investor's eye

Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Bharat Bijlee	29-Nov-04	192	**1,325**	1,425
Ceat	28-Nov-06	122	**131**	190
India Cements	28-Sep-06	220	**240**	315
Indo Tech Trans	28-Nov-06	199	**267**	280
Lupin	06-Jan-06	403	**582**	670

Pulse Track

November 2006 IIP zooms to 14.4%

The Index of Industrial Production (IIP) grew by a strong 14.4% year on year (yoy) for November 2006, as compared to a revised 4.4% growth in October 2006 and a 6% growth in November 2005. We have been mentioning the fact that the sudden blip in the IIP numbers for October 2006 was an aberration and a recovery was on the cards, but the current numbers have surpassed all expectations. The festive season had actually influenced the October IIP numbers and we can once again look forward to stable growth rates in the region of 10% or slightly above as we have been witnessing so far.

The current high growth has come on a lower base of 6% year-on-year (y-o-y) growth reported in November 2005, although the concerns of a slowdown may have been overshadowed by the strong growth reported in November 2006. We, however, feel a cautious approach going forward is better called for than expecting very high growth rates based on the latest data.

Manufacturing up 15.7% yoy

The manufacturing sector maintained its double-digit growth rate at 15.7% with most of the heavyweight sectors contributing to its growth unlike last month where the heavyweight sectors either reported a decline or reported a lower growth thus acting as a drag on the overall manufacturing production index.

The mining production in the economy grew by 7% yoy while the electricity production grew by 8.7% yoy during November 2006.

Capital goods growth rebounds strongly

The capital goods production index rebounded strongly to report a y-o-y growth of 25.3% after two months of sluggish y-o-y growth rates of 4.2% (in October 2006) and 6% (in September 2006). However, the base for November 2006 was comparatively lower than the previous month's base.

Consumer goods growth also reports a bounce back

The consumer goods production index bounced back strongly to report a y-o-y growth of 11.9% after reporting a 2.3% y-o-y decline in October 2006.

Year-till-date growth rates remain comfortable

The IIP growth for the eight months from April to November 2006 stood at 10.6% on a y-o-y basis compared to 8.3% in the corresponding period of the previous year. The growth in manufacturing stood at 11.5% yoy while the capital goods reported a growth of 16.1%.

November IIP numbers

In % yoy chg	Nov-06	Nov-05	Oct-06	YTD FY07	YTD FY06
IIP	14.4	6.0	4.4	10.6	8.3
General					
Manufacturing	15.7	7.0	3.8	11.5	9.4
Mining	7.0	-2.1	5.2	3.8	0.5
Electricity	8.7	3.4	9.7	7.3	5.0
Use based					
Capital goods	25.3	11.5	4.2	16.1	16.2
Consumer goods	11.9	11.1	-2.3	9.7	13.3
- Durables	11.4	16.2	0.2	12.5	14.2
- Non-durables	12.1	9.3	-3.4	8.7	12.9

Revised October IIP numbers

In % y-o-y change	Oct-2006	Oct-2006R*
IIP	6.2	4.4
General		
Manufacturing	6.0	3.8
Mining	4.0	5.2
Electricity	9.7	9.7
Use based		
Capital goods	8.2	4.2
Consumer goods	0.5	-2.3
- Durables	2.4	0.2
- Non-durables	-0.4	-3.4

*revised data

First revision of October data reports a further decline in IIP

The revised figures for October 2006 indicate a further decline in the earlier reported IIP numbers. The revised manufacturing index reported a further decline to 3.8% from the earlier reported 6% while the electricity production growth rate remained unchanged and mining reported an improvement from 4% to 5.2%. The downward revision is mainly on account of a downward revision in the production data by the Department of Industrial Policy and Promotion and Textile Commissioner.

Heavyweight manufacturing sectors report a rebound

The October 2006 manufacturing growth was poor on account of the decline in food products and other manufacturing industries production. The lower growth from the heavyweight sectors like chemicals and machinery equipments also restricted the growth.

The strong growth in the manufacturing sector for November 2006 was due to the double-digit growth witnessed in most of the heavyweight sectors. The basic metals pack grew by an impressive 25.4% yoy and the non-metallic minerals (primarily cement products) grew by 17.7%. Machinery and equipments grew by 17.3%, petroleum products grew by 23.2%, chemicals were up by 8.4% and the transport equipments grew by 21.8%.

As expected the October 2006 IIP numbers turned out to be an aberration and with a rebound in the IIP numbers in November, the outlook for Q3FY2007 corporate performance and gross domestic product (GDP) numbers remains bright.

Growth in key manufacturing sectors

% y-o-y change	Weight	Jul-06	Aug-06	Sep-06	Oct-06	Nov-06
Food products	9.1	27.1	2.0	10.0	-9.7	11.3
Beverages, tobacco and related products	2.4	11.8	16.4	19.8	11.5	11.0
Cotton textiles	5.5	13.1	12.2	14.5	10.8	18.3
Textile products incl. wearing apparel	2.5	29.3	11.2	5.6	9.3	16.0
Wood and wood products	2.7	3.0	-14.6	19.6	10.6	9.3
Paper & paper products	2.7	7.1	-2.5	8.4	7.2	15.6
Chemicals & chemical products	14.0	9.6	10.4	13.0	1.9	8.4
Rubber, plastic, petroleum & coal products	5.7	9.5	12.9	15.3	8.2	23.2
Non-metallic mineral products	4.4	12.8	5.3	16.7	12.5	17.7
Basic metal and alloy industries	7.5	19.7	13.6	19.8	20.8	25.4
Metal products	2.8	4.4	8.6	9.6	25.6	-1.5
Machinery and equipments	9.6	14.2	20.3	11.6	6.4	17.3
Transport equipment	4.0	22.3	10.9	11.9	5.4	21.8
Other manufacturing industries	2.6	22.0	18.6	10.9	-17.2	19.8

Marico

Apple Green

Stock Update

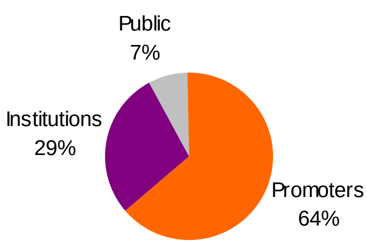
Intangible gains

Buy; CMP: Rs580

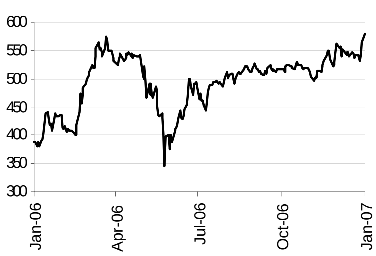
Company details

Price target:	Rs634
Market cap:	Rs3,527 cr
52 week high/low:	Rs598/330
NSE volume: (No of shares)	15,268
BSE code:	531642
NSE code:	MARICO
Sharekhan code:	MARICO
Free float: (No of shares)	2.2 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	7.6	9.7	15.7	43.7
Relative to Sensex	-0.6	-2.3	-10.4	-5.4

Key points

- The board of directors of Marico has approved a proposal to split the stock in the ratio of 1:10.
- The board has also proposed financial restructuring to write off the intangibles against the reserves.
- The restructuring will lead to a leaner balance sheet and better return ratios.
- Due to the restructuring our earnings estimate would be higher by 17.1% for FY2008. We are not changing our earnings estimates and price target but will be revisiting the same after the Q3FY2007 results.
- The stock is trading at a price/earnings ratio of 24.1x FY2008E and enterprise value/earnings before interest, depreciation, tax and amortisation of 13.7x FY2008E. We continue to remain bullish on Marico and reiterate a Buy on the stock with a price target of Rs634.

Marico board approves stock spilt...

The board of directors of Marico approved a sub-division of the nominal value of each equity share of the company from Rs10 into ten equity shares of nominal value of Re1 each. This is subject to shareholder approval at an extraordinary general meeting (EGM) to be held on February 8, 2007. This is a positive for the stock as the free float of 2.2 crore will expand and will also improve liquidity in the stock.

...also proposes to adjust intangible assets against reserves

Since January 2006, Marico has acquired brands like *Manjal*, *Nihar*, *Fiancée* and *HairCode*. These acquisitions have led to the creation of intangibles, as these were brand acquisitions in most cases. The balance under the head "Intangible Assets" as on January 12, 2007 is Rs452.1 crore. Since the benefits of these acquisitions accrue over a longer time, these intangibles are carried on the Balance Sheet and were to be written off over their economic life. The board has approved a scheme of

Earnings table

Particulars	FY2005	FY2006	FY2007E	FY2008E
Net profit (Rs cr)	70.1	86.4	112.2	146.1
Share in issue (cr)	5.8	5.8	6.1	6.1
EPS (Rs)	12.1	14.9	18.4	24.0
% y-o-y growth	*-41.1*	*23.2*	*23.7*	*30.1*
PER (x)	47.9	38.9	31.4	24.1
Book value (Rs)	37.1	44.8	92.1	109.8
P/BV (x)	15.6	12.9	6.3	5.3
EV/Ebidta (x)	40.2	26.6	16.5	13.7
Dividend Yield (%)	0.9	1.1	1.1	1.1
ROCE (%)	31.3	26.1	28.4	28.2
RONW (%)	32.6	33.3	20.0	21.8

financial restructuring wherein the "Intangible Assets" would be adjusted against the Special Reserves comprising the Securities Premium Account and the Capital Redemption Reserve Account. The maximum extent approved for the Securities Premium Account is Rs148.5 crore and that for the Capital Redemption Reserve Account is Rs180.0 crore. This implies that up to Rs328.5 crore of intangibles net of deferred tax can be written off.

This restructuring proposal is subject to the approval of the shareholders at an EGM on February 8, 2007. Further, the sanction of the Mumbai High Court will also be required. The restructuring, which would start from February 8, 2007, is expected to be completed by April 2007.

Implications of the financial restructuring on the financials

The restructuring will have no impact on the tangible net worth and tangible book value of the company's shares, while the apparent net worth and apparent book value will come down. Also the cash earnings and the cash flow will not be affected but the reported earnings will be higher. The benefits accruing from the restructuring would be (a) a leaner balance sheet without intangibles and (b) consequently better return on capital employed/return on net worth.

Impact of financial restructuring on FY2008E earnings

We have assumed a Rs25-crore intangible write-off for FY2007 and FY2008. Due to the write-off against the reserves our FY2008 earnings estimate should be higher by 17.1%. Also our financials don't include the recent acquisitions in Egypt due to lack of information on the acquisition cost. A back-of-the-envelope calculation shows that these acquisitions are earnings and value accretive. Further with the one-time write-off these acquisitions will be more earnings accretive. We are not changing our earnings estimates and price target but will be revisiting the same after the Q3FY2007 results.

Valuation and view

Given its strong core business (hair oil and edible oil) coupled with its intention to play on the broader beauty and health platform (soaps and functional foods) reinforces our faith in its strong growth traction. The stock is also trading at a PER of 24.1x FY2008E and EV/EBIDTA of 13.7x FY2008E. The valuations appear attractive in view of the company's growing risk appetite and ongoing transformation. We continue to remain bullish on Marico and reiterate a Buy on the stock with a price target of Rs634.

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

Elder Pharmaceuticals

Apple Green

Stock Update

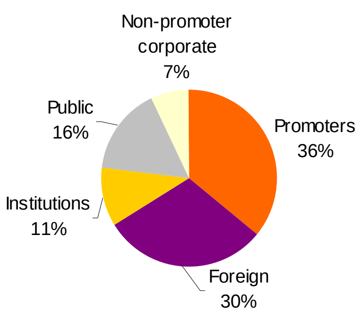
Price target revised to Rs508

Buy; CMP: Rs397

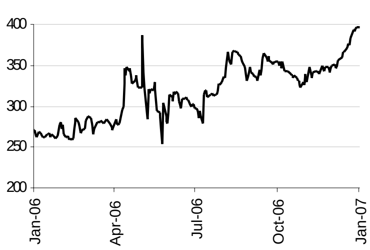
Company details

Price target:	Rs508
Market cap:	Rs738 cr
52 week high/low:	Rs408/223
NSE volume: (No of shares)	8,914
BSE code:	532322
NSE code:	ELDERPHARM
Sharekhan code:	ELDERPHARM
Free float: (No of shares)	1.1 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	15.5	12.4	32.4	44.1
Relative to Sensex	6.7	0.1	2.5	-5.2

Key points

- The revenues of Elder Pharmaceuticals (Elder) grew by 28.6% in H1FY2007 and by over 30% in Q2FY2007. We expect this 30% + growth trend to continue into H2FY2007 on the back of the sustained momentum in the company's core brands, pick-up in the revenues from the in-licenced products and the growing contribution from the *Fairone* brand.
- Elder has been spending aggressively on advertising and promoting its existing products. With the increased penetration of its existing brands, rapid pace of new product launches and new in-licencing deals, we believe the growth momentum will continue in FY2008 as well.
- A lower raw material cost on account of backward integration into active pharmaceutical ingredients (APIs), an improving product mix, and substantial excise and tax savings arising out of the shift of manufacturing to the plants in the fiscal havens of Uttaranchal and Himachal are expected to improve the margins of the company. The increased selling and marketing expenses, on the other hand, are likely to put pressure on the margins. We expect Elder's margins to expand by 180 basis points to 19% in FY2008E.
- To account for the above, we have revised our revenue and earnings estimates for Elder. We have revised Elder's revenue estimates upward by 9.2% and 12.9% to Rs457.5 crore and Rs562.1 crore for FY2007 and FY2008 respectively. We have also upgraded Elder's net profit estimate by 10.4% to Rs55.7 crore and Rs74.8 crore for FY2007 and FY2008 respectively.
- In view of its strong growth potential, we remain positive on Elder's future growth prospects. At the current market price of Rs397, Elder is quoting at 9.9x our revised FY2008 earnings estimate. Based on our revised earnings, we are upgrading our price target for the stock to Rs508.

Valuation table (consolidated) Rs (cr)

Particulars	FY2004	FY2005	FY2006	FY2007E	FY2008E
Net sales	256.4	283.7	352.4	457.5	562.1
PAT	16.5	20.4	36.7	55.7	74.8
Shares in issue (cr)	1.1	1.6	1.8	1.9	1.9
EPS (Rs)	15.0	12.7	21.0	29.9	40.2
% y-o-y growth	*94.3*	*-15.2*	*64.7*	*42.8*	*34.3*
PER (x)	26.4	31.2	18.9	13.3	9.9
cash EPS (Rs)	18.1	14.2	24.2	34.2	46.3
cash PER (x)	22.0	27.9	16.4	11.6	8.6
EV	533.8	675.0	814.8	856.1	815.8
EV/Ebidta (x)	15.0	16.0	13.3	10.4	7.6
Book value (Rs/share)	95.2	124.7	147.3	156.4	193.5
P/BV (x)	4.2	3.2	2.7	2.5	2.1
Mcap/sales	1.7	2.2	2.0	1.6	1.3

The performance of Elder in H1FY2007 has been above our expectations. The company grew by 28.6% in H1FY2007 and catapulted its growth rate to over 30% in Q2FY2007. We expect this 30%+ growth trend to continue in H2FY2007, as Elder continues to maintain the growth momentum in its core brands: *Shelcal*, *Chymoral* and *Eldervit* and derives a higher amount of its revenues from its in-licenced portfolio as the revenues from the newly in-licenced drugs, *Burn Aid* and *Bonviva* grow to significant levels. Further, the revenues from *Fairone*, Elder's women's fairness cream launched in partnership with renowned beautician Shahnaz Hussain in mid-September 2006 in south India, will pick up significantly in Q4FY2007, as the company has been spending aggressively on brand promotion and advertising of this product. With increased penetration of the existing brands, rapid pace of new product launches and new in-licencing deals, we believe the growth momentum will continue in FY2008 as well.

As a result, we have revised Elder's revenue estimates upward by 9.2% and 12.9% to Rs457.5 crore and Rs562.1 crore for FY2007 and FY2008 respectively.

With the commissioning of its plants in the tax-free areas of Uttaranchal and Himachal Pradesh, Elder has been able to substantially lower its incidence of excise duty and its tax provisioning. We expect this trend to continue through the remaining part of FY2007 and into FY2008 as the company continues to shift its production to these fiscal havens. We expect a 50% reduction in the excise duty cost as compared with our earlier estimates. Further, Elder's quarterly performance shows that its raw material cost has been significantly lower than our estimate, as the company continues to improve its product mix, rationalise its product portfolio to focus on high-margin products and backwardly integrate into APIs for most of its finished dosage forms. The company has also indicated that it has been spending aggressively on selling and marketing expenses to increase the penetration of its brands and will continue to do so in the future as well. We believe that the increased selling and marketing expenses will affect the margins of the company in the short term while it will strengthen the foundation for future growth of the company. We estimate Elder's margins to expand by 180 basis points to 19% in FY2008E.

The higher sales growth coupled with the improved operating performance is likely to translate into a strong earnings growth for Elder. Thus, we have upgraded Elder's net profit estimate by 10.4% to Rs55.7 crore and Rs74.8 crore for FY2007 and FY2008 respectively.

Revised estimates

	Old estimates		Revised estimates		% revision	
	FY07E	FY08E	FY07E	FY08E	FY07E	FY08E
Net sales	419.0	498.0	457.5	562.1	9.2	12.9
PAT	50.4	67.7	55.7	74.8	10.4	10.4
Shares in issue (cr)	1.9	1.9	1.9	1.9		
EPS (Rs)	27.1	36.4	29.9	40.2	10.4	10.4

Valuation

In view of its strong growth potential through in-licencing agreements with foreign firms, continued launch of new products, scale-up of business in the lifestyle, skin-care and paediatric areas, and effective cost-cutting measures, we remain positive on Elder's future growth prospects. At the current market price of Rs397, Elder is quoting at 9.9x our revised FY2008E earnings estimate. Based on our revised earnings, we are upgrading our price target for Elder to Rs508. We maintain our Buy recommendation on the stock with a revised price target of Rs508.

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

Aban Offshore

Emerging Star

Stock Update

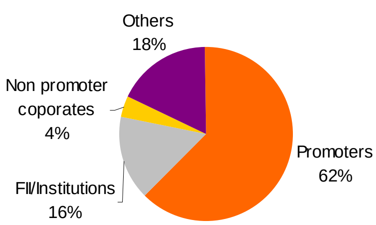
Results in line with expectations

Buy; CMP: Rs1,670

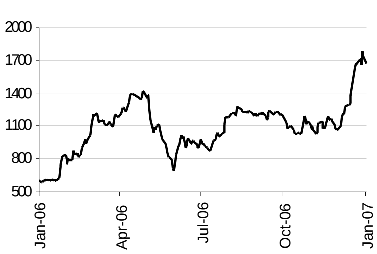
Company details

Price target:	Rs2,090
Market cap:	Rs6,680 cr
52 week high/low:	Rs1,815/566
NSE volume: (No of shares)	50,148
BSE code:	523204
NSE code:	ABANLOYD
Sharekhan code:	ABANLOYD
Free float: (No of shares)	1.4 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	60.5	44.6	92.3	202.1
Relative to Sensex	48.2	28.8	48.9	98.8

Result highlights

- Aban Offshore Ltd (AOL) reported a 4.5% growth in its stand-alone revenues to Rs126.1 crore for the third quarter ended December 2006.
- The operating profit margin (OPM) declined by 310 basis points to 54.8% largely due to higher insurance charges (up 260 basis points) and an increase in the other expenses (up 660 basis points due to the amortisation of the expenses related to the foreign currency convertible bond issue done earlier). On the other hand, the savings in the staff cost and repairs as a percentage of sales limited the decline in the OPM.
- The net profit grew at a relatively higher rate of 13% to Rs20.8 crore in line with expectations. The growth in the bottom line was aided by an 87% jump in the other income to Rs5.6 crore. However, it should be noted that the company does not declare consolidated quarterly results and the stand-alone results do not reflect the robust growth in the earnings on a consolidated basis. We expect the performance to improve significantly in FY2008 and FY2009 due to the huge incremental gains from the additional assets and the scheduled re-pricing of its assets at relatively much higher day rates going forward.
- Along with the results, the company has announced the signing of a joint venture with the state government of Gujarat to offer offshore drilling services. The memorandum of understanding (MoU) has been signed between Gujarat State Petroleum Corporation (nominee of the Gujarat state government) and AOL's subsidiary, Aban 8 Pte Ltd. The joint venture would function through a special purpose vehicle. The company is expected to spell out the specific details about the scope and scale of the operations of the new venture over the next couple of months.

Result table Rs (cr)

Particulars	Q3FY07	Q3FY06	% yoy chg	M9FY07	M9FY06	% yoy chg
Net sales	126.1	120.7	4.5	378.8	369.9	2.4
Total expenditure	57.1	50.8	12.3	178.9	157.2	13.8
Operating profit	69.1	69.9	-1.1	199.9	212.7	-6.0
Other income	5.6	3.0	87.0	24.3	11.5	112.1
Interest	9.6	11.6	-17.0	32.5	35.2	-7.6
Depreciation	24.1	24.3	-0.8	74.5	73.0	1.9
Good will amortised	1.6	1.6	0.0	4.7	4.7	0.0
PBT	39.4	35.4	11.3	112.6	111.2	1.2
Tax	18.6	17.0	9.4	50.5	49.4	2.2
PAT	**20.8**	**18.4**	**13.0**	**62.1**	**61.8**	**0.4**
EPS	5.6	5.0		16.8	16.8	
Margins (%)						
OPM	54.8	57.9		52.8	57.5	
NPM	16.5	15.2		16.4	16.7	

- At the current market price the stock trades at 14x FY2008 and 6.8x FY2009 consolidated earning estimates. We maintain our Buy call on the stock with a price target of Rs2,090 (based on the derived value of its subsidiaries combined with the calculated value of its stand-alone earning estimates).

Huge incremental gains from addition of assets and the scheduled re-pricing

Notwithstanding the muted performance in the current year, AOL is expected to gain immensely from the efforts taken to enhance its asset base (both organically and inorganically) in the past year. For example, the addition of Aban VII (ex-Rowan Texas) and Aban Abraham (New West African acquisition) are estimated to bring in incremental revenues of around Rs540 crore in FY2008. Both the assets have been added to AOL's subsidiary Aban Singapore Pte Ltd (ASPL) and the benefits of the same would get reflected in the consolidated performance.

Similarly, the re-pricing of assets at much higher day rates would not only drive the revenue growth but also substantially boost the margins in FY2008. The recent re-pricing of Aban II ($27,300 per day to $85,000 per day w.e.f. October 2006) and Aban VII ($70,000 per day to $140,000 per day w.e.f. October 2006) would get fully reflected in the FY2008 performance. Going ahead, the floating production unit ($26,000 per day to $60,000 per day in July 2007) and Aban VI ($39,000 per day to $95,000 per day in October 2007) would also boost the overall performance. The four other assets, Aban III, Aban IV, Aban V and Drillship (Frontier Ice), are scheduled to get re-priced at almost double the existing day rates during the last quarter of FY2008.

Re-pricing of assets to boost performance

Asset	Current day rates ($/day)	Scheduled Re-pricing	Revised day rates ($/day)
RIG ABAN - II	27300	Oct-06	85000
RIG ABAN - III	57600	Jan-08	125000
RIG ABAN - IV Hit Drill	57600	Dec-07	125000
RIG ABAN - V Pride west	53000	Jan-08	125000
FPU TAHARA	26900	Jul-07	60000
DRILLSHIP FRONTIER ICE	43000	Mar-08	80000
RIG ABAN -VI Enery Explorer IV	39000	Oct-07	95000
RIG ABAN - VII Rowan Texas Drill	70000	Oct-06	140000

ASPL valued at $1.46 billion

AOL has commenced an open offer for the remaining 49.99% stake in Sinvest at an estimated cost of $750-800 million. To fund the same, it has tied up for debt of $625 million at the subsidiary level and is making a private placement of $150 million in ASPL. This sets the equity value of ASPL at $1.46 billion, much ahead of the market expectations. Consequently, the implied value of AOL's stake (89.63% of the diluted equity) in ASPL works out to $1.3 billion (or Rs1,426 per share).

The stand-alone business is valued at Rs664 per share, which is 12x FY2009 estimated earnings (discounted by 12% for one year). The target multiple of 12x is at a slight premium to the industry leader Transocean due to the relatively higher estimated growth in earnings over the next few years and AOL's ability to successfully scale up its asset base (total of 28 assets, including the control of 24 offshore oil rigs [six under construction] as compared with less than five a couple of years ago).

Sum-of-the-parts valuations

Value of AOL's stake in ASPL (Rs/share) (A)	1426
Stand-alone entity	
EPS of stand-alone entity (FY2009)	62
Target multiple (12x)	744
Value/share - stand-alone (discounted by 12%) (B)	664
Consolidated value/share (A + B)	**2090**

Valuation

At the current market price the stock trades at 14x FY2008 and 6.8x FY2009 consolidated earnings estimates. We maintain our Buy call on the stock with a price target of Rs2,090.

Financials (consolidated assuming 50.01% stake in Sinvest)

Particulars	FY06	FY07E	FY08E	FY09E
Net profit (Rs cr)	76.8	70.1	476.8	980.0
Shares in issue (cr)	3.7	4.0	4.0	4.0
EPS (Rs)	20.8	17.5	119.0	244.6
% y-o-y growth		*-16.1*	*580.2*	*105.5*
PER (x)	80.1	95.4	14.0	6.8
Book value (Rs)	116.9	235.4	352.4	595.0
P/BV (Rs)	14.3	7.1	4.7	2.8
EV/EBIDTA (x)	24.8	13.4	7.4	4.5
RoCE (%)	16.1	12.9	23.2	37.0
RoNW (%)	17.8	7.4	33.8	41.1

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

UTI Bank

Emerging Star

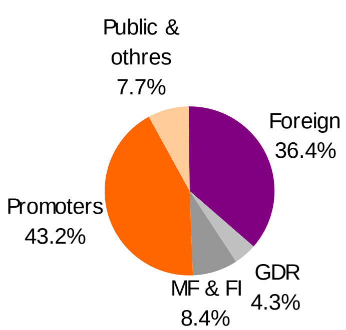
Stock Update

Performance above expectations

Buy; CMP: Rs535

Company details	
Price target:	Rs580
Market cap:	Rs15,044 cr
52 week high/low:	Rs538/222
NSE volume: (No of shares)	4.6 lakh
BSE code:	532215
NSE code:	UTIBANK
Sharekhan code:	UTIBANK
Free float: (No of shares)	14.8 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	15.4	25.6	80.7	60.8
Relative to Sensex	6.6	11.9	39.9	5.8

Result highlights

- UTI Bank's Q3FY2007 profit after tax (PAT) reported a 40% year on year (yoy) growth to Rs184.6 crore which is 6.4% higher than our estimate of Rs173.5 crore, mainly due to a higher trading income reported during the quarter.
- The net interest income (NII) was up by 44.7% to Rs415.8 crore compared with our estimate of Rs407 crore. The reported net interest margin (NIM) expanded by six basis points yoy and by eight basis points quarter on quarter (qoq).
- The other income zoomed by 61.3% to Rs279.7 crore due mainly to a higher trading income while the core fee income growth remained robust at 58.9% yoy.
- The operating expenses continue to remain high due to a significant increase in the employee expenses and network expansion.
- The bank currently has a network of 481 branches with 2,126 automated teller machines (ATMs). This has helped the bank to grow its savings and current account deposits by 58.8% and 61.3% respectively compared with the overall deposit growth rate of 49.7% and improve its current and savings account (CASA) ratio to 37.1% from 34.7% yoy. However on a sequential basis, the CASA ratio has declined to 37.1% from 40% in Q2FY2007 mainly due to a 14.2% quarter on quarter (q-o-q) decline in the current account balance.
- The capital adequacy ratio (CAR) for the bank as on December 2006 stood at 11.8% with the tier-I capital at 6.96%. The bank has already raised Rs420 crore of hybrid tier-I capital and exhausted the headroom to raise more funds using the same route. Hence, considering the growth potential of the bank, we feel the bank needs to come out with a plain equity issue in FY2008. We have factored in an equity dilution of 3.6 crore shares (12.8% of pre-issue equity capital) at an issue price of Rs500 per share. This would help the bank to raise Rs1,800 crore and improve the tier-I ratio to above 8%. The book value (BV) per share would increase by almost Rs40 per share post-dilution from our previous pre-issue estimates.

Result table Rs (cr)

Particulars	Q3FY07	Q3FY06	% yoy chg	% qoq chg	M9FY07	M9FY06	% yoy chg
Net interest income	415.8	287.4	44.7	13.9	1,102.9	765.4	44.1
Other income	279.7	173.4	61.3	36.6	709.0	501.6	41.4
Treasury income	*79.3*	*47.2*	*67.8*	*239.8*	*142.6*	*151.2*	*-5.7*
Fee	*200.5*	*126.2*	*58.9*	*10.5*	*543.9*	*343.5*	*58.3*
Net income	695.6	460.9	50.9	22.0	1,811.9	1,266.9	43.0
Operating expenses	337.0	204.7	64.6	14.0	871.6	571.2	52.6
Operating profit	358.6	256.2	40.0	30.7	940.3	695.8	35.1
Core operating profit (excluding treasury)	279.4	196.8	42.0	11.2	775.2	525.5	47.5
Provisions & contingencies	76.3	59.2	28.9	29.8	259.9	194.3	33.7
PBT	282.4	197.0	43.3	30.9	680.5	501.5	35.7
Provision for taxes	97.7	65.3	49.7	32.5	233.3	168.1	38.8
Net profit	184.6	131.7	40.2	30.0	447.1	333.4	34.1

- Based on the improved performance of the bank we have also increased our FY2007 and FY2008 PAT estimates by 7.3% to Rs645 crore and Rs829 crore respectively. Thus the revised FY2007 earnings per share (EPS) estimate stands at Rs23.2, up from Rs21.6. The equity dilution assumed by us has reduced the FY2008 EPS estimate from Rs27.8 to Rs26.4. At the current market price of Rs535 the stock is quoting at 20.3x its FY2008E EPS, 10.3x its FY2008E pre-provisional profit (PPP) and 2.9x its FY2008E BV. We feel the dilution would be BV accretive and hence maintain our Buy recommendation on the stock with a revised price target of Rs580.

NII reports a strong growth of 44.7%

UTI Bank reported a strong growth of 44.7% in its NII on the back of a robust growth of 51.8% in its assets driven mainly by a 66% growth in its advances and an improvement in its net interest margin (NIM). The bank's NIM improved by six basis points yoy to 3% during the period. The higher yields on assets reflect the increase in the yield on advances, which has partly gone up due to the bank's increased exposure to the personal loan segment (currently at 27% of the retail loans). Despite an increase in the cost of funds, the NIM has improved on a year-on-year and quarter-on-quarter bases; this shows that the strong growth has not come at the cost of margins. The management expects the margin improvement to continue. The network expansion would further help the bank to garner more low-cost CASA deposits and to expand its retail loan portfolio which will help in improving margins.

Yield analysis

In %	Q3FY2007	Q3FY2006	Q2FY2007
Yield on assets (reported)	8.53	7.80	8.34
Cost of funds (reported)	5.53	4.86	5.42
NIM (reported)	3.00	2.94	2.92

Strong growth in fee income

The bank's fee income grew by a robust 58.9% yoy in line with the growth in the retail advances, which grew by 58.8% during the quarter. All the segments continue to report a healthy growth in their fee income. We expect UTI Bank's fee income to grow at a compounded annual growth rate of 43% over FY2006-08E, in line with the growth in its various business segments.

Fee income categories	Q3FY07	Q3FY06	% yoy chg	% qoq chg
Corporate banking	52.0	36.0	44.4	10.6
Business banking	34.0	22.0	54.5	0.0
Capital markets	22.0	21.0	4.8	-21.4
Retail banking	76.0	38.0	100.0	11.8

Operating expenses continue to remain high

The operating expenses of the bank rose steeply by 64.6% yoy to Rs337 crore during the third quarter. Significant employee additions have kept the staff expenses high while network expansion continues to drive the "other expenses" component. However, the cost to income ratio moderated to 48% from the high of 52% in Q3FY2007 recorded in Q2FY2007.

Branch network	Q3FY07	Q2FY07	Q2FY06	Q1FY07
Branches	481	469	373	463
ATMs	2126	2,021	1,737	1,959

Asset quality shows consistent improvement

Although UTI Bank has grown at a robust pace in the last couple of years, yet there are no visible signs of any deterioration in its asset quality. The gross non-performing assets stood at 1.2% as on December 2006 compared to 1.6% in December 2005. The net non-performing asset level (as a percentage of its net customer assets) improved to 0.68 % from 0.74% in Q2FY2007.

Valuations

In view of the improved performance of the bank, we have increased our FY2007 and FY2008 PAT estimates for the bank by 7.3% to Rs645 crore and Rs829 crore respectively. Thus the revised FY2007 EPS estimate stands at Rs23.2 as against the earlier estimate of Rs21.6. Also, the equity dilution assumed by us has reduced the FY2008 EPS estimate from Rs27.8 to Rs26.4. At the current market price of Rs535 the stock is quoting at 20.3x its FY2008E EPS, 10.3x its FY2008E pre-provisional profit (PPP) and 2.9x its FY2008E BV. We feel the dilution would be BV accretive and hence maintain our Buy recommendation on the stock with a revised price target of Rs580.

Earnings table

Year to 31 March	FY04	FY05	FY06	FY07E	FY08E
Net profit (Rs cr)	279.8	334.6	485.1	645.6	829.2
Shares in issue (cr)	23.2	27.4	27.9	27.9	31.5
EPS (Rs)	12.1	12.2	17.4	23.2	26.4
EPS growth (%)	18.6	1.1	42.4	33.1	13.8
PE (x)	44.3	43.8	30.7	23.1	20.3
P/PPP (x)	18.0	25.9	15.0	11.5	10.3
Book value (Rs/share)	49.1	88.0	103.1	120.9	184.6
P/BV (x)	10.9	6.1	5.2	4.4	2.9
Adj book value	44.2	80.0	95.3	113.5	176.3
P/ABV (x)	12.1	6.7	5.6	4.7	3.0
RONW (%)	27.2	18.9	18.4	20.7	18.1

Nicholas Piramal India

Apple Green

Stock Update

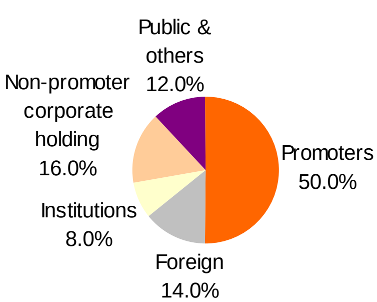
Earnings upgraded

Buy; CMP: Rs262

Company details

Price target:	Rs393
Market cap:	Rs5,476 cr
52 week high/low:	Rs287/150
NSE volume: (No of shares)	1.4 lakh
BSE code:	500302
NSE code:	NICHOLASPIR
Sharekhan code:	NICHPI
Free float: (No of shares)	10.4 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	9.4	8.8	23.2	-5.0
Relative to Sensex	1.1	-3.1	-4.7	-37.5

Key points

- Nicholas Piramal India Ltd (NPIL) and Eli Lilly and Co have signed a landmark new drug development agreement to develop and, in certain regions, commercialise a select group of Lilly's pre-clinical drug candidates that span multiple therapeutic areas. This agreement indicates the world-class research and development (R&D) capabilities of Nicholas Piramal.
- While NPIL's landmark deal with one of the leading innovative drug researchers like Eli Lilly has infused confidence among the investors the domestic formulations business has reported a more than expected growth. Alongside, the increased momentum in its CRAMS business and the successful integration and improvement in the capacity utilisation of the recently acquired facilities at Morpeth, UK (from Pfizer) enhances the earning visibility of the company. Hence, we are revising our estimates upward for FY2007 and FY2008.
- With the better than expected growth in the domestic formulation business, particularly in respiratory, anti-diabetics, gastrointestinal, dermatology, NSAIDs etc and the strong bounce back in the cough and cold brand--Phensedyl--we are revising the compounded annual growth rate (CAGR) of the formulation business from 12% to 14% during FY2006-08. On the other hand, the exports, largely supported by the successful integration and improvement in the capacity utilisation at Morpeth and the steady growth in the CRAMS business, would grow at a CAGR of 88% during FY2006-08. Hence, we are revising our revenue estimates to Rs2,347.8 crore and Rs2,770.1 crore for FY2007 and FY2008, respectively.
- On the margin front, we estimate a 480-basis-point expansion to 17.3% during FY2006-08, which would largely be driven by the increasing high-margin revenue flow from CRAMS, progressive shifting of manufacturing to excise-exempt facility at Baddi (Uttaranchal) and improved operating leverage at the Morpeth facility.

Valuation table (consolidated) Rs (cr)

Particulars	FY2004	FY2005	FY2006	FY2007E	FY2008E
Net sales	1391.5	1308.2	1582.5	2347.8	2770.1
PAT	199.7	164.1	124.2	232.8	345.0
Shares in issue (cr)	3.8	19.0	20.9	20.9	20.9
EPS (Rs)	58.8	4.3	6.0	11.0	16.4
PER (x)	4.5	61.0	43.9	23.8	16.0
cash EPS (Rs)	72.8	7.1	9.3	15.4	20.9
cash PER (x)	3.6	37.1	28.3	17.0	12.5
EV	1327.6	5330.5	5692.0	5669.9	5485.2
EV/Ebidta (x)	4.7	31.5	28.8	15.9	11.4
Book value (Rs/share)	120.6	29.0	48.5	55.4	67.7
P/BV (x)	2.2	9.0	5.4	4.7	3.9
Mcap/sales	0.7	3.8	3.5	2.3	2.0

- With the improving revenues and margin coupled with the lower tax burden due to the commissioning of the manufacturing facility at Baddi, we estimate the net earnings at Rs232.8 crore (87% growth) and Rs345 crore (48% growth) for FY2007 and FY2008, respectively. Our revised earnings estimates stand at Rs11.0 per share for FY2007 and Rs16.4 per share for FY2008. At the current market price of Rs262, NPIL is discounting its FY2008 estimated earnings by 16.0x.
- As per our revised estimates, we have valued NIPL's continuing business at Rs360 and have valued the drug development deal at Rs33 (ie 10x of the risk-adjusted EPS of Rs3.3). While valuing the drug development deal, we have just valued the potential milestone earning and ignored the potential royalties from the sale of the product by Eli Lilly in the USA, the EU & Japan and the revenue potential from the sale of the product by NPIL in other selected markets. Hence, we are fixing a revised target price of Rs393.

Valuation table (consolidated)

		Old earnings		Revised earnings	
	FY06	FY07E	FY08E	FY07E	FY08E
Net sales	1582.5	2298.5	2719.5	2347.8	2770.1
% yoy chg		*45.0*	*18.0*	*48.0*	*18.0*
PAT	124.2	226.5	336.3	232.8	345.0
% yoy chg		*82.0*	*49.0*	*87.0*	*48.0*
Shares in issue (cr)	18.6	20.9	20.9	20.9	20.9
EPS (Rs)	6.7	10.7	16.0	11.0	16.4

Nicholas' R&D pact with Eli Lilly--a positive surprise

Nicholas Piramal India Ltd and Eli Lilly and Co have signed a landmark new drug development agreement to develop and, in certain regions, commercialise a select group of Lilly's pre-clinical drug candidates that span multiple therapeutic areas. This agreement indicates the world-class research and development (R&D) capabilities of Nicholas Piramal. The deal with Eli Lilly--one of the leading innovative players in the world--comes as a positive surprise for the company. The motto of the alliance is to increase the productivity in drug development by synergising the unique strengths of both the companies and equitably sharing the risks and rewards.

As per the deal, NPIL will be responsible for the design and execution of the global clinical development programme, including investigational new drug-enabling (IND-enabling) non-clinical studies and human clinical trials up to Phase-III. The company expects the Phase-I trials to be completed by the end of 2007 or mid-2008 and the Phase-II trials by mid-2009, when the product will be returned to Eli Lilly for the Phase-III trials, registration and global launch. The partners plan to launch the product in 2010. According to the terms of the agreement, Eli Lilly will have the marketing rights in the US, European and Japanese markets and NPIL will receive royalty on the sale of the product in these geographies, while NPIL will have the marketing rights in other selected markets.

As far as the value proposition for NPIL is concerned, it would get a callback payment and potential milestone payments worth up to US$100 million. The payments would be in three tranches on the successful completion of Phase-I & Phase-II trials and on the successful registration and launch of the product by Eli Lilly. Apart from this, NPIL would get royalties on the sales upon the successful launch of the first compound and would also get commercialisation rights in select markets.

Valuation of the deal

The total potential payment from the deal to NPIL will be up to US$100 million, which is inclusive of a callback payment (callback payment means that if Eli Lilly discontinues the deal at any time then NPIL would get the callback payment). We have assumed the total potential milestone payments at $80 million that would be received in three tranches of $10 million on the completion of Phase-I trials in FY2009, $20 million on the completion of Phase-II trials in FY2010 and the balance $50 million on the registration and launch of the product in FY2011.

The company has indicated that they would be recruiting 72 patients for the Phase-I trials and 150-300 patients for the Phase-II clinical studies. The management has indicated that the cost of the same Phase-II trials in the USA would have been in the range of $30-50 million (we have assumed $40 million). The R&D cost in India is about one-fourth of the cost in the USA. Hence, the cost of the Phase-II trials (with the recruitment of 150-300 patients) in India would be one-fourth of $40 million ie $10 million. As the Phase-I trials will require about 72 patients we have assumed that the cost to be incurred by NPIL up to the Phase-I trials would be around 40% of the cost incurred in the Phase-II trials ie $4 million.

The assumed probability of the success of the Phase-I trials is 90% and that of the Phase-II trials is 60%, as one of the competing molecules with a similar potency has already completed the Phase-I and Phase-II trials successfully. But for the successful registration and launching, we assume a probability of 15% in line with the industry.

Hence, the estimated risk-adjusted milestones for NPIL on the completion of the Phase-I and Phase-II trials, the registration & launch are $5.4 million, $6.0 million and $7.50 million due in FY2009, FY2010 and FY2011, respectively.

The calculated weighted average cost of capital (WACC) for the company is 13.1%. Hence the discounted risk-adjusted earnings for NPIL from the deal would be Rs69.0 crore, leading to Rs3.3 per share. Maintaining the PE multiple of 10 to the EPS accretion (ie Rs3.3), the deal brings a possible price appreciation of Rs33 per share.

As of now, the upside from the deal is a bit remote but it could become a recurring stream of earnings, given Eli Lilly's drug discovery pipeline and its understanding with NPIL. Currently, Eli Lilly's drug discovery pipeline has 4 similar lead compounds which can be in-licenced by NPIL and would boost the earnings visibility for the company in the foreseeable future.

Valuation

As per our revised valuation, we estimate NPIL's net earnings at Rs232.8 crore (87% growth) and Rs345 crore (48% growth) for FY2007 and FY2008, respectively. Our revised earnings estimates stand at Rs11.0 per share for FY2007 and Rs16.4 per share for FY2008. At the current market price of Rs262, NPIL is discounting its FY2008 estimated earnings by 16.0x.

As per our revised estimates, we have valued NIPL's continuing business at Rs360 and have valued the drug development deal at Rs33 (ie 10x of the risk-adjusted EPS of Rs3.3). While valuing the drug development deal, we have just valued the potential milestone earning and ignored the potential royalties from the sale of the product by Eli Lilly in the USA, the EU & Japan and the revenue potential from the sale of the product by NPIL in other selected markets. Hence, we are fixing a revised target price of Rs393.

Year	FY2008E	FY2009E	FY2010E	FY2011E
Milestone ($mn)		10	20	50
Milestone relates to		Ph-I	Ph-II	Registration and launch
cost component (assumed 1/4th of US expenses)		4	10	0
Earnings for NPIL		6	10	50
Probability of success		90%	60%	15%
Risk-adjusted earnings ($mn)		5.40	6.00	7.50
Risk-adjusted earnings (Rs crore)		24.30	27.00	33.75
Discounted earnings (discounted @ WACC of 13.1%)	69.0			
No of shares	20.9			
Earning per share from the deal	3.3			
Value addition from the deal (@ 10x)	33.0			

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

HCL Technologies

Ugly Duckling

Stock Update

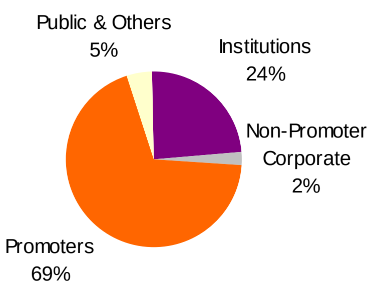
Firing on all cylinders

Buy; CMP: Rs630

Company details

Price target:	Rs720
Market cap:	Rs20,444 cr
52 week high/low:	Rs707/362
NSE volume: (No of shares)	5.0 lakh
BSE code:	532281
NSE code:	HCLTECH
Sharekhan code:	HCLTECH
Free float: (No of shares)	10.0 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	7.9	10.2	15.2	10.2
Relative to Sensex	-0.3	-1.9	-10.9	-27.5

Result highlights

- HCL Technologies has reported a revenue growth of 6.2% quarter on quarter (qoq) and 39% year on year (yoy) to Rs1,465.1 crore for the second quarter ended December 2006, which is slightly below expectations. The sequential growth was largely driven by a 12.5% increase in the revenues of the infrastructure management service (IMS) business. On the other hand, the business process outsourcing (BPO) and software services businesses grew at a relatively lower rate of 5.4% and 5.2% respectively, on a sequential basis.
- The earnings before interest, tax, depreciation and amortisation (EBITDA) margins improved by 40 basis points to 22.1% on a sequential basis, despite the annual salary hikes given to 15% (senior and middle management level) of its work force with effect from October, the adverse impact of the steep appreciation in the rupee (3.6% appreciation in the average realised exchange rate against the US dollar) and the relatively higher selling, general and administration (SG&A) cost as a percentage of sales. The margin expansion was primarily driven by the higher employee utilisation (positive impact of 120 basis points) and better realisations (positive impact of 140 basis points).
- In terms of segments, the EBITDA margins of the software service and BPO businesses improved by 60 basis points and 40 basis points respectively. On the other hand, the IMS business reported a marginal decline in the margins to 17.5%, down 10 basis points sequentially.

Result table Rs (cr)

Particulars	Q2FY07	Q2FY06	Q1FY07	% yoy	% qoq
Revenue ($ mln)	331.1	234.1	300.4	41.4	10.2
Derived exchange rate (Rs/USD)	44.2	45.0	45.9	-1.7	-3.6
Net sales	1465.1	1054.1	1379.4	39.0	6.2
Direct costs	910.7	656.1	870.9	38.8	4.6
Gross profit	554.4	398.0	508.6	39.3	9.0
SG&A	230.3	160.1	209.8	43.9	9.8
EBITDA	324.0	237.9	298.8	36.2	8.5
Depreciation & amortisation	62.3	49.3	55.6	26.4	12.1
EBIT	261.7	188.6	243.2	38.8	7.6
Interest	0.0	0.0	0.0	-	-
Forex gain/(loss)	34.7	-13.2	1.2	-	-
Other income	13.4	27.5	27.8	-51.3	-51.8
PBT	309.8	202.9	272.2	52.7	13.8
Tax provision	20.6	20.3	21.9	1.5	-5.9
PAT	289.2	182.6	250.3	58.4	15.6
Extraordinaries	0.7	0.7	-0.4	-	-
Stock based sales incentive	2.3	0.6	0.5	-	-
Net profit	286.2	181.3	250.2	57.8	14.4
Equity capital	64.7	64.7	64.7		
EPS (Rs)	8.8	5.6	7.7		
Margin (%)					
GPM	37.8	37.8	36.9		
OPM	22.1	22.6	21.7		
NPM	19.5	17.2	18.1		

- The earnings grew at a robust rate of 14.4% qoq and 57.8% yoy to Rs286.2 crore (ahead of our expectations of Rs258.8 crore and the consensus estimates of a flat growth sequentially). The growth in the earnings was also aided by the huge foreign exchange [forex] gains of Rs34.7 crore on the open forward contracts.
- In terms of operational highlights, the management indicated that the ramp-up in the large deals is beginning to make a material impact on the overall performance. The revenues from the six multi-million multi-year deals contributed to around 10% of the total turnover and is reflected in the third consecutive quarter of over 8% quarter-on-quarter (q-o-q) growth in the software services business in the dollar terms. What's more, the EBITDA margin on the revenues from the large deals is indicated to be higher than the average margins of the company.
- At the current market price the stock trades at 18.8x FY2007 and 15.2x FY2008 estimated earnings. We maintain our Buy recommendation on the stock with a price target of Rs720.

All engines firing together

HCL Tech reported an encouraging growth of 10.2% qoq in its revenues in dollar terms. All the three segments contributed to the overall growth in dollar terms; the software services business grew by 9.2% qoq, the BPO business grew by 9.4% qoq and the IMS business grew by 16.7% sequentially.

However, the steep appreciation in the rupee by 3.6% in terms of the average realisations limited the growth in rupee terms.

Segment-wise revenue growth

Particulars	Q2FY07	Q2FY06	Q1FY07	% yoy	% qoq
Software services	1073.9	800.1	1020.6	34.2	5.2
BPO	185.9	133.8	176.3	38.9	5.4
Infrastructure management	205.3	120.2	182.5	70.8	12.5
Total revenues	1465.1	1054.1	1379.4	39.0	6.2

Revenue growth accompanied by improvement in margins

What's more, the growth was accompanied by an improvement in the EBITDA margins in the software services (up 60 basis points) and BPO businesses (up 40 basis points) and the profitability in the IMS business was more or less stable at 17.5%. This is despite the fact that it was a difficult quarter given the adverse impact of a steep appreciation in the rupee and the higher SG&A charges (due to the global summit for customers).

Segmental margins

Particulars	Q2FY07	Q2FY06	Q1FY07	% yoy	% qoq
Software services	245.5	183.5	227.1	33.8	8.1
- margins (%)	*22.9*	*22.9*	*22.3*		
BPO	42.6	36.4	39.6	17.1	7.6
- margins (%)	*22.9*	*27.2*	*22.5*		
Infrastructure management	35.9	18.1	32.2	98.3	11.5
- margins (%)	*17.5*	*15.1*	*17.6*		
Total EBITDA	324.0	237.9	298.9	36.2	8.4
- margins (%)	*22.1*	*22.6*	*21.7*		

On an overall basis, the positive impact of higher employee utilisation and better average realisation resulted in a net positive impact of 40 basis points on the EBITDA margins. The utilisation improved in all segments; 3% improvement in the onsite IT services, .5% improvement in the offshore IT services and 5% improvement in the Indian operations of the BPO.

Factors influencing margins

Forex exchange	(150) bps
SG&A & others	(70) bps
Higher utilisation	120 bps
Better realisation	140 bps
Net impact	40 bps

Large deals make a substantial contribution

The key highlight of the results was the management's optimism to continue with the growth momentum in the coming quarters also. The successful ramp-up of revenues from the large deals appears to have boosted the management's confidence to do so. Especially since the six large deals (signed till date) contributed to around 10% of the total turnover during the quarter. The fact that the large deals have been margin accretive is also encouraging (higher than the average margins).

Upgrade of earning estimates

Given the robust performance in H1 (especially on the margin front), we have revised upwards the earnings estimates by 4.7% for FY2007 and by 3.1% for FY2008. The implied compounded growth rate (CQGR) in earnings (after excluding the huge forex gain in Q2) over the next two quarters works out to around 2.5% to meet the estimates.

Other highlights

The company added 1,865 employees during the quarter, including 580 employees in the software service business, 216 employees in the IMS business and the remaining 1,069 in the BPO business. This is the second consecutive quarter of over 1,000 net employee additions in the BPO business.

We expect the company to report addition of over 10,000 gross employees in the current year. The attrition rate in the software service division has inched up to 17.8% (up from 16.5% in Q1). However, the management maintains that the lucrative stock options plan has curtailed the attrition among the key employee base.

The revenues from the top 20 clients grew at a robust rate of 12% on a sequential basis. The number of clients with an annual revenue run rate of over $50 million increased to 3 (up from 2 in the last quarter) and with over $10 million run rate improved from 18 to 22 clients. The company added 23 new clients during the quarter and the repeat business was relatively much lower at 88.2% (as compared to around 95% for most of its peers).

In terms of the geographical mix, the revenues from Europe and Asia Pacific (especially Australia) continue to show a robust growth (double-digit sequentially).

For the quarter, the non-cash charge for the employee stock options was $6.17 million as against $4.6 million in the previous quarter (the same have not been shown in the above results table).

The unrealised treasury gains increased to $15.3 million as compared to $11.7 million as on September end 2007.

The quarterly dividend rate has been maintained at 200% (or Rs4 per share).

Valuation

At the current market price the stock trades at 18.8x FY2007 and 15.2x FY2008 estimated earnings. We maintain our Buy recommendation on the stock with a price target of Rs720 (17.5x FY2008 revised earning estimates).

Key financials

Particulars	FY05	FY06	FY07E	FY08E
Net sales (Rs cr)	3362.7	4388.3	6051.7	7843.0
Net profit (Rs cr)	609.1	773.9	1088.9	1354.5
No of shares (cr)	32.1	32.2	32.5	32.7
EPS (Rs)	19.0	24.1	33.5	41.5
% y-o-y chg	*15.2*	*26.9*	*39.2*	*23.8*
PER	33.2	26.2	18.8	15.2
OPM (%)	22.7	22.2	22.0	21.6
Dividend (Rs)	16	16	16	16
Dividend yield (%)	2.5	2.5	2.5	2.5

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

Tata Consultancy Services

Evergreen

Stock Update

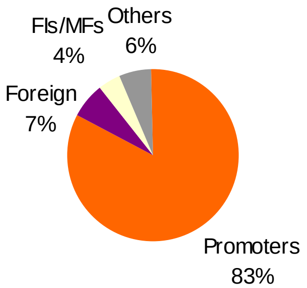
Q3FY2007—fist cut analysis

Buy; CMP: Rs1,328

Company details

Price target:	Under review
Market cap:	Rs129,958 cr
52 week high/low:	Rs1,370/900
NSE volume: (No of shares)	7.6 lakh
BSE code:	532540
NSE code:	TCS
Sharekhan code:	TCSCONS
Free float: (No of shares)	17.1 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	18.4	22.7	40.6	59.4
Relative to Sensex	9.4	9.3	8.9	4.8

Result highlights

- Tata Consultancy Services (TCS) has reported a growth of 8.4% quarter on quarter (qoq) and of 40.8% year on year (yoy) in its consolidated revenues to Rs4,860.5 crore. The sequential revenue growth was largely driven by a 7.87% growth in volumes, a 2% improvement in the billing rates and productivity gains of 2.6% on the fixed price projects. On the other hand, the revenue growth was dented by 2.46% due to the appreciation of the rupee and by 1.56% from the shift towards offshore business.
- The earnings before interest and tax (EBIT) margins improved by 79 basis points to 26.1% on a sequential basis. The steep appreciation of the rupee dented the margins by 1.37% that was more than made up by the positive impact of 1.74% from the higher billing rates, 0.28% from the shift towards offshore business and 0.14% from the cost efficiencies. The company maintained its broad guidance of maintaining the full year margins close to 25.8% reported in FY2006.
- The other income stood at Rs30 crore (includes foreign exchange fluctuation gain of around Rs5 crore), up from Rs7.7 crore in Q2FY2007. Consequently, the earnings grew at a relatively higher rate of 11.4% qoq and 47.2% yoy to Rs1,104.7 crore.
- In terms of operational highlights, the company added 5,562 employees and 5 new clients during the quarter. It also bagged five large deals; two deals of over $100 million and three deals of over $50 million.
- Given the higher-than-expected performance, we would be revising upward the earnings estimates and the price target in the detailed result update. We maintain the Buy call on the stock.

Result table (consolidated US GAAP) Rs (cr)

Particulars	Q3FY07	Q2FY07	Q3FY06	% qoq chg	% yoy chg
Revenue	4860.5	4482.2	3452.7	8.4	40.8
Development cost	2575.8	2388.0	1806.4	7.9	42.6
Gross profit	2284.7	2094.2	1646.3	9.1	38.8
SG&A expenses	909.4	864.8	669.6	5.2	35.8
Operating profit	1375.3	1229.4	976.7	11.9	40.8
Depreciation	108.0	95.8	73.8	12.7	46.4
EBIT	1267.3	1133.6	903.0	11.8	40.3
Other income	30.0	7.7	(15.4)	287.8	(294.7)
Profit before tax	1297.3	1141.4	887.6	13.7	46.2
Tax	182.8	144.7	131.9	26.3	38.6
PAT	1114.5	996.7	755.7	11.8	47.5
Affiliates earnings	1.7	0.8	(0.3)	122.6	(774.8)
Minority interest	11.5	5.9	4.8	93.5	137.3
PAT before one-time items	1104.7	991.5	750.6	11.4	47.2
One-time item	0.0	0.0	0.3	-	-
RPAT	**1104.7**	**991.5**	**750.3**	**11.4**	**47.2**
Equity capital	97.9	97.9	97.9		
EPS(Rs)	11.3	10.1	7.7		
GPM (%)	47.0	46.7	47.7		
OPM (%)	28.3	27.4	28.3		
EBIT (%)	26.1	25.3	26.2		
NPM (%)	22.6	22.1	21.8		

Sharekhan Stock Ideas

Evergreen

HDFC Bank
Infosys Technologies
Reliance Industries
Tata Consultancy Services

Apple Green

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

Cannonball

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

Emerging Star

3i Infotech
Aban Offshore
Alphageo India
Cadila Healthcare
KSB Pumps
Marksans Pharma
Navneet Publications (India)
New Delhi Television
Nucleus Software Exports
Orchid Chemicals & Pharmaceuticals
ORG Informatics
Solectron Centum Electronics
Tata Elxsi
Television Eighteen India
Thermax
TVS Motor Company
UTI Bank

Ugly Duckling

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

Vulture's Pick

Esab India
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