investor's eye

Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
BEL	26-Sep-06	1,108	**1,150**	1,525
ICICI Bank	23-Dec-03	284	**727**	770
India Cements	28-Sep-06	220	**222**	315
ITC	12-Aug-04	69	**193**	220
TV18	23-May-05	214	**651**	704

JM Financial

Ugly Duckling

Stock Update

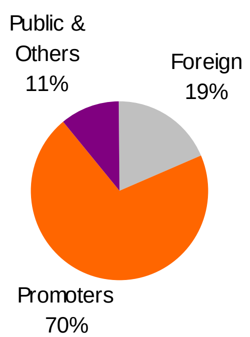
On strong financial wicket

Buy; CMP: Rs727

Company details

Price target:	Rs900
Market cap:	Rs2,108 cr
52 week high/low:	Rs957/316
BSE volume: (No of shares)	23,138
BSE code:	523405
NSE code:	JMSHARE
Sharekhan code:	JMSHR
Free float: (No of shares)	83 lakh

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-14.1	51.3	45.0	86.5
Relative to Sensex	-20.2	24.7	24.6	16.7

Result highlights

- JM Financial Ltd (JMFL) reported a strong 74.7% year-on-year (y-o-y) growth in the revenues for H1FY2007 to Rs183.5 crore. The strong growth in the revenues was backed by the institutional broking and investment banking divisions. The revenues of these divisions together grew by 62.2% year on year (yoy).
- The operating profit of JMFL grew by 70% yoy to Rs92.1 crore as the operating profit margin (OPM) was stable at 50.2%.
- The company's net profit for H1FY2007 stood at Rs41.2 crore, up by 68.6%.
- On a quarter-on-quarter (q-o-q) basis, its income for Q2FY2007 was lower by 11.1% to Rs86.4 crore as there were no big initial public offerings (IPOs) during Q2FY2007 and the income for Q1FY2007 was also abnormally higher due to the Reliance Petroleum IPO.
- On a q-o-q basis, the net profit for Q2FY2007 was lower by 37%.
- At the current market price of Rs727 the stock is quoting at 17x its FY2008E earnings per share and 2.7x its FY2008E book value per share.
- We have revised our price target on the stock to Rs900, as we have valued JMFL at 20x its FY2008E earnings.

Strong growth in revenues

JMFL reported a strong 74.7% y-o-y growth in its income for H1FY2007 to Rs183.5 crore on the back of a robust growth in the income from the investment banking and institutional broking businesses.

Note: JMFL's comparable numbers for Q2FY2006 are not available, as it has merged JM Financial Services Pvt Ltd with itself during Q3FY2006.

Result table Rs (cr)

Particulars	H1FY2007	H1FY2006	% yoy chg	Q2FY2007	Q1FY2007	% qoq chg
Total income	183.5	105.0	74.7	86.4	97.2	-11.1
Expenses	91.4	50.9	79.8	43.8	47.6	-8.1
Operating profit	92.1	54.2	70.0	42.6	49.5	-14.0
Depreciation	3.6	3.4	3.7	1.8	1.8	2.0
Interest	0.4	0.3	19.8	0.0	0.3	-87.2
Profit before tax	88.2	50.4	74.8	40.7	47.4	-14.1
Tax	28.8	15.6	88.0	13.0	15.7	-15.6
Profit after tax	59.3	34.9	70.1	27.6	31.7	-12.9
Less: Share of minority interest	14.2	10.7	32.7	8.8	5.4	63.4
PAT after minority interest	45.1	24.2	86.6	18.8	26.3	-28.6
Add/Less: Share in profit/(loss)	-3.9	0.3		-2.9	-1.0	
Consolidated PAT	41.2	24.5	68.6	15.9	25.3	-37.1
OPM (%)	50.2	51.6		49.3	51.0	

The income from fund-based activities also picked up with the growing margin funding book and the funding of the IPOs.

	H1 FY07	H1 FY06	% yoy chg	Q2 FY07	Q1 FY07	% qoq chg
Dividend	5.4	1.6	236.2	2.7	2.7	-0.7
Fees, commission & brokerage	157.3	97.0	62.2	75.7	81.6	-7.1
Income from fund-based activity	10.4	0.6	1579.9	3.0	7.4	-59.9
Interest & other income	10.4	5.8	78.9	5.0	5.5	-9.4
Total income	183.5	105.0	74.7	86.4	97.2	-11.1

On a q-o-q basis, the income was lower by just 11.1% at Rs86.4 crore despite the fact there were no big IPOs during Q2FY2007; the income was also lower because the same for Q1FY2007 was abnormally higher due to the Reliance Petroleum IPO.

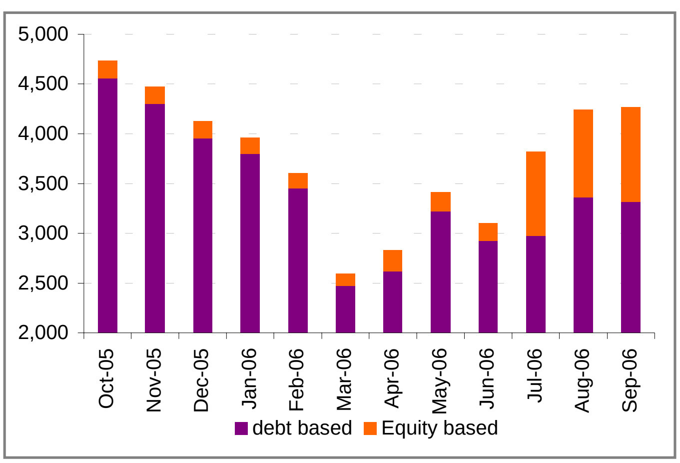
Net profit grows by 68.6% yoy

JMFL's operating profit grew by 70% yoy to Rs92.1 crore, as the OPM remained stable. The net profit grew by 68.6% yoy to Rs41.2 crore.

Many businesses still at nascent stage, vast opportunity ahead

Many of JMFL's businesses, like retail foray, margin funding and commodity trading, are at a nascent stage and present a vast opportunity going ahead for JMFL. Also the asset management company (AMC) is growing with steady expansion in the assets under management (AUMs) and the same will help to turn the AMC profitable.

AUMs have rebound (Rs crore)



Source: AMFI

JMFL has also launched its private equity and real estate funds. These kinds of businesses require a long gestation period. However these have the potential to offer a good internal rate of return in excess of 20%. We believe the private equity and real estate funds will be an icing on the cake for JMFL.

Better risk profile to offer better valuations

Currently JMFL is trading at a 30-100% premium to its peers in retail broking/financial service business and approximately at a 12% discount to its nearest comparable, Kotak Mahindra Bank (KMB). We believe that JMFL has a better risk profile than its peers. In contrast with its retail broking/financial service peers, JMFL's broking and investment banking businesses are more profitable as their clients are institutional investors and as JMFL has a stronger branch franchise too. Compared with KMB, we believe that JMFL has a better risk profile as it is in the same businesses as KMB but doesn't have a bank that can reduce its return on equity.

We have revised our price target on the stock to Rs900, as we have valued JMFL at 20x its FY2008 earnings (30x trailing 12 months) which is at a 73% premium to its peers in the retail broking/financial service business and equivalent to KMB's valuations.

	Trailing 12-month net profit (Rs crore)	Market capitalisation (Rs crore)	PER (x)	JMFL's prem/ (dis) (%)
I&FS Investsmart	77.0	1,358.5	17.6	53.4
India Infoline #	60.4	884.9	14.7	84.7
Indiabulls #	323.8	6,605.7	20.4	32.7
KMB #	374.0	11,478.9	30.7	(11.8)

Consolidated numbers

Valuation table (consolidated)

Particulars	FY2005	FY2006E	FY2007E	FY2008E
Net profit	44.4	67.2	102.6	145.1
Equity	2.9	2.9	3.2	3.2
EPS (Rs)	15.5	23.4	31.6	44.7
% y-o-y chg		*51.1*	*52.8*	*41.3*
PER (x)	48.7	32.2	23.9	16.9
Book value (Rs)	80.5	134.5	232.6	277.3
P/BV (x)	9.4	5.6	3.2	2.7
RoNW (%)	19.2	21.8	17.2	17.5

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

HDFC Bank

Evergreen

Stock Update

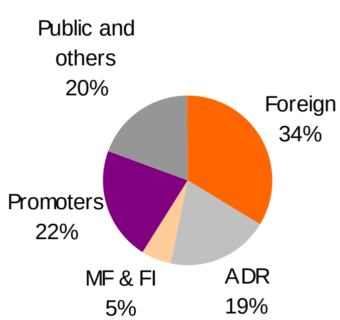
Strong operational growth

Buy; CMP: Rs1,010

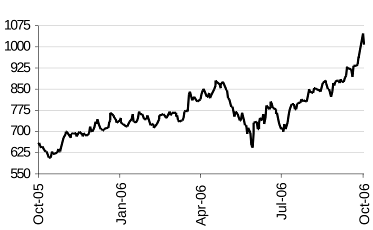
Company details

Price target:	Rs1,080
Market cap:	Rs31,411 cr
52 week high/low:	Rs1,075/603
NSE volume: (No of shares)	4.4 lakh
BSE code:	500180
NSE code:	HDFCBANK
Sharekhan code:	HDFCBANK
Free float: (No of shares)	18.2 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	19.5	43.6	30.6	60.0
Relative to Sensex	11.0	18.3	1.2	0.1

Result highlights

- HDFC Bank's Q2FY2007 results were better than our expectations driven by a higher fee income and controlled expenses.
- The net interest income (NII) grew by 38.1% year on year (yoy) to Rs845.6 crore in line with our expectations. The advances grew by 34.4%. The net interest margin (NIM) declined by eight basis points to 3.92%, albeit the same remained the highest in the industry.
- The other income grew by a strong 52.9% driven by a 44.2% year-on-year (y-o-y) growth in the fee income, which was higher than our expectations.
- The operating profit grew by 41.1% yoy to Rs664.2 crore as the operating expenses remained under check. The operating expenses grew by 44.2% yoy, lower than expected, probably because there was no expansion in its branch network during the quarter.
- That the bank did not add any branch in Q2FY2007 (for want of new licences from the Reserve Bank of India) is a cause for concern. Because of this the proportion of the CASA deposits in the total deposits fell to 52.2% in Q2FY2007 compared with 59.7% (Q2FY2006) and 52.6% (Q1FY2007).
- The growth in the advances was also lower than an average growth of 50%+ recorded over the previous four quarters.
- At the current market price of Rs1,010, the stock is quoting at 21.1x its FY2008E earnings per share (EPS), 8.5x its FY2008E pre-provision profits (P/PPP) and 4.3x its FY2008E book value (BV).
- We believe that the current market price fairly discounts the growth expected over FY2006-08E, leaving very marginal upside to the stock price. We are revising our price target for the stock to Rs1,080. At this level the stock would discount its FY2008E EPS by 22.6x and FY2008E BV at 4.6x.

Result table Rs (cr)

Particulars	H1FY07	H1FY06	% yoy chg	Q2FY07	Q2FY06	% yoy chg	% qoq chg
Net interest income	1,663.2	1,135.8	46.4	845.6	612.1	38.1	3.4
Other income	748.5	523.7	42.9	397.7	260.2	52.9	13.4
Treasury income	*18.3*	*35.3*	*-48.2*	*20.6*	*11.9*	*73.1*	*-995.7*
Fee income	*611.4*	*433.0*	*41.2*	*314.1*	*217.8*	*44.2*	*5.7*
Others	*114.0*	*55.4*	*105.8*	*58.2*	*30.5*	*91.1*	*4.3*
Net income	*2,411.7*	*1,659.5*	*45.3*	*1,243.3*	*872.3*	*42.5*	*6.4*
Operating expenses	1,131.9	759.7	49.0	579.1	401.6	44.2	4.8
Operating profit	1,279.9	899.9	42.2	664.2	470.6	41.1	7.9
Provisions	569.6	346.5	64.4	305.7	180.6	69.3	15.9
Taxes	208.1	170.2	22.2	95.5	90.4	5.7	-15.1
Net profit	502.3	383.1	31.1	262.9	199.6	31.7	9.9

NII grows by 38.1% yoy

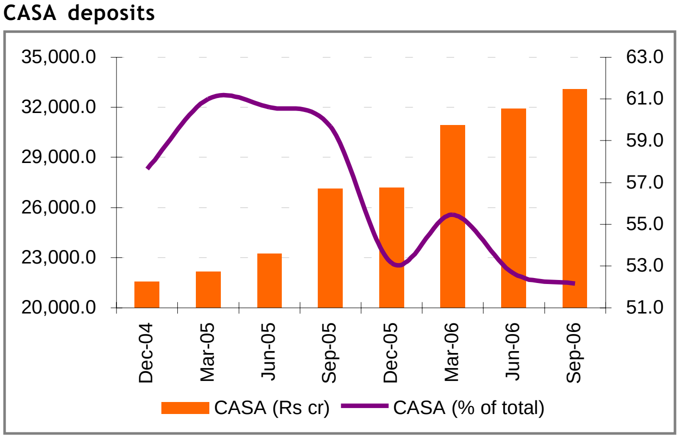
During the quarter HDFC Bank's NII grew by 38.1% yoy on the back of a strong growth of 34.4% in its gross advances. The growth in the advances came from a 44.4% increase in the retail advances, which stood at 56% of the total advance portfolio.

Despite a fall in the CASA deposits the decline in the NIM was limited to eight basis points over Q1FY2007 and Q2FY2006 due to an improvement in the yield on the assets following the improving proportion of the retail advances.

Faster branch expansion needed for CASA growth

Over the past six months HDFC Bank has not added any new branches. As a result the growth in the CASA deposits has slowed down substantially. The proportion of the CASA deposits declined to 52.2% of the total deposits at the end of Q2FY2007 compared with 59.7% at the end of Q2FY2006 and 52.6% at the end of Q1FY2007.

CASA deposits



Source: Company

However, the 22% y-o-y and 3.7% q-o-q growth in the CASA deposits is still commendable looking at the fact that there was no branch expansion during the quarter.

Rs crore	Q2FY07	Q2FY06	Q1FY07	% yoy chg	% qoq chg
Total deposits	63,447.0	45,446.0	60,630.0	39.6	4.6
Savings	18,241.0	14,395.0	17,244.0	26.7	5.8
% Of total	*28.7*	*31.7*	*28.4*		
Current	14,851.0	12,727.0	14,674.0	16.7	1.2
% Of total	*23.4*	*28*	*24.2*		
Total CASA deposits	33,092.0	27,122.0	31,918.0	22.0	3.7
% Of total	*52.2*	*59.7*	*52.6*		

Strong fee income drives operating profit

HDFC Bank's fee income grew by a strong 44.2% yoy and 5.7% qoq driven by the growth in the retail and credit card businesses, and the sale of third-party products.

The strong growth in the fee income coupled with the controlled operating expenses resulted in a 41.1% y-o-y growth in the operating profit to Rs664.2 crore.

Net profit grows at 31.7%

At 31.7% the y-o-y growth in the net profit was lower than that in the operating profit due to higher general provisioning on the standard assets. On July 12, 2006, the Reserve Bank of India increased the provisioning requirement for standard assets to 0.7% of the assets from 0.4% of the same.

Break-up of provisioning

Rs crore	Q2FY07	Q2FY06	Q1FY07
On NPAs and standard assets	220.7	122.8	185.4
Amortisation	57.6	57.6	59.9
Total provisions	305.7	180.6	263.9

Asset quality remains best in the industry

HDFC Bank's asset quality remains the best in the industry with net non-performing assets at 0.4% of its net advances at the end of September 2006.

Tier-I CAR at 8.2%

HDFC Bank's Tier-I capital adequacy ratio (CAR) stood at 8.2% at the end of Q2FY2007. During Q2FY2007 it raised Rs200 crore as non-convertible perpetual bonds for inclusion as Tier-I capital. As a result, the Tier-I CAR remained comfortable. We believe that the bank will be able to grow its loan portfolio at a rapid pace without diluting its equity over the next 12-18 months. With its Tier-II CAR at only 3.8%, the bank also has room for raising Tier-II capital.

Valuations

At the current market price of Rs1,010, the stock is quoting at 21.1x its FY2008E EPS, 8.5x its FY2008E P/PPP and 4.3x its FY2008E BV. We believe that the current market price fairly discounts the growth expected over FY2006-08E, leaving very marginal upside to the stock price. We are revising our price target for HDFC Bank to Rs1,080. At this level the stock would discount its FY2008E EPS by 22.6x and FY2008E BV at 4.6x

Key financials

Particulars	FY2005	FY2006E	FY2007E	FY2008E
Net profit (Rs cr)	665.6	870.8	1,129.8	1,499.6
Shares in issue (cr)	31.0	31.3	31.3	31.3
EPS (Rs)	21.5	27.8	36.1	47.9
EPS growth (%)	20.1	29.5	29.7	32.7
PE (x)	47.0	36.3	28.0	21.1
P/PPP (x)	22.0	15.3	11.1	8.5
Book value (Rs/share)	145.9	169.2	197.9	237.2
P/BV (x)	6.9	6.0	5.1	4.3
RONW (%)	17.9	17.7	19.7	22.0

Genus Overseas Electronics

Ugly Duckling

Stock Update

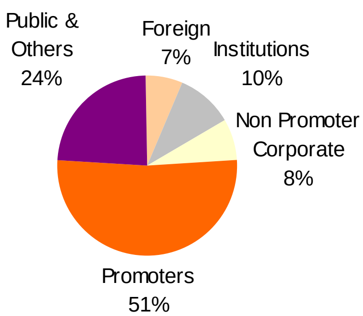
Profit meter ticking on

Buy; CMP: Rs230

Company details

Price target:	Rs270
Market cap:	Rs249 cr
52 week high/low:	Rs309/126
NSE volume: (No of shares)	32,085
BSE code:	530343
NSE code:	GENUSOVERE
Sharekhan code:	GENUSOVER
Free float: (No of shares)	53 lakh

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	11.1	24.3	10.9	77.3
Relative to Sensex	3.2	2.4	-4.7	10.9

Result highlights

- Genus Overseas reported a year-on-year (y-o-y) growth of 87% in its net profit to Rs5.6 crore for Q2FY2007. The same is above our expectations, primarily because of higher-than-expected revenue booking and operating profit margin (OPM) for the quarter.
- As a result of the healthy revenue booking for the project business and impressive offtake in the metering business, the company's net sales for the quarter grew by a smart 105% year on year (yoy) to Rs78 crore. Notably, the growth in the net sales was higher than that in the gross sales (y-o-y growth of 97%). This was primarily because the project business earned higher revenues, which were free of excise duty. The growth was also aided by the sales from the new excise-free plant at Uttaranchal.
- The operating profit for the quarter grew by 140 percentage points to Rs12 crore, as the OPM improved by 220 basis points to 15.4%. The margin improved on the back of higher order booking that brought operating leverage into play. This was clearly visible as the other expenditure as a percentage of sales came down to 11.6% in Q2FY2007 from 20.1% in Q2FY2006.
- However the interest expenses for the quarter trebled to Rs4.82 crore as the company had to avail of large working capital loans to execute project orders. The depreciation charge also rose by 135% to Rs1.2 crore as the company commissioned the first phase of its Uttaranchal plant.
- Consequently the net profit for the quarter grew by 87% yoy to Rs5.6 crore.
- The order book for the quarter jumped by 123% to Rs491 crore as the company started taking metering orders on project basis as against on the basis of pure metering sales.

Result table Rs (cr)

Particulars	Q2FY07	Q2FY06	% yoy chg	H1FY07	H1FY06	% yoy chg
Gross sales	85.2	43.2	97.0	141.3	84.7	67.0
Excise duty	7.2	5.2	38.0	12.4	9.3	33.0
Net sales	**78.0**	**38.0**	**105.0**	**129.0**	**75.4**	**71.0**
Total expenditure	65.9	33.0	100.0	109.0	66.6	64.0
Operating profit	12.0	5.0	140.0	20.0	8.9	125.0
Other income	0.6	0.1	300.0	0.8	0.3	189.0
EBIDTA	12.6	5.2	144.0	20.7	9.2	127.0
Interest	4.8	1.2	308.0	7.5	2.1	252.0
EBDT	7.8	4.0	95.0	13.3	7.0	89.0
Depreciation	1.2	0.5	135.0	2.4	1.0	136.0
EBT	6.6	3.5	90.0	10.9	6.0	81.0
Tax	1.0	0.5	106.0	1.6	0.9	73.0
EAT	**5.6**	**3.0**	**87.0**	**9.3**	**5.1**	**82.0**
Margins						
OPMs (%)	15.4	13.2		15.5	11.8	
EBIDTM (%)	16.2	13.6		16.1	12.1	
PATM (%)	7.2	7.9		7.2	6.8	

Overall, Genus Overseas' Q2FY2007 results are above our expectations and we are upgrading our earnings estimates for the company by 17% and 10% for FY2007 and FY2008 respectively. Our FY2007 and FY2008 earnings per share (EPS) estimates now stand at Rs18.9 and Rs27.3 respectively.

Going forward, the government's aim of power for all by 2012 along with its focus on 100% metering and replacement of old mechanical meters with electronic energy meters (EEMs) would drive the company's earnings. This opportunity and the order backlog of Rs491 crore, which stands at more than 2x the company's FY2006 revenue, provide a strong visibility to the earnings. Genus Overseas' recent joint venture with Mobix would further boost the earnings in the longer term. At the current market price of Rs230, the stock is discounting its FY2008E earnings by 8.4x. We maintain our Buy recommendation on the stock with a price target of Rs270.

Net sales up 105%

Genus Overseas' entry into the metering project business in FY2006 was very proactive and timely, given the change in the tendering process of the state electricity boards (SEBs). The SEBs have shifted to EPC-based contracts and hence the size of their orders has grown substantially. As a result of the healthy revenue booking for the project business, the company's net sales for the quarter grew by a smart 105% yoy to Rs78 crore. Notably, the growth in the net sales was higher than that in the gross sales (y-o-y growth of 97%). This was primarily because the project business earned higher revenues, which were free of excise duty. The growth was also aided by the sales from the new excise-free plant at Uttaranchal.

Operating profit up 140%

Following the significant growth in the revenues, the company's operating profit for the quarter grew by a whopping 140% to Rs12 crore, as the OPM for the quarter improved by 220 basis points to 15.4%. The OPM improved on the back higher order booking which brought operating leverage into play. This was clearly visible as the other expenditure as a percentage of sales came down to 11.6% in Q2FY2007 from 20.1% in Q2FY2006.

Expenditure as % of sales

Particulars	Q2FY07	Q2FY06	% yoy chg
Raw Material	53.6	23.2	131.0
As a % Sales	*68.8*	*61.1*	
Employee Cost	3.2	2.1	52.0
As a % Sales	*4.2*	*5.6*	
Other Exp	9.0	7.6	19.0
As a % Sales	*11.6*	*20.1*	

Higher interest charges restricts net profit growth to 87%

Typically the working capital requirement in project business is very high because of the large size of the orders involved and the nature of customers, who are predominantly SEBs. The same was clearly visible from the surge in Genus Overseas' interest expenses, which trebled to Rs4.82 crore during the quarter, as the company had to avail of large working capital loans to execute its project orders. The depreciation charge also rose by 135% to Rs1.2 crore as the company commissioned the first phase of its Uttaranchal plant. Consequently, the net profit for the quarter grew by 87% yoy to Rs5.6 crore.

Order book up 123% to Rs491 crore

With its entry into the metering project business, the order book for the business has zoomed by a staggering 123% yoy with an order backlog of Rs491 crore. At more than 2x its FY2006 revenue, the order book provides a strong visibility to its earnings.

Order backlog registers a sharp increase

Order book details	Q2FY07	Q2FY06	% yoy chg
Order at the beginning of Q2	455.0	101.0	350.0
Order inflow	121.0	162.0	-25.0
Revenue booked	85.2	43.2	97.0
Order backlog at the end of Q2	491.0	220.0	123.0

Upgrading earnings by 17% for FY2007

Genus's Q2FY2007 results are above our expectations, primarily because of higher-than-expected revenue booking and better OPM. Consequently, we are upgrading our earnings estimates for Genus Overseas by 17% and 10% for FY2007 and FY2008 respectively. Our FY2007 and FY2008 EPS estimates now stand at Rs18.9 and Rs27.3 respectively.

Genus Overseas enters overseas market

With the intention of capitalising on the huge potential in the overseas market, Genus Overseas has decided to enter into a joint venture with Mobix, a Brazilian company that is one of the leaders in communication technology. The deal involves a total investment of US$15 million or approximately Rs70 crore. The joint venture plans to raise USD9 million through a loan from a development bank in Brazil @ 0% interest. Both the companies would contribute the balance portion of USD6 million in the form of equity.

Genus Overseas had earlier raised USD7.5 million through a foreign currency convertible bond (FCCB) issue. The company would be using part of the proceeds to subscribe to the equity of the joint venture.

At 100% capacity utilisation, the company expects to clock a turnover of Rs200 crore from the Brazil unit. It has already started the formalities of acquiring land in Brazil and expects to commission the plant by the third quarter of FY2008. Thus we can expect the revenues to start accruing on the books from Q4FY2008. However we have not factored the benefits of this venture in our FY2008 earnings estimates.

Valuation and view

Going forward, the government's aim of power for all by 2012 along with its focus on 100% metering and replacement of old mechanical meters with EEMs would drive the company's earnings. This opportunity and the order backlog of Rs491 crore, which stands at more than 2x the company's FY2006 revenue, provide a strong visibility to the earnings. Genus Overseas' recent joint venture with Mobix would further boost the earnings in the longer term. At the current market price of Rs230, the stock is discounting its FY2008E earnings by 8.4x. We maintain our Buy recommendation on the stock with a price target of Rs270.

Key financials

Particulars	FY04	FY05	FY06	FY07E	FY08E
Net profit (Rs cr)	3.1	7.4	14.8	23.0	33.2
% y-o-y growth	*4.0*	*141.0*	*101.0*	*55.0*	*44.0*
Shares in issue (cr)	1.01	1.01	1.01	1.22	1.22
EPS (Rs)	3.0	7.3	14.7	18.9	27.3
% y-o-y growth	*4.0*	*141.0*	*101.0*	*55.0*	*44.0*
PER (x)	75.9	31.5	16.2	12.2	8.4
Book value (Rs)	17.5	23.1	39.1	78.8	104.5
P/BV (Rs)	13.2	10.0	5.9	2.9	2.2
EV/EBIDTA (x)	25.1	17.4	11.0	6.6	4.9
Dividend yield (%)	0.5	0.7	0.7	0.7	0.7
RoCE (%)	11.6	12.7	12.3	13.1	14
RoNW (%)	17.3	31.6	36.4	24.0	26.1

HCL Technologies

Ugly Duckling

Stock Update

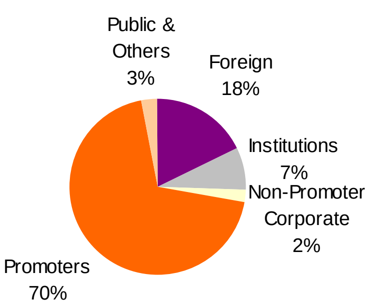
Results ahead of expectations

Buy; CMP: Rs609

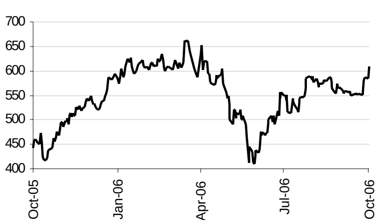
Company details

Price target:	Rs720
Market cap:	Rs19,698 cr
52 week high/low:	Rs707/362
NSE volume: (No of shares)	4.7 lakh
BSE code:	532281
NSE code:	HCLTECH
Sharekhan code:	HCLTECH
Free float: (No of shares)	9.9 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.2	4.9	0.4	34.4
Relative to Sensex	-4.1	-13.6	-13.7	-16.0

Result highlights

- HCL Technologies has reported a robust revenue growth of 10% quarter on quarter (qoq) and 42.1% year on year (yoy) to Rs1,379.5 crore for the first quarter ended September 2006. The sequential growth was driven by a 9.7% increase in the revenues of the software service business and a growth of 16.6% in the infrastructure management service (IMS) business. On the other hand, the business process outsourcing (BPO) business continues to lag behind with a relatively lower growth rate of 5.4% on a sequential basis.
- The earnings before interest, tax, depreciation and amortisation (EBITDA) declined by 70 basis points to 21.7% on a sequential basis, largely due to the salary hikes given to almost 85% (employees below "project manager" level) of its work force with effect from July. The worst affected was the profitability of the software service business that reported a 90-basis-point decline in the EBITDA margin to 22.3%. On the other hand, the IMS business reported another quarter of margin expansion (up 20 basis points to 17.6%). The operating profit grew 6.2% qoq and 43.9% yoy to Rs298.9 crore.
- The earnings grew at a relatively lower rate of 7.4% qoq and 49.6% yoy to Rs250.2 crore (ahead of our expectations of Rs239.5 crore and consensus estimates of a sequential drop in the earnings). The growth in the earnings was also aided by the 25.2% sequential growth in the other income (due to the lower base resulting from a negative foreign exchange [forex] impact of Rs16.6 crore in Q4).

Result table Rs (cr)

Particulars	Q1FY07	Q1FY06	Q4FY06	% yoy chg	% qoq chg
Revenue ($ mn)	300.4	220.6	272.4	36.2	10.3
Derived exchange rate (Rs/USD)	45.9	44.0	46.0	4.4	-0.2
Net sales	**1379.5**	**970.7**	**1253.8**	**42.1**	**10.0**
Direct costs	870.8	609.4	794.6	42.9	9.6
Gross profit	508.7	361.3	459.2	40.8	10.8
SG&A	209.8	145.8	177.7	43.9	18.0
EBITDA	298.9	215.5	281.5	38.7	6.2
Depreciation & amortisation	55.7	44.7	56.2	24.6	-1.0
EBIT	243.2	170.8	225.2	42.4	8.0
Forex gain/(loss)	1.2	-3.0	-16.6	-	-
Other Income	27.8	15.4	22.2	80.5	25.2
PBT	272.2	183.2	230.8	48.6	17.9
Tax provision	21.9	16.9	-2.3	-	-
PAT	250.3	166.3	233.1	50.5	7.4
Extraordinary items	-0.4	0.0	-0.7	-	-
Stock-based sales incentive	0.5	-0.9	0.8	-	-
Net profit	**250.2**	**167.2**	**233.0**	**49.6**	**7.4**
Equity capital	64.7	64.7	64.7		
EPS (Rs)	7.7	5.2	7.2		
Margin (%)					
GPM	36.9	37.2	36.6		
OPM	21.7	22.2	22.4		
NPM	18.1	17.2	18.6		

- In terms of operational highlights, the company added 3,826 employees during the quarter, one of the highest in the past 10 quarters. The revenues from the top 10 clients grew at a robust rate of 13% on a sequential basis.
- At the current market price the stock trades at 19x FY2007 and 15.2x FY2008 estimated earnings. We maintain our Buy recommendation on the stock with a revised price target of Rs720 (18x FY2008 revised earning estimates).

Robust growth in software services and IMS

The sequential growth in the software service and IMS businesses was quite robust at 9.7% and 16.6% respectively. The company has bagged large outsourcing orders cumulatively worth $750-800 million in the past few quarters and the ramp-up in some of the large deals (that have primarily application maintenance and infrastructure management as key components) is one of the key reasons for the pick-up in the growth in the two business segments. In the last quarter also, the company announced two large deals: Teradyne worth $70 million and another with a leading wireless communications company.

In case of the BPO business, it was another quarter of consolidation. The sequential growth declined further to 5.4% (lower than 6.9% reported in Q4). On the positive side, the employee addition was quite healthy in the BPO business. It added 1,769 employees taking the total base to 11,112 employees. Going forward, the management expects the BPO business to show more consistent growth on a sequential basis.

Revenue mix

Particulars	Q1FY07	Q1FY06	Q4FY06	% yoy	% qoq
Software services	1020.6	743.5	930.1	37.3	9.7
BPO	176.3	130.7	167.2	34.9	5.4
Infrastructure management	182.5	96.9	156.5	88.3	16.6

Margins decline sequentially by 70 basis points

The EBITDA margin declined by 70 basis points sequentially, largely due to the annual salary hikes (average hike of 17% given to around 85% of its employees below the "project manager" level) and an increase in the selling, general and administration (SG&A) expenses as a percentage of sales (up 100 basis points to 15.2%). On the other hand, the lower visa cost had a positive impact on the margins.

In terms of segmental performance, the software service and IMS businesses reported a sequential decline of 90 basis points and 30 basis points respectively in their margins. On the other hand, the IMS business has shown an improving trend in the margins for the last five quarters, with the margins moving up from 11.2% in Q4FY2005 to 17.6% in Q1FY2007.

The higher level of contribution from the export revenue in the IMS segment is boosting the margins. Moreover, the company has positioned itself as a dominant offshore player in the segment (with over Rs500 crore revenues from the IMS segment that has improved its pricing power).

Segmental margins

Particulars	Q1FY07	Q1FY06	Q4FY06	% yoy	% qoq
Software services	227.1	169.3	216.1	34.2	5.1
- margin	*22.3*	*22.8*	*23.2*		
BPO	39.6	34.4	38.1	15.2	4.0
- margin	*22.5*	*26.3*	*22.8*		
Infrastructure management	32.2	12.2	27.3	163.9	17.9
- margin	*17.6*	*12.6*	*17.4*		
Total EBITDA	**298.9**	**215.8**	**281.5**	**38.5**	**6.2**
- margin	*21.7*	*22.3*	*22.4*		

In Q2 also, the margins are likely to come under pressure due to the annual salary hikes (to be given to 15% of the employees with effect from October) and the initial start-up cost related to some of the large outsourcing deals. The average salary hike for the middle management and above level is also likely to be in the range of 17%. Moreover, the SG&A expenses could also increase substantially on the back of the global customer conference scheduled in December 2006 (over 500 CIOs of global corporations are likely to attend the conference).

On the full year basis, the company indicated that it would maintain the EBITDA margin at 22.2% reported in FY2006. However, we expect the margin to decline by 40-50 basis points in FY2007.

Other income grew 25.2% sequentially

The other income grew by 25.2% sequentially to Rs27.8 crore. That's because the company reported margin gains (roughly $300,000) from forex fluctuations as compared to the negative impact of $3.6 million reported in Q4FY2006.

The unrealised gains on the treasury investments were more or less flat at Rs53.7 crore as compared to Rs52.9 crore in the previous quarter.

Upgrade of earning estimates

Given the robust Q1 performance and better-than-expected margins, we have revised upwards the earnings estimates by 6.4% for FY2007 and by 5.8% for FY2008. The implied compounded growth rate (CQGR) over the next three quarters works out to just 2.5% to meet the estimates.

Other highlights

During the quarter, the company added 3,826 employees, one of the highest in the past ten quarters. It added 1,611 employees in the software service business, 446 employees in the IMS business and the remaining 1,769 in the BPO business. This works out to an addition of 11.7% over the base of 32,626 employees at the end of June 2006. The company expects to add 8,000-10,000 employees in the current year. The attrition rate in the software service division has declined slightly to 16.5% (down from 16.9% in Q4FY2006).

The revenues from the top 10 clients grew at a robust rate of 13% on a sequential basis. The number of clients with an annual revenue run rate of over $5 million has grown to 41, up from 35 in the last quarter. The company added 24 new clients during the quarter and the repeat business was relatively much lower at 87.5% (as compared to around 95% for most of its peers).

In terms of the geographical mix, the revenues from the USA and Europe continue to show a robust growth (high single-digit or double-digit sequentially) whereas those from the Asia Pacific region have shown a declining trend in the past three quarters. The management expects the growing contribution from the USA and Europe to have a positive impact on the average billing rates (resulting in higher employee productivity).

For the quarter, the non-cash charge for the employee stock options was $4.6 million as against $4.7 million in the previous quarter (the same have not been shown in the above results table).

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

Valuation

At the current market price the stock trades at 19x FY2007 and 15.2x FY2008 estimated earnings (excluding the non-cash charges related to the employee stock options). We maintain our Buy recommendation on the stock with a revised price target of Rs720 (18x FY2008 revised earning estimates).

Key financials

Particulars	FY2005	FY2006	FY2007E	FY2008E
Net sales (Rs cr)	3362.7	4388.3	6051.7	7843.0
Net profit (Rs cr)	609.1	773.9	1039.3	1311.5
Nos of equity shares	32.1	32.2	32.5	32.7
EPS (Rs)	19.0	24.1	32.0	40.2
% y-o-y chg	*15.2*	*26.9*	*32.9*	*25.6*
PER	32.1	25.3	19.0	15.2
OPM (%)	22.7	22.2	21.8	21.5
Dividend (Rs)	16.0	16.0	16.0	16.0
Dividend yield (%)	2.6	2.6	2.6	2.6

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

Crompton Greaves

Apple Green

Stock Update

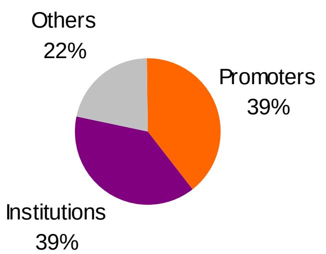
Price target revised to Rs258

Buy; CMP: Rs237

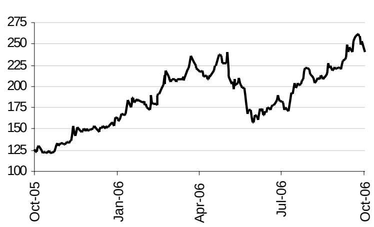
Company details

Price target:	Rs258
Market cap:	Rs6,205 cr
52 week high/low:	Rs270/120
NSE volume: (No of shares)	67,995
BSE code:	500093
NSE code:	CROMPGREAVE
Sharekhan code:	CROMPTON
Free float: (No of shares)	15.9 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8.8	31.9	8.3	93.3
Relative to Sensex	1.1	8.7	-7.0	20.9

Result highlights

- Crompton Greaves' revenues grew by 48.6% year on year (yoy) in Q2FY2007 to Rs824.0 crore, way ahead of our expectations. Although all its three divisions reported a strong performance, the power system division led the pack with a revenue growth of 68.7% yoy to Rs449.7 crore. The revenues of the consumer product division and the industrial system division grew by 33.3% and by 36.8% respectively.
- The raw material cost/sales ratio spiked to 75.6% in Q2FY2007 from 69.5% in Q2FY2006 largely due to an increase in the prices of the base metals like copper and the inability of the company to pass on the same to its customers. However, lower employee cost and other expenses muted the impact of the same. Consequently, the operating profit margin (OPM) reduced by 60 basis points yoy to 8.9%.
- The profit before interest and tax (PBIT) margin of the power system division declined by 50 basis points to 8.0% during the period. The high-margin businesses maintained their margins (the consumer product division's margin was up 10 basis points to 9.7% and the industrial system division's margin was up 20 basis points to 13.6%).
- Crompton Greaves provided for the full tax rate in Q2FY2007 as against the minimum alternate tax (MAT) rate in Q2FY2006.The increased tax provisioning led to a slower growth of 25.0% yoy to Rs40.7 crore in the profit after tax (PAT). But the growth was still in line with our expectations.
- Pauwels' top line grew by 86.4% yoy to Rs520.0 crore in Q2FY2007, way ahead of our estimates and the profit before tax (PBT) stood at Rs21.3 crore.
- The stand-alone order book grew by 0.6% sequentially and by 20.0% yoy to Rs1,800.0 crore in Q2FY2007. The consolidated order book stood at Rs3,739.0 crore, up 16.5% sequentially largely on account of the 36.5% jump in the order book of Pauwels.

Result table Rs (cr)

Particulars	Q2FY2007	Q2FY2006	% yoy chg
Net sales	824.0	554.6	48.6
Expenditure	750.4	501.7	49.6
Operating profit	73.6	52.9	39.1
Other income	9.4	6.5	44.8
PBIDT	83.0	59.4	39.7
Interest	7.2	5.9	22.7
Depreciation	8.1	10.4	-22.6
PBT	67.7	43.1	57.0
Tax	27.04	10.59	155.3
PAT	40.7	32.5	25.0
EPS (Rs/Share)	1.6	1.2	25.0
OPM (%)	8.9	9.5	-60 bps
PBTM (%)	8.2	7.8	40 bps
PATM (%)	4.9	5.9	-100 bps

- The Ganz acquisition, which was announced in July but is yet to be concluded will further accelerate the growth of the consolidated numbers. Though currently loss making, it is expected to contribute 70 million euros in FY2008 and turn profitable by then. We have not currently included these estimates in our numbers.
- The board has announced a bonus of two shares for every five shares held.
- Given the robust top line growth, higher raw material costs, the consequent margin contraction and higher provisioning for income tax, we are tweaking our FY2007 and FY2008 estimates. The FY2007 earnings per share (EPS) stand revised lower by 10% to Rs9.2. Although with the margins stabilising in FY2008 and the robust top line growth coupled with the strong performance of Pauwels we are revising our earnings estimates upward by 7.9%.
- At the current market price of Rs237, Crompton Greaves is trading at 25.7x its FY2008E stand-alone earnings and 17.4x its FY2008E consolidated earnings. We maintain a Buy on the stock with a revised price target of Rs258 discounting its FY2008E consolidated earnings by 19x.

Revenue growth above our expectations

Crompton Greaves' revenues grew by 48.6% yoy in Q2FY2007 to Rs824.0 crore on the back of a robust performance of all the three business segments, especially the power system segment. The power system division's revenue grew by 68.7% yoy to Rs449.7 crore, aided by the strong order booking. The revenue from the consumer product division grew by 33.3% yoy to Rs225.3 crore while the revenue from the industrial system segment grew by 36.8% yoy to Rs226.1 crore. While the top line growth of the consumer product and industrial system segments are marginally ahead of our estimates, the growth of the power system segment is above our estimates, leading to a positive surprise on the top line front.

OPM contraction of 60 basis points—below our estimates

The operating profit margin (OPM) reduced by 60 basis points yoy in the quarter to 8.9%. The margins were under pressure mainly due to the increase in the raw material costs due to higher copper and CRGO prices. As a percentage of sales the raw material cost was up to 75.6% in Q2FY2007 compared to 69.5% in Q2FY2006. However the decrease in the employee cost and the other expenses as a percentage of sales by 130 basis points and 420 basis points respectively helped mitigate the OPM contraction. Due to the OPM contraction the operating profit grew at a slower 39.1% to Rs73.6 crore.

Particulars	Q2FY2007	Q2FY2006	Change in basis points
Material cost	75.6	69.5	610.0
Employee cost	5.3	6.6	-130.0
Other cost	10.2	14.4	-420.0
OPM	8.9	9.5	-60.0

Segments analysis—power system division steals the show

During Q2FY2007 the power system division saw a superlative top line growth of 68.7% yoy to Rs449.7 crore. The consumer product and industrial system divisions also reported a growth of 33.3% and 36.8% respectively in the quarter. The profit before interest and tax (PBIT) margin for Q2FY2007 of the power system division declined by 50 basis points to 8.0%. The high-margin segments maintained their margins, with the consumer product division's margins increasing by 10 basis points to 8.2% and the industrial system division's margins increasing by 20 basis points to 13.6%.

Segment results

Particulars	Q2FY2007	Q2FY2006	% yoy chg
Revenues (Rs crore)			
Power systems	449.7	266.6	68.7
Consumer products	225.3	169.0	33.3
Industrial system	226.1	165.2	36.8
PBIT (Rs crore)			
Power systems	36.1	22.8	58.5
Consumer products	18.4	13.8	33.9
Industrial system	30.7	22.1	38.8
PBIT (%)			
Power systems	8.0	8.5	-50 bps
Consumer products	8.2	8.1	10 bps
Industrial system	13.6	13.4	20 bps

Earnings growth at 25.0% in the quarter—in line with our estimates

Crompton Greaves' PAT grew by 25.0% yoy to Rs40.7 crore in Q2FY2007, in line with our estimates. The growth could have been higher but for the income tax, which increased by 155.3% due to the exhaustion of the MAT credit and the provision for deferred tax. Going forward, the tax outgo will be at the full rate due to the exhaustion of the MAT credit and we have factored the same in our estimates.

Pauwels performance—ahead of expectations

Crompton Greaves acquired Pauwels, through its 100% subsidiary, CG International B.V. Netherlands in May 2005. Post-acquisition, Pauwels' performance has improved significantly with the focus of Crompton Greaves on margin improvement and debt reduction through better working capital management. Pauwels' top line grew by 86.4% yoy to Rs520.0 crore. The operating margins were stable compared to the previous quarter though there will be some margin pressure going forward. However, Pauwels had a strong order backlog of 332.3 million euros or Rs1,939 crore (1.2x its FY2006 revenues) at the end of Q2FY2007, lending visibility for FY2007 and FY2008 revenues and earnings growth.

Order book—concerns on the stand-alone order book

The stand-alone order book grew by 0.6% sequentially and by 20.0% yoy to Rs1,800 crore in Q2FY2007. The consolidated order book stood at Rs3,739 crore. The existing orders of Crompton Greaves (stand-alone) are mainly fixed price contracts, due to which the company has not been able to pass on the material price hikes to the customers. The low sequential growth in the order book would mean that a lot of the existing orders are still fixed price ones, leading the company to face continuous margins pressure as witnessed in the last two quarters. This is neutralised to some extent by Pauwels order book which grew by 38.3% yoy and by 18.6% sequentially to Rs1,939 crore.

Revising our FY2007 and FY2008 estimates

Given the robust top line growth, higher raw material costs, the consequent margin contraction and higher provisioning for income tax, we are tweaking our FY2007 and FY2008 estimates. We are revising the top line for FY2007 and FY2008 by 8.8% and 12.6% respectively. Due to the margin pressure and higher tax provisioning the net profit for FY2007 stands revised lower by 10% to Rs240.3 crore. Although with the margins stabilising in FY2008 and the robust top line growth coupled with the strong performance of Pauwels we are revising our earnings estimate upwards by 7.9%.

Ganz acquisition to further accelerate growth

Crompton Greaves has recently acquired two loss-making companies, Ganz Transelektri Villamossagi Zrt (GTV) and Transverticum Kft (collectively referred to as Ganz) for an enterprise value of 35 million euros. Through this acquisition Crompton Greaves acquires the following businesses of Ganz (1) transformers: the higher end range of upto 500MVA/KV; (2) gas insulated switchgear (GIS), which is not with either Pauwels or Crompton Greaves; (3) rotating machines & traction machines, with a range of up to 8MW motors; and (4) the contracting business.

According to the management, a portion of the Pauwels' order book would be shifted to the Ganz manufacturing facilities. This will enable Ganz to contribute 70 million euros in FY2008 to the top line and the management is confident to turn it profitable by then. So far the acquisition process is not complete and hence we have not considered the same in our estimates. On the completion of the acquisition we shall revise our numbers to incorporate the same.

Valuations and view

Historically, Crompton Greaves has traded at a discount to its industry peers due to its limited product range, especially high voltage products. But with the acquisition of Pauwels, the company has successfully plugged the gaps in its product portfolio. Access to a wider product range would differentiate it in the domestic market and enable it to compete effectively with the other MNCs such as ABB, Siemens and Areva. Moreover, the recent acquisition of Ganz, Hungary will help it augment its position.

Although for the coming quarters the company is likely to have an average set of results on a stand-alone basis, we are bullish on the prospects of Pauwels. Besides with the raw material cost stabilising going forward, FY2008 is likely to witness stable margins. This coupled with a robust top line growth makes Crompton Greaves a compelling buy. We maintain a Buy on the stock with a revised price target of Rs258, discounting its FY2008E consolidated earnings by 19x, in line with the large and strong product portfolio of the company.

Earnings table (consolidated)

Particulars	FY2005	FY2006	FY2007E	FY2008E
Net profit (Rs cr)	110.3	227.9	240.3	355.8
Share in issue (cr)	26.2	26.2	26.2	26.2
EPS (Rs)	4.2	8.7	9.2	13.6
% y-o-y growth	*NA*	*106.5*	*5.5*	*48.1*
PER (x)	60.0	29.1	25.8	17.4
Book value (Rs)	14.6	21.9	29.9	42.3
P/BV (x)	17.3	11.5	7.9	5.6
EV/Ebidta (x)	34.6	18.6	14.0	10.1
Dividend yield (%)	0.6	0.6	0.6	0.6
RoCE (%)	NA	32.2	30.3	35.8
RoNW (%)	NA	29.4	24.6	27.4

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

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Associated Cement Companies
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Bank of Baroda
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Bharat Bijlee
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Subros
Sun Pharmaceutical Industries
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UltraTech Cement
Union Bank of India
Universal Cables
Wockhardt

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Esab India
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WS Industries India

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