investor's eye

Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
BEL	26-Sep-06	1,108	**1,120**	1,525
ICICI Bank	23-Dec-03	284	**785**	*
India Cements	28-Sep-06	220	**220**	315
ITC	12-Aug-04	69	**187**	220
TV18	23-May-05	214	**700**	704

*Target under review

Bharat Heavy Electricals

Apple Green

Stock Update

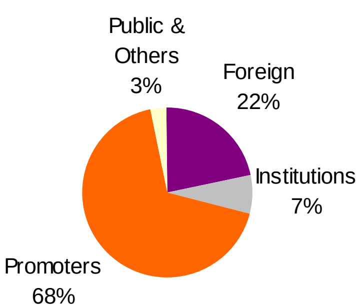
Unexciting performance

Buy; CMP: Rs2,440

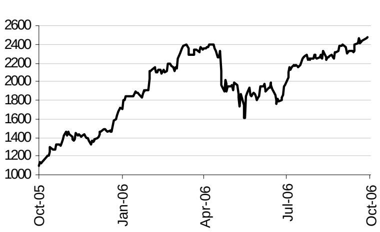
Company details

Price target:	Rs2,650
Market cap:	Rs55,879 cr
52 week high/low:	Rs2,498/1,080
NSE volume: (No of shares)	4.4 lakh
BSE code:	500103
NSE code:	BHEL
Sharekhan code:	BHEL
Free float: (No of shares)	7.9 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.6	26.9	4.8	124.9
Relative to Sensex	-0.8	5.3	-5.0	34.0

Result highlights

- At Rs360 crore the Q2FY2007 net profit of Bharat Heavy Electricals Ltd (BHEL) is marginally below our expectations, primarily because of higher-than-expected staff and other expenses.
- BHEL's revenues for the quarter grew by a smart 35% year on year (yoy) to Rs3,341 crore driven by the order backlog of Rs45,700 crore. The power division registered a 29% growth in its revenues whereas the industry division recorded a revenue growth of 35%.
- However the operating profit margin (OPM) for the quarter declined by 100 basis points to 13.7%, as its staff cost increased by 21% and the other expenditure rose by 38.6%. The staff cost increased on two counts. One, the company made an additional outlay of Rs45 crore during the quarter for gratuity provision on an actuarial basis, according to the new AS 15 norms. Two, the company also paid additional performance incentive of Rs15 crore during the quarter.
- The other income increased by 61% to Rs170 crore mainly on account of the rising yields on the huge cash reserves of the company. Also as BHEL's export revenue was higher during the quarter, the export incentive (which BHEL shows in the other income) boosted the other income.
- The net profit for the quarter grew by 38% yoy to Rs360 crore.
- The order backlog during the quarter maintained its momentum and grew by a very impressive 42% yoy to Rs45,700 crore, resulting in an order inflow of Rs10,035 crore.

Result table Rs (cr)

Particulars	Q2FY07	Q2FY06	% yoy chg	H1FY07	H1FY06	% yoy chg
Net sales	**3341.2**	**2510.3**	**33.0**	**5997.5**	**4446.9**	**35.0**
Raw material consumed	2147.9	1683.7		3698.3	2824.5	
Stock adjustment	-291.2	-341.8		-296.1	-408.6	
Employee expenses	566.0	466.1	21.4	1036.9	877.5	18.2
Other expenses	462.1	333.4	38.6	783.9	613.1	
Total expenditure	**2884.8**	**2141.4**		**5222.9**	**3906.4**	
Operating profit	**456.4**	**368.9**	**24.0**	**774.6**	**540.5**	**43.0**
Other income	169.9	105.7	61.0	290.0	198.7	46.0
Interest	13.6	13.3	2.0	26.7	25.6	4.0
Depreciation	66.7	62.4	7.0	130.5	120.0	9.0
PBT	**546.1**	**398.9**	**37.0**	**907.4**	**593.6**	**53.0**
Tax	186.0	138.8	34.0	310.6	205.6	51.0
Reported profit after tax	**360.1**	**260.2**	**38.0**	**596.8**	**388.0**	**54.0**
OPM (%)	13.7	14.7		12.9	12.2	
PBT (%)	16.3	15.9		15.1	13.3	
PATM (%)	10.8	10.4		10.0	8.7	

BHEL's Q2FY2007 results are marginally below our expectations, primarily because of higher-than-expected staff and other expenses. However we are not changing our earnings estimates for the stock in view of the company's higher-than-expected order backlog and order inflow which, we believe, would expedite the revenue booking. We were expecting a year-end order backlog of Rs45,000 crore and an order inflow of Rs28,000 crore for FY2007. However the order backlog at Rs45,700 is ahead our expectations as is the order inflow.

Going forward, huge orders from generation companies like National Thermal Power Corporation (NTPC) and Reliance Energy would drive the company's order book and earnings. Further, with the government's increasing thrust on ultra-mega power projects, the company's order book could receive a tremendous boost, as each of the 4,000MW projects would be worth Rs16,000 crore. At the current levels, the stock is trading at 19.4x its FY2008E earnings and 11.6x its FY2008E earnings before interest, depreciation, tax and amortisation (EBIDTA). Given the expectations of continued growth in its order book and the resultant strong earnings growth (at a compounded annual growth rate [CAGR] of 35%), we believe the valuations are attractive. Even on a comparative basis, the stock is trading at a huge discount to its peers like Siemens and ABB. We maintain our Buy recommendation on the stock with a price target of Rs2,650.

Continued momentum in revenue growth

BHEL's Q2FY2006 revenues grew by 33% to Rs5,516 crore driven by the strong order backlog of Rs45,700 crore. The revenue for both the divisions, ie power and industry, grew at a healthy pace. The power segment, which accounts for 70% of the company's revenue, grew by 29% whereas the industrial division's revenue grew by 35%. Going forward, with the huge order backlog of Rs45,700 crore, which is almost 3x the company's FY2006 revenue, the revenue booking is expected to maintain its growth momentum.

Segment results

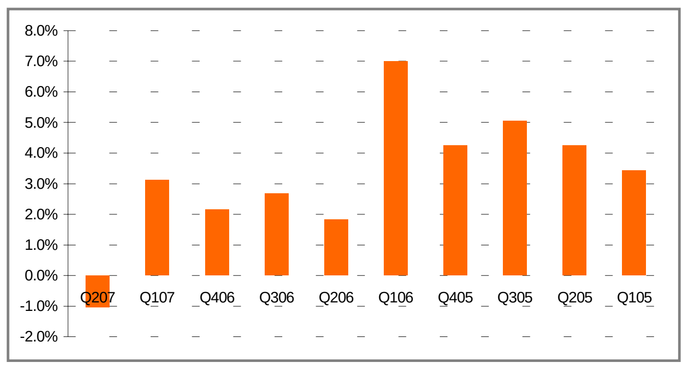
Segmental results	Q2FY07	Q2FY06	% yoy chg
Revenue	**3753.9**	**2879.3**	
Power	2714.0	2108.0	29.0
Industry	1039.9	771.3	35.0
EBIT		**536.7**	
Power	578.9	422.1	37.0
Industry	126.8	114.7	11.0
EBIT (%)	**0.0**	**18.6**	**-18.6**
Power (%)	21.3	20.0	1.3
Industry (%)	12.2	14.9	-2.7

Higher staff cost and other expenditure dents margins

For the last 10-12 quarters BHEL has been consistently expanding its margins, largely because of its operating leverage resulting from its healthy revenue booking. However during Q2FY2007, even after a healthy revenue growth of 33%, its OPM declined by 100 basis points to 12.7% as the operating leverage was lost because of a 21.4% increase in the staff cost and a 38.6% rise in the other expenditure. The staff cost increased on two counts. One, the company made an additional outlay of Rs45 crore during the quarter for gratuity provision on an actuarial basis, according to the new AS 15 norms. Two, the company also paid additional performance incentive of Rs15 crore during the quarter.

In terms of segments, the EBIT margin of the power division improved by 130 basis points to 21.3% whereas that of the industry division declined by 270 basis points to 12.2%. Consequently, the operating profit for the quarter registered a growth of 24%, lower than the revenue growth.

Margin expansion hits a roadblock



Huge cash reserves yielding fruits, other income up 60% yoy

BHEL has always been a cash-rich company and had a huge cash pile of Rs4,100 cash on its balance sheet as on March 31, 2006. Its other income during the quarter increased by 61% yoy to Rs170 crore mainly on account of the rising yields on its huge cash reserves. Also as BHEL's export revenue was higher during the quarter, the export incentive (which BHEL shows in the other income) boosted the other income. This coupled with a stable depreciation charge resulted in a 38% growth in the net profit during the quarter to Rs360 crore, marginally below our expectations.

Order book soars to Rs45,700 crore—an all-time high

BHEL's order backlog during the quarter maintained its growth momentum and grew by a very impressive 42% yoy to Rs45,700 crore, resulting in an order inflow of Rs10,035 crore. The strong order inflow was a result of the continued traction in the country's investment in the power sector and the hectic pace of capital expenditure by Indian Inc. We were expecting a year-end order backlog of Rs45,000 crore and an order inflow of Rs28,000 crore for FY2007. However the order backlog at Rs45,700 is ahead our expectations as is the order inflow.

With additional power capacity of 63,000MW slated to come up in the 11th Five-Year Plan, we expect BHEL's order backlog to maintain its growth momentum going forward. Further, the government's increasing thrust on ultra-mega power projects could provide a tremendous boost to the company's order book, as each of the 4,000MW projects would be worth Rs16,000 crore.

Order book details

Particulars	Q2FY07	Q2FY06	% yoy change
Order at the beginning of the quarter	39330	30600	29
Order inflow	10035	4388	129
Revenue booked	3665	2788	31
Order backlog at the end of the Q	45700	32200	42

BHEL fully equipped for supercritical technology

Doubts were raised on BHEL's capability to supply boiler and turbines with supercritical technology required to implement power plants with capacity above 500MW. Such power plants are expected to be the next big thing in India's power sector, given the government's ambitious plan to set up ultra-mega power projects.

However BHEL has tied this loose end by joining hands with global power equipment major Alstom. The company's management is very confident of executing power projects using supercritical technology. Besides, it's just a matter of executing the first project which would lead to gradual absorption of this new technology.

Given BHEL's track record of imbibing and implementing new technologies, we are confident that the company would repeat its feat and smoothly absorb the supercritical technology. This in turn would ensure the growth momentum in its order flow.

BHEL to invest Rs1,600 crore for capacity expansion

In order to meet India's proposed capacity addition target of 63,000MW during the Eleventh Five-Year Plan period, BHEL plans to spend Rs1,600 crore to modernise its power equipment manufacturing facilities and expand its capacity. Half of this amount has already been spent. The proposed expansion will raise BHEL's equipment production capacity to around 10,000MW from 6,000MW currently. The enhanced capacity will be fully operational by the end of FY2007. The entire capital expenditure would be done through internal accruals. The company has said that it would be more than willing to enhance its capacity further, even beyond 10,000MW, if required by the country's power sector.

Valuation and view

BHEL's Q2FY2007 results are marginally below our expectations, primarily because of higher-than-expected staff and other expenses. However we are not changing our earnings estimates for the stock in view of the company's higher-than-expected order backlog and order inflow which, we believe, would expedite the revenue booking. Going forward, huge orders from generation companies like NTPC and Reliance Energy would drive the company's order books and earnings.

Further, as we said the government's increasing thrust on ultra-mega power projects would also provide a tremendous boost to the company's order book. At the current levels, the stock is trading at 19.4x its FY2008E earnings and 11.6x its FY2008E EBIDTA. Given the expectations of continued growth in its order book and the resultant strong earnings growth (at a CAGR of 35%), we believe the valuations are attractive. Even on a comparative basis, the stock is trading at a huge discount to its peers like Siemens and ABB. We maintain our Buy recommendation on the stock with a price target of Rs2,650.

Earnings table

Year ended Mar 31	FY04	FY05	FY06E	FY07E	FY08E
Net profit (Rs cr)	658.1	955.0	1679.3	2416.8	3066.0
% y-o-y growth	*6.0*	*23.0*	*74.0*	*44.0*	*27.0*
Shares in issue (cr)	24.5	24.5	24.5	24.5	24.5
EPS (Rs)	26.9	39.0	68.6	98.7	125.3
% y-o-y growth	*6.0*	*23.0*	*74.0*	*44.0*	*27.0*
PER (x)	89.6	61.8	35.1	24.4	19.2
Book value (Rs)	216.4	246.2	298.3	376.3	475.3
P/BV (Rs)	11.1	9.8	8.1	6.4	5.1
EV/EBIDTA (x)	63.0	39.4	22.3	15.8	11.5
Dividend yield (%)	0.2	0.3	0.6	0.9	1.1
RoCE (%)	19.2	26.8	36.4	42.3	44.3
RoNW (%)	12.4	15.8	23.0	26.2	26.4

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

Bharat Electronics

Apple Green

Stock Update

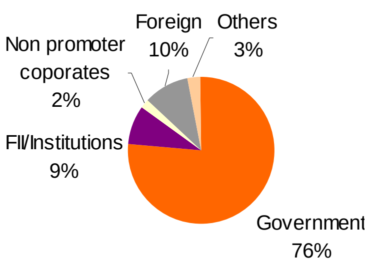
Better performance in H2

Buy; CMP: Rs1,120

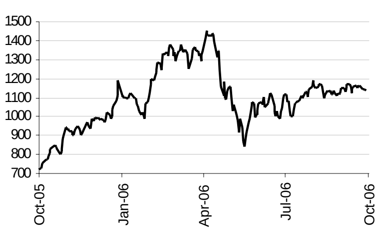
Company details

Price target:	Rs1,525
Market cap:	Rs8,960 cr
52 week high/low:	Rs1,472/712
NSE volume: (No of shares)	55,237
BSE code:	500049
NSE code:	BEL
Sharekhan code:	BEL
Free float: (No of shares)	1.9 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.6	4.5	-10.9	56.0
Relative to Sensex	-2.7	-13.3	-19.3	-7.1

Result highlights

- Bharat Electronics Ltd (BEL) has reported a lacklustre performance for the second quarter. On a stand-alone basis, its net revenues grew marginally by 0.7% to Rs834.3 crore.
- The operating profit margin (OPM) declined by 240 basis points to 22.4% from 24.8% in Q2FY2006. The OPM was dented by an increase in the employee cost as a percentage of sales (up from 12.1% in Q2FY2006 to 13.9% in Q2FY2007) and a jump of 38.8% in the other expenses. On the other hand, the raw material cost as a percentage of sales declined by 50 basis points and supported the margins.
- The other income more than doubled to Rs50.8 crore, which enabled the company to report a marginal growth (1.1% year on year [yoy]) in the net profit to Rs148.3 crore.
- On a half-yearly basis, the net revenues grew marginally by 0.7% to Rs1,317.4 crore. The OPM declined by 180 basis points to 19.6% during the period. The earnings grew by 2.6% to Rs208.6 crore aided by a 65.8% jump in the other income to Rs89.2 crore.
- Notwithstanding the lower-than-expected performance, the company is likely to achieve the stated gross revenue target of Rs4,200 crore during the current fiscal. The fresh order intake of over Rs800 crore during H1FY2007 was much better than that of Rs285 crore in H1FY2006. Moreover, the company generally accrues the bulk of its revenues (especially from the government segment) in the second half of the fiscal.
- In terms of valuations, the company trades at attractive valuations of 13.3x FY2007 and 11.8x FY2008 estimated earnings (without adjusting for the free cash of Rs229 per share on its books at the end of FY2006). We maintain our Buy call with a price target of Rs1,525.

Result table Rs (cr)

Particulars	Q2FY07	Q2FY06	Q1FY07	% yoy chg	% qoq chg
Net sales	834.3	828.8	483.1	0.7	72.7
Total expenditure	647.7	623.6	411.0	3.9	57.6
Operating profit	186.5	205.3	72.1	-9.1	158.7
Other income	50.8	24.0	38.4	111.9	32.5
Interest	0.7	0.6	0.3	14.8	180.0
Depreciation	19.8	17.6	20.8	12.8	-4.8
Profit before tax	216.9	211.1	89.4	2.7	142.6
Tax	69.2	64.4	29.1	7.5	137.6
RPAT	148.3	146.7	60.3	1.1	146.1
Equity share capital	80.0	80.0	80.0		
EPS (Rs)	18.5	18.3	7.5		
Margins (%)					
OPM (%)	22.4	24.8	14.9		
NPM (%)	17.8	17.7	12.5		

Volatility in quarterly results

Given the nature of the business, BEL's quarterly performance tends to be quite volatile and is not reflective of the expected performance during the full year. For instance, the company reported a decline of 8.4% in its revenues in H1FY2006 (as compared with H1FY2005). However, the company ended the full year with a double-digit growth in its revenues.

Moreover, the bulk of the revenues are accrued in the second half of the fiscal. For instance, the company generated over 63% of its total turnover in the last two quarters of FY2006. That's because the execution of large government contracts tends to get completed in the second half of the fiscal.

Civilian orders also affected margins

Apart from the higher employee cost (as a percentage of sales) and a jump in the other expenses, the company's OPM was also affected due to a higher contribution from the low-margin civilian orders during the first half of the current fiscal. The company accrued substantial revenues from the hardware supply part of the Mahanagar Telephone Nigam order (for convergent billing system) where the margins are relatively lower.

Valuation

Notwithstanding the lower-than-expected performance, we expect the company to report a robust growth in the second half of the fiscal. At the current market price the stock trades at 13.3x FY2007 and 11.8x FY2008 estimated earnings (without adjusting for the free cash of Rs229 per share on the company's books at the end of FY2006). We maintain our Buy call with a price target of Rs1525.

Key financials

Particulars	FY2005	FY2006E	FY2007E	FY2008E
Net sales (Rs cr)	3185.4	3502.0	4149.3	4741.4
Net profit (Rs cr)	446.3	583.0	672.6	759.6
No of shares (cr)	8.0	8.0	8.0	8.0
EPS (Rs)	55.8	72.9	84.1	95.0
% y-o-y change	-	*30.7*	*15.4*	*12.9*
PER (x)	20.1	15.4	13.3	11.8
Price/BV (x)	5.6	4.4	3.3	2.6
EV/EBIDTA (x)	11.9	8.4	6.8	5.3
Dividend yield (%)	1.0	1.0	1.1	1.1
RoCE (%)	42.6	41.7	36.7	32.7
RoNW (%)	29.5	29.7	25.6	22.5

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

Omax Autos

Apple Green

Stock Update

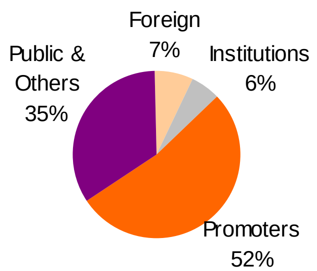
Price target revised to Rs134

Buy; CMP: Rs100

Company details

Price target:	Rs134
Market cap:	Rs214 cr
52 week high/low:	Rs174/58
NSE volume: (No of shares)	45,957
BSE code:	520021
NSE code:	OMAXAUTO
Sharekhan code:	OMAX
Free float: (No of shares)	1.0 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-1.5	26.3	-13.5	-25.5
Relative to Sensex	-5.6	-4.8	-21.7	-55.6

Result highlights

- Omax Auto's Q2FY2007 results are in line with our expectations with the sales reporting a growth of 12.1% to Rs168.6 crore. However, due to the delay in the export orders from Arvin Meritor and Tenneco, the company witnessed a slower-than-expected ramp-up in its exports.
- The operating profit margin (OPM) improved by 220 basis points to 9.9% on the back of lower power costs and other expenses. Consequently, the operating profit grew by 44.7% to Rs16.7 crore.
- However, higher interest and depreciation charges as a result of the capital expenditure incurred by the company led the profit before prior period expenses to grow by 22.2% to Rs5.8 crore. The net profit after the prior period expenses grew by 18.7% to Rs5.7 crore.
- Due to the delay in the export revenues and a muted performance in the domestic business (Hero Honda contributes 60% of the company's sales), higher interest and depreciation charges, we are downgrading our FY2007 and FY2008E earnings by 23% and 32% respectively.
- At the current market price of Rs100, the stock quotes at 6.8x its FY2008E earnings and enterprise value/earnings before interest, depreciation, tax and amortisation of 3.9x. Considering the cheap valuations we maintain our BUY recommendation on the stock with a revised price target of Rs134.

Result table Rs (cr)

Particulars	Q2FY07	Q2FY06	% yoy	H1FY07	H1FY06	% yoy
Net sales	**168.6**	**150.4**	**12.1**	**328.9**	**294.5**	**11.7**
Total expenditure	151.9	138.9	9.4	296.5	268.3	10.5
Raw material consumed	112.4	99.3	13.2	222.1	194.9	13.9
Change in stock	0.3	0.0		-2.9	-1.5	
Staff cost	16.0	6.5	146.2	31.6	14.0	126.7
Other expenses	23.2	33.1	-29.9	45.7	60.9	-24.9
Operating profit	**16.7**	**11.6**	**44.7**	**32.4**	**26.2**	**23.7**
Other income	1.7	1.4		3.6	2.5	
EBIDTA	**18.5**	**13.0**	**42.4**	**36.0**	**28.7**	**25.4**
Interest	4.1	2.1	94.8	7.9	4.5	76.3
PBDT	14.4	10.9		28.1	24.2	
Depreciation	5.3	3.6	49.4	10.4	8.7	18.4
PBT	9.1	7.3	24.0	17.8	15.5	14.7
Tax	3.2	2.5		6.3	5.3	
Reported PAT	**5.8**	**4.8**	**22.2**	**11.4**	**10.2**	**12.7**
Prior period expenses	0.2	0.0		0.2	0.0	
Adjusted PAT	5.7	4.8	18.7	11.3	10.2	11.0
EPS (Rs)	**2.7**	**2.2**		**5.3**	**4.7**	
OPM (%)	9.9	7.7		9.9	8.9	
NPM (%)	3.5	3.2		3.5	3.4	

Net revenues grew by 12.1% at Rs168.6 crore

The net revenues for Q2FY2007 are in line with our expectations as they marked a growth of 12.1% to Rs168.6 crore. At the beginning of the year, the company had revised its export target from Rs100 crore to Rs50 crore for the current fiscal and had set an export target of Rs100 crore for FY2008. Looking at the sluggish growth so far, we believe that the export target for the current year would not be met. The export revenues have not picked up due to a delay in the orders from its overseas customers like Arvin Meritor and Tenneco. Omax Auto has specifically commissioned the Binola plant, which is mainly reserved for export orders to the USA and Europe. The revenues from its Binola plant for the first half of the current fiscal stood at Rs10 crore as against Rs5 crore last year.

Improvement in operating profit margins

The operating profits for the quarter grew by 44.7% to Rs16.7 crore, as the operating margins improved by 220 basis points to 9.9%. Lower power costs and other expenditure led to an improvement in the margins.

The operating margins had been under pressure in the last one-year primarily due to higher raw material costs, power costs and employee expenses. To control costs, the company had undertaken a number of measures in an endeavour to improve its margins. To reduce the material costs, the company has set up a subsidiary Omax Steels at Ludhiana, which has commenced trial operations from September 2006 onwards. Omax is expected to utilise a majority of its subsidiary's output for its internal consumption, which should result in more economies and efficiency in material consumption that will help mitigate the volatility in the prices of steel--the main raw material of the company. Further there will also be an effective use of the scrap generated at its units. The plant will be fully operational by the end of the current fiscal.

To neutralise the rise in the power cost, the company has decided to use furnace oil power generator sets. It has already shifted to the use of heavy furnace oil for running its two manufacturing plants. It is further planning to reduce its power and fuel costs by replacing its diesel generation sets with low-cost fuel.

Capacity expansion plans

Omax has aggressive plans to expand capacities across all its units including the units at Dharuhera, Binola and Bangalore. For the current fiscal, the estimated capital expenditure (capex) is Rs60 crore. This includes a paint shop that is being set up in Bangalore specifically for the requirements of TVS Motors.

Further there are plans to put up a new manufacturing unit in the state of Uttranchal. The company is also negotiating with a major light commercial vehicle/medium commercial vehicle manufacturer to set up a plant for them. In case this materialises, the company would need to incur an additional capex of Rs60-70 crore in the next year. Omax is also planning to increase the sales of its tools and dies innovated and manufactured at its Manesar plant. All the capex will be funded partly by term loans and partly by internal accruals.

Downgrade and valuations

Due to the postponement of the export revenues and the lower-than-expected growth in the domestic revenues, higher interest and depreciation, we are downgrading our earnings estimates for FY2007E and FY2008E by 23% and 32% respectively.

Hero Honda, which accounts for nearly 60% of the company's revenues, is experiencing a sharp slowdown in its volume growth and has been facing intense margin pressure. As a result, Omax Auto is likely to face pricing pressure from Hero Honda, which can keep its operating margins capped at the current levels despite an improvement in the operational efficiencies.

At the current levels, the stock discounts its FY2008E earnings by 6.8x and enterprise value (EV) by 3.9x. Considering the cheap valuations we maintain a BUY on the stock with a downward revised price target of Rs134.

Key financials

Particulars	FY2005	FY2006E	FY2007E	FY2008E
Net sales (Rs cr)	505.3	578.6	664.8	786.0
% y-o-y growth		*14.5*	*14.9*	*18.2*
Net profit (Rs cr)	20.3	20.0	24.6	31.9
% y-o-y growth		*-1.2*	*22.6*	*29.8*
EPS (Rs)	8.9	9.4	11.5	14.9
PER (x)	11.3	10.8	8.8	6.8
Book value (x)	43.9	52.8	69.1	90.5
P/BV (x)	2.3	1.9	1.5	1.1
EV/EBITDA (x)	6.0	6.7	4.6	3.9
RoCE (%)	16.9	13.3	18.9	16.3
RoNW (%)	23.2	18.8	22.0	18.7

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

ITC

Apple Green

Stock Update

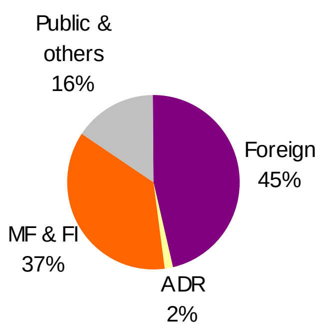
All-round performance

Buy; CMP: Rs188

Company details

Price target:	Rs220
Market cap:	Rs70,594 cr
52 week high/low:	Rs213/115
NSE volume: (No of shares)	61.5 lakh
BSE code:	500875
NSE code:	ITC
Sharekhan code:	ITC
Free float: (No of shares)	369 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	1.2	12.8	-5.8	64.7
Relative to Sensex	-3.1	-6.4	-14.7	-1.9

Result highlights

- ITC's Q2FY2007 net profit grew by 18.7% year on year (yoy) to Rs680.0 crore, in line with our expectations.
- The net revenues for the quarter grew by 32.3% yoy as most of its businesses grew strongly: cigarettes (14%), fast moving consumer goods (FMCG; 66%), hotels (30.5%), paperboards (11.3%) and agri-business (86.6%).
- The profit before interest and tax (PBIT) grew by 19.4% yoy as the PBIT margin contracted by 100 basis points, as per our expectations.
- The contraction in the margin was on account of a higher contribution from the low-margin agri-business. Except the agri-business all the other businesses witnessed a healthy expansion in their PBIT margin.
- The non-cigarette FMCG business is the only business in ITC's portfolio that is making losses. However, with a strong growth in the revenues, the magnitude of losses, ie the loss margin, have come down considerably.
- We have always liked the way ITC has channelised the strong cash flows generated from the cigarette business into the other businesses without affecting its return on capital employed (RoCE). At the current market price of Rs188, the stock is attractively quoting at 21.3x its FY2008E earnings per share (EPS) and 13.6x FY2008E enterprise value (EV)/earnings before interest, depreciation, tax and amortisation (EBIDTA). We maintain our Buy recommendation on ITC with a price target of Rs220.

Revenues grow on all-round performance

ITC's net revenues for Q2FY2007 grew by 32.3% yoy backed by a strong growth in all its businesses. The core business of cigarettes grew by 14% yoy. Among the other businesses, the non-cigarette FMCG business witnessed a growth of 66% yoy.

Result table Rs (cr)

Particulars	H1FY07	H1FY06	% yoy	Q2FY07	Q2FY06	% yoy	% qoq
Net sales	5,737.3	4,450.0	28.9	2,887.6	2,183.2	32.3	1.3
Other income	164.4	162.6	1.1	79.5	78.1	1.8	-6.4
Total income	5,901.8	4,612.6	27.9	2,967.1	2,261.2	31.2	1.1
Total expenditure	3,794.1	2,803.4	35.3	1,914.9	1,363.3	40.5	1.9
Operating profit	1,943.3	1,646.6	18.0	972.7	819.8	18.6	0.2
Interest	4.2	0.8	-	3.5	-0.3	-	-
Depreciation	178.6	163.0	9.5	91.0	83.0	9.6	3.8
Profit before tax	1,924.9	1,645.4	17.0	957.8	815.2	17.5	-1.0
Tax	593.0	514.8		278.2	242.9		
Reported profit after tax	1,331.8	1,130.6	17.8	679.6	572.3	18.7	4.2
Extraordinary items	0.0	26.8		0.0	0.0		
Profit after extraordinary	1,331.8	1,103.9	20.7	679.6	572.3	18.7	4.2
OPM (%)	33.9	37.0		33.7	37.6		

Segment-wise gross revenues (Rs crore)

Particulars	Q2FY07	Q2FY06	% yoy chg	% qoq chg
FMCG - cigarettes	3,101.7	2,723.1	13.9	-1.8
FMCG - others	409.6	246.9	65.9	13.9
Hotels	201.0	154.0	30.5	1.1
Agri-business	868.8	465.6	86.6	-21.8
Paperboards, paper & packaging	523.0	470.0	11.3	4.3
Total	5,104.0	4,059.5	25.7	-4.2

Source: Company

PBIT grows by 21.6% yoy

The PBIT grew by 21.6% yoy as the PBIT margin contracted by 100 basis points yoy. The margin contraction was a result of a higher contribution of the low-margin agri-business to the total revenues. Commendably, all the other businesses saw a healthy expansion in their PBIT margin.

Segmental PBIT

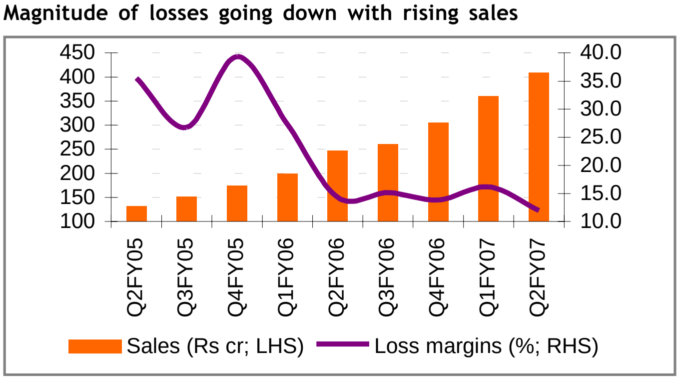
	Rs crore		% yoy	Margins (%)		Chg in
	Q2FY07	Q21FY06	chg	Q2FY07	Q2FY06	bps
FMCG						
- cigarettes	786.6	683.0	15.2	25.4	25.1	28.0
-others	-49.0	-35.3	-	-12.0	-14.3	235.5
Hotels	57.8	27.6	109.7	28.8	17.9	1085.9
Agri-business	46.1	30.9	49.4	5.3	6.6	-132.3
Paperboards, paper & packaging	110.9	91.9	20.7	21.2	19.5	165.2
Total	952.4	797.9	19.4	18.7	19.7	-99.6

Source: Company

Magnitude of losses in other FMCG businesses decreasing with scale

The non-cigarette FMCG business continued to make losses in Q2FY2007. However, over the past couple of quarters the magnitude of losses has decreased. The margin of losses has reduced from 35% in Q2FY2005 to around 12% in Q2FY2007.

Magnitude of losses going down with rising sales

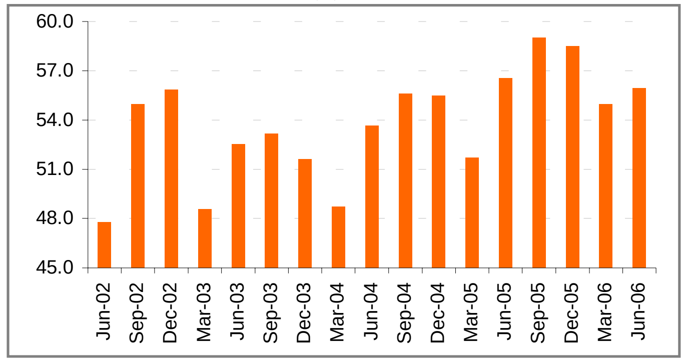


Source: Company, Sharekhan Research

Valuation and view

We have always liked the way ITC has channelised the strong cash flows generated from the cigarette business into the other businesses of FMCG products, hotels, paper boards and now e-Choupals. Notably, over FY2000-06 the company has incurred a capital expenditure of more than Rs4,500 crore for its various businesses without affecting the RoCE.

ITC's trailing 12-month RoCE (%)



Source: Company, Sharekhan Research

At the current market price of Rs188, the stock is attractively quoting at 21.3x its FY2008E EPS and 13.6x FY2008E EV/EBIDTA. We maintain our Buy recommendation on ITC with a price target of Rs220.

Key financials

Particulars	FY2005	FY2006E	FY2007E	FY2008E
Net profit (Rs crore)	1,837.5	2,275.8	2,791.3	3,312.4
Shares in issue (crore)	375.5	375.5	375.5	375.5
EPS (Rs)	4.9	6.1	7.4	8.8
y-o-y chg (%)	*15.3*	*23.9*	*22.7*	*18.7*
PER (x)	38.4	31.0	25.3	21.3
Book value (Rs)	21.0	24.1	28.5	34.3
P/BV (x)	8.9	7.8	6.6	5.5
EV/EBIDTA (x)	24.0	20.5	16.6	13.6
EV/Sales (x)	8.8	6.9	5.5	4.4
RoCE (%)	32.8	32.7	35.1	35.1
RoNW (%)	25.7	26.8	28.2	28.1

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

Godrej Consumer Products

Apple Green

Stock Update

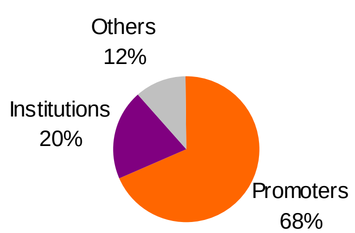
First-cut analysis

Buy; CMP: Rs182

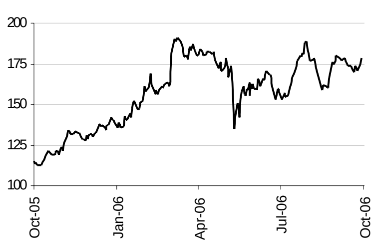
Company details

Price target:	Rs205
Market cap:	Rs4,119 cr
52 week high/low:	Rs200/111
NSE volume: (No of shares)	26,801
BSE code:	532424
NSE code:	GODREJCP
Sharekhan code:	GODRCON
Free float: (No of shares)	7.2 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.8	12.3	-0.3	61.7
Relative to Sensex	-2.5	-6.8	-9.7	-3.7

Result highlights

- The stand-alone revenues of Godrej Consumer Products Ltd (GCPL) grew by 16.2% year on year (yoy) to Rs182.5 crore in Q2FY2007. The revenue growth was below our expectations. The soap business grew by 16.5% yoy to Rs127.2 crore whereas the personal care business grew by 15.4% yoy to Rs55.3 crore.
- GCPL's operating profit (OP) grew by a meagre 3.8% yoy to Rs33.8 crore in Q2FY2007, also below our expectations. The operating profit margin contracted by 220 basis points to 18.5%. The mediocre growth in the OP was a result of a sharp increase in the material cost, which jumped by 27.8% to Rs92.2 crore during the quarter. This increase was a result of the hardening prices of vegetable oil, which is a key raw material for the fast moving consumer goods companies.
- The profit before interest and tax (PBIT) margin of the soap division reduced by 400 basis points yoy to 10.8% whereas that of the personal care division increased by 60 basis points yoy to 42.7% during the quarter.
- The interest cost zoomed by 87.1% to Rs1.6 crore. The effective tax rate also increased from 5.8% in Q2FY2006 to 12.7% Q2FY2007. The higher-than-expected interest cost and tax expenses coupled with the lower-than-expected operating performance led to a 6% decline in the profit after tax to Rs26.1 crore. The same was below our expectations.
- GCPL's consolidated revenues for Q2FY2007 stood at Rs231.8 crore. Its consolidated OP and net profit stood at Rs39.7 crore and Rs31.0 crore respectively. The company's consolidated numbers reflect the stand-alone numbers of Keyline, UK and Rapidol, South Africa (the latter is the subsidiary company GCPL acquired this quarter).
- The stock trades at a price/earnings ratio of 22.4x FY2008E consolidated earnings. In view of the lower-than-expected results in the second quarter we are revising our earnings estimates for the company. We shall update our estimates after attending the company's earnings conference call for the Q2FY2007 results.

Result table Rs (cr)

Particulars	Q2FY2007	Q2FY2006	% yoy chg
Net sales	182.5	157.1	16.2
Expenditure	148.7	124.5	19.4
Operating profit	33.8	32.6	3.8
Other income	0.6	0.5	7.7
PBIDT	34.4	33.1	3.9
Interest	1.6	0.9	87.1
Depreciation	2.9	2.7	4.8
PBT	29.9	29.5	1.4
Tax	3.8	1.7	122.9
PAT	26.1	27.8	-6.0
EPS (Rs/Share)	1.16	1.23	-6.0
OPM (%)	18.5	20.7	-220 bps
PBTM (%)	16.4	18.8	-240 bps
PATM (%)	14.3	17.7	-340 bps

Universal Cables

Ugly Duckling

Stock Update

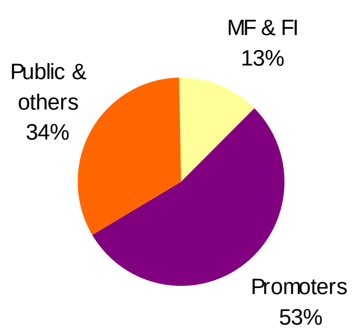
Performance in line with expectations

Buy; CMP: Rs118

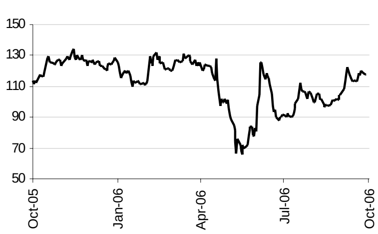
Company details

Price target:	Rs179
Market cap:	Rs258 cr
52 week high/low:	Rs139/61
NSE volume: (No of shares)	55,403
BSE code:	504212
NSE code:	UNIVCABLES
Sharekhan code:	UNCABLES
Free float: (No of shares)	1.1 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	16.8	31.1	-4.2	2.9
Relative to Sensex	11.9	8.8	-13.2	-38.7

Result highlights

- Universal Cables' Q2FY2007 net profit at Rs5.64 crore is in line with our expectations.
- The net revenues have grown by 20.4% year on year (yoy) to Rs91 crore driven by a 19.6% growth in the cable sales. The sales of capacitators grew by 45.3% yoy.
- The operating profit margin (OPM) contracted by 49 basis points yoy, resulting in a slower operating profit growth of 15.5% yoy.
- The margin at the profit before interest and tax (PBIT) level in the cable business contracted by 48 basis points yoy. This resulted in a slower growth of 14.8% yoy in the PBIT to Rs9.85 crore. The PBIT margin in the capacitator business contracted by 77 basis points, leading to a slower PBIT growth of 40.3% yoy to Rs0.87 crore.
- The net profit growth too was lower at 14.4% due to higher depreciation during the quarter.
- At the current market price of Rs118, the stock is quoting at 5.5x its FY2008E earnings per share (EPS) and 3.2x FY2008E enterprise value (EV)/earnings before interest, depreciation, tax and amortisation (EBIDTA).
- We reiterate our Buy recommendation on the stock with price target of Rs179.

Net sales grow by 23.1% yoy

Universal Cables' net sales grew by 20.4% yoy driven by a 19.6% year-on-year (y-o-y) growth in the sales of cables and a 45% y-o-y growth in the sales of capacitators.

Segmental revenues (net)

Particulars	H1FY07	H1FY06	% yoy chg	Q2FY07	Q2FY06	% yoy chg
Total revenues	175.7	148.1	18.6	91.2	75.6	20.5
Power cables	166.0	140.2	18.4	84.9	71.0	19.6
Capacitors	7.4	6.0	24.0	4.0	2.8	45.3
Telephone cables	2.2	1.9	19.3	2.2	1.9	19.3

Result table Rs (cr)

Particulars	H1FY07	H1FY06	% yoy chg	Q2FY07	Q2FY06	% yoy chg
Net sales	175.5	148.1	18.6	91.0	75.6	20.4
Other income	2.4	2.1	18.0	1.5	1.6	-4.5
Total income	178.0	150.1	18.5	92.5	77.2	19.9
Total expenditure	154.2	128.8	19.7	80.6	66.6	21.1
Operating profit	21.3	19.3	10.6	10.4	9.0	15.5
Interest	3.3	2.8	18.6	1.6	1.4	16.5
Depreciation	3.2	2.5	29.1	1.7	1.5	15.2
Profit before tax	17.3	16.1	7.3	8.5	7.7	11.2
Tax	6.0	5.7	5.7	2.9	2.7	5.5
Reported profit after tax	11.3	10.4	8.2	5.6	4.9	14.4
OPM (%)	12.2	13.03		11.4	11.9	

Operating profit grows by 15.5% as OPM declines

The operating profit for the quarter under review increased by a slower 15.5% yoy as the OPM contracted by 49 basis points yoy driven by a higher raw material cost (RMC). The RMC as a percentage of sales went up by 239 basis points yoy.

Particulars	H1 FY07	H1 FY06	% yoy chg	Q2 FY07	Q2 FY06	% yoy chg
RMC	117.6	95.4	23.3	62.3	48.8	27.7
As % of sales	*67.0*	*65.1*	*184.7* (bps)	*68.4*	*66.0*	*239.0* (bps)
Employee expenses	11.9	10.4	14.3	5.9	5.4	10.6
As % of sales	*6.8*	*7.1*	*-32.7* (bps)	*6.5*	*7.2*	*-73.1* (bps)
Other expenses	24.8	21.5	15.3	12.5	10.9	14.5
As % of sales	*14.1*	*14.7*	*-56.4* (bps)	*13.7*	*14.7*	*-101.7* (bps)
Total expenditure	154.2	127.2	21.2	80.6	65.1	24.0
As % of sales	*87.8*	*86.9*	*96.1* (bps)	*88.6*	*88.0*	*64.2* (bps)

The PBIT in the cable business grew by a slower 14.8% yoy as the PBIT margin contracted by 48 basis points yoy. The PBIT in the capacitator business grew by a slower 40.3% yoy as the PBIT margin contracted by 77 basis points yoy.

Particulars	H1 FY07	H1 FY06	% yoy chg	Q2 FY07	Q2 FY06	% yoy chg
Total PBIT (Rs cr)	**20.1**	**18.7**	**7.4**	**9.9**	**8.7**	**12.8**
Power cables	19.7	17.4	13.3	9.8	8.5	14.8
Capacitors	1.2	1.8	-30.3	0.9	0.6	40.3
Telephone cables	-0.8	-0.4	97.5	-0.8	-0.4	97.5
PBIT margins (%)			**Chng in bps**			**Chng in bps**
Total PBIT	11.4	12.6	-119.3	10.8	11.5	-73.8
Power cables	11.9	12.4	-53.2	11.5	12.0	-48.1
Capacitors	16.4	29.2	-1277.0	21.7	22.5	-76.8
Telephone cables	-35.4	-21.4		-35.4	-21.4	

Net profit grows by 14.4%

The net profit for the quarter under review grew by 14.4% yoy as the depreciation during the quarter was a little higher.

Valuation and view

We expect Universal Cables' OPM to expand by 247 basis points over FY2006-08E due to the following reasons.

- The company focuses on the higher-end products that have better margins.
- It is expanding its capacity at much lower capital and operational costs.
- Its 100% subsidiary Optic Fiber Goa shall turn profitable during the period.

We also expect the company's return ratios to improve considerably over the same period. The return on capital employed should improve from 18.1% to 20.2% and the return on net worth should improve from 11.9% to 16.4%.

At the current market price of Rs118, the stock is quoting at 7.5x its FY2008E EPS and 4.4x FY2008E EV/EBIDTA. We reiterate our Buy recommendation on the stock with sum-of-parts price target of Rs179.

Particulars	Rs per share	Comments
Value of business	144.0	@11x FY2008E EPS
Value of investments	34.0	At 40% discount to current market price
Total	179.0	

Key financials

Particulars	FY2005	FY2006E	FY2007E	FY2008E
Net profit (Rs cr)	3.9	16.6	21.6	30.5
Share in issue (cr)	2.0	2.0	2.3	2.3
EPS (Rs)	2.0	8.3	9.3	13.2
% y-o-y growth	*-193.9*	*322.4*	*13.0*	*40.9*
PER (x)	60.2	14.3	12.6	9.0
Book value (Rs)	46.6	70.7	75.2	95.1
P/BV (x)	2.5	1.7	1.6	1.2
EV/EBIDTA (x)	17.0	6.6	7.3	4.7
EV/sales (x)	1.4	0.9	1.0	0.7
Dividend yield (%)	0.8	1.7	1.7	1.7
ROCE (%)	8.3	18.1	15.9	20.2
RONW (%)	4.5	11.9	13.5	16.4

Allahabad Bank

Cannonball

Stock Update

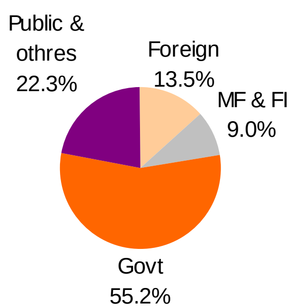
Core performance remains weak

Buy; CMP: Rs93

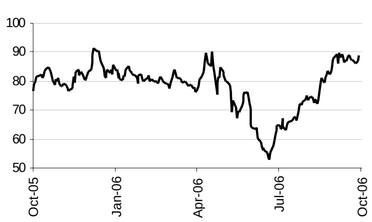
Company details

Price target:	Rs106
Market cap:	Rs4,154 cr
52 week high/low:	Rs94/53
NSE volume: (No of shares)	8.9 lakh
BSE code:	532480
NSE code:	ALBK
Sharekhan code:	ALLBANK
Free float: (No of shares)	20.0 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	5.8	41.3	21.6	20.3
Relative to Sensex	1.4	17.2	10.2	-28.3

Result highlights

- Allahabad Bank's net profit grew by 24.8% year on year (yoy) to Rs210.2 crore in Q2FY2007. The net profit grew at a rate higher than our expectations of 13.2% mainly due to a write-back in provisions, as at the operating level the profit growth was below our expectations at just 0.8% yoy.
- During the quarter, the bank's net interest income (NII) grew by 6.1% yoy to Rs389.9 crore, much below our expectations of a 16.9% year-on-year (y-o-y) growth.
- The NII growth was lower since the net interest margin (NIM) slipped by 47 basis points yoy and by 41 basis points quarter on quarter (qoq) to 2.6%. The yield on advances improved by 25 basis points yoy and by 11 basis points quarter on quarter (qoq) to 8.88%. However, the same and a 47.4% growth in the advances couldn't restrict the fall in the NIM. That is because the deposit cost increased by 56 basis points yoy and by 31 basis points qoq, and the deposits grew by 23.6% yoy during the quarter.
- The other income decreased by 24.6% yoy to Rs122.2 crore mainly due to a fall in the trading and other non-fee incomes. The other income excluding the treasury income also reported a fall of 15.5%. The core fee income, however, grew by 8% yoy.
- The operating expenses reported a fall of 6.8% yoy on account of a 12% fall in the staff expenses. As a result, the operating profit grew marginally by 0.8% yoy to Rs243.3 crore. The operating profit excluding the treasury income grew by 12.4% yoy, much below our expectations of a 21.5% growth.
- However, despite a marginal rise at the operating level, the bank reported a 41.8% rise in its profit before tax (PBT). This was mainly on account of a Rs19.7-crore write-back in the total provisions arising due to a Rs38.4-crore write-back in depreciation on investments.
- Even though the operating performance was below expectations and the write-back in the provisions higher than expected, the net profit at Rs210.2 crore was much above our expectations.

Result table Rs (cr)

Particulars	H1FY07	H1FY06	% yoy	Q2FY07	Q2FY06	% yoy	% qoq
Net interest income	780.8	727.3	7.4	389.9	367.6	6.1	-0.3
Other income	203.6	284.3	-28.4	122.2	162.1	-24.6	50.2
Other income (excl treasury)	191.7	213.6	-10.3	96.7	114.5	-15.5	1.8
Treasury income	11.9	70.7	-83.2	25.5	47.6	-46.4	LP
Net income	984.4	1,011.6	-2.7	512.1	529.7	-3.3	8.4
Operating expenses	533.6	585.2	-8.8	268.7	288.3	-6.8	1.5
Operating profit	450.8	426.5	5.7	243.3	241.4	0.8	17.3
Provisions	142.7	68.4	108.7	-19.7	55.9	-	-112.2
Tax	-30.3	26.8	-213.3	52.9	17.2	207.4	-30.3
Net profit	338.4	331.3	2.1	210.2	168.3	24.8	63.9

- We have revised our earnings per share (EPS) estimates for FY2007 from Rs14.6 to Rs15.7 mainly on account of the lower provisioning requirements and operating expenses of the bank. Our FY2008 EPS estimates however remain unchanged at Rs21.8.
- At the current market price of Rs93, the stock is quoting at 4.3x its FY2008E EPS, 3x pre-provision profit (PPP) and 0.8x book value. The bank is available at attractive valuations, considering its strong average return on equity (RoE) of 20.2% over FY2006-08E. We maintain our Buy call on the stock with a price target of Rs106.

NII growth muted at 6.1% yoy

Allahabad Bank reported a NII growth of 6.1% yoy to Rs389.9 crore and the same was below our expectations of a 16.9% growth mainly due to a fall in the NIM by 47 basis points. Although the yield on the advances improved by 25 basis points yoy and by 11 basis points qoq to 8.88%, yet the same and a 44.9% growth in the advances couldn't restrict the fall in the NIM. That is because the deposit cost increased by 56 basis points yoy and by 31 basis points qoq on the back of a 23.6% rise in the deposits.

Other income falls below expectations

For the second quarter, most public sector banks have reported a growth in their other income excluding the treasury income, but Allahabad Bank has reported a fall of 15.5% in the same. Its treasury income dropped by 46.4% yoy whereas its total other income declined by 24.6% yoy.

Other income (Rs crore)

Particulars	Q2Y07	Q2FY06	% yoy chg	% qoq chg
Other income (excl. treasury)	96.7	114.5	-15.5	1.8
Treasury income	25.5	47.6	-46.4	LP
Total	122.2	162.1	-24.6	50.2

Source: Company, Sharekhan Research

Operating expenses down due to lower staff expenses

The operating expenses of the bank dropped by 6.8% yoy to Rs268.7 crore with the staff cost falling by 12% to Rs138.3 crore.

Operating expenses (Rs crore)

Particulars	Q2Y07	Q2FY06	% yoy chg	% qoq chg
Employee cost	138.3	157.2	-12.0	-8.9
Other operating expenses	130.4	131.1	-0.5	15.3
Total operating expenses	268.7	288.3	-6.8	1.5

Write-back in provisions improve PAT growth

A decline in the bond yields helped the bank to write back depreciation on investments for Rs38.4 crore. This resulted in a write-back of total provisions to the tune of Rs19.7 crore during the quarter. Despite a marginal rise at the operating profit level, the bank reported a 41.8% increase in its PBT mainly on account of the write-back in the total provisions. With the core operating performance below our expectations and the write-back in provisions higher than expected, the net profit at Rs210.2 crore was much above our expectations.

Break-up of provisions

Particulars	Q2FY07	Q2FY06	% yoy chng
Amortisation and others	-29.7	33.1	-
NPA	10.0	22.8	-56.1
Total	-19.7	55.9	-

Asset quality improves mainly on strong advances growth

The bank's net non-performing assets (NPAs) reduced to 0.75% of the net advance at the end of September 2006 from 0.97% at the end of September 2005. However, on a sequential basis the same improved by only two basis points from 0.73% at the end of June 2006. On the other hand, the gross NPAs fell significantly in percentage terms, from 5.03% to 3.24%, mainly due to the strong growth in the

Yield assessment (%)

	H1FY07	H1FY06	yoy chg (in bps)	Q2FY07	Q2FY06	Q1FY07	yoy chg (in bps)	qoq chg (in bps)
Advances yield	8.83	8.62	21.0	8.88	8.63	8.77	25.0	11.0
Investment yield	7.45	7.21	24.0	7.44	7.07	7.46	37.0	-2.0
Average yield on funds	7.80	7.47	33.0	7.64	7.52	7.98	12.0	-34.0
Cost of deposit	5.45	4.99	46.0	5.60	5.04	5.29	56.0	31.0
Cost of borrowings	7.42	6.98	44.0	7.36	6.98	7.45	38.0	-9.0
Average cost of funds	5.01	4.42	59.0	5.04	4.45	5.34	59.0	-30.0
NIM	2.79	3.05	-26.0	2.60	3.07	3.01	-47.0	-41.0

Source: Sharekhan Research
Reported NIM on quarterly and half-yearly basis

advances (gross advances grew by 44.9% yoy). On absolute terms, the gross NPAs improved by only Rs85.3 crore.

Valuation and view

We have revised our earnings per share (EPS) estimates for FY2007 from Rs14.6 to Rs15.7 mainly on account of the lower provisioning requirements and operating expenses of the bank. Our FY2008 EPS estimates however remain unchanged at Rs21.8.

At the current market price of Rs93, the stock is quoting at 4.3x its FY2008E EPS, 3x PPP and 0.8x book value. The bank is available at attractive valuations, considering its strong average RoE of 20.2% over FY2006-08E. We maintain our Buy call on the stock with a price target of Rs106.

Key financials

Particulars	FY2005	FY2006E	FY2007E	FY2008E
Net profit (Rs cr)	541.8	706.1	702.4	973.7
Shares in issue (cr)	34.7	44.7	44.7	44.7
EPS (Rs)	15.6	15.8	15.7	21.8
EPS growth (%)	16.9	1.2	-0.5	38.6
PE (x)	6.0	5.9	5.9	4.3
P/PPP (x)	3.4	3.1	3.8	3.0
Book value (Rs)	67.1	81.5	93.8	110.4
P/BV (x)	1.4	1.1	1.0	0.8
Adj book value (Rs)	59.3	75.9	89.1	107.4
P/ABV (x)	1.6	1.2	1.0	0.9
RONW (%)	27.9	21.3	17.9	21.4

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

Andhra Bank

Cannonball

Stock Update

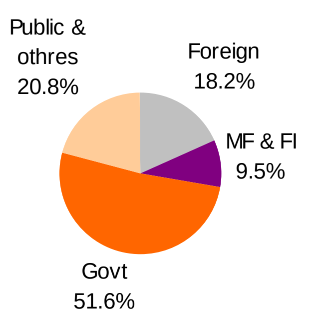
In line with expectations

Buy; CMP: Rs92

Company details

Price target:	Rs109
Market cap:	Rs4,457 cr
52 week high/low:	Rs109/57
NSE volume: (No of shares)	9.8 lakh
BSE code:	532418
NSE code:	ANDHRABANK
Sharekhan code:	ANDHBANK
Free float: (No of shares)	23.5 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	0.0	42.5	22.5	4.9
Relative to Sensex	-4.2	18.2	10.9	-37.5

Result highlights

- In Q2FY2007 Andhra Bank's net profit grew by 10.2% year on year (yoy) to Rs146.4 crore, in line with our expectations.
- During the quarter the bank's net interest income (NII) grew by 14.7% yoy to Rs330.9 crore, below our expectations of a 23.8% year-on-year (y-o-y) growth.
- The growth in the NII was lower because of an 8.7-basis-point fall in the net interest margin (NIM) due to a lower yield on investments and a higher cost of deposits.
- The other income increased by 9.1% yoy to Rs128.7 crore. The growth was in single digits mainly due to a fall of 39.7% in the trading income. However, the other income excluding the treasury income reported a strong growth of 25% with the core fee income growing by 22.3% yoy to Rs47.7 crore.
- The operating expenses reported a rise of 14.8% yoy and the operating profit grew by 11.3% yoy to Rs223.1 crore. The operating profit excluding the treasury income grew by 19.9% yoy, below our expectations.
- With the provisioning lower than expected, the net profit grew by 10.2% yoy to Rs146.4 crore, in line with our estimates.
- We have revised our earnings per share (EPS) estimates for FY2007 from Rs10.7 to Rs11.3 mainly on account of the improving core banking performance and the stable other income growth. Our FY2008 EPS estimates however remain at Rs13.3.
- At the current market price of Rs92, the stock is quoting at 6.9x its FY2008E EPS, 4.1x pre-provision profits (PPP) and 1.2x book value. The bank is available at attractive valuations given its improving operating performance, the adequate capital available in its books to meet the Basel II requirements and asset quality that is one of the best in the industry. We maintain our Buy call on the stock with a price target of Rs109.

Result table Rs (cr)

Particulars	H1FY07	H1FY06	% yoy chg	Q2FY07	Q2FY06	% yoy chg	% qoq chg
Net interest income	666.1	562.9	18.3	330.9	288.6	14.7	-1.3
Other income	230.5	195.1	18.1	128.7	117.9	9.1	26.3
Other income (excl treasury)	207.3	168.3	23.2	111.2	89.0	25.0	15.6
Treasury income	23.2	26.8	-13.7	17.5	29.0	-39.7	207.7
Net income	896.6	758.0	18.3	459.5	406.5	13.1	5.1
Operating expenses	467.0	397.4	17.5	236.5	206.0	14.8	2.6
Operating profit	429.6	360.6	19.1	223.1	200.5	11.3	8.0
Provisions	55.7	59.6	-6.4	9.2	14.6	-37.4	-80.4
Tax	111.0	83.0	33.7	67.5	53.0	27.4	111.0
Net profit	262.9	218.1	20.5	146.4	132.9	10.2	262.9

NII growth at 14.7% yoy

The growth in the NII was slightly lower than our expectations due to an 8.7-basis-point decline in the NIM on account of a lower yield on investments and a higher cost of deposits. However, on a sequential basis the NIM expanded by five basis points.

The bank's strategy to focus on low-cost deposits helped it to improve the proportion of the current and savings account deposits in the total deposits to 39.8% from 35.9% last year.

Yield assessment (%)

Particulars	Q2 FY07	Q2 FY06	Q1 FY07	yoy chg (in bps)	qoq chg (in bps)
Yield on advances	9.56	9.22	9.64	33.8	-7.9
Yield on investments	6.59	7.01	7.19	-41.6	-59.9
Cost of deposits	5.12	4.62	5.04	50.5	8.4
Yield on funds	7.90	7.64	7.58	25.5	32.0
Cost of funds	4.51	4.17	4.23	34.2	27.8
NIM	3.38	3.47	3.34	-8.7	4.2

Source: Sharekhan Research
Quarterly figures are calculated based on opening and closing balances

Advances up 23.2% yoy with retail advances up 36.1% yoy

The y-o-y growth of 23.2% in the bank's advances has been below the industry average of ~30%. However the bank has reported a strong growth of 36.1% yoy in the retail segment which has helped it to improve the yield on the advances.

Advances break-up (Rs crore)

Particulars	H1FY07	H1FY06	% yoy chng
Gross bank credit	23,600.0	19,153.0	23.2
Food credit	636.0	960.0	-33.8
Non-food credit	22,964.0	18,393.0	24.9
Retail	5,264.0	3,867.0	36.1
- Housing	2,867.0	1,792.0	60.0

Source: Sharekhan research

Other income up 9.1%, restricted due to fall in trading income

The other income increased by 9.1% yoy to Rs128.7 crore mainly due to a 39.7% fall in the trading income to Rs17.5 crore. Excluding the treasury income, the other income increased by a strong 25% with the fee income growing by 22% to Rs47.7 crore.

Other income (Rs crore)

Particulars	Q2Y07	Q2FY06	% yoy	% qoq
Other income (excl. treasury)	111.2	89.0	25.0	15.6
Treasury income	17.5	29.0	-39.7	207.7
Total	128.7	117.9	9.1	26.3

Source: Company, Sharekhan Research

Operating expenses up 14.8% yoy

The operating expenses reported a 14.8% increase yoy to Rs236.5 crore with the staff cost reporting a rise of 17% to Rs145.9 crore. The bank has provided Rs6.25 crore as further provision for the revised guidelines on AS15. For H1FY2007 the bank has provided Rs12.5 crore as further provision for the AS15 requirements.

Operating profit grew by 11.3% yoy

The core operating profit grew by 19.9% against our expectations of 30.8% mainly due to a lower-than-expected net income.

Operating expenses (Rs crore)

Particulars	Q2Y07	Q2FY06	% yoy	% qoq
Employee cost	145.9	124.7	17.1	6.1
Other operating expenses	90.5	81.3	11.3	-2.8
Total operating expenses	236.5	206.0	14.8	2.6

Lower provisions help boost net profit

With the provisioning lower than expected, the net profit grew by 10.2% yoy to Rs146.4 crore, in line with our estimates.

Break-up of provisions

Particulars	Q2FY07	Q2FY06	% yoy chng
NPA provision	-9.2	0.0	-
Investment Depreciation	-5.0	-1.7	-
Amortization Premium	18.6	13.8	35.2
Other Provisions	4.7	2.5	88.0
Total	9.2	14.6	-37.4

Asset quality among the best in the industry

The bank's net non-performing assets (NPAs) reduced to 0.1% of its net advances at the end of September 2006 from 0.26% at the end of September 2005. However, on a sequential basis the same increased by only three basis points from 0.07% at the end of June 2006.

Valuation and view

We have revised our EPS estimates for FY2007 from Rs10.7 to Rs11.3 mainly on account of the improving core banking performance and the stable other income growth. Our FY2008 EPS estimates however remain at Rs13.3. At the current market price of Rs92, the stock is quoting at 6.9x its FY2008E EPS, 4.1x PPP and 1.2x book value. The bank is available at attractive valuations given its improving operating performance, the adequate capital available in its books to meet the Basel II requirements and asset quality that is one of the best in the industry. We maintain our Buy call on the stock with a price target of Rs109.

Key financials

Particulars	FY2005	FY2006E	FY2007E	FY2008E
Net profit (Rs cr)	520.1	485.5	546.2	644.2
Shares in issue (cr)	40.0	48.5	48.5	48.5
EPS (Rs)	13.0	10.0	11.3	13.3
EPS growth (%)	12.2	-23.0	12.5	17.9
PE (x)	7.1	9.2	8.2	6.9
P/PPP (x)	3.7	5.8	5.0	4.1
Book value (Rs)	45.9	59.7	66.4	74.5
P/BV (x)	2.0	1.5	1.4	1.2
Adj. book value (Rs)	44.7	58.6	65.1	73.3
P/ABV (x)	2.1	1.6	1.4	1.3
RONW (%)	31.6	19.0	17.9	18.9

Bank of India

Apple Green

Stock Update

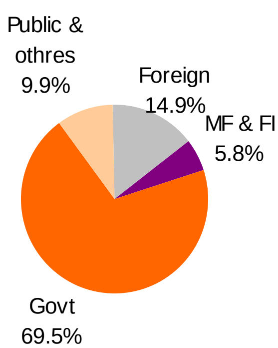
Exceptional results

Buy; CMP: Rs167

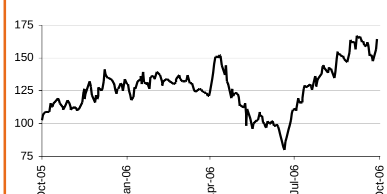
Company details

Price target:	Rs185
Market cap:	Rs8,100 cr
52 week high/low:	Rs169/80
NSE volume: (No of shares)	14.5 lakh
BSE code:	532149
NSE code:	BANKINDIA
Sharekhan code:	BOI
Free float: (No of shares)	14.9 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	7.1	52.4	40.3	67.8
Relative to Sensex	2.5	26.4	27.1	0.0

Result highlights

- Bank of India's net profit grew by 60.5% year on year (yoy) to Rs212.1 crore, which is above our expectations of a 52.5% growth. The excellent numbers were driven by an improvement in all the key parameters of the bank's business.
- During the quarter the bank's adjusted net interest income (NII) grew by a robust 39.6% yoy to Rs908.5 crore compared to our expectations of a 27% year-on-year (y-o-y) growth. The improvement in the NII was due to the expansion in the net interest margins (NIMs) coupled with the growth in the advances.
- The domestic NIMs improved by 45 basis points yoy while the global NIMs improved by 43 basis points yoy. The expansion was also robust on a quarter-on-quarter (q-o-q) basis as the domestic NIMs improved by 21 basis points while the global NIMs improved by 15 basis points.
- The other income showed a good growth of 16.5%, with the fee-based income showing a strong 30.7% growth.
- The operating expenses were up 31.2% mainly due to the expenses incurred on the implementation of the core banking solution (CBS) that the bank charges to the profit and loss account unlike the other banks that prefer to capitalise and claim depreciation on the same. Some promotional expenses for the centenary year celebration also kept the operating expenses on the higher side.
- As a result, the operating profit grew by 33.9% yoy to Rs538.2 crore. The operating profit excluding the treasury income grew by 37.6% yoy.
- We have revised our earnings per share (EPS) estimates for FY2007 and FY2008 from Rs15.5 and Rs18 to Rs18.8 and Rs22.2 respectively to take into account the improved expected operating performance of the bank going forward. The improved performance of the bank is based on the improving margins, which should stabilise going forward coupled with the stable other income and the operating expenses growth.

Result table Rs (cr)

Particulars	H1FY07	H1FY06	% yoy chg	Q2FY07	Q2FY06	% yoy chg	% qoq chg
Net interest income	1,733.1	1,273.5	36.1	908.5	650.6	39.6	10.2
Other income	663.9	597.5	11.1	353.3	303.1	16.5	13.7
Other income (excl treasury)	562.3	519.2	8.3	303.0	255.6	18.5	16.8
Treasury income	101.6	78.3	29.8	50.3	47.6	5.7	-2.1
Net income	2,397.0	1,870.9	28.1	1,261.7	953.7	32.3	11.1
Operating expenses	1,331.0	1,038.4	28.2	723.6	551.7	31.2	19.1
Operating profit	1,066.0	832.6	28.0	538.2	402.0	33.9	2.0
Provisions	446.5	427.1	4.5	217.8	224.0	-2.8	-4.8
Tax	198.7	101.6	95.6	108.3	45.9	136.1	19.8
Net profit	420.9	303.9	38.5	212.1	132.2	60.5	1.6

Above figures would differ from the reported numbers as we have adjusted for the amortisation expenses reported by the bank for the period.

- The capital adequacy ratio (CAR) of the bank stood at 11.85% with the Tier-I ratio at 6.19%. This leaves very little room for the bank to grow its assets without diluting its equity in the medium term. However, the bank has shown no intent of raising its equity capital, unless absolutely necessary. Hence, we feel that the bank would initially use all the options available like innovative Tier-I capital. A plain equity issue may follow in H1FY2008, which would enhance the bank's book value and be value accretive going forward for the investors.
- At the current market price of Rs167, the stock is quoting at 7.5x its FY2008E EPS, 3.3x pre-provision profits (PPP) and 1.2x its book value. The bank is available at attractive valuations looking at the strong visibility in its earnings and is less prone to interest rate risk shocks unlike some leading PSU banks. We reiterate our Buy call on the stock with a revised price target of Rs185.

NII up 39.6% yoy due to margin expansion and volume growth

Bank of India reported a NII growth of 39.6% yoy to Rs908.5 crore, which is above our expectations of a 27% growth mainly due to the better margin expansion coupled with the volume growth. The domestic spread improved by 45 basis points yoy and by 21 basis points quarter on quarter (qoq) while the domestic advances grew by 28.9% and the global advances increased by 24.5%.

Yield assessment (%) (Half yearly)

	H1FY07			H1FY06			Global
	Indian	Foreign	Global	Indian	Foreign	Global	yoy chg (bps)
Cost of deposits	4.4	4.2	4.4	4.3	2.8	4.1	30.0
Cost of funds	4.3	4.6	4.3	4.1	3.2	3.9	37.0
Yield on advances	9.1	6.0	8.4	8.3	4.5	7.4	102.0
Yield on investments	7.4	6.1	7.2	7.0	5.6	6.8	44.0
Yield on funds	7.5	6.2	7.3	7.0	4.5	6.5	75.0
Spread	3.3	1.6	2.9	2.9	1.3	2.6	38.0

Source: Sharekhan research
Half yearly numbers are as reported by the bank.

Yield assessment (%)

	Q2FY07	Q2FY06	yoy chg (in bps)
Yield on advances (domestic)*	9.45	8.41	104.4
Yield on advances (foreign)*	6.19	4.74	144.8
Yield on advances (global)*	8.78	7.55	122.6
Yield on funds	7.60	6.71	89.0
Cost of funds	4.54	4.08	46.0
Cost of deposits	4.53	4.19	34.0
Spread global	3.06	2.63	43.0
Spread domestic	3.42	2.97	45.0

Source: Sharekhan research
* Calculations based on opening and closing balances, rest as reported by the bank.

NIMs improve due to strategic shift in business

The bank doesn't wish to grow its advances book aggressively at the cost of eroding its margins. Hence, it has concentrated on the high-yielding advances in the retail (56.3% y-o-y growth) and SME (26.8% y-o-y growth) sectors, which has improved its yield on funds by 89 basis points to 7.6%. To keep its funding costs down the bank has selectively garnered deposits, which are mainly retail in nature. Its CASA deposits grew by 22% yoy and the CASA ratio stood at 40%.

Growth in key sectors (Rs crore)

Particulars	H1FY07	H1FY06	% yoy chng
Agriculture	9,959.0	8,152.0	22.2
Retail	18,539.0	11,859.0	56.3
SME	18,809.0	14,830.0	26.8
Domestic advances	58,494.0	45,371.0	28.9
Total advances	73,689.0	59,165.0	24.5

Source: Sharekhan research

Other income up 16.5% yoy, led by strong fee income growth

The fee income grew by 30.7% yoy to Rs228.6 crore, while the trading income was up by 5.7% yoy.

Other income (Rs crore)

Particulars	Q2Y07	Q2FY06	% yoy chng	% qoq chng
Trading	50.3	47.6	5.7	-2.1
Fee income	228.6	174.9	30.7	20.6
Forex income	40.2	49.7	-19.2	-20.1
Recovery	34.2	31.0	10.4	76.0
Total	353.3	303.1	16.5	13.7

Source: Company, Sharekhan Research

CBS and promotional expenses lift operating expenses up by 31.2% yoy

The operating expenses were up 31.2% mainly due to the expenses incurred on the implementation of CBS that the bank charges to the profit and loss account unlike the other banks, which prefer to capitalise and claim depreciation on the same. Some promotional expenses for the centenary year celebration also kept the operating expenses on the higher side.

Operating expenses (Rs crore)

Particulars	Q2Y07	Q2FY06	% yoy chng	% qoq chng
Employee cost	413.6	343.0	20.6	12.2
Other operating expenses	310.0	208.7	48.6	29.7
Total operating expenses	723.6	551.7	31.2	19.1

Lower provisions further boost profits

The net profit grew by a faster 60.5% due to the lower provisioning. Due to the lower provisioning on account of investment depreciation and amortisation and lower other provisions the total provisions declined by 2.8%

Break-up of provisions

Particulars	Q2FY07	Q2FY06	% yoy chng
NPA	150.0	117.0	28.2
Investment amortisation	59.1	71.9	-17.8
Other provisions	8.7	35.1	-75.3
Total	217.8	224.0	-2.8

Note: We have deducted for amortisation expenses for the half year/ quarter of Rs119.3/ Rs.59.1 (previous half year/quarter Rs.135.9 / Rs.71.9) from interest expended and added the same to investment amortization under provisions to arrive at the adjusted provisions figure

Net NPA target at 1% by March 2007

The gross non-performing assets (NPAs) reduced to Rs2,219.3 crore (2.96%) as on September 2006 from Rs2,808.1 crore (4.63%) as on September 2005. The net NPAs reduced to 1.07% of the net advances as on September 2006 from 2.25% of the advances as on September 2005.

May have to go for equity raising

The capital adequacy ratio (CAR) of the bank stood at 11.85% with the Tier-I ratio at 6.19%. This leaves very little room for the bank to grow its assets without diluting its equity in the medium term. However, the bank has shown no intent of raising its equity capital, unless absolutely necessary. Hence, we feel that the bank would initially use all the options available like innovative Tier-I capital and later on follow with a plain equity issue in H1FY2008. The issue would enhance its book value and be value accretive going forward for the investors.

Valuation and view

We have revised our EPS estimates for FY2007 and FY2008 from Rs15.5 and Rs18 to Rs18 and Rs22.2 respectively to take into account the improved expected operating performance of the bank going forward. The improved performance of the bank is based on improving margins which should stabilise going forward coupled with the stable other income and the operating expenses growth.

At the current market price of Rs167, the stock is quoting at 7.5x its FY2008E EPS, 3.3x pre-provision profits (PPP) and 1.2x its book value. The bank is available at attractive valuations looking at the strong visibility in its earnings and is less prone to interest rate risk shocks unlike some leading PSU banks. We reiterate our Buy call on the stock with a revised price target of Rs185.

Key financials

Particulars	FY2005	FY2006E	FY2007E	FY2008E
Net profit (Rs cr)	340.1	701.4	916.3	1,083.7
Shares in issue (cr)	48.8	48.8	48.8	48.8
EPS (Rs)	7.0	14.4	18.8	22.2
EPS growth (%)	-66.3	106.3	30.6	18.3
PE (x)	23.8	11.6	8.8	7.5
P/PPP (x)	5.5	4.8	3.7	3.3
Book value (Rs)	91.5	102.1	116.3	134.5
P/BV (x)	1.8	1.6	1.4	1.2
Adj. book value (Rs)	59.6	82.2	101.4	131.2
P/ABV (x)	2.8	2.0	1.6	1.3
RONW (%)	8.0	14.8	17.2	17.7

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

State Bank of India

Apple Green

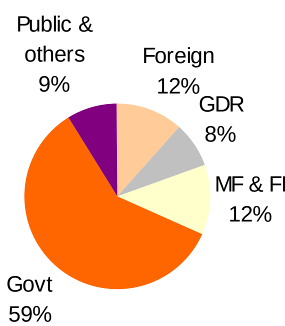
Stock Update

Strong growth in core operating profits

Buy; CMP: Rs1,095

Company details	
Price target:	Rs1,116
Market cap:	Rs57,619 cr
52 week high/low:	Rs1,106/684
NSE volume: (No of shares)	14.0 lakh
BSE code:	500112
NSE code:	SBIN
Sharekhan code:	SBI
Free float: (No of shares)	17.0 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	9.4	43.3	24.5	34.1
Relative to Sensex	4.8	18.9	12.7	-20.2

Result highlights

- State Bank of India's (SBI) Q2FY2007 stand-alone net profit at Rs1,184.5 crore was down 2.5% year on year (yoy), but above our expectations of a fall of 11.4% largely due to the lower-than-expected operating expenses reported by the bank and on account of lower provisions.
- The net interest income (NII) grew by 8.1% yoy to Rs3,898.7 crore, above our expectations of a 6.9% growth. The improved yield on the advances (up by 67 basis points) to 8.48% over a 21.2% advances growth coupled with the lower cost of deposits (down 15 basis points) to 4.64% mainly resulted in a better NII growth. The reported core net interest margin (NIM; adjusted for a one-time interest income) for H1FY2007 has improved by 40 basis points to 3.32%.
- Most other PSU banks have reported an increase in the cost of deposits, while SBI has reported a fall mainly due to the improvement in its CASA ratio to 42.6% from 39.5% and the lowering of the bulk deposit rates to discourage high-cost deposits in its books.
- The other income increased by 10.7% yoy to Rs1,433.8 crore, restricted mainly due to a drop of 96.9% in the trading income during Q2FY2007 to Rs7.7 crore from Rs246.7 crore in Q2FY2006. The other income excluding the treasury income reported a very strong growth of 36.1%.
- With the net income up by 8.8% yoy and a decrease of 2% in the operating expenses, the operating profit increased by a healthy 24.7% yoy. The operating profit excluding the treasury income was up 42% yoy.
- The provisions were down 16.7% yoy mainly on account of the absence of investment depreciation during the quarter. However the tax outflow at Rs606 crore with an effective tax rate of 33.9% was much above our expectations.
- At the current market price of Rs1,095, the stock is quoting at 9.6x its FY2008E earnings per share (EPS), 4.5x its pre-provision profits (PPP), 1.6x its stand-alone book value and 1.3x its consolidated book value. The bank is definitely a proxy investment for the Indian economy and the improved operating performance post the redemption of India Millennium Deposits (IMDs) could still provide some upside from the current levels. We maintain our Buy call on the stock with a price target of Rs1,116.

Result table Rs (cr)

Particulars	H1FY07	H1FY06	% yoy chg	Q2FY07	Q2FY06	% yoy chg	% qoq chg
Net interest income	7,782.7	7,861.2	-1.0	3,898.7	3,608.0	8.1	0.4
Other income	3,197.3	2,871.2	11.4	1,433.8	1,294.6	10.7	-18.7
Other income (excl treasury)	2,978.3	2,493.8	19.4	1,426.1	1,047.9	36.1	-8.1
Treasury income	219.0	377.4	-42.0	7.7	246.7	-96.9	-96.4
Net income	10,980.0	10,732.4	2.3	5,332.4	4,902.6	8.8	-5.6
Operating expenses	5,670.1	5,310.0	6.8	2,859.9	2,919.7	-2.0	1.8
Operating profit	5,309.9	5,422.4	-2.1	2,472.6	1,982.9	24.7	-12.9
Provisions	1,963.3	2,584.1	-24.0	681.3	817.5	-16.7	-46.9
Tax	1,362.6	400.1	240.6	606.7	-50.0	-	-19.7
Net profit	1,984.0	2,438.2	-18.6	1,184.5	1,215.4	-2.5	48.2

NII up 8.1%, strong 37.1% y-o-y increase in interest on advances

The NII has grown yoy by 8.1%, which is above our estimates of a growth of 6.9%. The improved NII was achieved due to a strong 37.1% year-on-year (y-o-y) increase in the interest on advances. The strong growth in the interest on advances was a result of a higher yield on the advances (up 67 basis points yoy) coupled with a 21.2% advances growth.

Improved CASA ratio helps in lowering deposit costs

The deposit costs have decreased by 15 basis points during the quarter on a y-o-y basis and by 17 basis points on a q-o-q basis. Most other PSU banks have reported an increase in the cost of deposits, while SBI has reported a fall mainly due to the increase in its CASA ratio to 42.6% from 39.5% and the lowering of the bulk deposit rates to discourage high-cost deposits in its books. The CASA ratio improvement was supported by its vast ATM network and the focus on new salary accounts.

Advances up 21% yoy with retail advances up 26.1% yoy

The advances growth of 21.2% yoy for the bank has been below the industry average of ~30%; however the bank has reported a strong growth of 26.1% yoy in the retail segment which constitutes 25.8% of the bank's gross domestic advances at the end of September 2006. The housing loans constitute 52.5% of the bank's retail advances as on September 2006.

Advances break-up (Rs crore)

	H1FY07	H1FY06	% yoy chng
Gross advances	288840	238351	21.2
- Agriculture	30610	23708	29.1
- Retail	65810	52208	26.1
- Housing loans	34571	28341	22.0

Fee income reports robust growth of 36.1% yoy

The other income increased by 10.7% yoy to Rs1,433.8 crore and was restricted mainly due to a sudden drop of 96.9% in the trading income during Q2FY2007 to Rs7.7 crore from Rs246.7 crore in Q2FY2006. The almost 100% y-o-y sudden drop in the trading income during Q2FY2007 despite the bond market activities remaining healthy with the benchmark yields having retraced by almost 50 basis points qoq raises some doubt on the bank's treasury management. However, the same has been taken care of post-September 2006; hence Q3FY2007 numbers would reflect the same.

The other income excluding the treasury income reported a very strong growth of 36.1%. The loan processing fees and the locker and ATM related fees have largely contributed to the robust growth in the fee income.

Other income (Rs crore)

Particulars	Q2Y07	Q2FY06	% yoy chng	% qoq chng
Other income (excl. treasury)	1,426.1	1,047.9	36.1	-8.1
Treasury income	7.7	246.7	-96.9	-96.4
Total	1,433.8	1,294.6	10.7	-18.7

Source: Company, Sharekhan Research

Operating expenses down 2%

The operating expenses reported a fall of 2% yoy to Rs2,859.9 crore with the staff costs reporting a y-o-y fall of 4.2% to Rs1,954.7 crore. The staff costs would have been much lower, in absence of the ongoing payments to the staff opting for an early exit.

Operating expenses (Rs crore)

Particulars	Q2Y07	Q2FY06	% yoy chng	% qoq chng
Employee cost	1,954.7	2,041.2	-4.2	1.6
Other operating expenses	905.1	878.5	3.0	2.2
Total operating expenses	2,859.9	2,919.7	-2.0	1.8

Provisions down 16.7%, due to absence of investment depreciation

The provisions were down 16.7% yoy mainly on account of the absence of investment depreciation during the quarter. However the non-performing asset (NPA) provisions and the provisions on standard assets were significantly higher on a y-o-y basis during the quarter.

Yield assessment (%)

	H1FY07	H1FY06	yoy chg (in bps)	Q2FY07	Q2FY06	Q1FY07	yoy chg (in bps)	qoq chg (in bps)
Yield on advances	8.55	7.81	74.0	8.48	7.81	8.49	67.2	-1
Yield on investments	7.70	7.61	9.4	7.62	8.04	7.43	-42.5	18.6
Yield on assets	7.39	7.40	-1.0	7.37	7.40	7.22	-2.6	15.4
Cost of deposits	4.51	4.64	-13.0	4.64	4.80	4.47	-15.5	17.5
NIM	3.32	2.92	40.0	3.33	3.44	3.37	-11.4	-4.4

Source: Sharekhan research
Quarterly figures are calculated based on the opening and closing balances.
Half yearly numbers are as reported by the bank, excluding yield on investments.

Break-up of provisions

Particulars	Q2FY07	Q2FY06	% yoy chg	Q1FY07
NPA	116.1	10.7	-	171.6
Amortisation / Investment depreciation	423.4	1,088.7	-61.1	1,104.0
Std assets	140.0	40.0	-	20.0
Others	1.8	-321.9	-	-13.6
Total provisions	681.3	817.5	-16.7	1,282.0

Asset quality remains steady

The gross NPAs reduced to Rs10,306.5 crore (3.57%) at the end of September 2006 from Rs12,531.8 crore (5.26%) at the end of September 2005 due to higher upgradations and recoveries. However on a sequential basis the gross NPAs stood at Rs10,386 crore (3.88%) at the end of June 2006. The net NPAs reduced to 1.67% of the net advances at the end of September 2006 from 2.27% at the end of September 2005; however on a q-o-q basis the net NPAs stood at 1.69% at the end of June 2006.

Capital adequacy remains comfortable

The capital adequacy ratio of the bank as on September 2006 stood at 12.63% with the Tier-I ratio at 8.74%. The bank has eligibility to raise further Tier-I hybrid debt of over Rs4,000 crore. The operational risk impact on the implementation of the Basel-II norms is estimated at 105 basis points.

Clarity provided on pension and AS15 impact

The management provided clarity on the key issues relating to the pension liabilities and the liabilities arising out of the implementation of the revised accounting standard (AS) 15. SBI had earlier indicated that almost Rs800 crore of the additional provision would have to be made to meet the increased pension requirements under the renegotiated agreement with the employees in FY2006. However, the management has now indicated that the same would not be required, as it has excess provisions to meet the liability.

The management has also indicated that its liability under the new AS15 (see our note 'Change in pension norms negative for PSBs' dated august 18, 2006) could be to the tune of Rs5,000 crore, much higher than our estimates of Rs3,200 crore. While this will have a huge impact on SBI's book value, a great reprieve would come if the Institute of Chartered Accountants of India (ICAI) and the Reserve Bank of India allow it to be written off over period of five years. SBI would be biggest beneficiary of such a reprieve.

Valuation and view

At the current market price of Rs1,095, the stock is quoting at 9.6x its FY2008E EPS, 4.5x its pre-provision profits (PPP), 1.6x its stand-alone book value and 1.3x its consolidated book value. The bank is definitely a proxy investment for the Indian economy and the improved operating performance with the busy season ahead could still provide some upside from the current levels. We maintain our Buy call on the stock with a price target of Rs1,116.

Valuation table

Particulars	FY2005	FY2006P	FY2007E	FY2008E
Net profit (Rs cr)	4,304.4	4,407.1	4,708.5	6,003.7
Shares in issue (cr)	52.6	52.6	52.6	52.6
EPS (Rs)	81.8	83.8	89.5	114.1
EPS growth (%)	16.9	2.4	6.8	27.5
PE (x)	13.4	13.1	12.2	9.6
P/PPP (x)	5.2	5.2	5.0	4.5
Book value (Rs)	457.4	525.3	597.0	691.7
Adj book value (Rs)	356.0	432.3	492.1	616.1
P/ABV (x)	3.1	2.5	2.2	1.8
Cons book value (Rs)	618.9	707.4	779.1	873.8
P/BV (x)	2.4	2.1	1.8	1.6
P/CBV (x)	1.8	1.5	1.4	1.3
RONW (%)	19.4	17.1	16.0	17.7

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

Orient Paper and Industries

Vulture's Pick

Stock Update

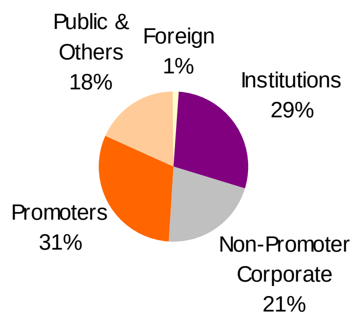
Performance below expectations

Buy; CMP: Rs590

Company details

Price target:	Rs800
Market cap:	Rs876 cr
52 week high/low:	Rs667/150
NSE volume: (No of shares)	42,815
BSE code:	502420
NSE code:	ORIENTPPR
Sharekhan code:	ORIENTPAP
Free float: (No of shares)	1.0 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	3.9	51.8	28.7	262.4
Relative to Sensex	-0.5	26.0	16.6	115.9

Result highlights

- Orient Paper & Industries Ltd's (OPIL) Q2FY2007 net profit at Rs20.4 crore is below our expectations primarily because of a 33-day maintenance shutdown at the company's Amlai paper unit for a major overhaul. This plant shutdown resulted in a 21% decline in the paper division's revenues, leading to a loss of Rs8.5 crore. However the performance of the cement business (earnings before interest, depreciation, tax and amortisation [EBIDTA] per tonne of Rs929 as against Rs111 per tonne) is above our expectations.
- The revenues for the quarter grew by 34.6% to Rs229 crore entirely driven by its cement division, which almost doubled its revenues to Rs141 crore. The paper division registered a decline of 21% in its revenue due to a shutdown and the fans division showed a decent performance registering a 22.6% growth in its revenues.
- The operating profit for the quarter grew by a whopping 288% to Rs43.8 crore as the cement division's earnings before interest and tax (EBIT) reported a significant jump to Rs49 crore signifying the effect of the cement prices on the company's profitability. The paper division reported an overall loss of Rs8.5 crore out of which Rs5.6 crore is the loss because of a 33-day plant shutdown and the balance is on the already non-operational Brijrajnagar unit. The other two units together reported a loss of Rs1 crore. Hence the overall profitability was significantly affected.
- The operating profit margins (OPMs) for the quarter jumped three-fold to 19.1%, driven by the stellar performance of the cement division.

Result table Rs (cr)

Particulars	Q2FY07	Q2FY06	% yoy chg	H1FY07	H1FY06	% yoy chg
Net sales	229.0	170.4	34.6	487.8	371.4	31.3
Total expenditure	185.7	159.2	16.6	390.7	338.3	15.5
Operating profit	43.8	11.3	288.2	97.1	33.1	193.1
Other income	2.4	1.9	25.1	3.8	2.4	57.9
PBIDT	46.2	13.2	249.4	101.0	35.6	183.9
Interest	8.7	11.8	-26.2	17.9	23.2	-22.6
PBDT	37.5	1.4		83.0	12.4	570.7
Depreciation	6.8	6.6	2.3	13.2	13.3	-0.4
PBT	30.7	-5.3	-683.0	69.8	-0.9	
Tax	10.3	-1.9	-640.0	23.7	-0.1	
PAT before extraordinary	20.4	-3.4	-707.0	46.2	-0.8	
Extraordinary items		6.6		0.0	6.6	
Adj profit after extraordinary	20.4	3.3	526.0	46.2	5.8	525.8
Margins						
OPM's	19.1	6.6		19.9	8.9	
EBIDTA	19.9	7.7		20.5	9.5	
PBT	13.2	-3.1		14.2	-0.2	
PAT	8.8	1.9		4.1	0.9	

- The performance at the operating level was strengthened by a 26% decline in the interest cost and a 25% increase in the other income to Rs2.44 core and consequently the pre-exceptional net profit for the quarter stood at Rs20.4 crore as against a loss of Rs3.36 crore a year ago. Q2FY2006 included a profit of Rs6.6 crore on the sale of investments which we have treated as an extraordinary income. Hence OPIL's reported net profit jumped by 526%.

As mentioned earlier OPIL's Q2FY2007 results are below our expectations primarily because of a 33-day maintenance shutdown at the company's Amlai paper unit for a major overhaul. The loss in the paper division is a significant swing from a profit of Rs 8.8 crore in Q1FY2007 to a loss of Rs8.5 crore in Q2FY2007. However the performance of the cement business (EBIDTA per tonne of Rs929 as against Rs111 per tonne a year ago) is above our expectations. On account of the better-than-expected performance of the cement division and the expectation of the same to strengthen further we are not changing our earnings estimates for OPIL.

Going forward with the strong pick-up in the cement consumption in Andhra Pradesh and Maharashtra and the resultant revival in the cement prices should maintain the performance of OPIL's cement division. The paper division is expected to better its performance on the back of a better paper consumption growth and the fans business will leverage on its export credential (supply to retail giant Wal-Mart) to ramp up and get a strong foothold in the export market. In a nutshell, the key drivers of OPIL's growth are intact and hence the outlook for the company's future remains positive. At the current market price of Rs590, the stock is discounting the FY2007E earnings by 8.8x and FY2008E earnings by 6.2x. On enterprise value (EV)/tonne basis the stock is trading at a valuation that is even below the replacement cost of a new cement plant, with EV/tonne of US$67 per tonne of cement (without considering the value of the investments in Hyedrabad Industries and Century Textiles). Also, thanks to the cash and cash equivalents of Rs100 per share on its books, the stock offers a decent margin for safety. We thus expect OPIL's valuation to improve and maintain our Buy recommendation on the stock with the sum-of-parts price target of Rs800.

Cement division drives revenues up by 35% year on year...

The cement consumption across the country continued its momentum during the quarter growing by 11%. On the back of such a buoyant consumption growth and a tight demand-supply scenario the prices remained firm hovering at Rs200 per 50kg bag as against Rs135 per 50kg bag last year. Thus against the backdrop of such sanguine industry scenario and with the base effect coming into play (the company's cement plant was shutdown for 15 days in the same quarter last year), the company's volumes witnessed a massive 35% year-on-year growth to 5.7 lakh tonne. The realisations too jumped by 42% year on year to Rs2,472/tonne from Rs1,736/tonne. The cumulative impact of both these factors led to a staggering growth of 92% year on year in the cement revenues, which stood at Rs141 crore. The revenues of the fans division increased by 23% year on year to Rs41 crore driven by the volumes in both the domestic and export markets.

But the paper division witnessed a decline of 21% year on year in its revenues to Rs47.8 crore on account of a 33-day five yearly-scheduled shutdown and maintenance exercise at its Amlai plant whereas its Brajrajnagar plant continued to remain non-operational. Consequently the overall revenue growth of the company remained muted at 35% year on year to Rs229 crore.

Segmental results

Particulars	Q2FY07	Q2FY06	% yoy chg
Revenue	**229.0**	**170.4**	**34.6**
Paper & board	47.8	60.6	-21.1
Cement	141.0	73.3	92.2
Electric fans	40.8	33.3	22.6
Know-how & service fees	0	3.3	-100.0
EBIT	**39.50**	**7.0**	**462.1**
Paper & board	-8.5	0.7	-1250.0
Cement	49.0	0.7	7101.5
Electric fans	-0.7	2.2	-133.2
Know-how & service fees	-0.2	3.4	-106.5
EBIT margin (%)			
Paper & board	-17.8	1.2	-19.0
Cement	34.8	0.9	33.8
Electric fans	-1.8	6.7	-8.5
Know-how & service fees		101.8	

...as well as operating profit

On a segmental basis, the cement division reported a stellar growth in its operating profits on account of its leverage to the cement prices. The spurt in the realisations led to a staggering profit of Rs49 crore as against a mere Rs70 lakh profit in the same quarter last year. The profits in the last quarter were negligible on account of the above-mentioned shutdown and maintenance at its cement plant. On account of the high leverage to the cement prices, the company's earnings before interest, tax, depreciation and amortisation (EBITDA)/tonne jumped multifold to Rs929 from a meagre Rs111 in the same quarter last year.

The paper division reported a loss of Rs8.5 crore as against a profit of Rs70 lakh in the same quarter last year. But if we compare the numbers on a sequential basis, we see a negative swing of Rs16 crore. A reduction in the volumes on account of the plant shutdown, losses from the non-operational Brajrajnagar plant as well as the maintenance expenses have led to such a big swing. The fans division too reported a loss of Rs74 lakh in the quarter under review. Driven by the excellent performance of the cement division, the overall operating profit of the company grew by a staggering 462% to Rs39.5 crore whereas the operating margins increased by 1,300 basis points to 19.1% as against 6.6% in the same quarter last year.

A reduction in interest cost and a flat depreciation charge boost net profit

The interest cost decreased by 26% year on year to Rs8.73 crore due to the repayment of debt whereas the depreciation charge remained flat at Rs6.8 crore. Helped by a 25% increase in the other income, the pre-exceptional net profit (after provision of tax at a marginal rate of 33.5%) stood at 20.4 crore as against a loss of 3.35 crore a year ago. Q2FY2006 included a profit of Rs6.6 crore on the sale of investments which we have treated as extrordinary income. Hence OPIL's net profit jumped by a staggering 526% year on year.

Capex plans of Rs250 crore...

The company has lined up a capital expenditure (capex) of Rs250 crore to be spent over the next couple of years whereby it will be augmenting its cement capacity by one million tonne in two phases to 3.4 million tonne per annum, its paper capacity by 20,000 tonne and also putting up a captive power plant (CPP) of 30MW. This capex is to be completed over the next two year.

Particulars	Amount (Rs crore)
Cement capacity expansion of 1 million tonne to 3.4MTPA	66.5
Paper capacity by 20,000 tonne	57
Captive power plant of 30MW	110
Fans	20

With the current trend in the cement industry expected to continue over the next three years, the increased capacities will augur well for the company and thus will be a significant revenue driver. The company's profitability too will improve once the CPP is in place, as it will save close to Rs30 crore in the company's power cost.

...to be funded through a rights issue of Rs175 crore

The company at its board meeting on October 5, 2006 has decided to raise Rs175 crore through a rights issue for the purpose of funding the capex plans (refer our note dated October 5, 2006). As mentioned in our earlier report, we expect an earnings per share (EPS) dilution of 12% in FY2008 whereas we expect the EPS dilution to be neutral in FY2009 on account of the availability of higher capacity and savings of on account of the repayment of debt.

Outlook—positive as all the three businesses are peaking simultaneously

Going forward with the strong pick-up in the cement consumption in Andhra Pradesh and Maharashtra and the resultant revival in the cement prices should maintain the performance of OPIL's cement division. The paper division is expected to better its performance on the back of a better paper consumption growth and the fans business will leverage on its export credential (supply to retail giant Wal-Mart) to ramp up and get a strong foothold in the export market. All the three businesses are peaking simultaneously with the cement business driving the growth. In a nutshell, the key drivers of OPIL's growth are intact and hence the outlook for the company's future remains positive.

Valuations and view

At the current market price of Rs590, the stock is discounting its FY2007E earnings by 8.8x and the FY2008E earnings by 6.2x. On EV/tonne basis the stock is trading at a valuation that is even below the replacement cost of a new cement plant, with EV/tonne of US$67 per tonne of cement (without considering the value of the investments in Hyedrabad Industries and Century Textiles). Also, thanks to the cash and cash equivalents of Rs100 per share on its books, the stock offers a decent margin for safety. We thus expect OPIL's valuation to improve and maintain our Buy recommendation on the stock with the sum-of-parts price target of Rs800.

Earnings table

Year ended Mar 31	FY04	FY05	FY06E	FY07E	FY08E
Net profit (Rs cr)	-7.7	2.7	39.1	103.2	141.2
% y-o-y growth	-	*-135.6*	*1332.0*	*164.0*	*36.9*
Shares in issue (cr)	1.5	1.5	1.5	1.5	1.5
EPS (Rs)	-5.2	1.8	26.3	69.5	95.1
% y-o-y growth	-	*-135.6*	*1332.0*	*164.0*	*36.9*
PER (x)	-118.2	331.8	23.2	8.8	6.2
Book value (Rs)	20.7	22.1	23.3	91.2	184.6
P/BV (Rs)	29.4	27.6	26.1	6.7	3.2
EV/EBIDTA (x)	21.0	20.2	11.5	5.5	4.0
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
RoCE (%)	8.3	9.7	18.0	35.0	36.9
RoNW (%)	-15.1	5.2	92.9	74.4	50.6

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

Moser Baer

Viewpoint

Strong reversal in fortune

CMP: Rs235

Incorporated in 1983, Moser Baer has emerged as one of the top three optical storage media manufacturers in the world. It has a wide range of products ranging from floppy disks, compact discs (CDs) to digital versatile discs (DVDs). It has relationship with all the top 12 global technology brands and has steadily gained market share over the past few years.

Recently, the company has diversified into manufacturing of photovoltaic cells to tap the growing demand for solar power generation globally. The company is likely to commission the first phase of its photovoltaic cell manufacturing facility in the fourth quarter of this fiscal.

Improving fundamentals of its core business…

Given the unfavourable supply-demand situation (after the huge installation of CD/DVD manufacturing capacities in 2003 and 2004), the optical storage media industry went through a difficult phase in the past two years (FY2005 and FY2006). However, the situation appears to have improved significantly in the past couple of quarters. Driven by the consolidation of capacities, continued growth in demand and softening of raw material prices, the large players like Moser Baer are witnessing a strong reversal in their fortunes. The average selling price (ASP) has improved considerably in the past two consecutive quarters (2.7% and 9.8% sequential growth in ASP in Q1 and Q2 respectively). On the other hand, the price of the key raw material (polycarbonate) has softened over the past six months.

Apart from this, the company is also benefiting from its efforts to drive growth in the higher-value products like high density (HD) DVDs as compared with CDs (which accounted for the bulk of sales in FY2005). The management expects the high-value products to contribute 60% of the turnover by Q4 of FY2007.

…reflected in the recent performance

The fundamental changes in the core business are reflected in the company’s recent quarterly performance that was extremely encouraging. Its net revenues grew by 30.1% year on year (yoy) and 10.2% quarter on quarter (qoq) to Rs500.9 crore. The operating profit margin (OPM) of 26.6% was better than 25.3% reported in Q2FY2006 and has seen a quantum jump from 19.2% in Q1FY2007. Consequently, despite the steep decline in the other income, the earnings grew by 745.9% yoy and 298.9% qoq to Rs26 crore during the quarter.

On a half-yearly basis, the net revenues have grown by 30% to Rs955.4 crore. The OPM has improved by 90 basis points to 23.1% and the company has reported a net profit of Rs32.5 crore (as compared with a net loss of Rs8.1 crore in H1FY2006).

The growth outlook is also encouraging. The management expects the realisation to firm up further on the back of a robust demand in Q3 (due to the seasonality factor). The company has maintained its long-term growth guidance of 25-35% compounded annual growth in revenues over the next three years.

Result summary

(Rs cr)	Q2FY07	YoY (%)	H1FY07	YoY (%)
Net Revenues	500.9	30.1	955.4	30.0
Total Expenditure	367.8	24.9	735.1	28.6
Operating profit	133.1	46.9	220.3	34.8
Net profit	26.0	745.9	32.5	LP
Equity Capital	111.5		111.5	
EPS (Rs)	2.3		2.9	
Margins (%)				
OPM	26.6		23.1	
NPM	5.1		3.2	

LP: loss to profit

Technological edge

In a major breakthrough, Moser Baer's in-house developed and patented technology has been considered as one of the four standard media to be included in the Blu-ray disc specifications by the Blu-ray Disc Association. This essentially means that Moser Baer is playing an important role in the development of the next-generation storage media and is now amongst a select few like Mitsubishi Kagaku Media Co, Fuji Photo Film and Taiyo Yuden of Japan to have its technology approved by the prestigious Blu-ray Disc Association.

In financial terms, it means that the company would get the first-mover advantage in the advanced storage media segment. The demand for products in this segment is estimated to grow to 1.5 billion discs over the next three years. In addition to the huge revenue potential, the first movers generally get the advantage of better margins in the initial part of the product life cycle.

This essentially shows that the long-term outlook of Moser Baer's optical storage business is encouraging. Thus, the management has maintained the guidance of 25-35% compounded annual growth in the revenues over the next three years.

Diversification into photovoltaic cells

To mitigate the impact of cyclicality in the optical media storage business and to develop alternate sources of revenues, Moser Baer has ventured into the photovoltaic business. Through its subsidiary, Moser Baer Photovoltaic, it is setting up facilities to manufacture solar cells and modules with an initial annual capacity of 80MW. The initial project cost is estimated to be Rs260 crore ($58 million), with Moser Baer investing Rs112 crore ($25 million) in the new venture. The investment includes capital expenditure of around $37-38 million while the balance would be used to meet the initial working capital requirement. The company is likely to start trial production in December 2006 and commission the plant for commercial production in early part of Q4FY2007.

Huge potential for solar power cells

Solar power is increasingly seen as the most important source of alternate energy and many countries have passed legislations to promote the installation of solar power generation capacities by offering fiscal and other incentives. Apart from this, the technological advancements are steadily reducing the initial cost of setting up solar power generation capacities and the recurring cost of supplying solar power. Consequently, the solar power industry is expected to grow exponentially over the next few years to $40-50 billion by 2010 (up from $5-6 billion in the last year).

Over the next three years, the company aims to invest around $120-150 million to ramp up the manufacturing capacity of its solar power cells to 240MW. Though a large portion of the capacity would be based on manufacturing of silicon-based cells, the company is also developing technology to manufacture non-silicon based cells (to mitigate the dependence on silicon, which is a scarce commodity currently). The management expects to generate revenues of $400-600 million from the manufacturing of silicon-based solar cells and modules alone by FY2010. In terms of return on investment, the business has relatively much better asset turnover ratio of around 4x the gross block; and the operating profit margin is expected to be in the range of 20-25%.

Valuation

At the current market price the stock trades at around 40x its H1FY2007 annualised earnings. However, the growth outlook is encouraging. The fundamentals of the core business are improving and the diversification into the photovoltaic business is likely to contribute significantly from FY2008.

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

Dr Reddy's Laboratories

Viewpoint

Results above expectations

CMP: Rs752

Result highlights

- Dr Reddy's Laboratories (DRL) reported revenues of Rs2,003.9 crore in Q2FY2007, as against Rs580.4 crore in Q2FY2006, representing an increase of 245% year on year (yoy).
- The revenues from the international markets increased by 391% yoy at Rs1,760 crore largely because of the contributions from the authorised generics and acquisitions.
- The revenues from its core businesses (excluding the contributions from the authorised generics and acquisitions) increased by an impressive 42% to Rs820 crore during the quarter.
- The overall gross margin declined to 41.3% from 51.6% in the corresponding quarter of the previous year, largely because of the pricing pressures in the USA and Europe and due to the integration of the Betapharma acquisition.
- However, with the impressive reduction in the selling, general and administrative (SG&A) cost to 18.3% of sales from 30% in Q2FY2006, the operating profit margin (OPM) expanded to 19.0% from 11.9% in Q2FY2006.
- The net profit increased by over two times (up by 214%) at Rs279.8 crore.
- At the current market price of Rs752, the stock trades at 18.2x and 22.0x of FY2007 and FY2008 consensus earnings. Currently, the management plans to focus strategically on enhancing the earnings by leveraging its Day-1 launches (as 55 ANDAs are in the pipeline) and authorised generic deals. On the cost front, DRL plans to curtail its litigation costs by out of court settlements and has already started tightening its SG&A expenses. On the R&D front, the company has already de-risked its model by partnering with financial partners. With all these developments we are positive about the stock.

Financials as per the US GAAP

Particulars	Q2FY07	Q2FY06	% change
Total revenue	2003.9	580.4	245.3
Cost of revenues	1175	280.7	318.6
Gross profit	828.9	299.7	176.6
SG&A expenses	366.7	176.7	107.5
R&D expenses	40.2	44.4	-9.5
Amortisation expenses	40.2	7.6	428.9
Other operating (income)/expenses	-0.2	2.4	
Operating profit before forex Adj.	382.0	68.6	456.9
Forex loss/(gain)	-5.5	1.3	
Operating profit	387.5	67.3	475.8
Equity in loss of affiliates	2.1	1.6	
Other expenses/(income)	32.1	-19.1	
PBT	353.1	84.9	315.9
Tax	73.7	-4.0	
Minority interest (MI)	-0.4	0.1	
PAT after MI	279.8	89.0	214.4
Gross margin (%)	41.4	51.6	
OPM (%)	19.3	11.6	
PAT margin (%)	14.0	15.3	

Authorised generics and acquisitions drive the top line

As per the US GAAP, DRL reported a surprising 245% jump in its consolidated revenues to Rs2,003.9 crore in Q2FY2007, predominantly fuelled by an over 10-time flare-up in the North America revenues to Rs1,019.6 crore. The incremental revenue flow from the acquisitions in Germany and Mexico has strengthened the top line further.

In terms of the geographical break-up, the international revenues increased by 391% to Rs1,760 crore. The North America business witnessed an over 10-time growth to Rs1,019.6 crore, as the generics finished dosage business jumped up to touch Rs908.2 crore. The authorised generic deal with Merck to sell Simvastatin and Finasteride fetched incremental revenues of Rs780.8 crore. Also the launch of Fexofenadine contributed revenues of Rs80.7 crore. With the fresh revenues flowing in, the North American business contributed about 51% of the total consolidated sales for the quarter. The acquisition in Mexico contributed Rs143.4 crore in Q2FY2007.

The European business saw a 340.8% hike to Rs384.8 crore, as the newly acquired Betapharma in Germany generated revenues worth Rs255.4 crore in Q2FY2007 (as against Rs199.8 crore in Q1FY2007). With the progressive integration of Betapharm with its existing base, the gross profit margin for Betapharma improved to 58% as against 53% in the previous quarter. However, the acquisitions in Mexico and Germany only contributed 20% to the total revenues in Q2FY2007. The domestic revenues were up 9.7% to Rs243 crore during the quarter.

The revenues from its core businesses (excluding the contributions from the authorised generics and acquisitions) increased by an impressive 42% to Rs820 crore during the quarter.

Geographical break-up

Particulars	Q2FY07	Q2FY06	% change
India	243	221.6	9.7
North America	1019.6	87.9	1060.0
Russia	78.3	66.8	17.2
Europe	384.8	87.3	340.8
Others	278.2	116.8	138.2
Total	2003.9	580.4	245.3

As far as the segmental break-up is concerned, the generics business boosted by the authorised generics and the Betapharma acquisition, flared up by over 14 times to Rs1,211.30 crore. In the generics segment, North America contributed 75% and Europe contributed the balance 25% to the segmental revenues.

The Mexico acquisition boosted the custom pharma services (CPS) revenues by over 12 times to Rs166.8 crore.

In the branded formulations business, the domestic revenues were Rs174.3 crore, up by 15.7%, primarily driven by the growth in the key brands of Omez, Nise and Reclimet. DRL launched 12 new products during the year contributing Rs6.3 crore to the sales and the new launches of Omez-D and Razo-D rank among the 10 most successful launches of 2006. As per ORG IMS August MAT, DRL recorded a volume growth of 17% as against the industry growth of 15%.

Segment Revenue

Particulars	Q2FY07	Q2FY06	% change
APIs	290.6	212.9	36.5
Out of India	*50.2*	*57.8*	*-13.1*
International	*240.4*	*155.1*	*55.0*
Branded formulations	305.6	257.7	18.6
Out of India	*174.3*	*150.7*	*15.7*
International	*131.3*	*107*	*22.7*
Generics	1211.3	77.3	1467.0
Emerging business	22.7	20.3	11.8
Custom pharma services	166.8	12.2	1267.2
Others	6.9	0	100.0
Total	**2003.9**	**580.4**	**245.3**

Though the gross margin fell, the OPM widened by 770 basis points

The overall gross margin declined to 41.3% in Q2FY2007 from 51.6% in the corresponding quarter of the previous year, largely because of the pricing pressures in the USA and Europe and due to the integration of the Betapharma acquisition that saw a price cut in the German market.

However, with the impressive reduction in the SG&A cost to 18.3% of sales from 30.4% in the corresponding quarter of the previous year, the OPM expanded to 19.3% from 11.6%. With the expansion in the revenues and the OPM, the operating profit witnessed a 475.8% jump to Rs387.5 crore.

The R&D investments (net) were 2% of the total revenues as against 8% of the revenues in Q2FY2006. In absolute terms, the gross R&D investments increased by 24% to Rs74.3 crore as against Rs59.9 crore in Q2FY2006. During the quarter, DRL recognised Rs34.1 crore under its R&D partnerships as a benefit to the R&D line item as against Rs15.5 crore in Q2 FY06.

Particulars	Q2FY07	Q2FY06	% change
Total revenues	2003.9	580.4	245.3
Cost of revenues	1175	280.7	318.6
Gross profit	828.9	299.7	176.6
Gross margin (%)	41.4	51.6	
SG&A expenses	366.7	176.7	107.5
% of sales	*18.3*	*30.4*	
R&D expenses	40.2	44.4	-9.5
% of sales	*2.0*	*7.6*	
Amortisation expenses	40.2	7.6	428.9
% of sales	*2.0*	*1.3*	
Other operating (income)/ expenses	-0.2	2.4	
Operating profit before forex adj.	382.0	68.6	456.9
Forex loss/(gain)	-5.5	1.3	
Operating profit	387.5	67.3	475.8
Operating margin (%)	19.3	11.6	

Net profit up by 214%

Though the tax incidence for the quarter was 20.9% at Rs73.7 crore against a tax credit of Rs4.0 crore in Q2FY2006, the net profit after minority interest zoomed by 214% to Rs279.8 crore in Q2FY2007.

In the H1FY2007, DRL reported a 199% growth in the top line to Rs3,408.8 crore, coupled with an 850-basis-point expansion to 16.7%, leading to a 239% growth in its net profit after minority interest to Rs419.5 crore.

Filings

During the quarter DRL filed 8 ANDAs, including 3 non-Para IVs. This takes the total ANDAs pending with the USFDA to 55. Out of the 55 pending ANDAs, the company expects a majority of the pipeline products would be given a Day-1 launch opportunity. On the active pharmaceutical ingredients (APIs) front, the company has filed 3 US drug master files (DMFs) during the quarter taking the total filings to 86 and 3 DMFs in Canada.

Valuation and view

At the current market price of Rs752, the stock trades at 18.2x and 22.0x of FY2007 and FY2008 consensus earnings. Currently, the management plans to focus strategically on enhancing the earnings by leveraging its Day-1 launches (as 55 ANDAs are in the pipeline) and authorised generic deals. On the cost front, DRL plans to curtail its litigation costs by out of court settlements and has already started tightening its SG&A expenses. On the R&D front, the company has already de-risked its model by partnering with financial partners. With all these developments we are positive about the stock.

Valuation table

	FY04	FY05	FY06	FY07E	FY08E
Net sales	1927.6	1832.7	2355.0	5085.9	4775.9
Operating profit	289.5	84.4	310.5	884.7	747.8
OPM (%)	15.0	4.6	13.2	17.4	15.7
Net profit	251.5	32.9	146.7	631.8	525.7
Net profit margin (%)	13.0	1.8	6.2	12.4	11.0
Shares in issue (cr)	7.7	7.7	7.7	15.4	15.4
EPS (Rs)	32.9	4.3	19.1	41.2	34.2
P/E (x)	22.9	174.8	39.3	18.3	22.0

Sales and profit estimates for FY2007 and FY2008 are consensus estimates

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

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