investor's eye

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Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Bharat Bijlee	29-Nov-04	192	**1,478**	1,730
BEL	25-Sep-06	1,108	**1,307**	1,525
Ceat	28-Nov-06	122	**158**	190
F-M Goetze	18-Jan-07	385	**395**	559
Lupin	06-Jan-06	403	**590**	670

ICICI Bank

Apple Green

Stock Update

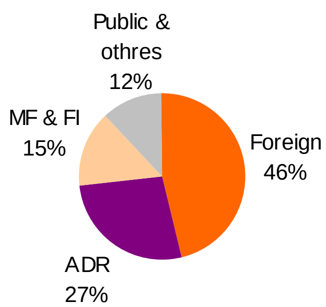
Price target revised to Rs1,240

Buy; CMP: Rs977

Company details

Price target:	Rs1,240
Market cap:	Rs86,953 cr
52 week high/low:	Rs999/444
NSE volume: (No of shares)	12.6 lakh
BSE code:	532174
NSE code:	ICICIBANK
Sharekhan code:	ICICIBANK
Free float: (No of shares)	65.2 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	13.5	33.1	111.0	76.0
Relative to Sensex	7.0	19.3	48.3	15.7

Result highlights

- ICICI Bank's Q3FY2007 net profit at Rs910 crore was much above our and market expectations. The net profit saw a growth of 42.2% year on year (yoy) against our expectation of a 26.1% year-on-year (y-o-y) growth. The robust performance was driven mainly by a very high growth in the fee income and the other income compared with our expectations. Despite a rise of 125.6% in the provisions, the profit growth was very strong on the back of a 65.4% growth in the operating profit.
- The net interest income (NII) grew by 31.9% yoy to Rs1,708.8 crore. What's impressive is that in Q3FY2006 the NII included a securitisation income excluding which the y-o-y NII growth stands at 53%.
- The other income grew by 68% yoy to Rs1,980.6 crore, of which the core fee income grew by a strong 52.7% yoy to Rs1,345 crore.
- The operating profit was up by a strong 65.4% on the back of a good NII growth and a sharp rise in the fee income. The operating expenses increased in line with the business growth.
- The provisions increased by 125.6% mainly due to higher provisions for the non-performing assets (NPAs). The asset quality deteriorated as non-collateralised retail loan products like credit cards reported defaults. The gross non-performing asset (GNPA) increased by Rs650 crore on a sequential basis and the net non-performing asset (NNPA) also increased in absolute and percentage terms.
- The capital adequacy ratio (CAR) stood at 13.4%, with the Tier-I CAR at 8.63%. Incorporating the Basel II guidelines the Tier-I CAR would be 9.5% and we feel the bank can maintain its current growth rates without any dilution in the medium term.

Result table Rs (cr)

Particulars	Q3FY07	Q3FY06	% yoy chg	% qoq chg	9MFY07	9MFY06	% yoy chg
Net interest income	1708.8	1295.6	31.9	8.4	4,761.1	3,334.6	43
Other income	1,980.6	1179.2	68.0	26.1	4,828.3	3,381.2	43
Treasury income	*310.0*	*134.0*	*131.3*	*8.4*	*684.0*	*557.0*	*23*
Fee	*1,345.0*	*881.0*	*52.7*	*18.2*	*3,468.0*	*2,242.5*	*55*
Net income	3,689.4	2345.9	57.3	17.2	9,589.4	6,715.8	43
Operating expenses	1,713.3	1151.4	48.8	11.6	4,770.0	3,506.5	36
Operating profit	1,976.1	1194.5	65.4	22.6	4,819.4	3,209.3	50
Core operating profit (excluding treasury)	1,666.1	1,060.5	57.1	25.7	4,135.4	2,652.3	56
Provisions & contingencies	891.0	395.0	125.6	25.6	2,083.1	996.7	109
PBT	1,085.1	799.5	35.7	20.2	2,736.3	2,212.7	24
Provision for taxes	175.1	159.3	9.9	18.7	451.2	462.5	-2
Current tax	365.6	103.0	255.0	103.2	712.6	451.4	58
Deferred tax	-190.5	56.4	-	-	(261.4)	11.1	-
Net profit	910.0	640.2	42.2	20.5	2,285.1	1,750.2	31

- We have revised our FY2007 and FY2008 estimates based on the bank's improved performance on the non-interest income front. We have also factored in the higher provisions that may be made in future in view of the signs of deterioration in the retail loan book. We have revised the FY2007 and FY2008 profit after tax (PAT) estimates by 2.9% and 2.4% to Rs3,375.7 crore and Rs4,041.9 crore respectively. We have also introduced our FY2009 numbers as we believe that slowly the market would start factoring in the FY2009 financials.
- At the current market price of Rs977, the stock is quoting at 17.5x its FY2009E earnings per share (EPS), 7.2x its pre-provisioning profits (PPP) and 2.8x book value (BV). The valuation looks attractive if one considers the value of the bank's subsidiaries which works out to Rs400 per share of the bank. We maintain our Buy recommendation on the stock with a one year price target of Rs1,240.

NII grows by 31.9% yoy

ICICI Bank's NII grew by 31.9% yoy to Rs1,708.8 crore in Q3FY2007. What's impressive is that in Q3FY2006 the NII included a securitisation income excluding which the y-o-y NII growth stands at 53%. The strong growth in the NII adjusted for securitisation came on the back of a 40.3% y-o-y growth in the interest earning assets and a marginal improvement in the net interest margin (NIM) on y-o-y and sequential basis. The asset growth seems to have been more skewed towards the end of the quarter.

Yield analysis (%)

Particulars	Q3FY07	Q3FY06	Q2FY07
Yield on funds	9.2	8.2	9.1
Cost of funds	6.6	5.7	6.6
NIM	2.6	2.5	2.5

Source: Company

Growth in advances remains robust

The strong growth in the advances was achieved on the back of a robust growth in the retail advances book, which grew by 50.2% yoy and contributed 68% of the total advances. The 50% y-o-y growth in the retail advances was evenly spread across categories. The auto loan segment looks to have come down steeply as a proportion of the total retail loans yoy, as the bank had sold out Rs6,000 crore of assets during the quarter. The 73% y-o-y growth in the loan portfolio of the international branches from Rs12,068 crore to Rs20,829 crore in Q3FY2006 has also contributed to the growth in the advances, as the bank has successfully leveraged its Indian corporate client base.

Retail loans (Rs crore)

Retail loans	Amount (Rs crore)	Dec06 (%)	Dec05 (%)	Sep 06 (%)
Two-wheelers	2,700.0	2.3	2.5	1.5
Cars	19,700.0	16.7	23.6	17.6
CV	14,000.0	11.9	11.6	11.6
Personal loans	10,800.0	9.2	5.1	8.5
Credit cards	4,600.0	3.9	3.6	3.7
Mortgages	59,700.0	50.6	50.6	50.6
Others	6,414.0	5.4	3.1	6.4
Total	117,914.0	100	100	100.0

Focus on SMEs and opportunities to tap global Indian corporates

The bank is focusing on non-fund-based products and services, as well as capitalising on the opportunities presented by the domestic and international expansion of the Indian companies. Its rural portfolio grew by about 43% on a y-o-y basis. The bank is also extending its reach in the small and medium enterprises (SME) segment. The same should help in improving the fee income and NIM going forward.

Deposit growth remains robust

ICICI Bank's deposits grew by 47.1% yoy to Rs196,893 crore while its savings deposits grew by 52.4% to Rs28,878 crore. The proportion of the current and savings accounts (CASA) deposits in the total deposits has gone up to 23.9% from 22.2% in Q2FY2007. The bank has opened 35 new branches during the quarter; going forward the CASA ratio is expected to improve with the addition of more new branches.

Fee income grows by a strong 52.7% yoy

The core fee income grew by 52.7%. From the current quarter ICICI Bank has started reporting the fee income earned on the derivatives and foreign exchange products under the "Fee income" head unlike in the earlier quarters when the same was reported under "Treasury". Adjusting for the same the growth rate remains at 50% yoy. A strong 50% y-o-y growth in the retail advances coupled with a 30% y-o-y increase in the remittances business resulted in a robust growth in the fee income.

Operating profit grows by a strong 65.4% yoy

ICICI Bank's operating profit was up 65.4% on the back of a good growth in the NII and fee income with operating expenses remaining on expected lines. The core operating profit excluding the trading gains grew by 57.1% yoy and 25.7% quarter on quarter (qoq).

Core operating profit

Particulars	Q3FY07	Q3FY06	% yoy chg	% qoq chg	9MFY07	9MFY06	% yoy chg
Operating profit before prov. & cont.	1,976.1	1,194.5	65.4	22.6	4,819.4	3,209.3	50
Core operating profit	1,666.1	1,060.5	57.1	25.7	4,251.4	2,750.3	55
Core operating profit excluding securitisation	1,708.8	1,114.2	53.4	28.9	4,251.4	2,148.2	98

Note: Before the new norms became effective from Q1FY2007, the income on securitised assets was booked under the NII at once. However, with the change in the norms any income on securitised assets can be accounted over the life of the asset, thus making the whole securitisation process less attractive to banks.

Provisioning up 125.6% on higher NPA provisioning

The provisions grew by 125.6% for Q3FY2007 to Rs891 crore from Rs395 crore in Q3FY2006. The provisioning was higher mainly on account of higher NPA provisions, which increased to Rs523 crore. During the quarter some frauds were detected on the advances granted against warehouse receipts for which the bank has provided Rs85 crore on its own estimates rather than on the figures reported in the press.

NPAs continue to be on the rise

ICICI Bank's GNPAs have gone up by 17.6% qoq, which is much higher than the 11.2% sequential growth seen in its advances. Despite the higher NPA provisions, the NNPAs have risen by 20.2% qoq. The NNPAs, as a percentage of its net customer assets, has increased by 20 basis points on a y-o-y basis and by ten basis points on a sequential basis to 1%.

Non-collateralised retail GNPAs show signs of deterioration

The sequential increase of Rs650 crore in the GNPAs comprises primarily retail GNPAs of Rs420 crore (ie 65%), rural portfolio Rs150 crore and corporate portfolio of Rs80 crore. The non-collateralised retail loan products like credit cards and personal loans have seen some defaults. The lending rates on the non-collateralised loan products are normally very high, hence some defaults are expected. However, going forward we need to keep a watch on the retail NPAs. The incremental retail GNPAs stood at 1.1% of the incremental retail advances and 5% of the incremental personal loan and credit card advances.

Adjusted profit growth would be lower than reported

However, adjusted for the one-times included in Q3FY2006, the profit growth was lower at 27%.

- During Q3FY2006, the change in the accounting policy had resulted in an income of Rs67 crore (Rs50 crore adjusted for tax).
- During the quarter (Q3FY2006) the Reserve Bank of India changed the standard assets provisioning on some of the loans and advances from 0.25% to 0.40% of the standard assets. This necessitated an extra provisioning of Rs169 crore, which was written off against the floating provision account. This had a negative impact of Rs29.8 crore at the PAT level.
- During the quarter ICICI Bank sold some bad assets to Standard Chartered Bank (SCB) for Rs258 crore. This resulted in a loss of Rs50 crore.

	Q3FY07	Q3FY06	% yoy chg
Reported net profit	910	640.2	42.2
Add: Loss on sale of assets to SCB	-	50.0	-
Add: Excess provision on account of change in RBI policy	-	-29.8	-
Less: Income due to change in accounting policy	-	-50.0	-
Adjusted profit after tax	910	716.3	27.0

Performance of subsidiaries

- ICICI Lombard General Insurance achieved a PAT of Rs16 crore in Q3FY2007 compared with that of Rs10 crore for Q3FY2006.
- The losses for ICICI Prudential Life Insurance were higher at Rs95 crore compared with Rs49 crore in Q3FY2006. However the new business (a key measure for insurance companies in the early stages) achieved a profit of Rs193 crore for Q3FY2007 compared with that of Rs142 crore in Q3FY2006. ICICI Prudential Life Insurance is the market leader among the private life insurance companies in India.
- ICICI Bank UK's unaudited PAT for M9FY2007 stood at approximately Rs128 crore (US$ 28.9 million), translating into a return on equity of about 20%.

International business expansion

ICICI Bank now has wholly-owned subsidiaries, branches and representative offices in 16 countries, and an offshore banking unit in Mumbai. The total assets of the bank's international banking subsidiaries increased to about Rs24,450 crore (US$5.5 billion) on December 31, 2006 from about Rs8,600 crore (US$1.9 billion) on December 31, 2005. During the quarter, the bank opened representative offices in Thailand and Malaysia. We feel the expanding international portfolio of ICICI Bank would help it sustain a high level of fee income growth and also help it bridge the valuation gap compared with its peer HDFC Bank.

Valuation and view

We believe the market would slowly start discounting the FY2009 numbers and expect ICICI Bank's earnings to grow at compounded annual growth rate of 25% over FY2006-09E on the back of a strong growth in the loan book, stable to improving NIMs and a strong rise in the fee income led by the retail and international businesses. However, the spike in the NPA levels (both gross and net) and provisioning requirement would require a close watch. We have valued the core banking business of the bank at 2.4X FY2009 BV and another Rs400 per share for the value of its subsdidiaries and other investment. At the current market price of Rs977, the stock is quoting at 17.5x its FY2009E earnings per share (EPS), 7.2x its pre-provisioning profits (PPP) and 2.8x book value (BV). The valuations look attractive if one considers the value of the bank's subsidiaries, which works out to almost Rs400 per share of the bank. We maintain our Buy recommendation on the stock with a 12-month price target of Rs1,240.

Earnings table

Particulars	FY05	FY06	FY07E	FY08E	FY09E
Net profit (Rs cr)	2005.2	2540.1	3375.7	4041.9	4958.0
Shares in issue (cr)	73.7	89.0	89.0	89.0	89.0
EPS (Rs)	27.2	28.5	37.9	45.4	55.7
% y-o-y change	*2.5*	*4.9*	*32.9*	*19.7*	*22.7*
PE (x)	35.9	34.2	25.8	21.5	17.5
P/PPP (x)	24.4	18.5	12.4	9.5	7.2
Book value	170.3	249.6	276.7	310.2	351.9
P/BV (x)	5.7	3.9	3.5	3.1	2.8
Adj book value	149.9	237.7	255.2	279.2	306.1
P/ABV (x)	6.5	4.1	3.8	3.5	3.2
RONW (%)	18.1	13.6	14.4	15.5	16.8

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

Maruti Udyog

Apple Green

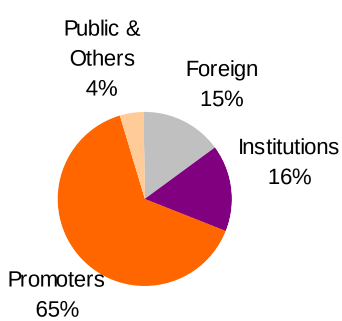
Stock Update

Loss of new plant impacts reported profits

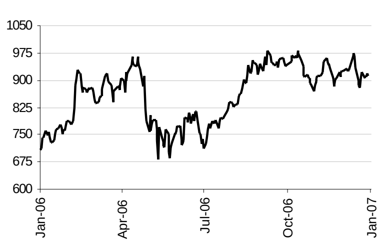
Buy; CMP: Rs939

Company details	
Price target:	Rs1,050
Market cap:	Rs27,129 cr
52 week high/low:	Rs991/649
NSE volume: (No of shares)	8.2 lakh
BSE code:	532500
NSE code:	MARUTI
Sharekhan code:	MARUTIUD
Free float: (No of shares)	10.3 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	0.2	-3.4	26.5	38.6
Relative to Sensex	-5.6	-13.4	-11.1	-9.0

Result highlights

- The Q3FY2007 results of Maruti Udyog Ltd (MUL) are in line with our expectations.
- The company's net sales for the quarter grew by 18.5% to Rs3,679.5 crore from Rs3,112.0 crore in Q3FY2006. The growth was led by a volume growth of 18.7% during the quarter and was in line with our expectations.
- The expenditure for the quarter was higher due to higher employee costs, an increase in royalty and a loss with respect to Maruti Suzuki Automobiles India Ltd (MSAIL). Considering all these the operating profit margin (OPM) declined by 52 basis points to 14.36%. The margins were affected due to higher royalty expenses. Consequently, the operating profit grew by 14% to Rs528.48 crore.
- The interest and depreciation costs for the quarter were higher due to the commencement of the Manesar plant. The adjusted net profit grew by 14% to Rs384.81 crore. The reported profit after tax (PAT) rose by 12% to Rs376.4 crore.
- MUL is expected launch the diesel *Swift* in January 2007. This is expected to be a big boost for MUL as it would be its first serious attempt to cater to the fast-growing diesel segment. The diesel segment constitutes about 25% of the total car market in India.
- We maintain our positive outlook on MUL, considering its leadership position in the Indian car market, planned product launches including the foray into the diesel segment and a strong outsourcing potential. Despite its rising raw material cost, MUL has been able to maintain its margins at commendable levels due to increasing efficiencies and a better product mix.
- At the current market price of Rs939, the stock quotes at 14.4x its FY2008E earnings and 9.9x its enterprise value (EV)/earnings before interest, depreciation, tax and amortisation (EBIDTA). We maintain our Buy recommendation on the stock with a price target of Rs1,050.

Result table Rs (cr)

Particulars	Q3FY07	Q3FY06	% yoy	9MFY07	9MFY06	% yoy
Net sales/ Total income	**3679.5**	**3112.0**	**18.2**	**10224.1**	**8777.4**	**16.5**
Total expenditure	3151.0	2648.8	19.0	8763.4	7639.6	14.7
Operating profits	**528.5**	**463.2**	**14.1**	**1460.7**	**1137.8**	**28.4**
Other income	115.5	106.6	8.3	348.9	312.3	11.7
EBIDTA	644.0	569.8	13.0	1809.6	1450.1	24.8
Interest	15.7	1.7	809.8	22.1	17.0	30.0
PBDT	628.3	568.1	10.6	1787.5	1433.1	24.7
Depreciation	75.9	68.1	11.5	199.5	212.9	-6.3
PBT	552.4	500.1	10.5	1588.0	1220.3	30.1
Tax	167.6	163.7	2.4	497.8	396.4	25.6
Adj profit after tax	**384.8**	**336.4**	**14.4**	**1090.2**	**823.9**	**32.3**
Extraordinary items	-8.4	0.0		23.2	1.6	
Reported PAT	**376.4**	**336.4**	**11.9**	**1113.4**	**825.5**	**34.9**
EPS	13.0	11.6		38.5	28.7	
OPM (%)	14.36	14.88		14.35	13.01	

Strong volume growth fuels the top line growth

MUL reported a growth of 18% in its net sales to Rs3,664.2 crore for the third quarter of FY2007. The growth was led by a volume growth of 18.7% during the quarter. The income from services grew by 55% to Rs15.28 crore during the same period.

The volumes in the A2 segment, which comprises *Alto*, *Zen*, *Wagon R* and *Swift*, marked a growth of 30.2% in the quarter. The growth was led by the strong performance of the *Wagon R Duo*, which was launched towards the end of the last quarter. The sales of *Omni* and *Versa* were also good in Q3, witnessing a growth of 31.7% year on year (yoy). The sales of *Baleno* and *Esteem*, on the other hand, declined by 13.1%. The exports grew by 15.1% yoy to 9,073 units.

With the launch of *Zen Estilo* in December and the expected launch of the diesel *Swift* in the current month, we expect the company to sustain its growth rate in the A2 segment going forward.

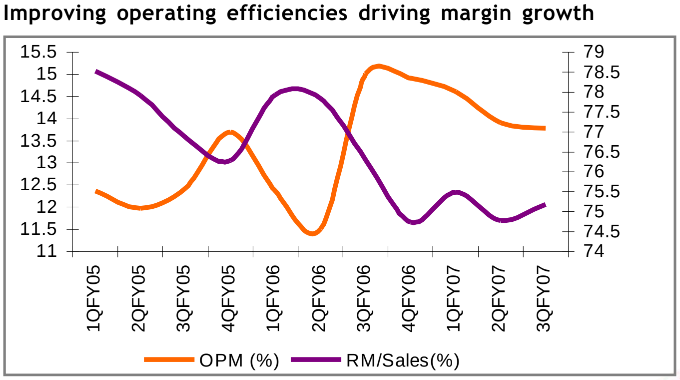
Sales performance

Volumes	Q3FY07	Q3FY06	% change
M-800	19,683	23,736	-17.1
Omni, Versa	21,426	16,264	31.7
Alto, Zen, Wagon-R, Swift	114,461	87,917	30.2
Baleno, Esteem	6,910	7,954	-13.1
Total passenger cars	162,480	135,871	19.6
MUV	628	1,256	-50.0
Domestic	**163,108**	**137,127**	**18.9**
Export	9,073	7,886	15.1
Total sales	**172,181**	**145,013**	**18.7**

OPM maintained; interest and depreciation costs rise due to higher capex

The OPM of the company declined by only 50 basis points to 14.4% during the quarter after adjusting the Rs33 crore loss made by its subsidiary MSAIL for the current quarter. The loss for the nine-month period April 2006-December 2006 stood at Rs54 crore. The dip in the OPM was caused by higher employee costs due to the commissioning of the new plant at Manesar, and higher other expenditures. The royalty paid to Suzuki Motors increased by about 25-30% due to the launch of newer models like *Wagon R Duo* and *Zen Estilo*. The operating profit for the quarter rose by 14% to Rs528.48 crore.

Improving operating efficiencies driving margin growth



The other income for the quarter stood at Rs115.5 crore. Both the interest and depreciation costs increased due to the commencement of operations at the Manesar plant. Consequently, the reported net profit for the quarter grew by 11% to Rs376.4 crore.

Capex

MUL's capital expenditure (capex) for the next two to three years stands at Rs9,000 crore. Out of this Rs4,000 crore would be spent on the Gurgaon plant to introduce, expand and automate new models and develop new engines. The remaining capex would be utilised to set up a new four-wheeler manufacturing facility at Manesar, Haryana for Nissan. The new four-wheeler manufacturing plant will have an overall capacity of 300,000 units. MUL will manufacture 100,000 units of *Swift* in the plant. It also plans to produce 200,000 units of a new small car that it would launch by the end of 2008. The company will export 100,000 units of the new model per year to Europe and sell another 50,000 units in the domestic market. Another 50,000 units will be supplied to Nissan for exports. MUL plans to launch a new small car by 2008-09, targeting both domestic and export markets. Code-named A Under (A-), the car is expected to be priced at around Rs4 lakh with an engine capacity of 1,000-1,200cc.

Diesel *Swift* expected to be launched this month

MUL is expected to enter the diesel segment by launching the diesel version of *Swift* in January 2007. The diesel *Swift* is expected to be a big boost for the company as it would be MUL's first serious attempt to cater to the fast-growing diesel segment. The diesel segment constitutes about 25% of the total car market in India. The new car would use the Fiat's 1.3-litre diesel engine and is expected to be launched in two variants: -Ldi and Vdi. The new model is expected to be priced aggressively.

Valuation and view

We maintain our positive outlook on MUL, considering its leadership position in the Indian car market, planned product launches including the foray into the diesel segment and a strong outsourcing potential. Despite its rising raw material cost, MUL has been able to maintain its margins at commendable levels, thanks to increasing efficiencies and a better product mix. At the current market price of Rs939, the stock is quoting at 9.9x its FY2008E earnings. We maintain our Buy recommendation on the stock with a price target of Rs1,050.

Earnings table (Rs crore)

Particulars	FY04	FY05	FY06	FY07E	FY08E
Net sales	9,109.0	10,962.4	12,052.2	14,368.9	18,001.3
Net profit	538.4	762.7	1,189.2	1,514.4	1,884.4
% y-o-y chg	*238.5*	*41.7*	*55.9*	*27.3*	*24.4*
EPS (Rs)	18.6	26.4	41.1	52.4	65.2
PER (x)	50.4	35.6	22.8	17.9	14.4
EV/EBIDTA (x)	24.5	18.4	15.4	11.4	9.9
RoNW (%)	19.3	20.4	24.7	21.0	19.5
RoCE (%)	15.5	27.0	34.5	34.6	31.5

Orchid Chemicals & Pharmaceuticals

Emerging Star

Stock Update

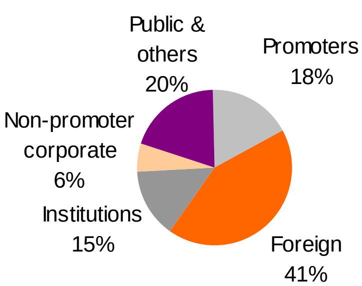
Strong growth potential despite poor performance

Buy; CMP: Rs217

Company details

Price target:	Rs390
Market cap:	Rs1,428 cr
52 week high/low:	Rs400/142
NSE volume: (No of shares)	10.8 lakh
BSE code:	524372
NSE code:	ORCHIDCHEM
Sharekhan code:	ORCHID
Free float: (No of shares)	5.4 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	7.9	0.4	22.3	-18.0
Relative to Sensex	1.7	-10.1	-14.6	-46.1

Result highlights

- The net sales of Orchid Chemicals & Pharmaceuticals (Orchid) rose by 0.5% year on year (yoy) to Rs238.7 crore in the third quarter of FY007. The sales growth was slightly below our expectations, partly due to an absence of any significant new product launches in the USA and partly due to the high base of Q3FY2006.
- The company maintained its performance in its major market, the USA. Its key products—Ceftriaoxne and Cefproxil—continued to maintain a healthy market share in excess of 20-25%.
- The company's operating profit margin (OPM) expanded by 350 basis points to 32.6% as against our expectation of 31.5%. The improvement in the margin was primarily on account of a 27% drop in the raw material cost, as the company continued to derive an increasing proportion of its revenues from the sale of formulations in the high-margin regulated markets. Formulations constituted roughly 45% of its sales, almost 90% of which came from the USA.
- Consequently, the operating profit grew by 12.4% to Rs77.8 crore in the quarter.
- Despite a substantial improvement in the margins, the high interest cost (up by 19.4% yoy) and the higher tax provisioning as compared to Q3FY2006 dragged down the net profit, which declined by 2.2% to Rs28.3 crore in the quarter. The profit growth was in line with our estimate.
- Orchid has just received approval from the UK MHRA for its betalactum API facility at Aurangabad. This development indicates that Orchid is on track to make its big entry into Europe in FY2008, which will add to its growth from FY2008 onwards.
- At the current market price of Rs217, the stock is quoting at 8.5x our estimated FY2008 earnings. The valuation is very attractive given the strong growth potential for FY2008 and FY2009 in view of some forthcoming big launches in the USA and a big entry into Europe. Hence, we maintain our Buy call on the company with a price target of Rs390.

Result table Rs (cr)

Particulars	Q3FY07	Q3FY06	% yoy	9MFY07	9MFY06	% yoy
Net sales	238.7	237.6	0.5	686.2	647.2	6.0
Expenditure	160.9	168.3	-4.4	472.5	458.7	3.0
Operating profit	77.8	69.3	12.4	213.7	188.4	13.4
Other income	0.3	0.5	-47.2	1.3	2.0	-38.2
EBIDTA	78.1	69.8	12.0	214.9	190.5	12.8
Interest	26.4	22.1	19.4	74.1	67.0	10.6
Depreciation	20.4	18.7	9.3	59.8	56.9	5.1
PBT	31.3	29.0	8.0	81.1	66.6	21.7
Taxes	3.0	0.0	-29700.0	8.7	3.1	181.0
PAT (before extraordinary)	28.3	29.0	-2.2	72.4	63.5	13.9
Extraordinary items	0.0	0.0	-	0.0	0.0	-
Net profit	28.3	29.0	-2.2	72.4	63.5	13.9
EPS (Rs)	4.3	4.7	-8.6	11.0	10.3	6.4
OPM (%)	77.8	69.3		213.7	188.4	
EBITBA margin (%)	32.7	29.4		31.3	29.4	
Net profit margin (%)	11.9	12.2		10.5	9.8	

Orchid reported a 0.5% increase yoy in its net sales to Rs238.7 crore in Q3FY2007. The sales growth was slightly below our expectations; it was low due to the high base of Q3FY2006. The company's OPM improved by 350 basis points to 32.6% in the quarter, driven by a sharp decline of 27% in its raw material cost. The OPM reported by the company was ahead of our estimates. Consequently, Orchid's operating profit rose by 12.4% to Rs77.8 crore in Q3FY2007. Despite a substantial jump in the margins, the net profit declined by 2.2% to Rs28.3 crore in the quarter, owing to the higher interest expense and tax provisioning.

On a consolidated basis, Orchid's revenues declined by 3% yoy and by 4.5% sequentially to Rs248.5 crore in Q3FY2007. The company's OPM expanded by 340 basis points to 30.2% in the quarter, causing the operating profit to rise by 9.4% to Rs75.1 crore. Once again, higher depreciation and interest costs, along with a higher tax outgo in the quarter, dragged down the net profit, which declined by 10.6% yoy to Rs24.7 crore. The consolidated profits were lower than the stand-alone profits on account of a Rs4-5 crore write-off of the costs associated with Bexel Pharmaceuticals.

US business maintains momentum despite no new launches

Orchid's sales grew by a mere 0.5% yoy to Rs238.7 crore during the quarter. The sales remained more or less flat partly due to the absence of any significant new launches in the US market during the quarter and also due to the high base of Q3FY2006. The sales in Q3FY2006 were relatively high due to the launch of Ceftriaxone in July 2005. The only product which was launched in October 2006 was Cefadroxil, which is a very small product having a total market size of only $30 million. However, Orchid's key products—Ceftriaxone and Cefprozil, launched in FY2006—have maintained their sales momentum and retained their respective market shares of over 20% each in the US market, which is encouraging given the tough competitive scenario in the US generic market. Further, Orchid continues to maintain its high margin and 85% market share for Cefazolin vials in the USA.

However, going forward, Orchid plans to have at least one new launch per quarter, which will contribute to its top line growth. The company has in its pipeline two more products slated for launch in Q4FY2007, Cefuroxime axetil and Cephalexin suspension. Even though these products are once again relatively small in size, they will add to Orchid's performance in the next quarter. On the positive side, Orchid's revenues are likely to get a big boost in FY2008, with at least two major new products—Tazobactum + Piperacillin (market size of $480 million) and Cefdinir (market size of over $600 million)—slated for launch.

Margins expand by 350 basis points—a positive surprise

Orchid's OPM improved by 350 basis points to 32.6% in the quarter, the highest margin ever recorded by the company. The improvement in the margin was driven by a 27% decline in the company's material cost. The material cost, which constituted 39.1% of sales in Q3FY2006, formed only 28.4% of sales in Q4FY2007. The sharp drop in the material cost was on account of an improved product and geographical mix, as the company continued to derive an increasing share of its revenues from the high-margin formulation exports to the regulated markets. However, the steep drop in the raw material cost was largely offset by a 28.5% rise in the company's other expenditure. The other expenses were higher on account of an increase in the expenses incurred on regulatory filings. With acceleration in the pace of filings made for the regulated markets, Orchid has substantially increased its expenditure on the same. The resultant improvement in the margin has caused the company's operating profit to grow by 12.4% to Rs77.8 crore in Q3FY2007.

Cost analysis Rs crore

Particulars	Q3FY2007	Q3FY2006	% change
Adjusted material cost	67.8	92.9	-27.0
% of sales	*28.4*	*39.1*	
Staff cost	19.2	18.0	7.1
% of sales	*8.1*	*7.6*	
Other expenditure	73.8	57.4	28.5
% of sales	*30.9*	*24.2*	

Interest cost continues to rise

Orchid's interest expense has jumped by 19.4% yoy and 3.3% qoq to Rs26.4 crore during the quarter. The increase in the interest cost is partly due to a general hardening of the interest rates and partly due to a further Rs100 crore increase in the company's debt level. Orchid's balance sheet is highly leveraged with over Rs1,200 crore of debt as on December 2006. Even though the operating performance of the company remains strong, the highly leveraged capital structure of the company remains a cause for concern.

The management intends to repay its high level of debt by issuing fresh equity. Orchid already has in place an enabling board resolution to raise $200 million through a foreign currency convertible bond issue or a global depository receipt issue. The company will raise the money at an appropriate time when the market price of the stock rises beyond the Rs350 level.

Higher interest cost and increased tax incidence drag down profits

Despite the strong margin expansion, Orchid's net profit declined by 2.2% yoy to Rs28.3 crore in Q3FY2007. The profitability was affected due to the rising interest cost and a substantially higher tax provisioning in Q3FY2007 as compared with that in Q3FY2006. The tax provisioning in Q3FY2006 was unusually low on account of a high deferred tax write-back during that period. The earnings for the quarter stood at Rs4.3 per share.

Accelerated pace of regulatory filings continues

Orchid has maintained its pace of regulatory filings in Q3FY2007. During the quarter, the company has filed four drug master files (DMFs) and two abbreviated new drug applications (ANDAs), taking the cumulative count to 39 DMFs and 34 ANDAs till date in the USA. Of the DMFs filed, 24 pertain to the Cephalosporin product range, 13 to the non-Penicillin, non-Cephalosporin (NPNC) range and two to the Penicillin product space. Similarly among the ANDAs filed till date, 25 are in the Cephalosporin segment, seven in the NPNC space and two in the Penicillin product segment. As of date, Orchid has received approvals from the US Food and Drug Administration for 18 ANDAs. Orchid has also been progressing fast in its regulatory filings for the European market. The company has filed two additional marketing authorisation applications (MAAs) during the quarter, taking the cumulative count to ten MAAs till date.

Even though the company's increased focus on regulatory filings has led to an increase in its expenses, we believe that Orchid is laying down the foundations for its future growth. With this pace of filings, the company is expected to have a cumulative filing count of 71 ANDAs in the USA and an equal number in Europe by FY2008. This robust product pipeline will result in an accelerated pace of new launches and lead to stronger growth.

UK MHRA approval for Betalactum API facility received

Orchid's plan to enter the Euopean market in FY2008 seems to be on track. The company's betalactam API facility located in Aurangabad has been approved by the UK regulator, Medicines and Healthcare products Regulatory Agency (MHRA). The MHRA approval is an important step in the overall regulatory road map for and marketing of Orchid's key betalactam product, Piperacillin - Tazobactam in the lucrative European markets, the API for which will be manufactured at this facility. The betalactum formulation facility located at Irungattukottai near Chennai, in which the Tazo-Pip formulation will be manufactured is currently undergoing inspection. We expect an announcement of approval soon. Once this approval comes through, Orchid will be all set to make its big foray into the European market. We view this as a positive development in the growth plans of the company.

Valuation & view

Even though Orchid's Q3FY2007 performance appears poor, we remain confident on the company's future growth potential. Orchid has been investing steadily in building its product pipeline to expand its presence in the regulated markets of the USA and Europe. Going forward, especially from FY2008 onwards, we believe the company will grow by leaps and bounds, with its big launches in the USA and entry into Europe. The approval from the UK MHRA for the betalactum API facility at Aurangabad is indicative of the fact that Orchid seems to be on track with its planned launches in the European market. Given, Orchid's robust margins, we believe that the higher sales growth would lead to a greater growth in profits.

Even though the stock has underperformed in recent times, we believe that the worst is over for the company. At the current market price of Rs217, Orchid is trading at 8.5x its estimated FY2008 earnings. These valuations seem very attractive, given Orchid's strong growth plans in FY2008. Hence, we maintain our positive outlook on the company, with a price target of Rs390.

Earnings table

Particulars	FY04	FY05	FY06	FY07E	FY08E
Net sales (Rs cr)	680.8	638.4	821.5	907.4	1181.1
PAT (Rs cr)	31.0	31.0	82.9	92.3	177.2
Shares in issue (cr)	3.2	3.4	6.5	6.9	6.9
EPS (Rs)	9.6	9.1	12.8	13.3	25.5
PER (x)	22.6	23.9	16.9	16.3	8.5
cash EPS (Rs)	27.1	27.2	25.7	26.8	40.6
cash PER (x)	8.0	8.0	8.5	8.1	5.2
EV	1441.4	1707.0	2419.2	2427.5	2296.3
EV/Ebidta (x)	9.5	10.4	9.5	8.3	5.8
Book value	129.3	138.1	121.5	140.2	162.8
P/BV (x)	1.7	1.6	1.8	1.5	1.3

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

Nucleus Software Exports

Emerging Star

Stock Update

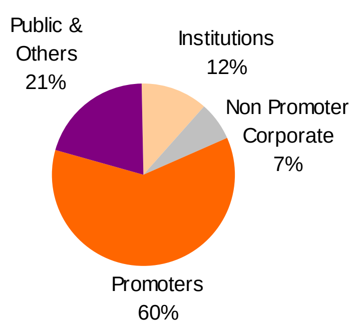
Price target revised to Rs898

Buy; CMP: Rs811

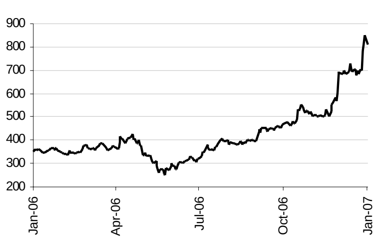
Company details

Price target:	Rs898
Market cap:	Rs1,305 cr
52 week high/low:	Rs871/245
NSE volume: (No of shares)	35,110
BSE code:	531209
NSE code:	NUCLEUS
Sharekhan code:	NUCSEX
Free float: (No of shares)	0.64 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	50.2	86.3	179.7	135.1
Relative to Sensex	41.5	60.9	96.5	54.4

Result highlights

- Nucleus Software Exports has announced lower-than-expected sequential growth in its revenues at 2% quarter on quarter (qoq) and 50.3% year on year (yoy) to Rs56.2 crore (against the expectations of Rs58.6 crore). The product revenues have grown at a robust rate of 12.8% sequential. However the revenues from the project and services business declined 9.3% sequentially and resulted in a lower-than-expected overall growth in the revenues during the third quarter.
- The operating profit margin (OPM) declined by 110 basis points sequentially to 27.9% during the quarter, largely due to the steep increase in the selling, general and administration expenses (SG&A) as a percentage of sales (up from 12.6% of the sales in Q2 to 15.7% in Q3). The huge jump in the SG&A expenses was driven by the additional cost incurred (on travel and other related expenses) in pursuing some of the large deals in the pipeline (including the recently bagged order from ACOM).
- Consequently, the earnings were largely flat at Rs13.9 crore on a sequential basis. However, the earnings grew at a robust rate of 58.1% on an annual basis.
- Notwithstanding the muted performance (sequentially) during the quarter, the company has shown an exponential growth in its order backlog that is likely to boost the overall revenue growth in the coming quarters. The pending order book jumped to Rs335 crore, up from Rs135 crore at the end of the previous quarter. The order backlog includes the multi-million multi-year order from ACOM, a leading consumer finance company in Japan.
- To factor in the impact of the huge fresh order intake, we are revising upwards the revenues and earnings estimates by 7% and 9% respectively, for FY2008. At the current market price the stock trades at 22.8x FY2007 and 16.5x FY2008 earning estimates. We maintain our Buy call on the stock with a one-year revised target price of Rs898 (15x its rolling four-quarter earnings).

Result table Rs (cr)

Particulars	Q3FY07	Q3FY06	Q2FY06	% yoy	% qoq
Net revenue	56.2	37.4	55.1	50.3	2.0
Software development expenditure	31.7	21.9	32.2	44.9	-1.5
Gross profit	24.5	15.5	22.9	57.8	6.9
Selling & marketing expenses	5.5	2.8	4.0	99.1	38.1
General & administration expenses	3.3	2.7	2.9	22.5	12.4
EBIDTA	15.7	10.1	16.0	55.8	-2.0
Other income	1.6	1.4	1.0	17.0	53.0
Depreciation	1.7	0.9	1.7	96.0	2.9
PBT	15.6	10.5	15.4	47.4	1.2
Tax	1.6	1.7	1.5	-6.8	7.0
RPAT	**13.9**	**8.8**	**13.9**	**58.1**	**0.6**
Extraordinary items	0.0	0.0	0.0	-	-
APAT	13.9	8.8	13.9	58.1	0.6
Equity capital	16.1	16.1	16.1		
EPS	8.7	5.5	8.6		
Margins (%)					
GPM	43.6	41.5	41.6		
OPM	27.9	26.9	29.0		
NPM	24.1	22.7	24.7		

Lower services revenues dented the overall growth

The company's overall revenue growth continues to be driven by the product business that grew by 12.8% sequentially to Rs31.8 crore. This is the sixth consecutive quarter of double-digit sequential growth in the product revenues. The performance in the third quarter is all the more commendable since the revenues from the GMAC order were relatively lower due to the transition phase in terms of beginning of the implementation work at a new geography.

On the other hand, the revenues from the relatively low-margin projects and services business has been growing at a rate of 1-8% sequentially in the past five quarters and declined by 9.3% in Q3FY2007. The sequential decline is the result of a conscious decision to exit out of some low-margin software services contracts so that the required manpower is available to execute its pending order book.

Revenue break-up

	Q3FY07	Q3FY06	Q2FY06	% yoy	% qoq
Product	31.8	14.1	28.2	124.8	12.8
Project and services business	24.4	23.3	26.9	5.0	-9.3

Order book bloats up

Notwithstanding the muted sequential growth in Q3, the company has shown an encouraging growth in its pending order book, which has leapfrogged to Rs335 crore, up from Rs135 crore in Q2FY2007. It has signed eight new contracts that include the implementation of 23 modules. Some of the contracts involve the roll-out of its products in multiple geographies (like the order from a European financial company for implementation in 16 countries).

What's more, the company has also announced its largest ever order. It has bagged a multi-year multi-million dollar order from a leading Japanese consumer finance company, ACOM, to implement its FinnOne and PowerCARD products across all the branches. The ACOM order alone is expected to bring in additional revenues of around Rs150 crore (includes just the licence fee and the implementation part of the order) over the next 6-8 quarters. It would start contributing to the top line from the current quarter. Consequently, the overall revenue growth is expected to pick up further in the coming quarters.

Margins likely to look up

The company's decision to exit some of the low-margin software services businesses and the expected ramp-up of the revenues in the high-margin product business (on the back of the huge pending order book) would result in a favourable shift in the revenue mix towards the high-margin product business. This, in turn, is expected to boost the overall profitability over the coming quarters.

Revision of estimates

To factor in the impact of the huge fresh order intake, we are revising upwards the revenues and earnings estimates by 7% and 9% respectively, for FY2008.

Other highlights

The employee base stood at 1,429 people, including the net addition of 32 employees in Q3. The attrition rate continues to be at an uncomfortable level of around 20%.

The company has been able to bring down the receivable days to 61 from 79 days reported in Q2FY2007.

The cash & cash equivalent situation was comfortable at Rs84 crore as on December 31, 2006 (up from Rs62 crore reported in the previous quarter).

The top five clients contributed 63% of the revenues as against 72% in Q2FY2007, largely due to the slow-down in the business from GMAC (in a transition phase).

Valuation

At the current market price the stock trades at 22.8x FY2007 and 16.5x FY2008 earning estimates. We maintain our Buy call on the stock with a one-year revised target price of Rs898 (15x its rolling four-quarter earnings).

Earnings table

Particulars	FY05	FY06	FY07E	FY08E
Net sales (Rs cr)	103.0	148.2	222.4	303.4
Net profit (Rs cr)	20.6	37.0	57.4	79.5
No of shares (crore)	1.6	1.6	1.6	1.6
EPS (Rs)	6.4	23.0	35.5	49.1
% y-o-y change	-	*260.4*	*54.3*	*38.3*
PER (x)	63.4	35.3	22.8	16.5
Price/BV (x)	15.5	11.4	8.0	5.6
EV/EBIDTA(x)	43.3	26.1	17.9	12.5
Dividend yield (%)	0.3	0.4	0.6	0.7
RoCE (%)	30.9	38.0	39.3	38.7
RoNW (%)	24.5	32.3	35.0	34.1

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

India Cements

Ugly Duckling

Stock Update

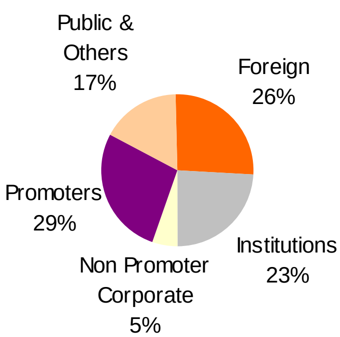
Net profit up 1,000%

Buy; CMP: Rs242

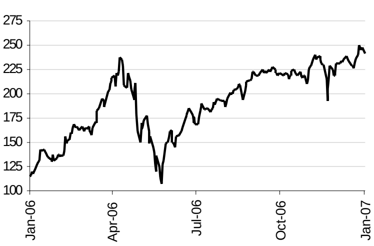
Company details

Price target:	Rs315
Market cap:	Rs5,544 cr
52 week high/low:	Rs254/103
NSE volume: (No of shares)	3.3 lakh
BSE code:	530005
NSE code:	INDIACEM
Sharekhan code:	INDCEM
Free float: (No of shares)	12.7 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	13.0	13.3	45.7	110.5
Relative to Sensex	6.6	1.5	2.4	38.3

Result highlights

- India Cements achieved a net profit of Rs79.77 crore for Q3FY2007, clocking a year-on-year (y-o-y) growth of 1,000% , though it was below our expectations on account of higher-than-expected increase in the costs.
- The top line grew by a robust 36% year on year (yoy) to Rs472 crore on the back of a 4% y-o-y growth in the volumes to 1.75 million metric tonne (MMT) and a 32% growth in the realisations to Rs2,700 per tonne.
- The company's operating expenditure increased by 13% yoy to Rs339 crore on the back of a 20% increase in the raw material costs and an 18% rise in the distribution costs. Sequentially, the freight cost and the power & fuel cost increased by Rs30 per tonne and Rs15 per tonne respectively.
- The company's high leverage to the cement prices resulted in an operating profit growth of 185% yoy to Rs133 crore whereas the operating margin expanded by a mammoth 1,400 basis points to 28%.
- The earnings before interest, tax, depreciation and amortisation (EBITDA) per tonne tripled to Rs761 though it was down 12% quarter on quarter (qoq) on account of lower volumes due to the monsoons in the southern region namely Tamil Nadu and Andhra Pradesh.
- The interest expenditure and the depreciation cost remained flat qoq at Rs34.7 crore and Rs19.82 crore respectively. These factors coupled with a negligible tax provision helped the company's net profit to register a 1,000% year-on-year jump to Rs79.77 crore.

Result table Rs (cr)

Particulars	Q3FY07	Q3FY06	% yoy	Q2FY07	% qoq
Net sales	472.4	346.6	36.3	516.3	-8.5
Total expenditure	339.4	299.9	13.2	343.8	-1.3
Raw material consumed	54.2	45.1	20.2	57.8	-6.2
Stock adjustment	5.9	-4.5		-9.4	-163.1
Total RM	60.1	40.6	48.1	48.4	24.3
Employee expenses	24.2	20.4	18.3	25.3	-4.4
Power, oil & fuel	118.9	114.3	4.0	128.1	-7.2
Selling & administrative expenses	76.9	65.4	17.5	80.3	-4.3
Other expenses	59.4	59.1	0.4	61.7	-3.8
Operating profits	133.0	46.8	184.4	172.5	-22.9
Other income	1.7	10.3	-83.4	0.8	106.0
EBIDTA	134.8	57.1	136.1	173.4	-22.3
Interest	34.7	29.6	17.2	36.4	-4.8
PBDT	100.1	27.5	263.8	19.3	419.7
Depreciation	19.8	19.7	0.7	172.5	-88.5
PBT	80.3	7.8		117.7	-31.8
Tax	0.5	0.6		0.4	25.0
Deferred tax		0		0.0	
Reported profit after tax	79.8	7.2	1004.9	117.3	-32.0
Operating margins(%)	28.2	13.5		33.4	
EBIDTA(%)	28.5	16.5		33.6	
PBDT (%)	21.2	7.9		26.5	
PATM(%)	16.9	2.1		22.7	

- The company's plan to augment its capacity by 2MMT at its existing facilities (namely Sankaridurg and Vishnupuram) is well on schedule. One million tonne of the capacity is expected to come in June 2007 whereas the balance one million will kick in by December 2007.
- We expect the company's volumes to bounce back in the fourth quarter and also expect the prices to firm up further by Rs5-10 per bag.
- At the current price of Rs242, the stock trades at 12.2x its FY2007E and 8.5x its FY2008E earnings. On an enterprise value (EV)/tonne basis, the company is trading at USD115 per tonne, which is a steep discount to its peer Madras Cement, which is trading at USD155 per tonne. We continue to maintain our positive outlook on the company with a price target of Rs315.

Net sales grow by 36% year on year

The company's dispatches for the quarter grew by 4% year on year to 1.75MMT and were down 11% sequentially as the southern region (mainly Tamil Nadu and Andhra Pradesh) witnessed monsoons in the quarter. But despite the heavy rains in this quarter, the realisations grew by 32% yoy and 5% qoq to stand at Rs2,700 per tonne. The cumulative impact of these factors resulted in the top line witnessing a robust 36% y-o-y growth to Rs472.4 crore.

High leverage to prices results in a mammoth 185% y-o-y growth in operating profits

The company's operating expenditure increased by 13% yoy to Rs339 crore on the back of a 20% increase in the raw material costs and an 18% rise in the distribution costs. Sequentially, the freight cost and the power & fuel cost increased by Rs30 per tonne and Rs15 per tonne respectively. But the higher realisation growth led to the operating profits zooming by 185% yoy to Rs133 crore whereas the operating margins expanded by 1,400 basis points to 28%. The high leverage to the cement prices led to its EBITDA per tonne tripling yoy to Rs761 though on a sequential basis the EBITDA per tonne was down 12%.

Net profit balloons by 1,000%

The company's interest cost (which has come down over the last one year on account of the repayment of debt) stood at Rs34.7 crore whereas the depreciation provision remained flat at Rs19.82 crore. The company continued to pay negligible tax at Rs0.5 crore on account of the write-off of the accumulated losses. These factors cumulatively led to the net profit zooming by 1,000% to Rs79.77 crore.

Volumes to bounce back in fourth Quarter

We expect the company's volumes to bounce back in the fourth quarter, which generally witnesses hectic activity in the housing and construction sector as the contractors hurry to complete their projects to book revenues. As a result, we also expect the prices to firm up by Rs5-10 per bag as the demand-supply gap tightens further. Thus we expect the company to maintain its profitability and consequently expect it to achieve our full year FY2007 estimates.

Capex on track

The company's plan to augment its capacity by 2MMT at its existing facilities (namely Sankaridurg and Vishnupuram) is well on schedule. One million tonne of capacity is expected to come in June 2007 whereas the balance one million will kick in by December 2007. The capital expenditure (capex) will be funded by the foreign currency convertible bond (FCCB) issue amount of $75 million raised by the company earlier. Thus going ahead, the fresh volumes will significantly drive the revenues for the company.

Outlook

The company has transformed its balance sheet over the last couple of years through various measures like global depository receipts (GDRs) and warrants and consequently the debt-equity ratio has come down drastically to 1.2:1 as against 6:1 in FY2005. This coupled with the fact that the industry scenario looks buoyant in the southern region in the next one year provides a sanguine outlook for the company. If things pan out in favour of the company, we may be able to witness an additional capacity of 2MMT coming up in Himachal Pradesh (though not in the next two years). At the current price of Rs242, the stock trades at 12.2x its FY2007E and 8.5x its FY2008E earnings. On an EV/tonne basis, the company is trading at USD115 per tonne, which is a steep discount to its peer Madras Cement, which is trading at USD155 per tonne. We continue to maintain our positive outlook on the company with a price target of Rs315.

Earnings table

Particulars	FY04	FY05	FY06	FY07E	FY08E
Net profit (Rs cr)	-95.9	-61.1	35.8	435.4	629.9
% y-o-y growth	-	-	-	*1116.4*	*44.7*
Shares in issue (cr)	13.9	13.9	19.1	22.0	22.0
EPS (Rs)	-6.9	-4.4	1.9	19.8	28.6
PER (x)	-35.0	-54.9	128.9	12.2	8.5
Book value (Rs)	26.0	24.4	45.1	65.2	93.7
P/BV (Rs)	9.3	9.9	5.4	3.7	2.6
EV/EBIDTA (x)	54.9	47.0	24.6	8.5	6.0
RoCE (%)	2.0	3.0	8.0	26.1	32.6
RoNW (%)	-28.6	-19.5	4.3	30.9	30.9

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

Indo Tech Transformers

Ugly Duckling

Stock Update

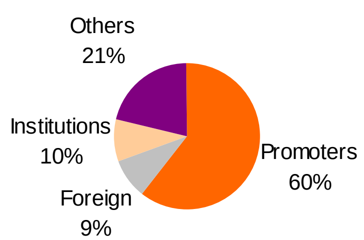
Price target revised to Rs335

Buy; CMP: Rs288

Company details

Price target:	Rs335
Market cap:	Rs306 cr
52 week high/low:	Rs306/118
NSE volume: (No of shares)	1.1 lakh
BSE code:	532717
NSE code:	INDOTECH
Sharekhan code:	INDOTECH
Free float: (No of shares)	0.4 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	8.1	60.0	101.2	-
Relative to Sensex	1.9	43.4	41.4	-

Result highlights

- The Q3FY2007 results of Indo Tech Transformers Ltd (ITTL) are above our expectations.
- The company has reported strong quarterly results. The revenues for the quarter grew by 130% to Rs45.04 crore as against our expectations of Rs40 crore while the net profit grew by 166% to Rs7.3 crore against our expectations of Rs5.3 crore. The volume growth was 89% as the company sold 672 mega Volt Ampere (MVA) during the quarter as against 355MVA in Q3FY2006.
- The above performance was due to the fact that the company executed some high-margin orders during the quarter under review and hence the operating profit for the quarter grew by 153% to Rs11.86 crore. The operating profit margin (OPM) for the quarter improved by 240 basis points to 26.3% as against 23.9% in Q3FY2006. Going forward the company expects to maintain its OPM in the range of 19-20%.
- The interest expense for the quarter stood at Rs0.23 crore while the depreciation cost for the quarter was Rs0.28 crore.
- The order backlog at the end of Q3FY2007 stood at Rs153 crore as against Rs79 crore at the end of the previous quarter, showing a growth of 94%.

ITTL has a 3,450MVA installed transformer manufacturing capacity which it has recently expanded from 2,450MVA. The company is further expanding its capacity from 3,450MVA to 7,450MVA that will be operational by September 2007. The demand for transformers is on the rise, as every 1MW of generation capacity requires 7MVA of transformer capacity and the government's mission of providing power for all by 2012 augurs well for the company. Going forward we expect the company to post strong results because of its capacity expansion and increased order flow.

Result table Rs (cr)

Particulars	Q3FY07	Q3FY06	% yoy	9MFY07	9MFY06	% yoy
Net sales	45.0	19.6	130.3	98.9	61.2	61.7
Total expenditure	33.2	14.9	123.0	76.6	49.2	55.7
Operating profit	11.9	4.7	153.4	22.4	12.1	85.7
Other income	0.7	0.1	527.3	2.5	0.4	517.5
EBIDTA	12.6	4.8	162.0	24.9	12.5	99.6
Interest	0.2	0.0	-	0.2	0.0	-
Depreciation	0.3	0.3	7.7	0.8	0.7	14.9
PBT	12.0	4.5	165.8	23.9	11.8	102.5
Tax	4.8	1.6	205.1	8.8	4.1	114.5
PAT	7.3	2.7	165.7	15.1	7.7	96.1
Extraordinary items	0.0	0.0	-	0.0	0.0	-
Reported PAT	7.3	2.7	165.7	15.1	7.7	96.1
EPS	6.9	2.6	165.7	14.2	7.3	96.1
Margins						
OPM (%)	26.3	23.9		22.6	19.7	
PATM (%)	16.2	14.0		15.3	12.6	

Customer break-up during the quarter

Customer	Q3FY2007	Q3FY006
State electricity boards	85.76%	69.63%
Industrial & EPC customers	14.24%	30.37%

Product break-up during the quarter

Transformer type	Q3FY2007	Q3FY006
Power transformers	83.20%	70.04%
Dist transformers	16.80%	29.96%

Order Book details

Transformer type	Value	%
Distribution transformers	25 crore	16.33%
Power transformers	128 crore	83.66%
Total	153 crore	
Customer type	**Value**	**%**
SEB's	124 crore	81.04%
Industrial	29 crore	18.96%
Total	153 crore	

Revision of estimates

Considering the strong order book position and better-than-expected results, we are upgrading our estimates for the company. Our earnings per share (EPS) estimates for FY2007 & FY2008 now stand at Rs19.4 and Rs25.7, higher by 27.8% and 10.6% respectively.

Particulars	FY2007	FY2008
Earlier	15.2	23.2
Current	19.4	25.7
% change	27.8	10.6

Dry type transformer to be commissioned by February end 2007

ITTL has signed a memorandum of understanding (MOU) with DuPont (USA) for setting up a 100MVA plant capable of manufacturing dry type transformers using Nomex insulating materials, the technology being provided by the MNC. This facility will be set up at the Thirumazhisai complex and will mainly cater to the requirements of industrial and corporate customers. A lot of software technology parks (STP), hotels, hospitals and high-rise buildings are coming in the major cities all over India where there is lack of sufficient space for setting up sub-stations for oil filled transformers. A lot of these projects require dry type transformers that can be placed indoor, as these transformers are environment friendly and are very safe. This plant is expected to start trial production from February 2007 and will start contributing to the revenues from Q1FY2008.

Capex plans

The company is putting up a new power transformer facility at Kancheepuram of 4,000MVA, which will come up by September 2007 at a cost of Rs48.60 crore that will take the total capacity of 3,450MVA to 7,450MVA. This will be funded partly through the money the company raised from the initial public offering (IPO), while the rest will be through internal accruals and debt.

Valuation and view

At the current market price of Rs288, the stock is quoting at 11.2x its FY2008E EPS and 6.5x its FY2008E enterprise value (EV)/earnings before interest, depreciation, tax and amortisation (EBIDTA). We initiated coverage on ITTL in November 2006 with a price target of Rs280 that has been achieved. In view of the better-than-expected results and strong growth prospects ahead we are revising our price target to Rs335 at which it will trade at 13x its FY2008E EPS. Hence we maintain our Buy recommendation on the stock with a revised price target of Rs335.

Earnings table

Particulars	FY04	FY05	FY06	FY07E	FY08E
Net sales (Rs crore)	55.2	67.5	92.7	140.9	219.9
Net profit (Rs crore)	4.1	7.5	11.1	20.6	27.2
Shares in issue (crore)	0.3	0.3	1.1	1.1	1.1
EPS (Rs)	14.4	26.5	10.5	19.4	25.7
% y-o-y change		*84.0*	*(60.6)*	*85.9*	*32.0*
PER (x)	20.0	10.8	27.5	14.8	11.2
Book value (Rs)	58.9	85.1	67.2	83.6	106.3
P/BV (x)	4.9	3.4	4.3	3.4	2.7
EV/EBIDTA (x)		6.2	14.3	8.7	6.5
EV/Sales (x)	1.5	1.1	2.8	2.0	1.3
Dividend yield (%)	0.0	0.0	0.7	1.0	1.0
RoCE (%)	29.2	39.2	23.0	32.3	34.4
RoNW (%)	24.5	36.8	23.3	25.8	27.0

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
- Federal-Mogul Goetze (India)
- 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
- Orient Paper and Industries
- WS Industries India

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