investor's eye

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Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Aban Loyd	03-Mar-05	330	**933**	1,760
Bajaj Auto	15-Nov-05	1,873	**2,618**	3,500
BHEL	11-Nov-05	1,203	**1,858**	2,650
Infosys	30-Dec-03	1,378	**2,844**	3,324
TV18	23-May-05	280	**490**	704

Pulse Track

May 2006 trade deficit springs positive surprise

Despite the rising oil import bill, India was able to control its trade deficit to $3.8 billion compared with $3.6 billion in May 2005, as its exports grew at a strong rate of 30% year on year (yoy) for the same month.

India's exports for May 2006 grew by a strong 30% to $9.4 billion, the third highest ever achieved by the country. The imports grew by 22.1% to $13.2 billion during the same period. The trade deficit for the month stood at $3.8 billion, only marginally up from $3.6 billion in May 2005.

For the first two months of FY2007, the exports grew by 28.4% while the imports grew by 22.4%. The oil imports grew by 31.7% whereas the non-oil imports also reported a strong growth of 19.2%. The trade deficit for the period April-May 2006 stood at $8.0 billion compared with $7.2 billion in the same period last year.

US$ billion	May-06	May-05	% yoy change	Apr-May 2006	Apr-May 2005	% yoy change
Exports	9.4	7.2	29.9	17.7	13.8	28.4
Imports	13.2	10.8	22.1	25.7	21.0	22.4
Oil	4.2	3.2	29.7	8.3	6.3	31.7
Non-oil	9.0	7.5	20.0	17.4	14.6	19.2
Trade deficit	-3.8	-3.6	6.7	-8.0	-7.2	10.8

FY2006 numbers denote strong investment trend

The commodity wise numbers, which come with a lag of two months, suggest that the much-spoken-about underlying investment theme remains strong. For FY2006, the non-oil imports grew by 21% yoy led by a strong growth in the imports of capital goods (up 21.8%), chemicals and related products (up 28.8%), metal ores (up 53%), coal and coke (up 16%), plastic materials (up 53.5%) and iron and steel (up 71%).

US$ billion	FY2006	FY2005	% yoy change
Exports	83.5	102.7	23.0
Imports	108.0	133.4	23.5
Of which			
Oil	26.4	35.0	32.7
Non-Oil	81.6	98.4	20.6
Of which			
Food & related items	3.5	3.2	-9.8
Textile yarn fabrics, made-up articles	1.6	2.0	29.3
Chemicals and related products	8.7	11.2	28.8
Capital goods	15.1	18.4	21.8
Other non-POL items	48.5	57.6	18.7
Other commodities	4.2	6.1	43.2

Ashok Leyland

Ugly Duckling

Stock Update

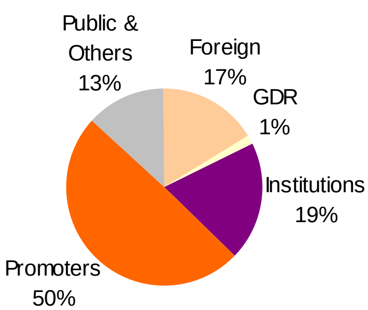
Widening its product portfolio

Buy; CMP: Rs35

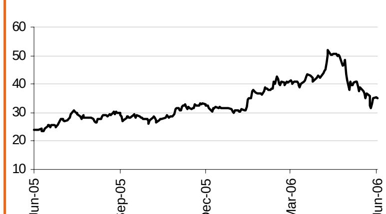
Company details

Price target:	Rs53
Market cap:	Rs4,276 cr
52 week high/low:	Rs54/23
NSE volume: (No of shares)	76.9 lakh
BSE code:	500477
NSE code:	ASHOKLEY
Sharekhan code:	ASHOKLEY
Free float: (No of shares)	60.1 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-14.4	-12.2	7.9	53.1
Relative to Sensex	-6.7	-5.1	0.7	4.0

Ashok Leyland Ltd (ALL) has made a couple of announcements in the recent times. For instance, it plans to gain a foothold in the light commercial vehicle (LCV) segment through a joint venture or a technical tie-up. The company also has ambitious plans for its automotive component division as it aims to tap newer export markets. To fund its capital expenditure (capex) plans it has also passed a resolution to raise funds up to $150 million. We recently spoke to the company to know more about these plans and present an update below.

Entry into the LCV business

ALL plans to enter into the LCV business. For this purpose, the company is actively in talks with global players to form either a joint venture or a technical tie-up in the LCV segment. ALL's expertise lies in the medium and heavy commercial vehicle segment where it has a market share of around 27%. It also has a tie-up with Iveco in the heavy commercial vehicle segment. At present, the company has a minimal presence in the LCV segment with volumes of just 798 vehicles in FY2006.

In the LCV market, the company wants to enter the 2.5-5.0-tonne segment, where it does not have any presence as of now. It plans to set up a new plant to manufacture LCVs and the same would be its sixth production facility. The new facility is likely to be set up after two years when the company's production crosses 100,000 units. However, greater details of the same are not available as the talks are still at a very initial stage. We view the development in positive light considering the strong prospects for commercial vehicles (CVs) in the country and also the strong demand for Indian-made CVs from some of the export markets. A tie-up with a company with expertise in this area will help ALL to roll out new models in the segment and consequently improve its market share in the segment. The entry into the LCV business should help ALL broaden its product portfolio to capitalise on the growth opportunities.

Automotive component division scaling up its operations

ALL is quite bullish on the prospects of its auto component division and is exploring the opportunities to enter newer export markets. The division, known as Auto Components Group (ACG), has recently scaled up its operations in Malaysia by supplying its components to several ancillary companies there. ALL has drawn out ambitious plans to catapult ACG's revenues to $100 million by FY2009 from the current $20 million. This would be done by widening its product range and entering into new export markets in the USA, Europe, South-east Asia and West Asia.

Raising funds to finance its capex plans

ALL plans to spend Rs600 crore in the next two years to raise its vehicle capacity from 77,000 units to 100,000 units. To finance its capex, the company also recently passed a resolution enabling it to raise funds up to $150 million through foreign currency convertible bonds or notes, global depository receipts or private placement. The final capital-raising instrument is yet to be decided and a committee of directors has been formed to deal with the issue of raising funds.

Stricter implementation of the overloading ban likely

The sales of CVs have picked up after the Supreme Court banned the overloading of trucks. While the ruling was implemented strictly in the states like Maharashtra, Gujarat and Haryana, its implementation in some of the other states lacked firmness. We expect its stricter implementation in these other states, especially the southern ones as the elections are now over in Tamil Nadu and Kerela. Consequently, the volumes of CV majors like ALL should receive a boost.

New product launches in the pipeline

The company plans to introduce a number of products in the next two years. Its Inter Century-Luxura buses are likely to be introduced in Q3FY2007 whereas the new J-series should be launched in the second or third quarter of FY2007. The other launches planned are the NEWGEN range of trucks and a new HMV defence truck for the Indian army.

Outlook

We believe that ALL's plans to increase its presence in the LCV segment and scale up the operations of the ACG would strengthen its product portfolio and further de-risk its business model. At the current market price of Rs35, the stock quotes at 9.3x its FY2008E earnings and 5.2x its FY2008E earnings before interest, depreciation, tax and amortisation. We believe that the valuations are very reasonable and maintain our Buy recommendation on the stock with a price target of Rs53.

Earnings table

Year ended Mar 31	FY2005	FY2006	FY2007E	FY2008E
Net profit (Rs cr)	281.0	305.6	406.7	503.5
% y-o-y growth		*9.0*	*33.0*	*24.0*
Shares in issue (cr)	118.90	122.16	133.20	133.20
EPS (Rs)	2.4	2.5	3.1	3.8
% y-o-y growth		*9.0*	*33.0*	*24.0*
PER (x)	14.8	14.0	11.5	9.3
Book value (Rs)	9.6	11.4	15.0	15.6
P/BV (Rs)	3.6	3.1	2.3	2.2
EV/EBIDTA (x)	10.0	7.8	6.5	5.2
Dividend yield (%)	2.9	3.4	3.4	3.4
RoCE (%)	20.7	22.1	26.3	28.8
RoNW (%)	23.7	23.6	20.4	24.2

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

Welspun Gujarat Stahl Rohren

Emerging Star

Stock Update

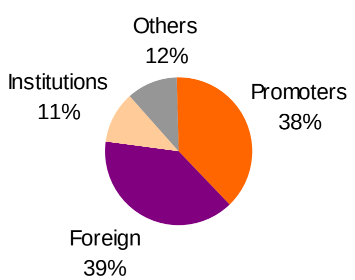
Gains in 'pipeline'

Buy; CMP: Rs69

Company details

Price target:	Rs100
Market cap:	Rs895 cr
52 week high/low:	Rs113/53
NSE volume: (No of shares)	2.7 lakh
BSE code:	532144
NSE code:	WELGUJ
Sharekhan code:	WELSPUNGUJ
Free float: (No of shares)	8.0 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-3.8	-22.0	-21.6	-1.2
Relative to Sensex	4.8	-15.7	-26.8	-32.9

Result highlights

- Welspun Gujarat Stahl Rohren (WGSR) has reported a 76% growth in its revenues to Rs1,829.8 crore in FY2006. Its profit after tax (PAT) for the same period has grown by 81.4% year on year (yoy) to Rs61.3 crore. The operating profit margin (OPM) has improved by 240 basis points from 6.6% in FY2005 to 9% in FY2006, thanks to a 350-basis-point improvement in the raw materials cost to sales.
- For the reported quarter, the net sales grew by 86% to Rs644 crore from Rs346 crore in the corresponding quarter last year. The operating profit for the quarter surged to Rs55.2 crore from Rs0.3 crore in Q4FY2005. The PAT stood at Rs19.4 crore in Q4FY2006.
- WGSR's current order book stands approximately at Rs1,800 crore and the same is executable over three quarters. Some of the major orders include a repeat order worth Rs212 crore to the region of Gulf of Mexico, a PGN-Indonesia order worth Rs500 crore and a Rs301-crore order from Algeria.
- After completing its capacity expansion at Anjar in FY2006, WGSR has currently undertaken a capital expenditure (capex) programme worth Rs1,225 crore to set up a plate and coil mill as backward integration exercise. The backward integration is expected to improve its OPM significantly from FY2008 and onwards.
- At the current market price of Rs69, on a fully diluted equity of Rs84.6 crore WGSR is trading at 6x FY2008E earnings per share (EPS) of Rs11 and 4.3x 2008E enterprise value (EV)/earnings before interest, depreciation, tax and amortisation (EBIDTA). We feel the valuations are quite attractive and we maintain a Buy on WGSR with a revised price target of Rs100. Our price target discounts WGSR's FY2008E EPS by 9x.

Result table **Rs (cr)**

Particulars	FY2006	FY2005	% yoy chg	Q4FY06	Q4FY05	% yoy chg
Net sales	1,829.8	1,038.5	76.2	644.0	346	86.1
Raw material consumed	1,357.4	807.4	68.1	456.2	293.7	55.3
Employee expenses	40.8	17.1	138.6	14.5	7.4	95.9
Other expenses	266.1	145.7	82.6	118.1	44.6	164.8
Total expenditure	1,664.3	970.2	71.5	588.8	345.7	70.3
Operating profit	165.5	68.3	142.3	55.2	0.3	18,300.0
Other income	1.9	26.2	-92.7	0.3	11.2	-97.3
PBIDT	167.4	94.5	77.1	55.5	11.5	382.6
Interest	41.9	20.3	106.4	17.8	7.2	147.2
PBDT	125.5	74.2	69.1	37.7	4.3	776.7
Depreciation	35.2	24.1	46.1	12.2	4.9	149.0
PBT	90.3	50.1	80.2	25.5	-0.6	-4,350.0
Tax	29.0	16.3	75.5	6.1	-2.4	-354.2
Reported profit after tax	61.3	33.8	81.4	19.4	1.8	977.8

A strong sales growth: 86% for Q4FY2006

WGSR's net sales grew by a strong 86% from Rs346 crore in Q4FY2005 to Rs644 crore in Q4FY2006. The same was on account of the commencement of the company's Anjar facility and a strong order book position. For the full year, the net sales grew by 76% from Rs1,038.5 crore in FY2005 to Rs1,829.8 crore in FY2006. The FY2006 sales mix stands at 60:40 in favour of exports.

Q4FY2006 operating profit zooms to Rs55 crore

WGSR reported a strong growth in the operating profit for Q4FY2006. For the quarter it grew exceptionally well to Rs55.2 crore from Rs0.3 crore in Q4FY2005. The whopping growth was also caused by a lower base effect of last year. The OPM for Q4FY2006 grew to 8.6% from an abysmally low of 0.1% in Q4FY2005. The improvement in the margins was largely due to the lower raw materials cost as a percentage of sales at 70.8%, down from 84.9% in Q4FY2005.

For FY2006, the operating profit grew by 142% from Rs68.3 crore in FY2005 to Rs165.5 crore in Q4FY2006 helped by a 240-basis-point improvement in the OPM. The OPM for FY2006 improved to 9% from 6.6% in FY2005, thanks to significant savings in the raw material cost. The raw material cost as a percentage of sales improved by 350 basis points from 77.7% in FY2005 to 74.2% in FY2006.

PAT grows ninefold to Rs19.4 crore in Q4FY2006

The PAT for Q4FY2006 stood at Rs19.4 crore, nine times more than that of Rs1.8 crore reported in Q4FY2005. The higher growth is also on account of a lower base effect of last year. For FY2006, the PAT stood at Rs61.3 crore as against Rs33.8 crore in Q4FY2005, a growth of 81.4%. The growth in the bottom line was lower than that in the operating profit due to a higher interest cost and depreciation.

In FY2006, its new Anjar facility went on stream. The company has also undertaken a Rs1,225-crore capex programme to set up a plate and coil mill, which will be part financed by 8.5% loans. This has resulted in a higher interest cost and depreciation. For FY2006, the interest cost increased by 106.4% from Rs20.3 crore in FY2005 to Rs41.9 crore in FY2006. The depreciation charge increased by 46% from Rs24.1 crore in FY2005 to Rs35.2 crore in FY2006.

A strong order book position at Rs1,800 crore

WGSR's present order book stands at Rs1,800 crore to be executed over the next three quarters. Some of the major orders received during FY2006 include a Rs212-crore order to the region of Gulf of Mexico, a PGN-Indonesia order worth Rs500 crore and a Rs301-crore order from Algeria. The Gulf of Mexico order is a repeat one and reflects the customers' confidence in WGSR. The present order book of the company stands at 70:30 in favour of exports compared to the domestic market.

Major orders under Implementation

Project	Kms	USD Million
Enterprise	230	112
NIGC Iran	100	85
PGN -1	193	92
PGN -2	32	14
STG	163	68
Total	718	371

Source: Company

Prospective Projects

Project	Kms	USD Million
Saudi Aramco	300	95
Enterprise	120	42
Transneft & Gazprom (Russia)	670	600
Chevron Texaco	900	400
Iran	250	50
Total	2240	1187

Source: Company

Backward integration to result in higher OPM

WGSR has currently embarked on a major capex programme worth Rs1,225 crore to manufacture steel plates and coils. The project will act as a backward integration as a result of which the company will in-source the critical raw material components that are being imported at present. The project will be completed during H1FY2008. Once completed, the company will be able to produce high-grade steel plates of up to 4.5 metre width and coils of up to 2.8 metre width and 25mm thickness. The project is financed with a combination of foreign currency convertible bonds (FCCBs) worth Rs325 crore and term loans amounting to Rs900 crore @ 8.5% from domestic institutions.

Once completed the backward integration exercise is expected to significantly improve WGSR's OPM. The management expects a cost saving of $100 for per tonne of output in the raw material cost once the project comes on stream. With a cost saving of $30 per tonne of output, we expect WGSR's OPM to improve to 11.3% in FY2008E from the present 9% in FY2006. The OPM will improve further in FY2009, as it will be the first full year when the benefits of the backward integration would be visible.

WGSR to benefit from robust demand for steel pipes

According to the industry estimates, the global demand for steel pipes is likely to be around $52.5 billion over the next five years. In the doemstic market also, the heighened activity in the oil and gas sector is likely to result in an opportunity worth $6.4 billion in the same period.

Global demand projections up to FY2010

Geographical zone	Total length (km)	Number of projects	Equivalent (USD Million)
Middle East and Asia	82114	105	20529
North America	59875	167	14969
Europe	22729	46	5682
Latin America	21430	42	5358
Australasia	12658	18	3165
Africa	12236	28	3059
Total	211042	406	52762

Source: Company

WGSR is well poised to exploit this huge opportunity with its wide range of product portfolio. WGSR offers solutions for spiral (helical) (H-SAW), longitudinal (L-SAW) as well as ERW (electric resistance welded) pipes. Furthermore, WGSR has received approvals from major international customers. Some of the companies which have included WGSR in their approved suppliers' list are TOTAL (France), Saudi Aramco, Chevron (US), PGN (Indonesia) and FPAL (UK). WGSR has also bagged repeat orders from its international customers which reflects its execution skills and quality of work. Some of the recently bagged orders, like the Rs211-crore order from the Gulf of Mexico and the Rs81-crore order from PGN-Indonesia, are repeat orders. Thus, we feel that its wide product offerings, strong relationship with customers and execution skills are its key strengths that can be leveraged to tap future growth opportunities.

Product offerings by various pipes manufacturers

Company	Products				
	LSAW	HSAW	ERW	DI/CI	Seamless
Maharashtra Seamless			✓		✓
Jindal Saw	✓	✓		✓	✓
WGSR	✓	✓	✓		
MAN Industries	✓	✓			
PSL		✓			

Key concern

WGSR raised FCCBs worth $75 million (Rs337 crore) in October 2005 to part finance its Rs1,225-crore backward integration project. The FCCBs are convertible at Rs162 per share. For some reason if the FCCBs are not converted into equity, WGSR will have to repay this amount after March 2011 with a yield till maturity of 7.25%.

Valuation

With a strong order book position and a backward integration exercise underway, we expect WSGR's earnings to grow at a CAGR of over 75% in the FY2006-08E period. At the current market price of Rs69, on a fully diluted equity of Rs84.6 crore, WGSR is trading at 6x FY2008E EPS of Rs11 and 4.3x 2008E EV/EBIDTA. We feel the valuations are quite attractive and maintain a Buy on WGSR with a revised price target of Rs100. Our price target discounts WGSR's FY2008E EPS by 9x.

Financials

Profit and loss account Rs (cr)

Particulars	FY04	FY05	FY06E	FY07E	FY08E
Net sales	811.9	1038.5	1829.8	2743.7	3620.6
Expenditure	690.4	970.1	1664.3	2497.0	3211.0
Operating profit	137.2	68.4	165.5	246.6	409.7
Other income	19.8	26.2	1.9	15.0	10.0
PBIDT	157.0	94.6	167.4	261.6	419.7
Interest	23.0	20.3	41.9	55.1	65.3
Depreciation	18.3	24.1	35.2	56.4	79.5
PBT	115.7	50.1	90.3	150.1	274.9
Tax	40.2	16.3	29.0	48.0	88.0
PAT	72.0	33.8	61.3	102.1	186.9

Balance sheet Rs (cr)

Particulars	FY04	FY05	FY06E	FY07E	FY08E
Liabilities					
Share capital	141.4	75.6	84.6	84.6	84.6
Reserves	74.4	217.2	888.7	990.7	1177.7
Shareholders funds	215.7	292.8	973.2	1075.3	1262.2
Secured loans	159.6	204.0	389.8	977.3	877.3
Unsecured loans	5.7	180.6	5.7	5.7	5.7
Deferred tax	37.6	53.9	53.9	53.9	53.9
Total liabilities	418.6	731.4	1422.5	2112.1	2199.0
Assets					
Net fixed assets	266.1	397.5	999.9	1168.5	1889.1
CWIP	11.3	137.7	125.0	700.0	50.0
Investments	8.4	5.3	5.3	5.3	5.3
Net working capital	132.8	191.0	292.3	238.3	254.7
Total assets	418.6	731.4	1422.5	2112.1	2199.0

Valuation

Particulars	FY04	FY05	FY06E	FY07E	FY08E
EPS (Rs)	2.5	3.2	3.6	6.0	11.1
CEPS (Rs)	3.2	5.4	5.7	9.4	15.8
PE (x)	27.1	21.8	19.0	11.4	6.2
P/CEPS	21.6	12.8	12.1	7.4	4.4
P/BV	9.0	2.5	1.2	1.1	0.9
EV/EBIDTA	15.0	12.8	7.6	7.2	4.3
EV/Sales	2.4	0.8	0.7	0.6	0.5
EV/Order book	1.1	0.5	0.7	1.0	1.0
M Cap/sales	2.2	0.7	0.6	0.4	0.3

Key ratios

Particulars	FY04	FY05	FY06E	FY07E	FY08E
OPM (%)	16.6	6.6	9.0	9.0	11.3
PAT (%)	8.7	3.3	3.3	3.7	5.2
ROCE (%)	36.4	10.4	9.7	10.0	15.9
RONW (%)	33.4	11.6	6.3	9.5	14.8
Debt/Equity (x)	0.8	1.2	0.4	0.9	0.7

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
- Godrej Consumer Products
- Elder Pharmaceuticals
- Grasim Industries
- Hindustan Lever
- Hyderabad Industries
- ICICI Bank
- Indian Hotel Company
- ITC
- Mahindra & Mahindra
- Marico Industries
- Maruti Udyog
- MRO-TEK
- Lupin
- Nicholas Piramal India
- Omax Auto
- Ranbaxy Laboratories
- Satyam Computer Services
- Sintex Industries
- SKF India
- State Bank of India
- Sundaram Clayton
- Tata Motors
- Tata Tea
- Unichem Laboratories
- Wipro

Cannonball

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

Emerging Star

- 3i Infotech
- Aarvee Denim and Exports
- Aban Loyd Chiles Offshore
- Alok Industries
- Alphageo India
- Cadila Healthcare
- KSB Pumps
- Marksans Pharma
- Navneet Publications (India)
- New Delhi Television
- Orchid Chemicals & Pharmaceuticals
- ORG Informatics
- Solectron Centum Electronics
- Television Eighteen India
- Thermax
- Tube Investments of India
- TVS Motor Company
- UTI Bank
- Welspun Gujarat Stahl Rohren
- Welspun India

Ugly Duckling

- Ashok Leyland
- Deepak Fertilisers & Petrochemicals Corporation
- Genus Overseas Electronics
- HCL Technologies
- ICI India
- Jaiprakash Associates
- JM Financial
- KEI Industries
- Nelco
- NIIT Technologies
- Punjab National Bank
- Ratnamani Metals and Tubes
- Sanghvi Movers
- Saregama India
- Selan Exploration Technology
- Subros
- Sun Pharmaceutical Industries
- Surya Pharmaceuticals
- UltraTech Cement
- Union Bank of India
- Universal Cables
- Wockhardt

Vulture's Pick

- Esab India
- Orient Paper and Industries
- WS Industries India

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