investor's eye

Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Aurobindo	28-May-07	684	**727**	914
BASF	18-Sep-06	220	**258**	300
Grasim	30-Aug-04	1,119	**2,435**	2,975
Infosys	30-Dec-03	689	**1,954**	2,440
JP Associates	30-Dec-03	125	**660**	850

Nicholas Piramal India

Apple Green

Stock Update

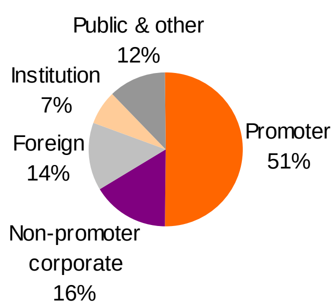
Annual report review

Buy; CMP: Rs265

Company details

Price target:	Rs393
Market cap:	Rs5,538 cr
52 week high/low:	Rs290/148
NSE volume: (No of shares)	3.8 lakh
BSE code:	500302
NSE code:	NICHOLASPIR
Sharekhan code:	NICHPI
Free float: (No of shares)	10.4 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	3.8	28.7	12.0	48.0
Relative to Sensex	1.4	14.2	9.0	2.0

We have reviewed the recently released annual report of Nicholas Piramal India Ltd (NPIL). We present below the highlights of the report.

Impressive revenue growth across business segments

NPIL reported an overall growth of 52.9% in its consolidated sales to Rs2,420.2 crore in FY2007. This was driven by an impressive performance across segments of its business. The domestic branded formulation business of the company, which provides a solid foundation for the business, recorded a 12% increase in revenues. The growth was more or less in line with the growth seen in the domestic pharmaceutical industry. On the other hand, the global business of the company witnessed an astounding increase of 214%, driven mainly by the consolidation of the Avecia Pharmaceuticals, UK (Avecia), Torcan and Morpeth acquisitions. The performance of the allied pathology laboratory (path lab) business of the company was also worth noting: It grew by a robust 54.5%, touching the Rs70 crore mark.

Even though a large part of the overall growth was inorganic, the like-to-like organic growth was also impressive at 17%.

Changing revenue mix

NPIL has witnessed a dramatic shift in its revenue mix during FY2007. A comparison of the revenue composition of the company over the last few years indicates that NPIL has transformed its business model from one that was centered around selling branded formulations in the domestic market to one that is providing custom research and manufacturing services to global pharmaceutical companies. Branded formulations for the domestic market, which contributed 72% to NPIL's revenues in FY2005, formed only 47.5% of its revenues in FY2007. On the other hand, the contribution from the global business comprising the custom research and manufacturing services for global pharmaceutical giants has increased from 12.4% in FY2005 to 43% in FY2007.

Valuation table (consolidated) Rs crore

Particulars	FY2005	FY2006	FY2007	FY2008E	FY2009E
Net sales	1308.2	1582.5	2420.2	2946.4	3343.5
PAT	84.4	127.5	232.6	297.0	355.3
Shares in issue (cr)	19.0	20.9	20.9	20.9	20.9
EPS (Rs)	4.3	6.0	11	14.1	16.9
PER (x)	61.7	44.4	24	18.8	15.7
EV	5387.5	5754.7	6127.1	6074.6	5946.3
EV/Ebidta (x)	31.8	29.1	18.5	12.9	10.8
Book value (Rs/share)	29.0	48.5	52	61.3	71.6
P/BV (x)	9.1	5.5	5.1	4.3	3.7
Mcap/sales	3.8	3.5	2.3	1.9	1.7
ROCE (%)	15.3	12.0	16.6	18.3	19.8
RONW (%)	15.3	12.6	21.4	23.2	23.7

Revenue composition (% of sales)

Particulars	FY2005	FY2006	FY2007
Domestic	87.6	78.7	56.9
Branded formulations	71.9	65.8	47.5
CMO	9.3	5.9	3.3
Path Labs	2.8	2.8	2.8
Others	3.6	4.2	3.3
Global	12.4	21.3	43.1
PDS	0.0	2.6	5.9
PMS	0.0	5.7	26.9
MMBB	11.3	11.9	9.2
Others	1.1	1.1	1.1

Branded formulation business grows in line with industry growth

NPIL's domestic branded formulation business, which constitutes 47.5% of its revenues, continued to register a healthy growth. The branded formulation sales were up by 12% to Rs1,174.2 crore in FY2007, which was more or less in line with the industry growth. The company's top ten brands grew by 12.7%. In keeping with its trend of making new launches every year, NPIL launched 22 new products including line extensions in the domestic market during FY2007. As a result of the company's strong brand building capabilities, the sales from new launches during the past two years contributed 5.2% to the total revenues from the branded formulation business. The company's ability to transform new launches into big brands in a relatively short span of time assumes great significance in the product patent era where generic copies of drugs patented after 1995 have been disallowed. In such a scenario, product innovation, field force strength and geographical coverage will be the key differentiating factors for any company competing in the Indian market.

During FY2007, NPIL added 208 people to its field force of 2,778 people, taking the total field headcount to 2,986. This strength of the field force continues to be amongst the largest in the Indian pharmaceutical industry. The company's field force is organised into 14 divisions, out of which seven divisions focus on specific therapeutic segments. Not only does the strong field force increase market penetration and coverage, but it also adds to the company's in-licencing attractiveness. During the year, NPIL also created a new division as a 100% subsidiary named NPIL Healthcare, which aims to target the general practitioners for mass market branded formulations.

Path lab business picking up

NPIL's path lab business has grown by an encouraging 54.5% from Rs44.97 crore in FY2006 to Rs69.5 crore in FY2007. The company has undertaken aggressive initiatives during the year to expand this business—it acquired six new laboratories during the year, took over the remainder 40% stake in its joint venture with Dr. Phadke Pathology Laboratory, entered into a strategic alliance with Doctors Diagnostic and Research Center, the largest diagnostic centre in Kerala, and lastly, also made an entry into the high-end health imaging arena by acquiring Jhankaria Imaging, a leading imaging and radiology centre in Mumbai. Even though the revenue growth of the business was strong, the business reported losses due to the high interest and depreciation expenses incurred due to the acquisition of new labs and setting up of greenfield facilities.

International acquisitions boost global business

NPIL's international sales grew by 214.1% in FY2007, driven by the consolidation of revenues from the acquired businesses of Avecia and Morpeth and higher custom manufacturing revenues from the Indian base. Sales from contracts from the Indian facilities for FY2007 touched Rs76.74 crore as compared with only Rs20.64 crore in FY2006. The sales from the AMO and Allergan contracts, which were relatively small in size, also grew to a steady volume during the year. NPIL also secured a number of additional contracts during FY2007 from its Indian assets, which are yet to commence revenues.

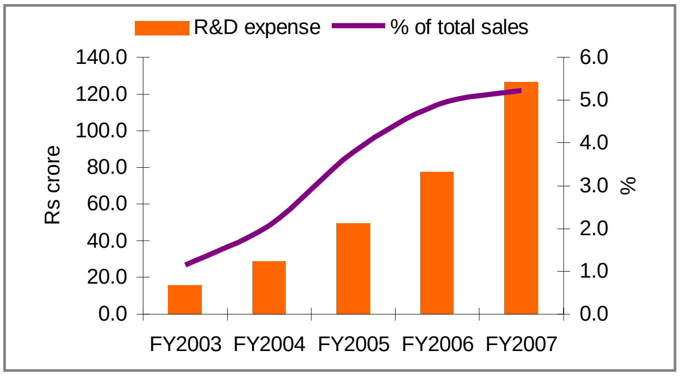
Avecia turns profitable

Also noteworthy is the remarkable turn-around of Avecia which was acquired by NPIL in December 2005. From operating losses of Rs24.7 crore recorded at the time of acquisition, NPIL has turned around the company to a profit-making one during FY2007. This has been achieved through substantial growth in revenues by increasing capacity utilisation, cheap sourcing of raw materials from India and rationalisation of fixed costs.

Discovery R&D spend increasing; trials progressing well

NPIL's research and development (R&D) expenses have been on the rise year after year; they have grown at a compounded annual growth rate (CAGR) of 69% over FY2003-07. The R&D spend as a proportion of sales has also been rising—from 1% in FY2003 to over 5% in FY2007. By continuously investing its resources in R&D, NPIL has built a state-of-the-art R&D facility and strengthened its R&D knowledge and expertise to world-class standards. Having built world-class facilities, NIPL has also created an impressive discovery R&D pipeline. Its lead oncology molecule P276-00, which was undergoing clinical trials in Canada, has also begun simultaneous clinical trials in India during FY2007. Further, two more phytopharmaceutical molecules entered Phase II trials, which are being conducted in India. During the year, NPIL entered into a landmark agreement with Eli Lilly, wherein NIPL has in-licenced one of Elli Lilly's metabolic disorder molecules for clinical development.

R&D spend on the rise



Financial metrics rebound in FY2007

Operating profit margins expand by 120 basis points: After showing a decline every year from FY2003 to FY2006, NPIL's margin finally showed an expansion of 120 basis points to 13.7% in FY2007, causing the operating profit to grow by 68% during the year. The increase in the operating profit and margin is largely due to the increased traction in the high margin custom manufacturing business and the turn-around in the operations of Avecia, leading to a substantial jump in the gross margins from 57.4% in FY2006 to 63.7% in FY2007.

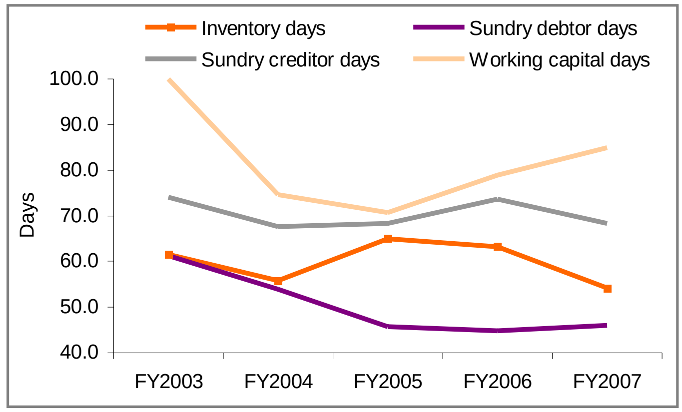
Return ratios jump up significantly: NPIL's return ratios, namely the return on capital employed (ROCE) and return on net worth (RONW), which had also been on a continuous decline year after year, showed a substantial jump in FY2007. The company's ROCE improved by 460 basis points to 16.6%, whereas the RONW increased by 880 basis points to 21.4% during FY2007. The improvement in the return ratios is attributed to the dramatic improvement in the operating profit and net profit.

Debt/equity ratio jumps to 0.6: NPIL's debt/equity ratio sprung back up in FY2007 after having declined for the past few years. This is due to the 100% plus increase in the company's debt level from Rs311.4 crore in FY2006 to Rs639.2 crore in FY2007. The company has raised additional debt to finance its large capital expenditure as well as to part finance the acquisition of Pfizer's Morpeth facility in the UK.

Key ratios (%)

Particulars	FY2003	FY2004	FY2005	FY2006	FY2007
OPM (%)	22.0	20.2	12.9	12.5	13.7
NPM (%)	13.2	16.2	6.5	8.1	9.6
ROCE (%)	20.7	29.6	15.3	12.0	16.6
RONW (%)	38.9	49.2	15.3	12.6	21.4
Debt/Equity Ratio	1.4	0.8	0.7	0.3	0.6

Working capital cycle increases: NPIL's net working capital days increased from 79 days in FY2006 to 85 days in FY2007. This was despite an improvement in the inventory days from 63 days in FY2006 to 54 days in FY2007. The sharp increase in the working capital cycle was primarily driven by an increase in the creditor turnover ratio, as the company derived a higher proportion of its revenues from international markets, which have lower material costs and hence a lower level of creditors.



Other highlights presented in the annual report

- The NPIL management believes that the interest of innovator companies to outsource their research and manufacturing activities to low-cost destinations like India is set to grow by leaps and bounds as global players face increasing pressure to reduce their operating costs as more blockbuster drugs are replaced by their generic versions and new ones are hard to come by.
- NPIL has successfully shifted production of inhalation anaesthetic products from Rhodia's UK facilities to its own Indian base. This should lead to a substantial improvement in the margins of this business going forward.
- During FY2007, NPIL has also completed the migration of manufacturing of its domestic branded formulation products from Pithampur to its new facility at Baddi. This shift should reflect in an improvement in the company's margins due to a lowered excise and tax incidence.

Valuation & view

From being a formulation player in the domestic market, NIPL has emerged as a leader in the custom manufacturing space. Through strategic acquisitions and expansions, the company has achieved a good growth. Simultaneously, it has also maintained its focus on building its innovative pipeline of molecules. The company's strength in the R&D field is vindicated through its recent drug development deal with global pharma major, Eli Lilly.

Through steady growth in the branded formulation segment, ramp-up in the custom manufacturing contracts, the expansion of the path lab business and a ramp-up in the capacity utilisation at Morpeth and NPIL UK, NIPL is well-positioned to exhibit strong growth both in the domestic market and internationally. Further, with the operations of Avecia, turning profitable and the Rhodia business having been shifted to India, the margins of the company should show improvement.

Considering the strong revenue flows and enhanced profitability picture for the coming years, we remain positive on the company. At the current market price of Rs265, NIPL is quoting at 15.7x estimated FY2008 earnings. We maintain our Buy recommendation on the stock with a price target of Rs393.

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

Shree Cement

Cannonball

Stock Update

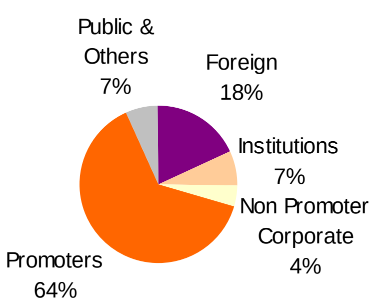
Price target revised to Rs1,500

Buy; CMP: Rs1,187

Company details

Price target:	Rs1,500
Market cap:	Rs4,131 cr
52 week high/low:	Rs1,590/650
NSE volume: (No of shares)	22,984
BSE code:	532349
NSE code:	SHREECEM
Sharekhan code:	SHREECEM
Free float: (No of shares)	1.3 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	7.6	0.3	-17.0	47.4
Relative to Sensex	5.1	-11.0	-19.2	1.6

Result highlights

- Shree Cement's top line grew by a robust 68% year on year (yoy) to Rs378 crore in Q4FY2007. The growth was achieved on the back of a robust 36% growth in volumes and a 24% rise in realisations over last year.
- The operating expenditure grew by 67% yoy to Rs226.97 crore on account of higher power& fuel expenditure and employee cost.
- Consequently, the operating profit grew by 69% yoy to Rs151 crore whereas the operating profit margin (OPM) stood flat at 40% yoy.
- The company claimed an additional depreciation of Rs114 crore on its new unit (the fourth one) at Ras in the fourth quarter. This resulted in an overall depreciation cost of Rs134 crore. The interest cost reduced from Rs2.3 crore in Q4FY2006 to Rs1.64 crore in the quarter.
- The tax provision remained very low at Rs0.3 crore, thanks to a higher depreciation provision. On the back of high depreciation provision, the net profit remained low at Rs24 crore.
- With additional capacity of 4MMT coming up over the next two years, Shree Cement will witness a robust year-on-year (y-o-y) volume growth of 19% in FY2008 and of 26% in FY2009.
- In view of the high volume growth and strict control measures, we expect the company's profits to grow by 22% yoy in FY2008 and by 9% in FY2009, resulting in a compounded annual growth of 15% over FY2007-09.
- At the current market price of Rs1,187, the stock is trading at 9.4x its FY2008 earnings per share (EPS) and 8.7x its FY2009 EPS. On an enterprise value (EV)/ per tonne basis the stock trades at USD84. Keeping our bullish view on the stock, we maintain our Buy recommendation with a price target of Rs1,500 per share.

Result table Rs (cr)

Particulars	FY2007	FY2006	% yoy	Q4FY07	Q4FY06	% yoy
Net sales	1368.0	694.8	97	378.3	225.5	68
Total expenditure	775.7	469.1	65	227.0	136.2	67
Operating profit	592.3	225.8	162	151.3	89.3	69
Other income	21.2	7.2	196	9.1	1.7	428
EBIDTA	613.4	232.9	163	160.4	91.0	76
Interest	10.4	14.1	-27	1.6	2.3	-28
PBDT	603.1	218.8	176	158.8	88.7	79
Depreciation	234.0	57.5	307	134.7	20.7	552
PBT	369.1	161.3	129	24.1	68.1	-65
Tax	12.4	8.7	43	0.3	-0.3	-195
Profit after tax	356.7	152.6	134	23.8	68.4	-65

A robust volume growth boosts top line by 68% yoy

Shree Cement continued to register robust volume growth with its volumes growing by 36% yoy in the quarter driven by the additional capacity of 1.5MMT from the third unit. As the construction activity remained strong in the industry, cement prices witnessed a rise, pushing the realisations up by 24% yoy to Rs2,997. Thus the overall top line grew by 68% yoy to Rs378 crore. The company has commissioned its fourth unit of 1.5MMT in March 2007. Thus it would be able to continue its volume growth going ahead.

Overall expenditure jumps by 67% yoy

Higher pet coke prices led the company's power and fuel cost to rise by 51% yoy to Rs72.16 crore whereas the freight expenses grew by 51% yoy to Rs53.47 crore. Employee expenses jumped by 105% yoy and 52% sequentially to Rs21 crore mainly on account of the bonus declared by the company. Consequently the overall expenditure grew by 67% yoy to Rs227 crore.

Operating profit increases by 69% yoy; OPM flat at 40%

The operating profit grew by 69% yoy to Rs151.3 crore whereas the OPM stood flat at 40% yoy and declined 4% sequentially, thanks to the higher operating expenditure. The earnings before interest, tax, depreciation and amortisation (EBITDA) per tonne at Rs1,199 for the quarter were the lowest in FY2007.

Per tonne analysis

Particulars	Q4FY07	Q4FY06	% yoy	Q3FY07	% yoy
Raw material	376.0	105.8	255.3	343.0	9.6
Stocks	-45.5	0.0		-17.8	155.8
Employee	166.7	110.2	51.3	105.3	58.3
Power and fuel	571.9	513.1	11.4	471.0	21.4
Freight	423.8	424.9	-0.3	390.0	8.7
Other exp	305.9	312.3	-2.0	268.6	13.9
Total cost per tonne	1798.8	1466.4	22.7	1560.0	15.3
Realisation	2997.8	2427.3	23.5	2782.0	7.7
EBIDTA	1199.1	961.0	24.8	1222.0	-1.9

Source: Sharekhan

Accelerated depreciation for fourth unit depresses net profit

The company commissioned its fourth unit of 1.5MMT at Ras in March 2007. It claimed an accelerated depreciation of Rs114 crore which resulted in an overall depreciation charge of Rs134 crore for the quarter. The interest cost reduced to Rs1.64 crore from Rs2.3 crore in the same quarter last year. The higher depreciation resulted in a tax provision of a meagre Rs.03 crore. The net profit stood low at Rs24 crore.

Capacity addition to help volume grow at 22.1% CAGR

Shree Cement is one of the first companies to put up fresh capacities in the industry. In the previous fiscal it had commissioned its third unit of 1.5MMT at Ras. Its fourth unit of 1.5MMT was commissioned ahead of schedule in March 2007, effectively making it available for all of FY2008. The company has a plan to augment the capacity by 4MMT over the next two years; of this 2MMT will come up by the end of the third quarter of FY2008 and the rest by December 2008. Thus Shree Cement will witness a robust y-o-y volume growth of 19% in FY2008 and of 26% in FY2009.

...consequently earnings would grow by 15% over FY2007-09

We maintain our assumption that the prices would remain constant for the next one year but drop by Rs5 per bag in FY2009. But on account of the company's high volume growth and strict control measures, we expect Shree Cement's profits to grow by 22% yoy in FY2008 and by 9% in FY2009, resulting in a compounded annual growth of 15% over FY2007-09.

Outlook

We remain positive on the stock in view of the strong volume growth it will witness going ahead. This coupled with better cost control measures would help the company grow its profits at a compounded annual growth rate (CAGR) of 15% over the next two years. The company's excellent cash flows and comfortable financial position put it in firm footing despite a downturn in the cement industry. At the current market price of Rs1,187, the stock trades at 9.4x its FY2008 EPS and 8.7x its FY2009 EPS. On an EV/per tonne basis the stock trades at USD84. Keeping our bullish view on the stock, we maintain our Buy recommendation with a price target of Rs1,500 per share.

Valuation table

Particulars	FY05	FY06	FY07	FY08E	FY09E
Net profit (Rs cr)	109.6	152.6	356.7	433.6	472.9
% y-o-y growth	*169*	*39*	*134*	*22*	*9*
Shares in issue (cr)	3.5	3.5	3.5	3.5	3.5
EPS (Rs)	31.5	43.8	102.4	124.5	135.7
% y-o-y growth	*169.2*	*39.2*	*133.7*	*21.6*	*9.1*
PER (x)	37.3	26.8	11.5	9.4	8.7
P/BV (Rs)	16.1	15.6	11.5	4.0	2.8
EV/EBIDTA (x)	25.4	19.4	7.0	5.4	4.4
RoCE (%)	21.2	26.5	42.6	50.0	40.8
RoNW (%)	45.3	51.5	56.0	41.3	31.6

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

Sharekhan Stock Ideas

Evergreen

HDFC Bank
Infosys Technologies
Reliance Industries
Tata Consultancy Services

Apple Green

Aditya Birla Nuvo
ACC
Apollo Tyres
Bajaj Auto
Bank of Baroda
Bank of India
Bharat Bijlee
Bharat Electronics
Bharat Heavy Electricals
Bharti Airtel
Canara Bank
Corporation Bank
Crompton Greaves
Elder Pharmaceuticals
Grasim Industries
HCL Technologies
Hindustan Lever
ICICI Bank
Indian Hotels Company
ITC
Mahindra & Mahindra
Marico
Maruti Udyog
Lupin
Nicholas Piramal India
Omax Autos
Ranbaxy Laboratories
Satyam Computer Services
SKF India
State Bank of India
Sundaram Clayton
Tata Motors
Tata Tea
Unichem Laboratories
Wipro

Cannonball

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

Emerging Star

3i Infotech
Aban Offshore
Alphageo India
Cadila Healthcare
Federal-Mogul Goetze (India)
KSB Pumps
Marksans Pharma
Navneet Publications (India)
New Delhi Television
Nucleus Software Exports
Orchid Chemicals & Pharmaceuticals
ORG Informatics
Tata Elxsi
Television Eighteen India
Thermax
UTI Bank

Ugly Duckling

Ahmednagar Forgings
Ashok Leyland
Aurobindo Pharma
BASF India
Ceat
Deepak Fertilisers & Petrochemicals Corporation
Fem Care Pharma
Genus Power Infrastructures
Hexaware Technologies
ICI India
India Cements
Indo Tech Transformers
Jaiprakash Associates
JM Financial
KEI Industries
NIIT Technologies
Punjab National Bank
Ratnamani Metals and Tubes
Sanghvi Movers
Saregama India
Selan Exploration Technology
South East Asia Marine Engineering & Construction
Subros
Sun Pharmaceutical Industries
Surya Pharmaceuticals
UltraTech Cement
Union Bank of India
Universal Cables
Wockhardt

Vulture's Pick

Esab India
Orient Paper and Industries
WS Industries India