (1.9x revenues), which provides healthy revenue visibility. The order book of subsidiaries is ~INR 7000 mn. All the orders have in built price escalation clause.

**Shifting its focus from power sector:** Although MBE has a diversified order book, ~25% of its orders come from power sector, which is currently experiencing severe slowdown in ordering activity. Hence it is looking to focus on other sectors like MHE, Minerals, Metals etc. It has secured orders worth INR 580 mn in the newly formed Oil & Gas SBU and expects to bag its first order in its cement EPC business very soon.

**Over 600 bn worth of business opportunities:** MBE is expecting business opportunities of over INR 600 bn in coming 5 years on the back of robust economic environment. As of now MBE has bidded for projects worth ~INR 40 bn and is L1 in projects worth INR 7 bn. It has a strike rate of 45% and aims to close FY12 with an order backlog of INR 45 bn. On the consolidated basis it aims to close the year with an order backlog of INR 53 bn.

**Four dimensional growth model:** MBE has charted out a four dimensional growth strategy to maintain its growth momentum. The company is looking to 1) increase its customer base, 2) enter in new area in related space, 3) increase participation in value chain of customer and 4) expand its presence beyond geographical boundary. MBE indicated that longer term growth will be driven by execution of larger projects in Power and Steel, expansion in international space and diversification into Civil Engineering.

**Targeting to more than double its revenue base:** MBE expects to register a consolidated top line of ~INR 27 bn in FY12 and operate at an operating margins of 8-9%. By FY15 MBE is targeting consolidated revenues of INR 50 bn & increase its margins to ~10%. Increasing presence in high margin business in Minerals, Mines, Cement EPC, Steel & Power will be the major growth drivers.

## Valuation & Outlook

MBE is best positioned to capitalise on the material handling equipment opportunities provided by various sectors of Indian economy especially in power, metal and ports. It has has been growing at a robust pace backed by its sound business strategy. We expect the company to maintain sustainable growth rate based on its healthy order book position and considering the expected investments in its participating sectors of activity. **We have valued MBE at a PE of 8x on FY12E EPS to arrive at a target price of INR 210, which provides an upside of 76% at current levels. We therefore recommend a "BUY" on the stock.**

SPA THE FINANCIAL ADVISORS

# ONGC CMP: INR 275 Target: INR 328

**ONGC, a Fortune 500 company, is India's largest E&P Company with ~7.0Bn boe of oil and gas reserves. It currently accounts for more than 80% of India's current oil and gas production. ONGC has a portfolio of 164 blocks out of which 85 blocks were awarded under NELP among which 53 are in exploration phase. Through its 100% subsidiary ONGC Videsh Limited (OVL), it has overseas investments in E&P blocks in 16 countries. It has also Downstream presence through its subsidiary (71.6% stake), MRPL.**

## Key Data

| | |
|---|---|
| BSE Code | 500312 |
| NSE Code | ONGC |
| Bloomberg Code | ONGC IN |
| Reuters Code | ONGC.BO |
| Shares Outstanding (mn) | 8555 |
| Face Value | 5 |
| Mcap (INR bn) | 2363.45 |
| 52 Week H/L | 349/248 |
| 2W Avg. Qty, BSE/ NSE | 2465992 |
| Free Float (INR bn) | 612 |
| Beta | 0.56 |

| Shareholding (%) | Sep-11 |
|---|---|
| Promoters | 74.14 |
| FIIs | 5.17 |
| DIIS | 6.99 |
| Others | 13.70 |

| Y/E March (INR mn) | FY10 | FY11 | FY12E | FY13E |
|---|---|---|---|---|
| Net Sales | 1034389 | 1219293 | 1412432 | 1528928 |
| *Growth (%)* | *-1.73%* | *17.88%* | *15.84%* | *8.25%* |
| EBIDTA | 461177 | 527551 | 662275 | 735819 |
| EBIDTAM (%) | 45.32% | 44.86% | 48.52% | 49.83% |
| Adj. PAT | 194035 | 224560 | 287305 | 305997 |
| *Growth (%)* | *-1.88%* | *15.73%* | *27.94%* | *6.51%* |
| Adj. EPS (INR) | 22.68 | 26.25 | 33.58 | 35.77 |
| P/E (x) | 5.09 | 8.4 | 8.19 | 7.69 |

## Key Investment Rationales

**OVL and Marginal fields to drive volume growth:** With the implementation of Improved/Enhanced Oil Recovery (IOR/ EOR) programme, ONGC has successfully curtailed the production drop in its own maturing fields. We expect monetization of the marginal fields to add about 8%-10% i.e. 5 mmtoe of production from FY14E. The management expects OVL's production to remain flat in FY12 and increase from 9.45 mmtoe in FY11 to 13.4 mmtoe by FY14E with increasing production from Brazil and Columbia.

**Plans to maintain RRR at more than 1.5x:** ONGC's current reserve replacement ratio of 1.76 is favorably compared against global range of 0.9-1.39x. The company is likely to maintain RRR of more than 1.5 going forward. ONGC has reserve life index of ~23 years based on 1P and ~15 years based on 2P reserves which is significantly higher than the Global E&P Companies average Reserve life index of 20 years for 1P reserves and 10 years for 2P reserves.

**CMP discounting the worst case scenario:** After analysing net realization trend of ONGC under different scenarios it appears that CMP is discounting the worst case scenario of net realization US$ 32.5/bbl and upstream sharing at 50% of total under recoveries.

**ONGC's Net realization cap increased to US$ 68.5 /bbl:** Assuming upstream to share 38.5% of the total under recoveries and no further hike in retail price, ONGC's net crude realisation would be capped at US$ 68.5/bbl which was US$ 60/bbl pre Govt. reforms in June 2011. We estimate post-subsidy realization for ONGC would be US$ 61.7/bbl and US$ 66.9/bbl respectively in FY12E & FY13E respectively against US$54/bbl in FY11 .

**CCEA approved royalty on Rajasthan Block to be cost recoverable:** CCEA has finally approved the royalty on Rajasthan block to be cost recoverable and also agreed ONGC's royalty to cap up to 30% of its participating interest in Rajasthan Block. This will have positive impact on EPS by ~INR 1.33 in FY12E and INR 1.76 in FY13E.

## Valuation & Outlook

ONGC's future outlook remains positive as domestic production is expected to increase from most of the existing JVs, IOR/ EOR gains, marginal field developments and probable transparent subsidy-sharing mechanism before FPO is likely to help ONGC's cash flows. Increasing overseas production is improving overall realization as oil prices are likely to stay robust. Hence **we recommend BUY on ONGC with a target price of INR 328 per share which implies a P/E multiple of 9.7x of FY13E earnings and 1.9x FY13E book value. Our price objective is on the basis of average of the target price based on 5.5x EV/BOE of 2P reserves and 3.8x EV/EBIDTA approach.**

# Persistent Systems CMP: INR 317 Target – INR 403

SPA THE FINANCIAL ADVISORS

**Persistent Systems is a leading Indian IT services vendor in the niche domain of Outsourcing Product Development. It is also one of the few companies that were first to venture into four new verticals of Cloud, Mobility, Collaboration and Analytics which are high growth verticals (CAGR of 30%+ since FY07-11) and have high margins than the ADM businesses.**

| Key Data | |
|---|---|
| BSE | 533179 |
| NSE | PERSISTENT |
| Bloomberg Code | PSYS IN |
| Reuters Code | PERS.BO |
| No.of Shares,mn | 40.0 |
| Face Value | 10.0 |
| Mcap, INR mn | 12,672.0 |
| 52 week H/L | 467.2 / 280.8 |
| 2 Week Avg. Qty. BSE | 11,200 |
| Free Float | 61.05% |
| Beta | 0.74 |

| Shareholding - Sep '11 | % Holding |
|---|---|
| Promoter | 39.0 |
| FIIs | 5.7 |
| DIIs | 26.5 |
| Others | 28.9 |

## Key Investment Rationales

**R&D spending in OPD increasing.** The OPD segment is growing at a rate of 16.7% CAGR to be a $65.7bn industry by 2014. Within this the offshoring segment is growing at faster pace of 19.1% CAGR to $ 16.1bn. India taps only c.3% of the overall USD 40bn market thus presenting huge opportunity for the Indian OPD players.

**Moving up the value chain:** PSYS has successfully transformed from a “cost-benefit” player to “faster-turn-around-time” to “design-excellence” team. Persistent has established its market by capturing marquee clients in the Software Development segment.

**Focus on growth verticals:** The company has taken a lead into providing services to clients in the high growth segments such as BI/Analytics, Cloud Computing, Enterprise Mobility and Collaboration and moving quickly to capture this market. It is presently a nascent margin with more than 30% growth and 20%+ margins on offer.

**IP Business – Margin and Growth Lever:** The company has invested heavily (5.5% of its available technical time) into IP business and is seeing good deal pipeline from (i) Connector Royalties from top client (Top client contribution increased from 15.1% to 16% QoQ) (ii) IPs such as PaxPro, Klisma and eMee which are ready to be shipped are seeing good traction in the market.

| Y/E March (INR mn) | FY10 | FY11 | FY12E | FY13E |
|---|---|---|---|---|
| Net Sales | 6,012 | 7,758 | 9,617 | 11,920 |
| *Growth (%)* | *1.23%* | *29.06%* | *23.95%* | *23.95%* |
| EBIDTAM (%) | 24.35% | 20.40% | 22.00% | 22.50% |
| Adj. PAT | 1,150 | 1,397 | 1,306 | 1,612 |
| *Growth (%)* | *74.04%* | *21.48%* | *-6.51%* | *23.38%* |
| Adj. EPS (INR) | 32 | 35 | 33 | 40 |
| P/E (x) | 9.88 | 9.07 | 9.70 | 7.86 |
| EV/EBIDTA | 7.35 | 7.37 | 5.70 | 3.79 |
| Net Debt/Equity | (0.30) | (0.13) | (0.07) | (0.25) |
| RoIC (%) | 27.19% | 21.04% | 21.89% | 26.30% |
| RoCE (%) | 23.90% | 21.58% | 23.83% | 25.39% |

## Valuation & Outlook

The company should trades at a premium to Indian mid-tier peers due to high growth and quality of earnings. We expect this to continue. With limited competition and a strong client roster (IBM, Microsoft, Nokia, Samsung etc.) especially in the four focus verticals we expect a healthy 24%/30%/7.4% revenue/EBITDA/EPS CAGR over FY11-13E. EPS CAGR is lower due to higher tax outgo from FY12E. **We expect Persistent to trade at 10x multiple on our FY13E earnings of INR 40.3 to arrive at our target price of Rs. 403. Key risks to our estimates are rupee depreciation as it is already in a favorable position of c.49**

| PVR | CMP: INR 128 | Target : INR 143 |
|---|---|---|

PVR Ltd. is a leading Multiplex Cinema Exhibition company with growing presence across various verticals of lifestyle entertainment domain. The company has registered 37% growth in FY11 net operating income, led by growth in domestic market on the back of increased footfalls and higher average ticket prices. With the company deciding to concentrate more on distribution segment rather than movie production, we expect the growth momentum to continue.

| Key Data | |
|---|---|
| BSE Code | 532689 |
| Bloomberg Code | PVRL IN |
| Reuters Code | PVRL.BO |
| Shares Outstanding (mn) | 25.79 |
| Face Value | 10 |
| M.cap (INR mn) | 3295.59 |
| 52 Week H/L | 177/93 |
| 2W Avg. Vol, BSE | 18852 |
| Free Float (%) | 55.20 |
| Beta | 0.64 |

| Shareholding (%) | Sep-11 |
|---|---|
| Promoters | 44.80% |
| FIIs | 2.54% |
| DIIs | 18.09% |
| Others | 34.57% |

## Key Investment Rationales

**Derisked Business Model:** Presence across film entertainment and retail entertainment space, helps PVR to enjoy a derisked business model. The company is engaged in movie exhibition-production-distribution as well as operating bowling centres under retail entertainment space through PVR Blu-O. The company currently has 158 screens under operation with 2 bowling alleys operating at Gurgaon and Delhi.

**India's Film Industry - Set to grow ahead:** The Indian film industry worth INR 83bn in 2010, is estimated to achieve a 9% growth to touch ~INR 91bn in 2011-12 with an interesting line up of films. In the long term, the industry is projected to grow at the CAGR of 9.6% from 2010-2014, and reach the size of INR 132bn by 2014. Quality content and screen expansion are likely to be the key growth driver for the growth of Indian Film industry. PVR with its 158 screens and screen additionis best set to capture the growth in the industry.

**Focus on Exhibition - Production to Take Backstage:** The company has decided to concentrate more on distribution segment rather than movie production. The reason for this shift is to focus aggressively on the cinema exhibition business and go slow on the production business, which has been a drain on the company's revenues . The only upcoming movie produced by PVR in FY12 will be 'Shanghai', with a budget of INR 130mn and would release by Q4FY12.

**Capex Plans:** The company plans to add 55 screens in FY12, incurring a capex of INR 750-800mn. 16 screens have already been added this year, bringing the total number of screens to 158. PVR intends to add 74 new bowling lanes in FY12 (26 lanes already installed) and ~80 odd lanes in FY13.

**PVR Blu-O - Another Game Changer in Making:** PVR Blu-o consists of bowling alleys, karaoke centres and ice skating rinks. The company currently has 2 PVR Blu-o operatingin Gurgaon and Delhi with a total of 50 bowling lanes. PVR intendsto add 74 new lanes (26 already commissioned) across 3 centresby FY12E. We expect the Bowling revenues to grow at a two year CAGR of 117% to INR 291mn in FY13E.

| Y/E March (INR mn) | FY10 | FY11 | FY12E | FY13E |
|---|---|---|---|---|
| Net Sales | 3341 | 4573 | 5778 | 6874 |
| EBIDTA | 342 | 853 | 1208 | 1574 |
| EBIDTAM (%) | 10.25% | 18.66% | 20.90% | 22.90% |
| Adj. PAT | 14 | 82 | 152 | 218 |
| *Growth (%)* | -84.33% | 499.02% | 85.87% | 42.92% |
| Adj. EPS (INR) | 0.53 | 3.02 | 5.91 | 8.44 |
| Adj. P/E (x) | 239.57 | 42.37 | 21.65 | 15.15 |

## Valuation & Outlook

Due to company's aggressive stance on exhibition and bowling business, we maintain a positive view on the stock. Exhibition business especially will be the eye-catcher with stupendous performance on revenue and margins front, on account of increased screens and footfalls. **At the CMP of INR 127.9, PVR is trading at 21.65x and 15.15x per FY12E and FY13E earnings estimates. We assign a valuation multiple of 17x 1 yr forward PER to PVR and arrive at a target price of INR 143 with a BUY rating.**

# Rain Commodities CMP: INR 29 TARGET: INR 67

**Rain Commodities Ltd, the world's leading producer of CPC with a market share of 10% in the global CPC market, is expected to significantly benefit from the increasing demand for CPC and limited GPC availability. It has a total CPC capacity of 2.5 mn tn spread across US, India & China. The company has 4 waste heat recovery plants with a capacity of 125 MW and two integrated cement plants in AP with a capacity of 3.5 mn tn and sells its cement under the brand Priya Cement in South India.**

## Key Data

| | |
|---|---|
| BSE Code | 500339 |
| NSE Code | RAINCOM |
| Bloomberg Code | RCOL IN |
| Reuters Code | RACL.BO |
| Shares Outstanding (mn) | 354.18 |
| Face Value | 2 |
| Mcap (INR bn) | 10.34 |
| 52 Week H/L | 40/25 |
| 2W Avg. Qty, NSE | 219632 |
| Free Float (INR bn) | 5.95 |
| Beta | 0.92 |

| Shareholding (%) | Sep-11 |
|---|---|
| Promoters | 42.48 |
| FIIs | 16.35 |
| DIIs | 19.97 |
| Others | 23.21 |

| Y/E December (INR mn) | CY09 | CY10 | CY11E | CY12E |
|---|---|---|---|---|
| Net Sales | 36338 | 37455 | 55985 | 61784 |
| *Growth (%)* | *-18.43%* | *3.07%* | *49.47%* | *10.36%* |
| EBIDTA | 8980 | 7399 | 12174 | 12928 |
| EBIDTAM (%) | *24.71%* | *19.76%* | *21.75%* | *20.92%* |
| Adj. PAT | 4438 | 2407 | 6133 | 6439 |
| *Growth (%)* | *9.92%* | *-45.77%* | *154.79%* | *4.99%* |
| Adj. EPS (INR) | 12.53 | 6.80 | 17.32 | 18.18 |
| P/E (x) | 3.59 | 5.41 | 1.69 | 1.61 |

## Key Investment Rationales

**Aluminium industry to drive growth:** RCL being the world's largest CPC producer is expected to benefit enormously from robust demand in Aluminium industry, its primary end user. Aluminium production is expected to increase at a CAGR of ~7% to 59 mtpa by CY15, resulting in 7% CAGR in CPC demand to 28 mn ton.

**Secured supply of GPC:** Limited availability of GPC, a key raw material in the CPC industry, is a major entry barrier in CPC industry, which augurs well for the existing players like RCL. RCL has secured the supply of GPC by entering into long term contracts with refiners in USA. Its US plants are strategically located at North & Central America, where ~45% of the world's total refining capacities are located, thereby resulting in significant freight cost savings.

**CPC business trading at huge discount:** The company's CPC business is currently available at EV/ton of $ 248. This is at a huge discount to the latest acquisition done by Oxbow Carbon (~$ 900/ton) and is almost 24% lower than the price paid for CII acquisition ($325) and 36% lower than the price paid by Oxbow for GLC Carbon ($389) in 2007.

**Balance sheet deleveraging to improve return ratios:** RCL has restructured its debt and it plans to repay ~$160 mn during next three years (H2CY11 - $11 mn, CY12 - $26 mn and CY13 - $122 mn). The Net D/E ratio will decline from 2.0 in CY10 (HICY11: 1.6) to 1.0 by CY12, leading to improvement in return ratios.

**70 MW waste heat recovery power plant:** RCL is setting up 70 MW (35X2) WHRP in US at a cost of ~$125 mn. One plant of 35 MW is expected to be operational by Dec 12 and the other is expected to be operational in CY13. The project is eligible for government support in the form of tax breaks, capital grants and highest tariff. RCL is looking to charge a tariff of 6-8 cents and generate a combined operational profit of $ 22 mn from the plants.

**CPC business to drive growth:** We expect revenues to grow at a CAGR of 28% over CY10-12E led by 32% CAGR in CPC’s revenues aided by 6% CAGR in volumes coupled with significant improvement in realisations. Net Profit is expected to grow at a CAGR of 63% over the same period led by 117 bps improvement in EBIDTA margins.

## Valuation & Outlook

Increasing demand for aluminium, dominant presence in CPC market, supply agreement for GPC and limited GPC availability augurs well for RCL. Currently the stock trades at lucrative valuations at 1.6x P/E, 0.4x P/BV and 2.7x EV/EBIDTA its CY12E earnings.

**We have valued RCL using SOTP method, to arrive at a target price of INR 67 implying a potential upside of 131% over a period of 18 months. The CPC business has been valued based on 4x CY12E EV/EBIDTA, while the cement business has been valued at EV/ton of $60. We therefore recommend a "BUY" on the stock.**

# Ranbaxy labs  CMP: INR 505  Target: INR 578

**Ranbaxy, incorporated in 1961, is India's largest pharma company with presence in domestic, emerging, and regulated markets. The company has strong presence in the domestic market and ranks No. 2 as per IMS. Over the years it has build a well diversified model with presence in various international markets (including LATAM, Europe, Russia, Africa, Asia, US and Canada) which renders sustainable growth to overall business.**

| Key Data | |
|---|---|
| BSE Code | 500359 |
| NSE Code | RANBAXY |
| Bloomberg Code | RBXY IN |
| Reuters Code | RANB.BO |
| Shares Outstanding (mn) | 421 |
| Face Value | 5 |
| Mcap (INR bn) | 213.13 |
| 52 Week H/L | 624/414 |
| 2W Avg. Qty, NSE ('000) | 412.16 |
| Free Float (INR bn) | 77.26 |
| Beta | 0.73 |

| Shareholding (%) | Sep-11 |
|---|---|
| Promoters | 63.75 |
| FIIs | 8.86 |
| DIIS | 11.64 |
| Others | 15.75 |

## Key Investment Rationales

**Lipitor opportunity adds 10% upside to core earnings:** With Strong probability of generic Lipitor launch in November, we estimate incremental USD 350 mn sales from Lipitor launch, based on assumption of 35% market share and 50% price erosion during exclusivity period. Further, post exclusivity, we estimate incremental earnings of INR 1.6 per share to CY12E core EPS. Overall, the option value of Lipitor would be INR 64 per share (incl. recurring earnings).

**Upsides from positive FDA-DOJ resolution:** Ranbaxy management has been seeking a composite resolution of the FDA-DOJ issue. A resolution will definitely be positive for RBXY and enable it to cover lost ground in the US market. We estimate INR 74 per share value from positive FDA resolution. However, we build in USD 200 mn penalty costs based on 18% of US sales recognized from Ponta and Dewas over the three years before the import alert was imposed.

**To garner further opportunities:** We expect post positive resolution of the issue; it will bring some clarity on the monetization of its FTF pipeline along with other niche opportunities such as Penems (potential USD 50-60 mn revenue in the first year of launch) aiding Ranbaxy in launcjing launch these products in the US market.

**India back in focus:** Ranbaxy India's domestic formulation business has been reporting 7–8% growth rate, below the industry's average growth rate, from the past few years. In CY2010, Ranbaxy's domestic sales grew by 13%, contributing 24% to the company's total sales turnover. The company has now renewed its focus on one of the fastest-growing pharmaceutical markets by completely rolling out Project Viraat in 2010 with a view of establishing a leadership position in the next 2–3 years. Under the project, Ranbaxy increased its field force from 2,500 to 4,000 MRs in CY2010, launched new products and penetrated rural areas. Going forward, with this, the company plans to achieve 15–20% growth on the domestic front.

| Y/E March (INR mn) | CY10 | CY11 | CY12E | CY13E |
|---|---|---|---|---|
| Net Sales | 47974.9 | 56873.3 | 66769 | 76984 |
| Growth (%) | 18.54% | 18.55% | 17.40% | 15.30% |
| EBIDTA | 6106 | 16802 | 21775 | 25826 |
| EBIDTAM (%) | 12.73% | 29.54% | 32.61% | 33.55% |
| Adj. PAT | 3,586 | 12,929 | 15,155 | 17,491 |
| *Growth (%)* | 100.00% | 260.54% | 17.22% | 15.41% |
| Adj. EPS (INR) | 8.5 | 30.7 | 36 | 41.5 |
| P/E (x) | 57.4 | 15.9 | 13.6 | 11.8 |

## Valuation & Outlook

Slower-than-expected ramp-up in EMs and lack of traction in core business margin have been major disappointments. We believe post FDA resolution, investor focus would be on core business performance which will act as catalyst for higher valuations in the long term. Incremental news on Lipitor and positive FDA resolution will act as near term triggers.

**We recommend a "BUY" on the stock with a target price of INR 578, valuing the core business at INR 483 at 2.2x CY2012E EV/Sales and attaching INR 95/share for Para IVs.**

# REC Ltd    CMP: INR 173    Target: INR 204

**Rural Electrification Corporation (REC) being a 'Navratna' company and registered as an NBFC by RBI in 1998, finances all types of power generation projects, and offers financial assistance to power utilities in the country in T&D sector; also it is the nodal agency for the Rajiv Gandhi Grameen Vidyutikaran Yojana (RGGVY) scheme launched by GOI**

| Key Data | |
|---|---|
| BSE Code | 532955 |
| NSE Code | REC |
| Bloomberg Code | RECL IN |
| Reuters Code | RURL.BO |
| No of Shares (Mn.) | 1147.8 |
| Face Value | 10 |
| Mcap (INR Bn.) | 171.2 |
| 52 week H/L | 386.6/155 |
| 2 week Avg Qty NSE | 2,292,300 |
| CMP (INR) | 173.4 |

| Shareholding (%) | Jun-11 |
|---|---|
| Promoters | 66.8% |
| FIIs | 19.0% |
| DIIS | 5.2% |
| Others | 9.0% |

## Key Investment Rationales

**Loan Book growth – to remain stellar:** REC has been a focused player in the T&D segment, and with an estimated Investment of INR 1400bn, opportunities remain robust for REC. REC has diversified into generation and allied segments for funding opportunities. We believe T&D segment to contribute 50% of the total loan assets by FY13E. The decrease in the share of T&D is likely to be picked up by an increase in overall share of Generation segment in its total loan book, from 27% in FY08 to 43.5% in FY13E. Overall, we expect a steady 29% CAGR in REC's loan book over the period FY11 to FY13E.

**Borrowings Mix – Bonds to be the most preferred option:** REC issues Capital Gains Tax Exemption Bonds with tenure of 3/5/7 years. Further, with the grant of IFC status, it can now issue Infrastructure bonds to retail investors as well. These bonds typically are the cheapest source of borrowings for REC, which helps buffer its NIMs. Also, with new avenue of borrowing ie ECBs to the extent of 50% of the networth due to grant of IFC status will also start picking up from FY11E.

**NIMs to remain stable:** REC has maintained stable NIMs in the range of 3.5% to 3.9% over a period of FY08 to FY10. The yield on advances has been inching up, and so has been the cost of borrowings due to increasing leverage on the balance sheet. Going forward, we expect REC to maintain a steady NIM at 3.85%, and believe the NII to grow at a healthy rate of 26% for the period FY11E to FY13E.

**Asset Quality – remains healthy:** REC, though has ~87% of its loan book concentrated to SEBs, ~20% of its book is backed by government guarantees. Also, with Escrow mechanism in place for all its Government funding, it helps REC glide over the concentration risks with ease. We expect REC to continue having negligible levels of NPA in its book, despite the CAGR of ~34% in its total loan book.

| Y/E March (INR mn) | FY10 | FY11 | FY12E | FY13E |
|---|---|---|---|---|
| NII | 25,441 | 32,578 | 38,332 | 44,790 |
| *Growth (%)* | *42.4%* | *28.1%* | *17.7%* | *16.8%* |
| Operating Expenses | 1,009 | 1,336 | 1,750 | 2,709 |
| PAT | 20,221 | 25,699 | 26,479 | 30,240 |
| *Growth (%)* | | *27.1%* | *3.0%* | *27.1%* |
| ABV (INR) | 112.3 | 138.3 | 142.9 | 157.5 |
| P/ABV (x) | 1.5 | 1.3 | 1.2 | 1.1 |
| RoA (%) | 3.4% | 3.4% | 2.8% | 2.7% |

## Valuation & Outlook

REC, being the dominant player in T&D sector, will remain the largest benefactor of the likely reforms in this sector. Also, with investments expected to the tune of INR 4tn in this segment, the funding opportunities remain large, with REC likely to maintain its market share as the largest lender on this segment. With an expected NII growth of 26% CAGR till FY13E supported by cost effective liability side of the balance sheet, we expect REC to grow in line with the industry with a stable asset quality and stable return ratios. REC is trading at 5.7x and 1.1x its FY13E ABV and EPS respectively. **We recommend a BUY on the stock with a price target of INR 204, that values the company at 1.4x and 1.3x its FY12E and FY13E ABV respectively.**

# Setco Automotive CMP: INR 175 Target: INR 226

**Setco Automotive is a leading Indian auto component company and one among the top five manufacturers of clutches for M&HCV in the world. Headquartered in Mumbai, the company has manufacturing presence across four locations, including 2 in India and one each in UK and USA. The company sells its clutches under the renowned 'LIPE' & Setco brands.**

| Key Data | |
|---|---|
| BSE Code | 505075 |
| Bloomberg Code | SETC IN |
| Reuters Code | SETC.BO |
| Shares Outstanding (mn) | 17.64 |
| Face Value | 10 |
| Mcap (INR bn) | 3.08 |
| 52 Week H/L | 185/108 |
| 2W Avg. Vol, BSE | 4760 |
| Free Float (INR bn) | 1.12 |
| Beta | 0.38 |

| Shareholding (%) | Jun-11 |
|---|---|
| Promoters | 63.52% |
| FIIs | 1.63% |
| DIIs | 2.87% |
| Others | 31.98% |

## Key Investment Rationales

**Market leader:** Setco is a domestic market leader having ~80% of the market share in OEM segment and ~35% market share in after-markets. In view of change in technology and transition from BS-II to BS III compliant products in October 2010, we expect replacement demand to pick-up for these products by October 2012; given clutch usually has an average life of around 2 years or 200,000 kms whichever is earlier. At present it is doing production in 2 shifts which it can increase to 3 shifts, if required.

**Expansion in margins:** Setco derived ~43% of revenues through OEMs, ~49% through replacement market and ~6% through exports in FY11. Going forward, we expect replacement market & exports to contribute ~52 & ~8% to revenues by FY13. Margins are highest in case of exports, while in replacement markets it is at ~22%-24% vs. margins of ~12%-14% in the OEM segment. We expect EBITDA margin to expand to 19.24% in FY13 from 18.04% in FY11.

**Marquee clients:** Setco is the largest supplier of M&HCV clutches to Tata Motors, Eicher and Asia Motor Works, meeting upto 100% of their clutch requirement. It also meets 60-65% of the clutch requirement of Ashok Leyland. It has now also become an approved supplier for Daimler's Indian operations whose supplies are expected to begin from next year onwards.

**Revenues to register 20% CAGR over next 2 years:** Setco has increased its capacity of clutch driven plate by 45% to 800,000 units and by 67% to 500,000 units in case clutch cover assembly in FY11. On the back of buoyant domestic demand, addition of new clients and healthy replacement market, we expect, capacity utilization to increase to 85-90% in FY13 from 70-75% in FY11, leading to revenues & profits growth of 20% & 24% respectively over the next 2 years. Its revenue has registered a CAGR of 38% over FY06-FY11.

| Y/E March (INR mn) | FY10 | FY11 | FY12E | FY13E |
|---|---|---|---|---|
| Net Sales | 2620 | 3590 | 4154 | 5151 |
| Growth (%) | 11.45% | 37.02% | 15.69% | 24.00% |
| EBIDTA | 388 | 648 | 791 | 991 |
| EBIDTAM (%) | 14.80% | 18.04% | 19.04% | 19.24% |
| Adj. PAT | 143 | 335 | 395 | 519 |
| *Growth (%)* | 7.44% | 134.05% | 17.87% | 31.37% |
| Adj. EPS (INR) | 8.11 | 18.99 | 22.38 | 29.40 |
| P/E (x) | 11.10 | 6.47 | 7.82 | 5.95 |

## Valuation & Outlook

Setco has pro-actively doubled its capacity in the last two years which has helped it in maintaining its market dominance. A 13-15% CAGR in OEMs coupled with 17-18% CAGR in replacement market, addition of new client's viz. Diamler, is expected to translate into revenues & profits registering a CAGR of 20% & 24% respectively over the next 2 years. EBITDA margins are also expected to expand to 19.24% in FY13 from 18.04% in FY11 aided by backward integration, improvement in blended realisations and implementation of higher emission norms. **We recommend a "BUY" with a target Price of INR 226 in 18 months, at 5.5x FY13E EV/EBITDA, implying an upside potential of ~ 29%.**

SPA THE FINANCIAL ADVISORS

# Siyaram Silk Mills CMP: INR 274 Target: INR 419

**Siyaram Silk Mills (SSML) is a vertically integrated textile company operating 7 manufacturing units located across Tarapur, Daman and Mumbai. Company's product line includes yarns, fabric, home textiles and apparels. Siyaram's, J Hampstead, Mistair, MSD, Oxemberg are some of the known brands of the company. SSML has Yarn dyeing capacity of 6,000 tonnes, 494 looms (53mn mtrs p.a.) and 746 stitching machines (2.4mn pieces p.a.).**

| Key Data | |
|---|---|
| BSE Code | 503811 |
| Bloomberg Code | SIYA IN |
| Reuters Code | SIYR.BO |
| Shares Outstanding (mn) | 9.37 |
| Face Value | 10 |
| M.cap (INR mn) | 2571.60 |
| 52 Week H/L | 464/250 |
| 2W Avg. Vol, BSE | 3105 |
| Free Float (%) | 32.94 |
| Beta | 0.92 |

| Shareholding (%) | Sep-11 |
|---|---|
| Promoters | 67.06% |
| FIIs | 0.07% |
| DIIs | 6.06% |
| Others | 26.81% |

## Key Investment Rationales

**Branded Play and Robust Rural demand:** The company markets value-for-money brands like Siyaram, Mistair, J Hampstead etc. and enjoys strong brand recall. Around 75% of its revenue comes from Tier I and Tier II cities. The poly-viscose fabric is more preferred here over cotton as it is cheaper, easy-to-maintain and much more durable. The popularity of the brand can be envisaged by the fact that the fabric division experienced a volume growth of 17% despite increase in price realisation by 12% in FY11. Fabrics contributed 85% of its sales in FY11 while Readymade contributed 11%

**Ready-to-Wear Demand to Remain Buoyant:** The Indian domestic Apparel market size in 2009 was US$ 33bn and is expected to grow @ 11% CAGR to reach US$ 100bn by 2020. Ready-To-Wear share is expected to increase to 88% by 2020 as against 77% in 2009. In view of this buoyant readymade garment demand scenario, the company is scaling its garmenting capacity by 75,000pieces/month by FY13. The current capacity stands at 2.4mn pieces p.a. Management expects revenue of around INR 1,100mn from this segment in FY12.

**Efficient Working Capital Management:** SSML doesn't have any owned retail outlets, thereby saving on costs. Also the company's strict control on working capital management has seen its Debtor days to reduce from 85 days in FY08 to 64 days in FY11. These controls have helped the company to achieve high ROE of 26%, second only to 42% of RSWM.

**Capacity Play:** The company plans to increase the production capacity of fabrics and readymade garment divisions by 2mn meters and 75,000pieces/month respectively. The envisaged capital expenditure is around INR 2,200mn. INR 150mn will be financed by way of term loan while the rest would be financed through internal accruals. Out of the capital expenditure, INR 800mn would be utilized in FY12 while INR 1,000mn would be put to use in FY13.

| Y/E March (INR mn) | FY10 | FY11 | FY12E | FY13E |
|---|---|---|---|---|
| Net Sales | 6597 | 8548 | 10316 | 12489 |
| EBIDTA | 795 | 1185 | 1270 | 1545 |
| EBIDTAM (%) | 12.05% | 13.86% | 12.31% | 12.37% |
| Adj. PAT | 337 | 575 | 651 | 786 |
| *Growth (%)* | 194.16% | 70.91% | 13.22% | 20.74% |
| Adj. EPS (INR) | 35.91 | 61.38 | 69.52 | 83.86 |
| P/E (x) | 7.6 | 4.5 | 3.9 | 3.3 |

## Valuation & Outlook

Company expects a top-line of around INR 10,000mn and PAT of around INR 700mn in FY12. Company currently has a debt of INR 2,855mn of which it will pay back INR 250mn every year. Debt/Equity ratio for the company stood at 1.3x in FY11. Company's current cost of interest is approx 9.5%**. At the CMP of INR 274.45, SSML is trading at 3.9x and 3.3x per FY12E and FY13E earnings estimates. We assign a valuation multiple of 5x 1 yr forward PER to SSML and arrive at a target price of INR 419 with a BUY rating.**

# Tata Steel CMP: INR 450 Target: INR 726

**Tata Steel Ltd is the world's 10th largest steel company and the world's 2nd most geographically diversified steel producer. The company is a diversified steel producer with major operations in India, Europe and South East Asia. Tata Steel has not limited its operations and businesses within India but has built an imposing presence around the globe as well. With the acquisition of Corus in 2007 and commencement of European operations, it is the 10th largest steel producer in the world.**

| Key Data | |
|---|---|
| BSE Code | 500470 |
| NSE Code | TATASTEEL |
| Bloomberg Code | TATA IN |
| Reuters Code | TISC.BO |
| Shares Outstanding (mn) | 959 |
| Face Value | 10 |
| Mcap (INR bn) | 418.6 |
| 52 Week H/L | 737/390 |
| 2W Avg. Qty, BSE/ NSE | 3865224 |
| Free Float (INR bn) | 290 |
| Beta | 1.14 |

| Shareholding (%) | Sep-11 |
|---|---|
| Promoters | 30.71 |
| FIIs | 14.61 |
| DIIS | 27.77 |
| Others | 26.91 |

## Key Investment Rationales

**Expansion Projects – Brownfield:** Tata Steel is executing its plan to increase its crude steel capacity from 6.80 mmtpa to 9.70 mmtpa at its Jamshedpur facility by FY12E. Simultaneously the company has also few major ongoing capital projects. The company has also entered into an MoU with Nippon Steel, Japan for setting up a continuous annealing and processing line at Jamshedpur with 0.6 mmtpa capacity.

**Orissa project on schedule:** Of the planned 6mt Orissa project ($8bn), 3mt is likely to be up by FY15E, with the rest likely to be completed within another 2 years. At the group level, the planned capex is ~$2.2bn in FY12 (similar to last year).

**Riversdale coal asset:** Tata Steel effectively holds around 50% of Riversdale (27% of the parent and 35% of the project company). It has plans to develop the asset in 3 phases, with 1.7-2mt of coking coal production in the first phase. Since Tata Steel has a 40% offtake share in Riversdale's Mozambique coking coal project, it will get ~ 800kt from the asset once the capacity is fully ramped up (expected by end CY12).

**Stepping up profitability:** Corus is improving its cost structure and lifting self-sufficiency in raw materials. We also believe that Corus's restructuring initiatives will lead to a sustainable cost reduction of US$8-10/t in the short term and US$10-15/t in the medium term.

**Margam coking-coal mines :** the long-term catalyst for Corus: Currently, Corus is working on developing a captive coking-coal mine near its Port Talbot site in Margam, South Wales. However, with new technology for mining available now, Corus has drawn up plans to explore this mine. Given the high cost of coking coal currently and the quality of the coal (ash content of less than 5%, other things still under study), we believe this mine would lead to substantial cost savings given that captive coking coal will replace external purchases.

| Y/E March (INR mn) | FY10 | FY11 | FY12E | FY13E |
|---|---|---|---|---|
| Net Sales | 1,023,931 | 1,187,531 | 1276659 | 1456098 |
| *Growth (%)* | -30.50% | 15.98% | 7.51% | 14.06% |
| *EBIDTA* | 97,008 | 174,136 | 164668 | 187944 |
| EBIDTAM (%) | 9.47% | 14.66% | 12.90% | 12.91% |
| Adj. PAT | (21,208) | 88,561 | 103263 | 87629 |
| *Growth (%)* | -143.74% | 517.57% | 16.60% | -15.14% |
| Adj. EPS (INR) | -23.18 | 93.71 | 100 | 85 |
| P/E (x) | 11.22 | 8.67 | 4.50 | 5.31 |

## Valuation & Outlook

Although there are near term concerns on margin contraction , mainly in Europe on weak demand and higher raw material cost, structural improvement in the health of the company remains on track led by cost reduction in Europe and rising share of highly profitable Indian operations. On the other hand, large infrastructure development projects and construction activities in India and Singapore would continue to pose robust outlook.. **At CMP of Rs561, the stock is trading at 5.7x and 4.6x its estimated EV/EDBITA multiple for FY2012E & FY2013E. We recommend a BUY on the stock with a target price of Rs. 726, thus valuing it at 6X FY13E EV/EBIDTA.**

SPA THE FINANCIAL ADVISORS

# Whirlpool of India CMP: INR 216 Target: INR 320

**Whirlpool of India (WPL) is the Indian unit of world's largest consumer durables company Whirlpool Corporation, USA. WPL is primarily engaged in manufacturing and trading of refrigerators, washing machines, air conditioners, microwave ovens, etc. It is the second largest player in washing machine and refrigerators category in India. WPL is expected to gain significantly on back of its parent focus to derive higher proportion of its revenue from the India markets by gaining market share and introducing new products/categories from its large global portfolio of products.**

| Key Data | |
|---|---|
| BSE Code | 500238 |
| Bloomberg Code | WHIRL IN |
| Reuters Code | WHIR.BO |
| Shares Outstanding (mn) | 126.9 |
| Face Value | 10 |
| Mcap (INR bn) | 27.4 |
| 52 Week H/L | 329/192 |
| 2W Avg. Vol, BSE | 5,734 |
| Free Float (INR bn) | 6.84 |
| Beta | 0.98 |

| Shareholding (%) | Jun-11 |
|---|---|
| Promoters | 75.00% |
| FIIs | 4.17% |
| DIIS | 5.96% |
| Others | 14.86% |

## Key Investment Rationales

**Riding the consumption wave:** We expect consumer durable sector to witness double digit volume growth for many years to come on back of high consumption demand supported by high disposable income & changing lifestyle. WPL's washing machine and AC category has outpaced the industry growth in last few years by growing at a 4 year CAGR of 22.1% and 62.8%. WPL plans to expand it categories of products by launching host of kitchen products such as hobs, hoods, built-in ovens and dishwashers in the current fiscal.

**Change in mix to aid margins :** Change in product mix towards fast growing premium segment product (frost free refrigerators, fully automatic washing and split ACs) along with other cost management efforts helped company to expand its EBIDTA margins from 3.6% in FY07 to 9.7% in FY11. We expect company's EBIDTA margins to expand by 62bps in next two years to 10.3% in FY13.

**Expected higher growth in smaller categories portfolio:** Contribution from refrigerators, which is the largest category for WPL, has reduced from 67% in FY07 to 60% in FY11 on back of higher growth in other categories like washing machine, AC and microwave oven. Going forward we expect refrigerator's contribution to sales to further reduce to 53% in FY13. This further strengthens our belief of long term sustainability of growth of the company with diversified product portfolio.

**Strong support of parent company:** WPL is the subsidiary of Whirlpool Corporation Ltd (WCL), USA which holds 75% stake in the company. WCL is the world's largest manufacturer and marketer of major home appliances, with annual sales of USD 18.4bn in 2010. Going forward, company plans to grow its global revenue to USD 25bn in 2014 and increase its revenue share from fast growing Indian market.

| Y/E March (INR mn) | FY10 | FY11 | FY12E | FY13E |
|---|---|---|---|---|
| Net Sales | 22,149 | 27,005 | 28,796 | 33,906 |
| *Growth (%)* | *28.83* | *21.92* | *6.63* | *17.75* |
| EBIDTA | 2,412 | 2,613 | 2,571 | 3,699 |
| *EBIDTAM (%)* | *10.89* | *9.68* | *8.93* | *10.91* |
| Adj. PAT | 1,450 | 1,658 | 1,591 | 2,537 |
| *Growth (%)* | *105.56* | *14.34* | *-4.02* | *59.46* |
| Adj. EPS (INR) | 4.76 | 12.16 | 12.42 | 20.00 |
| P/E (x) | 20.51 | 21.55 | 17.40 | 10.80 |

## Valuation & Outlook

WPL is a strong play on Indian consumer story. Innovation, new products/categories backed by higher demand with change in lifestyle would provide sustainable long term growth to the company. With strong cash flows, high return on networth and 20%+ profit CAGR, we believe company should trade at atleast 0.8x PEG. Therefore, **we value the company at 16x FY13E operating EPS of INR 18 plus INR 31/share of excess cash on books (FY13 cash surplus discounted by 15%) and arrive at 1 year target price of INR 320. This implies an upside of 48% from CMP.**

| | | | | |
|---|---|---|---|---|
| Girish Bhutra | Head of Equity | girish.bhutra@spagroupindia.com | Tel.: +91-22-4289 5600 | Ext.634 |
| Sharad Avasthi | Dy Head - Equity Research | sharad.avasthi@spagroupindia.com | Tel.: +91-33-4011 4800 | Ext.832 |




**Disclosure of Interest Statement**

| | | | |
|---|---|---|---|
| 1. | Analyst ownership of the stock | - | No |
| 2. | Group/Directors ownership of the stock | - | No |
| 3. | Broking relationship with company covered | - | No |

This information is subject to change without any prior notice. SPA reserves the right to make modifications and alternations to this statement as may be required from time to time. Nevertheless, SPA is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.


SPA Securities Limited : SPA House, Nyay Sagar, Near Gurunanak Hospital, Bandra (E), Mumbai - 400051, Tel. No. : +91-022-4289 5600

For More Information Visit Us At : www.spasecurities.com

**SPA CAPITAL SERVICES LIMITED**
Investment Advisory services,
AMFI Reg. No. ARN-0007

**SPA MERCHANT BANKERS LTD.**
SEBI registered Category-1
Merchant Bankers
SEBI Regn. No. INM000010825

**SPA COMTRADE PRIVATE LIMITED**

Member of NCDEX & MCX.
NCDEX TMID-00729,
NCDEX FMC No.NCDEX/TCM/CORP/0714

**SPA INSURANCE BROKING SERVICES LTD.**
Direct Broker for Life and General
Insurance Broking
IRDA Lic. Code No. DB053/03

| | |
|---|---|
| NSE Cash | INB231178238 |
| NSE Future & Option | INF231173238 |
| NSE Currency Derivatives | INE231178238 |
| BSE Cash | INB011178234 |
| BSE Currency Derivatives | INE011178234 |
| MCX-SX Currency Derivatives | INE261178238 |
| OTCEI | INB200891838 |
| PMS | INP000003179 |
| CDSL DP | IN-DP-CDSL-485-2008 |
| NSDL DP | IN-DP-NSDL-316-2009 |


Thank You!