investor's eye

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Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Aban Loyd	03-Mar-05	330	**1,199**	1,760
BHEL	11-Nov-05	1,203	**2,249**	2,650
ICICI Bank	23-Dec-03	284	**590**	750
Infosys	30-Dec-03	689	**1,767**	1,870
Orient Paper	30-Aug-05	214	**428**	675

Bharat Heavy Electricals

Apple Green

Stock Update

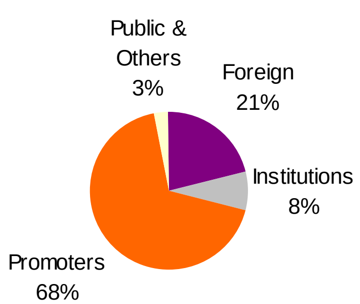
Employees dissatisfied

Buy; CMP: Rs2,247

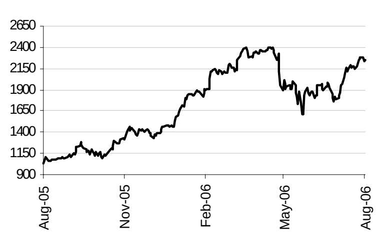
Company details

Price target:	Rs2,650
Market cap:	Rs54,998 cr
52 week high/low:	Rs2,465/1,020
NSE volume: (No of shares)	4.3 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	25.2	18.2	17.3	114.6
Relative to Sensex	9.6	6.6	3.1	42.5

BHEL executives unhappy with performance pay for FY2006—to boycott jubilee celebrations

According to newspaper reports, some 9,000 executives of the public sector unit Bharat Heavy Electricals Ltd (BHEL) are reportedly unhappy with what they call a measly 4% performance-based incentive they got for FY2006. These executives are hence returning the amount that was electronically transferred to their banks by BHEL. To further show their dissent, these executives across 14 units are boycotting the golden jubilee celebrations slated for August 29, 2006.

BHEL has given all its 43,000 employees a flat annual plant performance payment of Rs14,000 each, even though the executives are entitled to 22% of the company's distributable profit amounting to an incentive of Rs48,000 each. BHEL is a Navaratna company with all its financial parameters doing well, yet its incentive is far lower than the NTPC and ONGC pay-outs of Rs1-1.5 lakh to each of its officers; even mini-ratnas HAL and BEL have paid better, at Rs70,000-80,000 to each of its officers. Hence, the executives of BHEL are unhappy with the wide wage disparity with their counterparts in the other public sector companies and the private sector. BHEL's Executives Association said the satisfaction level of the employees is extremely low.

If Rs50,000 were to be paid to all the 9,000 employees that are protesting, the additional provision required by BHEL for the same would be close to Rs45 crore, which is less than 1% of the FY2007E profit before tax (PBT). However if all the 43,000 employees are given the additional performance pay of Rs50,000 each, the amount is significant at 6% of the PBT. We believe the matter is significant in two ways. First the amount is substantial and second it could affect the delivery schedules for the already bulging order book that stands at more than Rs40,000 crore.

View

We believe that the management of BHEL would quickly gauge the seriousness of the issue and would amicably settle the same with the executives. In the wake of unclarity of the above-mentioned issue we are not changing our estimates for BHEL and maintain our Buy recommendation on the stock with a price target of Rs2,650.

Earnings table

Year ended March 31	FY04	FY05	FY06E	FY07E	FY08E
Net profit (Rs cr)	658.1	953.4	1,679.1	2,416.8	3,066.0
% y-o-y growth	*6.0*	*22.0*	*74.0*	*44.0*	*27.0*
Shares in issue (Cr)	24.5	24.5	24.5	24.5	24.5
EPS (Rs)	26.9	38.9	68.6	98.7	125.2
% y-o-y growth	*6.0*	*22.0*	*74.0*	*44.0*	*27.0*
PER (x)	83.6	57.7	32.8	22.8	17.9
Book value (Rs)	216.3	251.5	293.9	358.7	439.8
P/BV (Rs)	10.4	8.9	7.6	6.3	5.1
EV/EBIDTA (x)	58.6	36.6	22.2	14.7	10.9
RoCE (%)	19.2	26.5	36.3	44.1	47.9
RoNW (%)	12.4	15.5	23.3	27.5	28.5

Navneet Publications (India)

Emerging Star

Stock Update

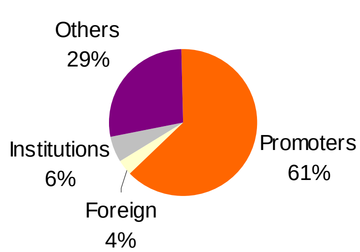
Annual report review

Buy; CMP: Rs290

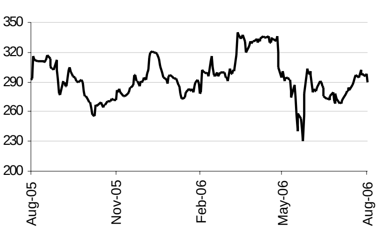
Company details

Price target:	Rs362
Market cap:	Rs553 cr
52 week high/low:	Rs354/230
NSE volume: (No of shares)	8,259
BSE code:	508989
NSE code:	NAVNETPUBL
Sharekhan code:	NAVNEET
Free float: (No of shares)	73 lakh

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	9.3	1.5	8.6	6.3
Relative to Sensex	-4.3	-8.4	-4.6	-29.4

The key highlights of the latest annual report of Navneet Publications (India) (Navneet) are given below.

Change in syllabus remains the key growth driver

The modest growth in the publications revenue of 8% to Rs180 crore during FY2006 was largely driven by the change in the syllabus of standards IX and XII in the state of Gujarat. The educational publications segment is the core business and contributes nearly 53% of the total turnover of Navneet.

In the current year, the syllabus has been revised for the states of Gujarat (standard X) and Maharashtra (Standards: I, V, IX, XI). These changes would be the catalyst for the growth in the current fiscal as per the annual report. The impact would be more pronounced in the first half of the year. According to the annual report, the management is looking forward to a healthy growth in the publication division over the next three years (FY2007-09) on account of the procedure of the change in the syllabus. The second-hand books of the old syllabus become redundant once the syllabus changes and this is what leads to the growth in sales.

Schedule for change in syllabus

	FY2007	FY2008	FY2009	FY2010
Gujarat	X			
Maharashtra	I+V+IX+XII	II+VI+X+XII	III+VII	IV+VIII

The children's general book publication revenues remained more or less stagnant at around Rs19.6 crore during FY2006. The company doesn't expect any significant growth in the segment.

Domestic sales drive growth in stationery segment

In the stationary segment, the revenue growth of 6% during FY2006 to Rs112 crore was led by a 37% increase in the domestic stationery business. The management reports that the stationary business in the domestic market is showing encouraging signs both in terms of volumes and profitability. Furthermore, in an attempt to reduce its dependence on paper stationery, the company will introduce products in the non-paper stationery segment. It has already introduced pencils and will introduce other non-paper stationary products like erasers, sharpeners and pencil boxes.

The growth in the domestic business would more than make up for the loss of the business in the highly competitive export markets. The export revenue in the stationary business declined to Rs27.8 crore in FY2006, down from Rs44.6 crore in FY2005.

Operating margins to improve

Navneet's operating profit margins for FY2006 declined slightly by 50 basis points to 20.1%. This was mainly on account of increased staff cost, as the company increased its field force to effectively exploit the opportunity arising from the changes in the syllabus. However, as per the annual report, the operating profit margins are expected to improve during the current year due to better sales mix towards the high-margin publication business. The margins in the stationary business are also expected to pick up due to a higher proportion of the revenues from the domestic market.

Higher inventory affects cash flow generation

Navneet's inventory as on March 31, 2006 increased by Rs25 crore to Rs122 crore. The company had to prepone the printing of the books for the standards with the old syllabus as a higher number of copies were required for the books of the standards with the new syllabus. Further, the company had to procure extra raw material keeping an eye on the additional requirement for the new syllabus books. This led to an increase in the inventory and ultimately lower cash flow generation (net of working capital) to Rs39.8 crore in FY2006 (R64 crore in FY2005). The increased inventories also resulted in an increase in the debt/equity ratio as on March 31, 2006 to 0.27 from 0.23 as on March 2005. However, we believe that considering the nature of the business of educational publishing, inventories tend to be high at the year-end and the same are not extraordinary in nature. Going ahead, with higher cash generation led by the growth in the publications sales will ensure higher cash flow generation during FY2007.

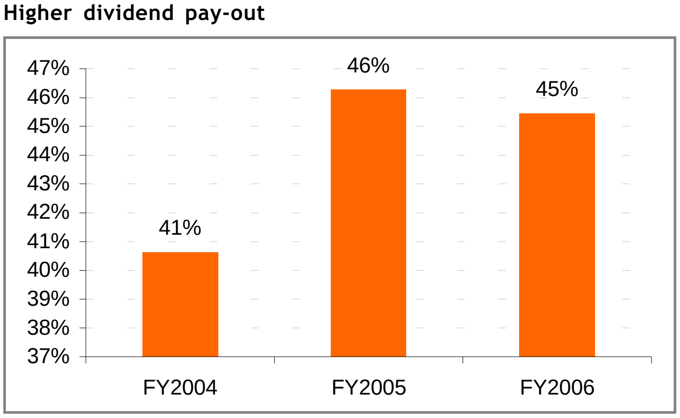
Moderate capex plans ahead

Navneet's capital expenditure (capex) for FY2006 was Rs7.5 crore, which was mainly towards the modernisation of machinery. For the current year, according to the annual report, the company expects to spend around Rs10 crore to modernise some of its printing facilities. The capex would be comfortably funded from internal accruals.

Increased dividend pay-out, stock split

During FY2006, Navneet declared a dividend of Rs8.5 per share, up from Rs7.5 per share in FY2005. With the current price near Rs290, the stock offers a decent dividend yield of nearly 3%. Given the benign capex plans and the expected growth in FY2007, the dividend rate would at least be maintained if not increased.

Higher dividend pay-out



Furthermore, the company also announced a stock split, sub-dividing the shares of the company from a paid-up value of Rs10 each to a paid-up value of Rs2 each. The same has been announced to improve the liquidity in the stock.

Grafalco generates revenues of Rs1.9 crore

During early FY2006, Navneet acquired Spanish children's book company Grafalco, through its wholly-owned subsidiary Chaplin Disenos SL for Rs2.7 crore. During the year, the subsidiary recorded sales of Rs1.9 crore. The company reported a meagre operating loss of Rs0.5 crore on account of initial set up costs. Its focus has been on introducing new products and tying up with supermarkets. During the year, the company should complete the registration with most of the big chain stores. The titles introduced by the company were well accepted in the market. The management expects to reap the benefits from the acquisition over the coming years.

Valuation

The management has reiterated in the annual report that the growth over the next couple of years would be led by the changes in the syllabus in the states of Gujarat and Maharashtra. In the stationery segment, the company will focus on the domestic market and will leverage on its brand for selling non-paper stationery products. The operating margins are likely to improve on the back of a better sales mix. In addition to the fundamental factors, the reasonably attractive dividend yield and the enhanced liquidity (through stock split) should limit any downside risk in the stock.

At the current market price of Rs290 Navneet trades at 10x FY2008E earnings per share of Rs29 and 5.8x FY2008E enterprise value/earnings before interest, depreciation, tax and amortisation. We maintain a Buy on Navneet with a price target of Rs362.

Earnings table

Particulars	FY04	FY05	FY06	FY07E	FY08E
Net profit (Rs cr)	35.2	30.9	35.6	44.8	55.4
Shares in issue (cr)	1.9	1.9	1.9	1.9	1.9
EPS Rs	18.5	16.2	18.7	23.5	29.1
% y-o-y chg		*-12.2*	*15.4*	*25.6*	*23.8*
PE (x)	15.7	17.9	15.5	12.3	10.0
BV (Rs)	83.1	91.1	96.5	108.9	126.8
P/BV	3.5	3.2	3.0	2.7	2.3
EV/EBIDTA	11.2	10.5	10.2	7.3	5.8
ROCE (%)	15.0	15.0	16.0	20.0	23.0
RONW (%)	22.0	18.0	19.0	22.0	23.0
Dividend yield (%)	2.6	2.6	2.9	3.4	3.4

Cipla

Cannonball

Stock Update

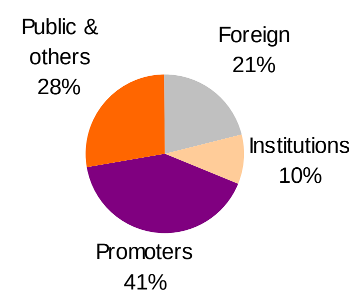
Annual report review

Buy; CMP: Rs246

Company details

Price target:	Rs300
Market cap:	Rs19,119 cr
52 week high/low:	Rs305/126
NSE volume: (No of shares)	1.2 lakh
BSE code:	500087
NSE code:	CIPLA
Sharekhan code:	CIPLA
Free float: (No of shares)	17.7 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	15.1	12.4	13.4	77.3
Relative to Sensex	0.8	1.4	-0.3	17.7

Cipla is the second largest player in the domestic formulations market, with a presence across most therapeutic areas. Cipla has 18 brands in its product portfolio that rank among the top 300 pharma brands in the country. The company also has a strong presence in the export market, with its products being exported to 170 countries including the USA, Europe, South Africa, Australia and the Middle East.

We recently received Cipla's FY2006 annual report, the highlights of which are discussed below.

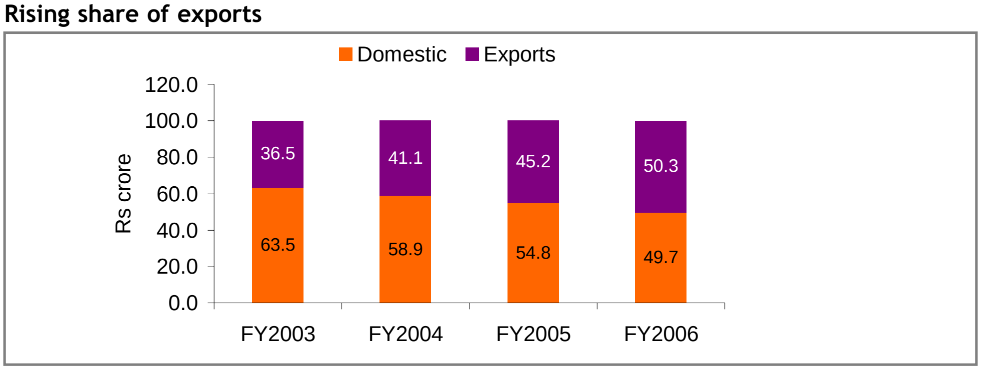
Unique partnership model for international markets

Cipla exports its active pharmaceutical ingredients (APIs) and formulations to over 170 countries through strategic alliances and partnerships. The company's main business strategy is to collaborate with international business partners to develop and supply products to the developing and regulated markets. Having built relationships with more than 200 partners in 170 countries, Cipla now has 4,000 product registrations and 7,000 registrations pending approval. This unique model enables Cipla to leverage its in-depth local expertise while limiting the need to set up its own facilities and marketing infrastructure, thus reducing fixed costs. Through this partnership model, Cipla can easily scale up its export revenues by tapping opportunities in various geographies.

Increasing contribution of exports

Cipla's revenues have growth at a compounded annual growth rate (CAGR) of 26.3% over the FY2003-06 period. During the same time frame, export revenues have grown at a CAGR of 39% whereas the domestic revenues have growth at a CAGR of 15%. The contribution of the high-margin exports to Cipla's total revenues has been gradually increasing, from 36.5% of sales in FY2003 to 50.3% of sales in FY2006.

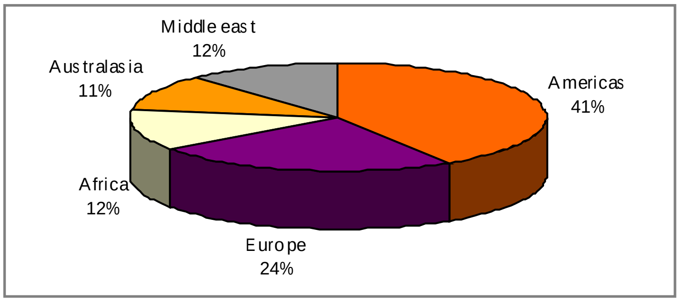
Rising share of exports



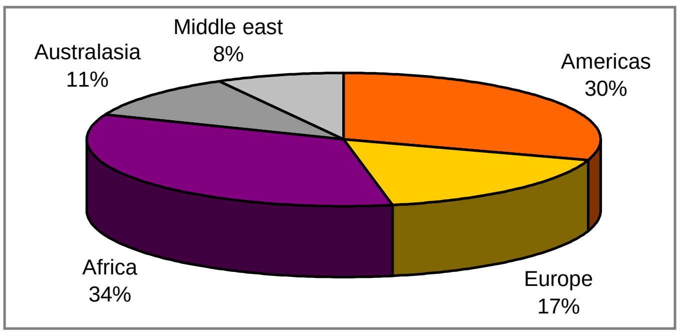
Revenue stream diversified across geographies

Moreover, it is seen that Cipla's export revenues are well diversified across various geographies. Through its prudent strategy and marketing tie-ups, Cipla has been able to successfully reduce its dependence on any one particular country. The company exports to over 170 countries. The USA, which accounted for 41% of the company's export revenues in FY2002 contributed only 30% in FY2006, which is less than 6% of the overall turnover of the company. The reduced exposure of the company to the US market insulates Cipla from the huge pricing pressures being witnessed by most generic players in the USA. The contribution from Africa has risen in FY2006 to 34% of the total exports, possibly on account of the exponential increase in the supply of anti-retroviral products to that region.

Export revenue composition in FY2002



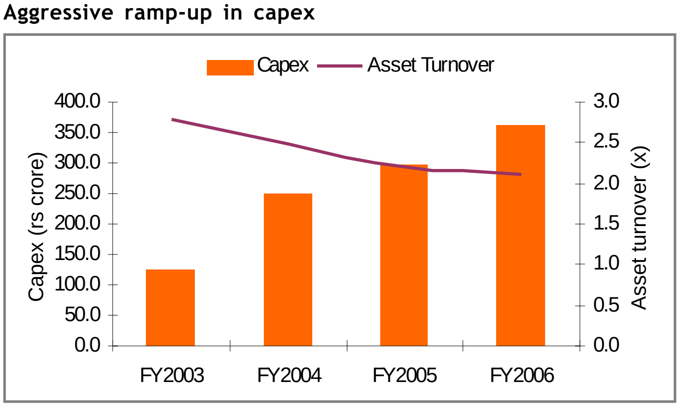
Export revenue composition in FY2006



Aggressive capex provides further revenue visibility

Cipla's capital expenditure (capex) has risen three-fold from Rs125 crore in FY2003 to Rs360 crore in FY2006. The company has been steadily investing in expanding its capacities across plants in order to scale up its operations. The aggressive ramp-up in the capex has caused the asset turnover ratio to decline from 2.8x in FY2003 to 2.1x in FY2006. However, we believe that this will improve as the company reaps the benefits of its investments by recording impressive increases in its top line.

Aggressive ramp-up in capex



Moreover, a detailed analysis of the annual report reveals that the major capacity expansions are being focused on the high-margin products such as inhalers and injectables. On the other hand, the capacities for bulk drugs have been on the decline. This reinforces Cipla's focus on the high-margin formulation products, with bulk drugs reducing in importance.

Increase in capacities across high-margin products

	Unit	FY2000	FY2006	Change
Bulk drugs	Tonne	2101.0	1598.0	-503.0
Tablets & capsules	Million	2600.0	12298.0	9698.0
Liquids	Kilo Litre	2200.0	1404.0	-796.0
Creams	Tonne	100.0	616.0	516.0
Aerosols/Inhalation devices	Thousands	7100.0	53580.0	46480.0
Injections/Sterlie solutions	Kilo Litre	500.0	1071.0	571.0

Through a capex close to Rs360 crore incurred in FY2006, Cipla has set up a new export-oriented manufacturing unit for APIs and formulations at Patalganga. This unit is nearing completion and is expected to commence production in the second quarter of FY2007. The company has also expanded its facilities at Baddi in Himachal Pradesh. In addition, the company is planning to set up a large drug formulation manufacturing facility for various dosage forms at the special economic zone (SEZ) in Goa. Cipla has also planned major capacity additions to its manufacturing facilities at Kurkumbh and Bangalore. The incremental capex at Goa is likely to enjoy fiscal incentives regarding excise duty, income tax and sales tax. We believe that such significant capex is an indication of the management's confidence regarding the long-term growth of the company.

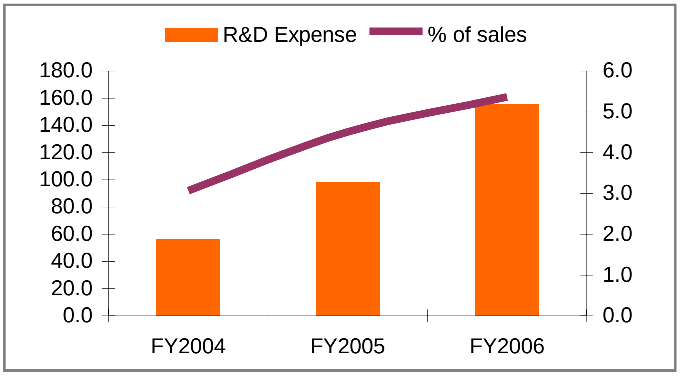
$170 million GDR issue to fund acquisitions, capex

Cipla has recently concluded a $170 million (approximately Rs765 crore) global depository receipt (GDR) issue. The company plans to utilise the proceeds to expand capacities, to fund its working capital requirement and for acquisitions. Any form of inorganic growth could provide a further trigger to Cipla's future growth. The GDR issue has diluted Cipla's equity by 3.7%.

Increased focus on R&D

Cipla is gradually increasing its focus and spending on research and development (R&D) to enhance its existing processes, as well as developing new ones for the APIs and formulations. The company is also focusing on the development of new drug delivery systems for existing and newer active drug substances. Cipla has introduced over 118 new products in the domestic market over the last two years and has filed 658 drug master files (DMFs), 71 abbreviated new drug applications (ANDAs), 170 marketing authorisations in Europe and over 4,000 product registrations globally. The above efforts have resulted in the R&D spend increasing from 3.1% of sales in FY2003 to 5.4% of sales in FY2006.

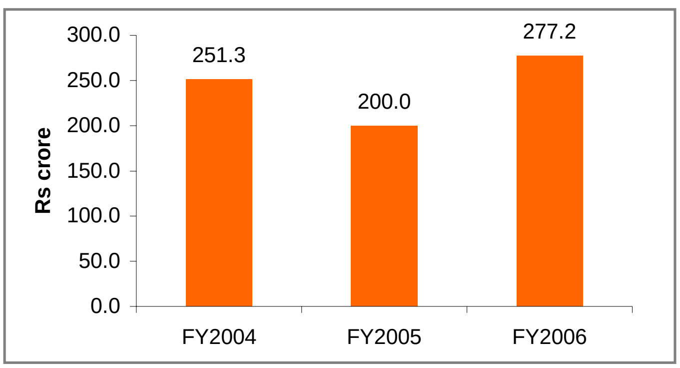
R&D spend on an uptrend



Healthy operating cash flows despite increase in working capital requirements

Cipla continued to record healthy operating cash flows in FY2006 despite a substantial jump in the company's working capital requirement.

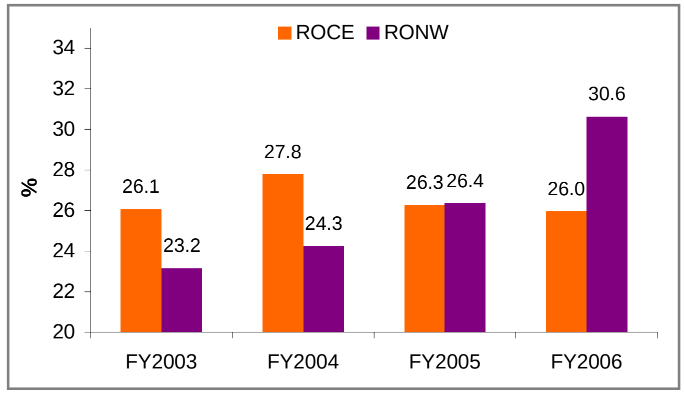
Operating cash flows remain steady



Stable return ratios despite aggressive capex

Cipla's strategy of focusing on its core competence of product development and manufacturing as well as pure organic growth has enabled it to maintain consistently high return ratios. The company has delivered return ratios in excess of 25% despite aggressive capital expenditure and the worsening competitive environment. Going forward, the return ratios might be depressed slightly due to the equity dilution post the GDR and bonus issues.

Steady returns despite aggressive capex



Valuation and view

Cipla has reported a strong all-round performance with a robust growth in the domestic and export sales. The lower excise duty, an improving product mix and a leaner cost structure have led to the company's margins springing back above the 20% level in FY2006. We expect the growth momentum to continue in the upcoming quarters, led by the ramp-up in the sales of Finasteride and Sertraline in the US markets. A favourable change in the sales mix driven by the high-margin formulation exports is expected to provide a further boost to Cipla's margins. Given the unique partnership model for the US generics market and the strong growth traction of the company, we maintain our positive outlook on Cipla.

At the current market price of Rs246, the company is trading at 20.4x its estimated FY2008 earnings. We reiterate our Buy recommendation on Cipla, retaining our price target of Rs300.

Valuation table Rs (cr)

Particulars	FY04	FY05	FY06	FY07E	FY08E
Net sales	1842.2	2181.3	2897.4	3651.1	4344.8
Net profit	306.7	409.6	607.6	758.8	938.5
Shares in issue (cr)	30.0	30.0	30.0	77.7	77.7
EPS (Rs)	10.2	13.7	20.3	9.8	12.1
PER (x)	24.1	18.0	12.1	25.2	20.4
Book value (Rs/share)	42.2	51.8	66.1	43.2	53.2
Price/BV (x)	5.8	4.7	3.7	5.7	4.6
EV/EBITDA	22.4	17.6	12.7	21.3	17.2

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

Sharekhan Stock Ideas

Evergreen

HDFC Bank
Infosys Technologies
Reliance Industries
Tata Consultancy Services

Apple Green

Aditya Birla Nuvo
Associated Cement Companies
Bajaj Auto
Balrampur Chini Mills
Bharat Bijlee
Bharat Heavy Electricals
Corporation Bank
Crompton Greaves
Elder Pharmaceuticals
Godrej Consumer Products
Grasim Industries
Hindustan Lever
Hyderabad Industries
ICICI Bank
Indian Hotels Company
ITC
Mahindra & Mahindra
Marico Industries
Maruti Udyog
MRO-TEK
Lupin
Nicholas Piramal India
Omax Auto
Ranbaxy Laboratories
Satyam Computer Services
SKF India
State Bank of India
Sundaram Clayton
Tata Motors
Tata Tea
Unichem Laboratories
Wipro

Cannonball

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

Emerging Star

3i Infotech
Aban Loyd Chiles Offshore
Cadila Healthcare
KSB Pumps
Marksans Pharma
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Solectron Centum Electronics
Television Eighteen India
Thermax
TVS Motor Company
UTI Bank
Welspun Gujarat Stahl Rohren

Ugly Duckling

Ashok Leyland
Deepak Fertilisers & Petrochemicals Corporation
Genus Overseas Electronics
HCL Technologies
ICI India
Jaiprakash Associates
JM Financial
KEI Industries
NIIT Technologies
Punjab National Bank
Ratnamani Metals and Tubes
Sanghvi Movers
Saregama India
Selan Exploration Technology
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