investor's eye

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Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Balaji Tele	9-July-07	231	**250**	303
Crompton	19-Aug-05	88	**273**	280
HDFC Bank	23-Dec-03	358	**1,160**	1355
Ranbaxy	24-Dec-03	533	**377**	558
Maruti	23-Dec-03	360	**847**	921

Ceat

Ugly Duckling

Stock Update

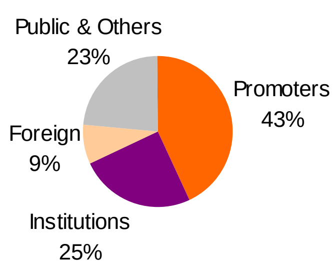
Price target revised to Rs216

Buy; CMP: Rs177

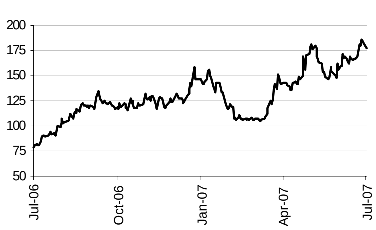
Company details

Price target:	Rs216
Market cap:	Rs812 cr
52 week high/low:	Rs191/75
NSE volume: (No of shares)	3.7 lakh
BSE code:	500878
NSE code:	CEAT
Sharekhan code:	CEAT
Free float: (No of shares)	2.6 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	24.4	30.0	25.6	132.4
Relative to Sensex	17.7	18.1	16.8	61.8

Result highlights

- Ceat's Q1FY2008 results were in line with our expectations. The net sales have risen by 7.8% to Rs536.4 crore, mainly driven by strong realisation growth due to price hikes and product mix changes. In line with the industry slowdown, the original equipment manufacturer (OEM) sales declined by 11% year on year (yoy), but the effect of the same was mitigated because of strong growth in the replacement and the export markets.
- The operating margins expanded 550 basis points to 9.2% during the quarter as a result of lower raw material cost, price hikes, improved product mix and other efficiencies. As a result, the operating profits grew by 166.3% to Rs49.4 crore.
- Adjusting for the impact of tax provisioning on the extraordinary gain, we estimate that the quarterly profits have grown to Rs20.4 crore against Rs0.2 crore same quarter last year. The quarter's results contain extraordinary items relating to refund from excise and income tax and reversal of export benefits granted in earlier years. Profit after tax (PAT) after extraordinary items have grown to Rs30.4 crore.
- Last few quarters have been pretty exciting for Ceat, as it has effected a smart turnaroud during the period and now its margins are comparable with the best in the industry. We expect this strong growth to continue, particularly driven by the replacement and the exports segment. We also expect the company to maintain its margins at these levels going forward. On the basis of strong performances by Ceat, we are raising our earnings estimate for Ceat by 6% to Rs16.9 for FY2008 and are introducing our FY2009 estimates of Rs21.1.

Result table Rs (cr)

Particulars	Q1FY2008	Q1FY2007	% yoy chg
Net sales	**536.4**	**497.7**	**7.8**
Expenditure	487.1	479.1	1.7
RM consumed	357.1	364.0	
Stock adjustment	-13.8	-6.4	
Staff cost	34.4	30.8	
Other expenditure	109.4	90.8	
Operating profit	**49.4**	**18.5**	**166.3**
Other income	3.7	6.4	
EBIDTA	53.1	25.0	112.8
Interest	14.0	16.1	
PBDT	39.1	8.8	
Depreciation	8.0	7.6	
Profit before tax	**31.1**	**1.3**	**2309.3**
Tax	10.6	1.1	
Profit after tax	20.4	0.2	8786.8
Extraordinary items	9.9	0.0	
PAT after extraordinary items	**30.4**	**0.2**	**13104.3**
EPS	3.3	0.1	
OPM (%)	9.2	3.7	
EBIDTA (%)	9.9	5.0	

- The slowdown in the OEM segment is expected to continue for another couple of quarters. To counter the same, the company has already put in place strategies to concentrate more on the exports and the replacement markets.
- The land sale is expected to be finalised by the third quarter of the current fiscal, while the demerger process is expected to be completed by the end of this fiscal.
- At the current market price of Rs177, the stock is trading at 8.4x its FY2009E earnings and at an enterprise value (EV)/earnings before interest depreciation and amortisation (EBIDTA) of 3.9x. We maintain our Buy recommendation on the stock with a revised price target of Rs216.

Realisation growth fuels top line

The net sales of the company for the quarter grew by a 7.8% largely on account of realisation gains, while the growth in tonnage terms remained flat. The realisation growth was on the back of price hikes effected in the last one year and product mix changes.

Sales break-up (Rs crore)

Particualrs	Q1FY08	Q1FY07	% yoy
OE	107	120	-11
Replacement	382	337	13
Exports	112	100	12
Total	**601**	**557**	**8**

During the quarter, the OEM sales declined by 11% on account of a slowdown in the industry. However, the company managed to offset this decline by recording a strong growth in the replacement and the exports segment, which grew by 13% and 12% respectively.

The company expects the slowdown in the OEM segment to continue, though things are expected to improve by September-October this year with the commencement of the festive season. However, the company has already put its strategy in place to concentrate more on the replacement and the export sales. In the next couple of quarters, we expect the exports and the replacement segment to maintain the growth.

Strong improvement in the margins

The OPM improved by 550 basis points yoy to 9.2% primarily because of lower raw material cost, price hikes in the last one year, better cost efficiencies and an improvement in the product mix. We are confident that the company would be able to maintain these levels of margins even if there is a rise in raw material prices. Though the rubber prices have come down to about Rs80 per kg from average level of about Rs95 per kg earlier, the crude prices have gone up significantly in the last few months. Consequently, the prices of some of the crude linked raw materials like carbon black are on a rise. Though some of the impact of these two factors would be set off against one another, we believe that the company should be in a position to pass on any adverse effects of the rise in raw material prices in the times to come. Moreover, it is easier for the company to pass on the prices in the replacement and the export markets, the segments that would largely fuel its future growth.

The other income for the quarter was lower at Rs3.7 crore as against Rs6.4 crore last year. However, we expect the other income to be higher in the second quarter, which would also account for the dividend income from group companies like KEC International and CESC. The interest cost of the company is under control despite higher rates because of the repayment of some debts and debt restructuring. A higher tax charge for the quarter is on account of taxes relating to extraordinary income during the quarter.

The quarterly results contain extraordinary items relating to refund from excise and income tax and reversal of export benefits for earlier years. Assuming similar tax rates, we estimate that the profits (pre-extra-ordinary) for the quarter have grown to Rs20.4 crore from Rs0.2 crore same quarter last year. The net profits after extraordinary items have grown to Rs30.4 crore against Rs0.2 crore in the same quarter last year.

Land sale conclusion by Q3FY2008

As mentioned in some of the previous updates, the company plans to sell a part of its Bhandup property and has already obtained the board approval towards the same. The process was, however, delayed a bit due to certain approvals required. The management expects the land sale to be concluded by the third quarter of this fiscal.

Valuations and view

Considering the strong growth opportunities for the company (particularly in the in the specialty tyre segment), the smart turnaround and the improving productivity, we maintain our positive outlook on the company. The company is also raising its capacity in the off the road (OTR) segment to 45 tonnes a day from 25 tonnes a day by November 2007.

The company has also announced to demerge the company into two—one to look the core business and the other, the investment portfolio. For every 100 shares held, the shareholder would get 75 shares of the core company and 25 shares of the new investment company. We believe the move is a positive one, and would lead to greater value unlocking for the shareholders. The de-merger is expected to be implemented during the current financial year.

Sum of parts valuation

Particulars	Price (Rs)	Remark
Core business	190	At 9x FY2009 earnings
Investment value	26	At 75% discount to CMP
Fair value	**216**	

We continue to value the company on sum-of-parts basis. On the basis of strong performances rendered by Ceat in the recent times, we are raising our earnings estimate for Ceat by 6% to Rs16.9 for FY2008 and are introducing our FY2009 estimates of Rs21.1. At the current levels, the stock is trading at 8.4x its FY2009E earnings and at an EV/EBIDTA of 3.9x. We believe the valuations are very attractive and maintain our Buy recommendation with a revised price target of Rs216.

Earnings table

Particulars	FY05	FY06	FY07	FY08E	FY09E
Net sales (Rs cr)	1532.2	1744.1	2133.1	2314.5	2573.9
Net profit (Rs cr)	-1.9	0.5	39.2	77.1	96.4
Shares in issue (cr)	3.51	4.57	4.57	4.57	4.57
EPS (Rs)	-0.5	0.1	8.6	16.9	21.1
% y-o-y growth			*7448*	*96*	*25*
PER (x)	-359.1	1029.2	19.0	10.5	8.4
Book value (Rs)	179.5	76.4	85.6	102.2	123.1
P/BV	1.0	2.3	2.1	1.7	2.1
EV/EBITDA	17.9	13.6	7.3	5.0	3.9
Mcap/Sales	0.4	0.5	0.4	0.4	0.3
RoCE (%)	6.4	8.4	15.4	22.9	25.0
RoNW (%)	-0.3	0.2	11.0	16.5	17.1

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

State Bank of India

Apple Green

Stock Update

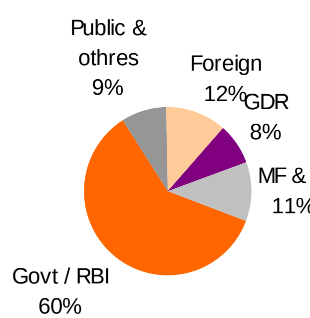
Strong operating performance

Buy; CMP: Rs1,579

Company details

Price target:	Rs1,780
Market cap:	Rs83,103 cr
52 week high/low:	Rs1,760/758
NSE volume: (No of shares)	14.3 lakh
BSE code:	500112
NSE code:	SBIN
Sharekhan code:	SBI
Free float: (No of shares)	17 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	3.7	38.0	29.0	98.8
Relative to Sensex	-2.0	25.4	19.9	38.4

Result highlights

- State Bank of India's (SBI) results have been way above the market's and our expectations with the profit after tax (PAT) growing by 78.5% year on year (yoy) to Rs1,425.8 crore compared with our estimate of Rs1,147 crore. The results are significantly above estimates due to a higher than expected write-back in investment provisions and subdued operating expenses.
- The net interest income (NII) was up by 15% yoy to Rs4,497 crore. The reported net interest margin (NIM) remained more or less stable on a sequential basis but declined by six basis points yoy. Most of the public sector banks have reported a sequential decline in margins whereas SBI has maintained its NIM and grown its NII by 15.8% yoy which are commendable.
- The non-interest income grew by 18.7% yoy to Rs842.6 crore driven by good growth in the core fee income, which rose by 16.3% yoy, and a higher trading income, which increased by 30.5% yoy due to the gains recorded in the National Stock Exchange stake sale for around Rs150 crore. "Others" reflect a net negative figure due to amortisation expenses and one-time shifting losses booked through the non-interest income category as per new Reserve Bank of India (RBI) directives.
- The operating expenses grew by only 5.8% yoy to Rs2,978.5 crore mainly due to lower staff expenses, which grew by 5.3% yoy and remained almost unchanged on a sequential basis at Rs2,026.4 crore. A good net income growth of 15.6% yoy coupled with lower operating expenses helped the operating profit to increase by 30.8% to Rs2,361.5 crore. The core operating profit growth was at 15.8% yoy to Rs2,691.5 crore.
- Provisions declined by 36.4% yoy mainly due to a write-back in investments provisions for Rs376 crore. The bank made a Rs200-crore non-performing asset (NPA) provision during the quarter over and above the RBI's requirements, which helped it to improve the provision coverage by 140 basis points to 48.8% on a sequential basis.

Result table Rs (cr)

Particulars	Q1FY2008	Q1FY2007	% yoy chg	% yoy chg
Net interest income*	4,497.4	3,910.6	15.0	2.1
Non-interest income	842.6	709.6	18.7	-70.9
Trading	275.1	210.8	30.5	-
CEB	885.9	761.9	16.3	-62.1
Others	-318.3	-263.0	21.0	-
Net income	5,340.0	4,620.2	15.6	-26.8
Operating expenses	2,978.5	2,814.6	5.8	-8.2
Operating profit	2,361.5	1,805.6	30.8	-41.7
Core operating profit**	2,691.5	2,323.3	15.8	-28.4
Provisions & Contingencies	159.8	251.2	-36.4	-88.7
PBT	2,201.7	1,554.5	41.6	-13.9
Provision for taxes	776.3	755.9	2.7	-26.9
Net profit	1,425.8	798.6	78.5	-4.5

*Aadjusted for Rs175 crore of CRR interest and interest paid to IT department in Q4FY2007

**Adjusted for treasury and amortisation expenses and miscellaneous income

- Business growth was strong with net advances up 29.3% yoy and deposits higher by 19% yoy. However, the asset quality showed deterioration with the gross NPA up by Rs760 crore in absolute terms and the net NPA up from 1.56% in Q4FY2007 to 1.62% in percentage terms.
- The operating performance has been strong with stable margins and robust business growth. However the margins are likely to be under pressure going forward as the bank has a net effective negative spread on the combined statutory liquidity ratio (SLR) and cash reserve ratio (CRR) book. On the other hand, it has reduced its interest rate risk significantly, with only 24% of its investment book under the marked-to-market category with a duration of 1.7 years. A lower provision coverage and the non-provision of transitional Accounting Standard (AS)-15 expenses (as it awaits the RBI's guidelines on this front) are the only concerns. Hence, we have not upgraded our numbers as we feel the AS-15 related provisions could restrict the earnings growth of the bank in FY2008 despite earnings being significantly above estimates. At the current market price of Rs1,579, the stock is quoting at 14.4x its FY2009E earnings, 5.9x pre-provision profits and, 1.9x stand-alone and 1.5x consolidated FY2009E book value. We maintain our Buy recommendation on the stock with a price target of Rs1,780.

NII up 15%, margins remain stable sequentially

SBI's NII grew by 15% yoy and 2.1% quarter on quarter (qoq) to Rs4,497.4 crore, mainly driven by a strong year-on-year (y-o-y) growth of 29.3% in the advances. The bank's reported NIM remained stable on a sequential basis but declined by six basis points yoy. The bank's yield on investment or, as the bank reports, resources deployed (which includes investment income and income from money market activities) declined sharply yoy as well as qoq. The primary reason for the decline is the higher idle (ie non-interest paying) CRR balances that the bank needs to maintain with the RBI.

The yield on the advances increased handsomely by 132 basis points yoy and by 116 basis points qoq with hikes in PLR. However the deposit cost also shot up by 72 basis points yoy and by 67 basis points qoq. Higher term deposit rates and a decline in the current account and savings account (CASA) ratio to 41.1% (down 161 basis points yoy and 251 basis points qoq as a result of attractive term deposit rates) also inflated the deposit cost. We expect the margins to remain under pressure as the spread between the yield on investments and the effective cost of term deposits at 7.5% is negative by around 130 basis points.

Yield analysis (%) table

Particulars	Q1 FY08	Q1 FY07	yoy chng in bps	qoq chng in bps	Q4FY07*
Yield on advances	9.80	8.48	132	116	8.67
Cost of deposits	5.35	4.63	72	67	4.79
Yield on investments/ resources	6.21	7.22	-101	-67	6.88
NIM - reported	3.31	3.37	-6	1	3.31

Source: * All figures are simple average of the cumulative figures reported by the bank, Sharekhan Research

Non-interest income up 18.7% yoy

The non-interest income grew by 18.7% yoy to Rs842.6 crore driven by a good growth in the core fee income (up 16.3% yoy) and a higher trading income (up 30.5% yoy due to the gains recorded in the NSE stake sale for around Rs150 crore). The core non-interest income comprising the fee, foreign exchange [forex] and lease incomes has shown an increase of 13.9% yoy to Rs1,001.2 crore. The revision in the service charges and a good business growth kept the growth in the other income steady. The bank has plans to get into various fund management businesses (for example, venture capital, private equity, wealth management, infrastructure fund etc) in a big way. The new businesses should help it to sustain a steady growth in its core non-interest income component in the future.

Non-iterest income details

Particulars	Q1FY08	Q1FY07	yoy chng	qoq chng
Treasury	275.1	210.8	30.5	620.2
Fee income	885.9	761.9	16.3	-62.1
Forex income	98.8	84.0	17.6	102.9
Dividend	171.4	348.1	-50.8	-22.7
Lease income	16.6	33.3	-50.3	-361.2
Miscellaneous	402.7	305.8	31.7	-301.1
Amortization	-710.1	-808.5	-12.2	-
Shifting loss—one-time	-297.7	-225.7	31.9	-
Total—non-interest income	842.6	709.6	18.7	-70.9
Core non-interest income (fee, forex, and lease income)	1,001.2	879.2	13.9	-57.9

Operating expenses remain contained on account of lower staff expenses

The operating expenses grew by only 5.8% yoy to Rs2,978.5 crore. The growth was lower than expectations mainly due to lower staff expenses, which grew by 5.3% yoy and remained almost unchanged on a sequential basis at Rs2,026.4 crore. As the RBI guidelines on the accounting treatment for the revised AS-15 (2005) are awaited, the bank has not yet started providing for the transitional AS-15 expenses (the shortfall in the pension liability is estimated at Rs4,500 crore, which translates into Rs900 crore of annual provisions) to be written over five years through the Profit and Loss Account. SBI's current employee provisions are also based on the earlier (1995) AS-15 guidelines unlike some other banks, which are providing the same on an estimated basis. Going forward, the operating expenses may remain higher than witnessed during the first quarter after the RBI's guidelines are issued.

Operating expenses	Q1FY08	Q1FY07	% yoy chng	% qoq chng
Total staff expenses	2,026.4	1,924.3	5.3	0.1
Payment to Employees	1,735.8	1,590.3	9.1	-6.9
Contribution for Employees	290.6	334.0	-13.0	81.2
Other operating expenses	952.1	890.3	6.9	-22.1
Total operating expenses	2,978.5	2,814.6	5.8	-8.2

Provisions decline on account of a write-back

The bank's provisions declined by 36.4% yoy mainly due to a write-back in investment provisions for Rs376 crore as bond yields were down sequentially. The bank had also transferred Rs9,000 crore of securities to its "held to maturity" portfolio from the "available for sale" portfolio which also should have resulted in excess provisions under the marked-to-market portfolio. The bank made an excess NPA provision of Rs200 crore during the quarter over and above the RBI's requirements; this helped it to improve the provision coverage by 140 basis points to 48.8% on a sequential basis.

Provisions & Contingencies	Q1FY08	Q1FY07	% yoy chng	Q4FY07
NPA	506.3	171.6	195.2	731.2
Investment depreciation	-376.4	73.2	-614.3	325.8
Std assets	31.8	20.0	59.2	299.2
Others	-2.0	-13.6	-85.3	56.4
Total	**159.8**	**251.2**	**-36.4**	**1412.6**

Asset quality trends have been concerning

The gross NPA increased by 7.6% qoq (or by Rs760 crore) while the advances remained almost flat sequentially. The net NPA increased in both absolute and percentage terms on a sequential basis; in percentage terms the net NPA increased to 1.62% from 1.56% in Q4FY2007. Going forward, we need to keep a close watch on the NPAs. The bank could have utilised the release in investment provisions to improve the net NPA levels and the provision coverage further.

Particulars	Q1FY08	Q1FY07	Q4FY07	Q3FY07
GNPA (Rs crore)	10,758.0	9,721.0	9,998.0	10,429.0
GNPA (%)	3.13	3.64	2.92	3.3
NNPA (Rs crore)	5,505.0	4,833.0	5,258.0	4,487.0
NNPA (%)	1.62	1.84	1.56	1.5
Coverage (%)	48.8	50.3	47.4	57.0

Capital raising plans in FY2008

SBI'S capital adequacy ratio (CAR) stood at 13.1% as in June 2007 with the Tier-I CAR at 8.3%. The Tier-I ratio improved by 30 basis points sequentially due to quarterly profits and the $225 million of innovative perpetual debt raised by the bank during the quarter. The bank plans to raise funds to the tune of Rs15,000 crore (debt + equity) during FY2008. We have already factored in an 8.5% pre-issue dilution in equity at an expected follow-on offer price of Rs1,350 per share, which assumes that the government holding shall stay at 55% post-issue. This should help the bank to raise around Rs6,000 crore.

Valuation and view

The operating performance has been strong with stable margins and robust business growth. However the margins are likely to be under pressure going forward as the bank has a net effective spread on the combined SLR and CRR book. On the other hand, it has reduced its interest rate risk significantly, with only 24% of its investment book under the marked-to-market category with duration of 1.7 years. A lower provision coverage and the non-provision of transitional AS-15 expenses (as it awaits the RBI's guidelines on this front) are the only concerns. Hence, we have not upgraded our numbers as we feel the AS-15 related provisions could restrict the earnings growth of the bank in FY2008 despite earnings being significantly above estimates. At the current market price of Rs1,579, the stock is quoting at 14.4x its FY2009E earnings, 5.9x pre-provision profits and, 1.9x stand-alone and 1.5x consolidated FY2009E book value. We maintain our Buy recommendation on the stock with a price target of Rs1,780.

Valuation table

Year to 31 March	FY05	FY06	FY07	FY08E	FY09E
Net profit (Rs cr)	4304.5	4406.7	4541.3	5164.7	6267.4
Shares in issue (cr)	52.6	52.6	52.6	57.1	57.1
EPS (Rs)	81.8	83.7	86.3	90.4	109.7
% y-o-y change	*16.9*	*2.4*	*3.1*	*4.8*	*21.4*
PE (x)	19.3	18.9	18.3	17.5	14.4
P/PPP (x)	7.6	7.4	7.3	6.8	5.9
Book value (Rs/share)	457.4	525.3	594.7	727.7	812.2
P/BV (x)	3.5	3.0	2.7	2.2	1.9
Adj book value	355.8	432.0	494.8	641.6	691.7
P/ABV (x)	4.4	3.7	3.2	2.5	2.3
RoNW (%)	19.4	17.0	15.4	13.7	13.5
Cons book value (Rs)	618.9	707.4	802.0	943.4	1060.2
P/CBV (x)	2.6	2.2	2.0	1.7	1.5

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

Bank of Baroda

Apple Green

Stock Update

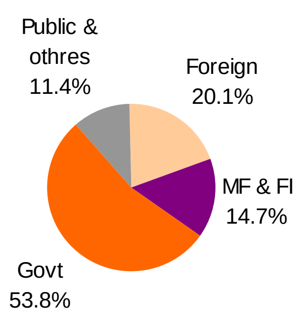
Price target revised to Rs366

Buy; CMP: Rs293

Company details

Price target:	Rs366
Market cap:	Rs10,753 cr
52 week high/low:	Rs319/189
NSE volume: (No of shares)	6 lakh
BSE code:	532134
NSE code:	BANKBARODA
Sharekhan code:	BOB
Free float: (No of shares)	16.9 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	11.6	20.5	16.0	37.9
Relative to Sensex	5.5	9.4	7.8	-4.0

Result highlights

- In Q1FY2008, Bank of Baroda's (BOB) net profit increased by 102.5% year on year (yoy) and 34.7% quarter on quarter (qoq) to Rs330.8 crore. The profits of the bank more than doubled on year-on-year (y-o-y) basis mainly because of a decline in provisions during the quarter on account of a write-back in the investment provisions on its marked-to-market investment portfolio.
- During the quarter the bank's net interest income (NII) increased by 15.5% yoy but declined by 8.9% on a sequential basis. The Q4FY2007 NII was adjusted for Rs30 crore for the cash reserve ratio (CRR) from the interest income and Rs22 crore interest income related to BOB Housing. The margins have remained stable on a y-o-y basis but have shown a six-basis-point decline at 3.2% on a quarter-on-quarter (q-o-q) basis.
- The non-interest income was up by 64.4% yoy mainly due to a higher treasury income component of Rs130 crore which included Rs90 crore from the National Stock Exchange (NSE) stake sale; the fee income was up by 13.5% yoy to Rs107.7 crore.
- The operating expenses were up 24% yoy to Rs684 crore as both the staff expenses and the other expenses increased by 17.6% yoy and 38.6% yoy respectively. The staff expenses were high because of higher retirement benefits while the other expenses increased due to higher depreciation on the assets (mainly technology). Although the operating profits improved by 28% yoy, the core operating profits (ie operating profits adjusted for treasury) declined by 6%.
- The bank's loan growth moderated to 27.5% yoy as in June 2007 from the high of 40% y-o-y growth in FY2007. The retail and foreign advances continued to be the main drivers of the growth with 38.5% and 44% y-o-y rise respectively. The deposit growth also moderated to 22.7% yoy from 33.4% registered in FY2007. The moderation in the overall business growth to a more comfortable level of 22-25%

Result table Rs (cr)

Particulars	Q1FY08	Q1FY07	% yoy	% qoq*
Net interest income	958.6	829.9	15.5	-8.9
Non-interest income	370.2	225.2	64.4	-6.9
Treasury	130.2	6.8	-	-
Fee income	107.7	94.9	13.5	-25.0
Others	132.3	123.5	7.1	-41.6
Net income	1,328.7	1,055.1	25.9	-8.4
Operating expenses	684.3	551.6	24.1	-9.8
Operating profit	644.5	503.6	28.0	-6.9
Core operating profit (excluding treasury)	514.2	548.6	-6.3	-10.7
Provisions & contingencies	141.4	253.1	-44.1	-54.6
PBT	503.0	250.5	100.8	16.4
Provision for taxes	172.2	87.1	97.7	-7.7
Net profit	330.8	163.3	102.5	34.7

*Adjusted for a one-time CRR interest income of Rs30 crore and Rs22 crore of interest income related to BOB Housing from Q4FY2007 interest income and added back at PBT level.

would help the bank conserve precious capital, maintain the margins and reduce the likeliness of higher defaults going forward.

- We have seen a marginal deterioration in the asset quality with the gross non-performing asset (NPA) level up 5.5% qoq and the net NPA level at 0.67% compared with 0.6% in March 2007.
- Although the margins were not under severe pressure, the core operating performance was dismal as the operating expenses remained high mainly due to technology implementation and providing retirement benefits for the staff. We expect higher operating expenses in FY2008 because of technology implementation and the Accounting Standard (AS)-15 provisions. We also expect the margins to remain under pressure as the bank plans to grow significantly its international operations (margins are comparatively lower in the international business). However the bank has comfortable capital adequacy and asset quality levels with a strong management focus to improve profitability. Due to its low return on equity (RoE) the bank trades at a much lower price to book value (BV) multiple than its peers. But with its RoE expected to improve to 15% plus going forward, we feel at the current valuations the bank is one of the most attractively valued among the public sector banks. We have introduced our FY2009 estimates in this report. At the current market price of Rs293, the stock is quoting at 6.8x its FY2009E earnings per share (EPS), 3.4x pre-provision profits (PPP) and 1x BV. We maintain a Buy recommendation on the stock with a revised price target of Rs366 at which it would trade at 1.25x FY2009E BV.

Margins under slight pressure

During the quarter the bank's NII increased by 15.5% yoy but declined by 8.9% on a sequential basis. The Q4FY2007 NII was adjusted for Rs30 crore for the CRR from the interest income and Rs22 crore interest income related to BOB Housing. The margins remained stable on a y-o-y basis but showed a six-basis-point decline at 3.2% on a q-o-q basis.

Although there was a strong improvement of 130 basis points yoy and of 125 basis points qoq in the loan yield, yet the investments yield declined by 62 basis points which negated the improvement in the loan yield and caused the NIM to remain flat at 3.2%. The deposit cost, on the other hand, shot up by 101 basis points on a y-o-y basis and by 70 basis points on a q-o-q basis. The lower current account and savings account (CASA) ratio, which was down by 280 basis points yoy and by 100 basis points qoq at 38.4%, also contributed to the rise in the deposit cost. We expect the NIM to remain under pressure as the bank is looking to focus on expanding its international operations where the margins are comparatively lower.

Yield analysis (%)

Particulars	Q1FY08	Q1FY07	yoy chg in bps	Q4FY07	qoq chg in bps
Yield on advances (reported)	9.51	8.21	130	8.27	125
Cost of deposit (reported)	5.42	4.41	101	4.72	70
NIM (reported)	3.20	3.19	1	3.42	-22
NIM (adjusted)*	3.20	3.19	1	3.26*	-6

*Adjusted for CRR & income related to BOB Housing

Non-interest income up 64.4% yoy driven by higher treasury income

The non-interest income was up by 64.4% yoy mainly due to a higher treasury income component of Rs130 crore which included Rs90 crore from the NSE stake sale; the fee income was up by 13.5% yoy to Rs107.7 crore.

Non-interest income Rs (crore)

	Q1FY08	Q1FY07	% yoy chg	% qoq chg
Non-interest income	370.2	225.2	64.4	-6.9
Treasury	130.2	6.8	1,806.7	373.6
Fee income	107.7	94.9	13.5	-25.0
Forex	62.9	72.1	-12.8	-24.7
Misc. other income	69.4	51.4	35.2	26.7

Source: Company, Sharekhan Research

Operating expenses likely to remain high

The operating expenses were up 24% yoy to Rs684 crore as both the staff expenses and the other expenses increased by 17.6% yoy and 38.6% yoy respectively. The staff expenses were high because of higher retirement benefits while the other expenses increased due to higher depreciation on the assets (mainly technology). The operating expenses are expected to remain high in FY2008 as the bank plans to bring 70% of its total domestic branches under the core banking solution platform by FY2008 from 38% at the end of June 2007. It also plans to open ten new foreign offices.

Again, the bank has not yet provided for the transitional expenses related to the shortfall in pension liability calculated as per the new AS-15 (2005) guidelines, as the Reserve Bank of India (RBI) guidelines are still awaited. Hence going forward the operating expenses are likely to remain high on account of the revised AS-15 related expenses and higher depreciation on assets (mainly those on technology).

Asset quality shows some weakness but remains comfortable

We have seen a marginal deterioration in the asset quality with the gross NPA up 5.5% qoq to Rs2,207 crore and the net NPA level at 0.67% compared with 0.6% in March 2007.

Particulars	Q1FY2008	Q1FY2007	Q4FY2007
GNPA	2,207.0	2,554.7	2,092.1
NNPA	519.6	561.0	501.7
(%) GNPA	2.8	4.1	2.47
(%) NNPA	0.67	0.92	0.60
Coverage (%)	76	78	76

Capital adequacy remains comfortable

The capital adequacy ratio of the bank stood at 14.3% with the Tier-I capital at 8-8.5% as in June 2007. The same is adequate to sustain the growth in its assets and comply with the Basel II norms going forward.

Valuation and view

Although the margins were not under severe pressure, the core operating performance was dismal as the operating expenses remained high mainly due to technology implementation and providing retirement benefits for the staff. We expect higher operating expenses in FY2008 because of technology implementation and the AS-15 provisions. We also expect the margins to remain under pressure as the bank plans to grow significantly its international operations (margins are comparatively lower in the international business). However the bank has comfortable capital adequacy and asset quality levels with a strong management focus to improve profitability. Due to its low RoE the bank trades at a much lower price to BV multiple than its peers. But with its RoE expected to improve to 15% plus going forward, we feel at the current valuations the bank is one of the most attractively valued among the public sector banks. We have introduced our FY2009 estimates in this report. At the current market price of Rs293, the stock is quoting at 6.8x its FY2009E EPS, 3.4x PPP and 1x BV. We maintain a Buy recommendation on the stock with a revised price target of Rs366 at which it would trade at 1.25x FY2009E BV.

Earnings table

Particulars	FY05	FY06	FY07	FY08E	FY09E
Net profit (Rs cr)	676.9	827.0	1026.5	1307.7	1576.7
Shares in issue (cr)	29.5	36.6	36.6	36.6	36.6
EPS (Rs)	23.0	22.6	28.1	35.8	43.1
EPS growth (%)	-30.0	-1.6	24.1	27.4	20.6
PE (x)	12.7	13.0	10.4	8.2	6.8
P/PPP (x)	3.7	5.3	4.9	3.9	3.4
Book value (Rs/share)	191.1	214.6	236.6	262.2	293.1
P/BV (x)	1.5	1.4	1.2	1.1	1.0
Ad book value	170.0	200.4	222.9	258.7	283.9
P/ABV (x)	1.7	1.5	1.3	1.1	1.0
RONW (%)	12.6	11.2	12.4	14.3	15.5

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

Grasim Industries

Apple Green

Stock Update

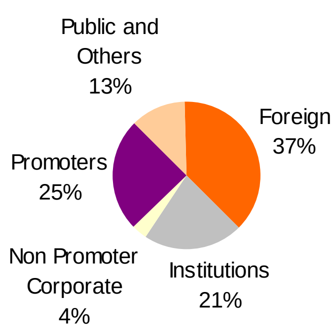
Price target revised to Rs3,250

Buy; CMP: Rs2,947

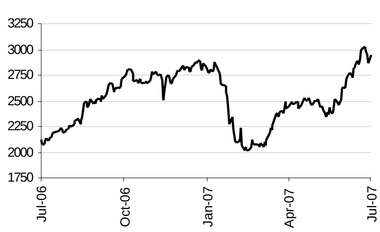
Company details

Price target:	Rs3,250
Market cap:	Rs30,710 cr
52 week high/low:	Rs3,060/1,880
NSE volume: (No of shares)	1.6 lakh
BSE code:	500300
NSE code:	GRASIM
Sharekhan code:	GRASIM
Free float: (No of shares)	6.9 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	14.4	18.2	1.3	41.2
Relative to Sensex	8.2	7.4	-5.8	-1.7

Result highlights

- The Q1FY2008 net sales of Grasim Industries (Grasim) grew by 30.3% year on year (yoy) to Rs2,450 crore, mainly due to a pick-up in its viscose staple fibre (VSF) volumes as well as realisation and higher sponge iron prices. The VSF revenues grew by a robust 59% yoy to Rs700 crore on the back of a healthy 34% growth in the volumes and a 20% growth in the realisation yoy. The cement revenues improved by 25% yoy to Rs1,390 crore driven by a 12% growth in volumes and a 13% growth in realisations yoy.
- On the back of a higher top line growth, the operating profit grew by 54% yoy to Rs792 crore whereas the earnings before interest, tax, depreciation and amortisation (EBITDA) margin improved by 510 basis points to 32.4%.
- The interest expenses rose by 21.1% yoy to Rs28.5 crore on account of higher borrowings in the quarter whereas the depreciation provision increased by 14.7% yoy to Rs85 crore mainly due to part commissioning of the additional VSF capacity in FY2008.
- The other income jumped by 81% yoy to Rs67.7 crore on account of a high interest income from the profitable deployment of surplus cash from operations.
- Consequently, the net profit rose by 64% yoy to Rs512 crore, much ahead of expectations.
- The company has slightly modified its capital expenditure (capex) plans. As against expanding the capacities at Kotputli and Shambhpura by 4 million metric tonne (MMT) each as planned earlier, the company is now expanding the capacities at these two locations by 4.4MMT each. The Shambhupra capacity is expected to come up by Q4FY2008 whereas the Kotputli plant is expected to be commissioned by Q1FY2009.

Result table Rs (cr)

Particulars	Q1FY08	Q1FY07	% yoy	FY07	FY06	% yoy
Net sales	2444.7	1877.0	30.2	8661.0	6618.0	30.9
Total expenditure	1652.6	1363.7	21.2	6255.3	5235.0	19.5
Operating profit	792.1	513.3	54.3	2405.7	1383.0	73.9
Other income	67.74	37.5	80.8	209.7	123.7	69.5
PBIDT	859.8	550.7	56.1	2615.3	1506.7	73.6
Interest	28.5	23.5	21.1	108.2	97.3	11.1
PBDT	831.4	527.2	57.7	2507.2	1409.4	77.9
Depreciation	85.0	74.1	14.7	317.9	291.6	9.0
PBT	746.4	453.1	64.7	2189.3	1117.8	95.9
Tax	234.7	141.2	66.2	690.6	329.7	109.4
Reported profit after tax	511.7	311.9	64.0	1498.8	788.1	90.2
Extraordinary items	0	0	0.0	37.1	49.4	
Adj PAT after extraordinary	511.7	311.9	0.0	1535.9	837.5	

- The company is also augmenting its VSF capacity at Kharach, Gujarat from 45,625 tonne to 63,725 tonne. The company is also in the process of getting regulatory clearance for expanding the capacity at Harihar by 31,000 tonne.
- Considering the optimistic outlook for the VSF business, the higher realisations from the sponge iron business and the higher earnings of UltraTech Cement, we are upgrading our earnings per share (EPS) estimate for FY2008 by 8.2% to Rs264 and for FY2009 by 12.6% to Rs234.

The outlook for the company remains extremely bright with the VSF business expected to perform well going ahead, thanks to higher capacities, better global prices and better cost control measures. The cement business is expected to do well for the next couple of years on the back of a high volume growth, thanks to the capacity augmentation. Also, the higher cash flows from the VSF business will act as a cushion for the downturn in the cement cycle. This coupled with the superlative performance of UltraTech Cement will drive the earnings of the company. At the current market price of Rs2,947, the stock trades at 11x its FY2008E EPS and 13x its FY2009E EPS. Taking cognisance of the positive outlook for the future, we maintain our Buy recommendation with a revised price target of Rs3,250.

Cement business continues to perform well

The grey cement volumes rose by 12% yoy to 3.90MMT on the back of a capacity utilisation level of 118% whereas the realisations grew by 13% yoy to Rs3,083 per tonne. The white cement business grew by 8% yoy whereas the ready-mix concrete (RMC) revenues grew by 19% yoy to Rs96 crore on the back of a strong realisation growth. Consequently, the overall cement revenues grew by a robust 25% yoy to Rs1,390.7 crore. On the cost front, the fuel cost improved sharply by 28% yoy on the back of higher petcoke prices and reduction in the availability of linkage coal. The freight cost, on the other hand, increased by 8% yoy. The operating profit grew by 30% yoy to Rs491 crore whereas the operating profit margin (OPM) improved by 100 basis points to 35.3%.

Strong growth in volume and realisations boost division's performance

The volume grew by a healthy 34% yoy to 69,396 tonne on the back of higher capacity utilisation and the fact in Q1FY2007 the volumes had been affected by a water shortage at Nagda. A strong global demand for VSF resulted in higher prices which translated into a realisation growth of 20% yoy, thereby leading to 59% growth in the top line yoy to Rs700 crore. The OPM improved by 1,000 basis points to 36.6% despite an increase in pulp and sulphur prices, as the higher raw material prices were overshadowed by the higher realisation and economies of scale. The operating profit jumped by 124% yoy to Rs256.3 crore.

VSF performance

Particulars	Q1FY08	Q1FY07
Sales volume (million tonne)	69396.0	68588.0
Realisation (Rs/Tonne)	94455.0	101652.2
Sales (Rs crore)	698.0	697.2
EBIDT (Rs crore)	256.3	244.0
EBIDT(%)	36.7	35.0

Higher realisation growth improves sponge iron performance

With the uptrend in global scrap prices, the sponge iron realisation was up by 22% yoy to Rs14,753 per tonne. The production was higher by 9% yoy, though the volumes remained more or less flat at 139,706 tonne. The strong realisation growth led the top line to grow by 25% yoy to Rs218 crore. Consequently, the operating profit more than doubled to Rs35.3 crore whereas the margin improved by 800 basis points as the higher realisation partially offset the higher feedstock cost.

Chemical business volumes jump by 40%

On account of normal operations in this quarter and a lower base in the same quarter last year, the volumes jumped by 39% yoy to 42,872 tonne. But a steep fall in chlorine and HCL prices resulted in 10% drop in the realisation yoy to 17,254 per tonne. Consequently, the top line grew by 22% yoy to Rs86.3 crore. On the back of a lower power cost (on account of shift to membrane cell plant as well as higher operating leverage), the operating profit grew by 57% yoy to Rs28.1 crore whereas the OPM expanded by 700 basis points to 32.5%.

Segmental break-up

Particulars	Volumes	% yoy	Realisation	% yoy
Grey cement in MMT	3.96	13.1	3083	12.9
White cement	85005	4.8	6403	3.1
VSF	69396	33.6	94455	19.6
Sponge iron	139706	-0.9	14753	22.4

Higher other income boosts net profit by 64% yoy

The interest cost increased by 20% yoy to Rs28.5 crore on account of higher borrowings in the quarter whereas the depreciation provision increased by 14.7% yoy to Rs85 crore mainly due to part commissioning of the VSF expansion in FY2008. But the other income jumped by 80.8% yoy to Rs67 crore on account of a higher interest income from the profitable deployment of surplus cash from operations. This resulted in a much higher growth of 64% in the net profit to Rs512 crore, which was ahead of our expectations.

On-going cement capacity expansion increased by 10% yoy

Grasim's capacity expansion is progressing well albeit with a slight change. The company has decided to enhance its capacities at Shambhupura and Kotputli by 4.4MMT each as against by 4MMT each earlier. The Shambhupura plant is expected to be commissioned by Q4FY2008 while the Kotputli plant is expected to become operational by Q1FY2009. Also, as mentioned in our earlier updates, the company is expanding its VSF capacity at Kharach, Gujarat from 45,625 tonne to 63,725 tonne. The company is also in the process of getting regulatory clearances for expanding the capacity at Harihar by 31,000 tonne. On completion, the company's VSF capacity will expand to 350,000 tonne.

Upgrading earnings

Considering the optimistic outlook for the VSF business, the higher realisations from the sponge iron business and the higher earnings of UltraTech Cement, we are upgrading our EPS estimate for FY2008 by 8.2% to Rs264 and for FY2009 by 12.6% to Rs234.

Outlook

The outlook for the company remains extremely bright with the VSF business expected to perform well going ahead, thanks to higher capacities, better global prices and better cost control measures. The cement business is expected to do well for the next couple of years on the back of a high volume growth, thanks to the capacity augmentation. Also, the higher cash flows from the VSF business will act as a cushion for the downturn in the cement cycle. This coupled with the superlative performance of UltraTech Cement will drive the earnings of the company. At the current market price of Rs2,947, the stock trades at 11x its FY2008E EPS and 13x its FY2009E EPS. Taking cognisance of the positive outlook for the future, we maintain our Buy recommendation with a revised price target of Rs3,250.

Earnings table

Particulars	FY05	FY06	FY07	FY08E	FY09E
Net profit (Rs cr)	959.0	1,039.0	1,967.5	2,430.0	2,115.0
% y-o-y growth	*0.2*	*0.1*	*0.9*	*23.5*	*-13.0*
Shares in issue (cr)	9.2	9.2	9.2	9.2	9.2
EPS (Rs)	104.6	101.3	214.6	265.0	230.7
% y-o-y growth	*0.2*	*0.1*	*0.9*	*0.1*	*-0.2*
PER (x)	28.3	29.2	13.8	11.2	12.8

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

Tata Elxsi

Emerging Star

Stock Update

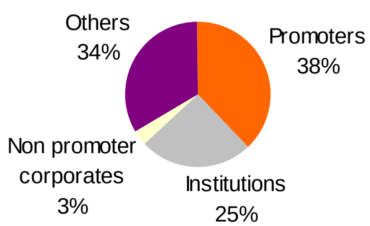
Price target revised to Rs370

Buy; CMP: Rs288

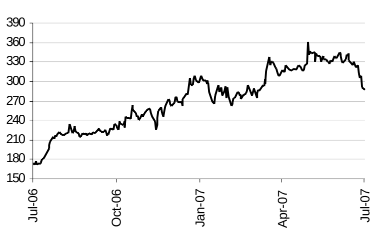
Company details

Price target:	Rs370
Market cap:	Rs902 cr
52 week high/low:	Rs365/168
NSE volume: (No of shares)	95,904
BSE code:	500408
NSE code:	TATAELXSI
Sharekhan code:	TATAELX
Free float: (No of shares)	1.9 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-12.5	-3.6	-1.2	74.2
Relative to Sensex	-17.2	-12.4	-8.1	21.3

Result highlights

- For Q1FY2008, Tata Elxsi has reported a growth of 3.6% quarter on quarter (qoq) and of 45.7% year on year (yoy) in its revenues to Rs92.4 crore. The performance was ahead of expectations in view of the seasonal weakness in Q1 (especially in the system integration [SI] business) and the steep appreciation in the rupee during the quarter.
- However, the performance on the margin front was disappointing. The operating profit margin (OPM) plummeted by 670 basis points sequentially to 17.6%, which is among the lowest in any quarter during the past two years. The same can be attributed to the cumulative impact of the rupee's appreciation, wage hikes (given to a small part of its employee base; wage hikes are being effected since January for most of the employees), intake of fresh graduates (under training and not billable) and seasonal weakness in Q1 in case of the SI business. Consequently, the operating profit declined by 25.1% qoq to Rs16.2 crore.
- In line with the operating profit, the earnings declined by 24.5% qoq and grew by 18.4% yoy to Rs12.1 crore, which was lower than our expectations of Rs12.6 crore.
- In terms of segmental performance, the sequential growth of 7.3% in the software development service (SDS) business was ahead of expectations. However, the profitability declined by 470 basis points sequentially to 17.5% during the quarter. On the other hand, the SI revenues declined by 13.8%. The segmental margins plummeted to 12.6% as compared with 29.4% in Q4FY2007 but were far better than 1.6% in Q1FY2007.
- To factor in the higher than expected pressure on the margins, we have revised downwards the earnings estimate for FY2008 and FY2009 by 4.5% and 3.4% respectively. At the current market price the stock trades at 14.2x FY2008 and 11.3x FY2009 estimated earnings. We maintain our Buy call on the stock with a revised price target of Rs370 (14.5x FY2009 earnings).

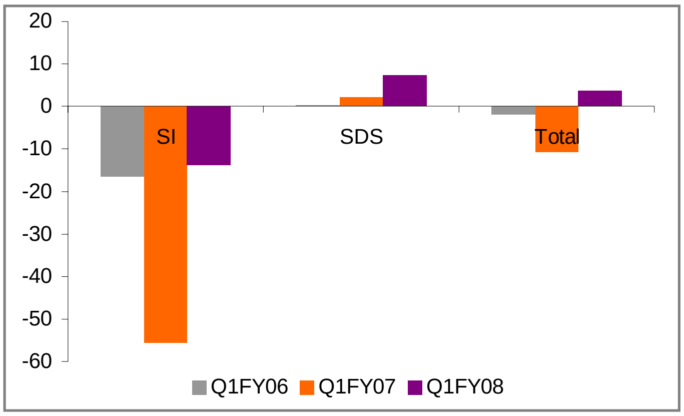
Result table Rs (cr)

Particulars	Q1FY08	Q1FY07	Q4FY07	% yoy	% qoq
Net sales	92.4	63.4	89.1	45.7	3.6
Total expenditure	76.1	49.9	67.4	52.6	12.9
Operating profit	16.2	13.5	21.7	20.2	-25.1
Other income	0.4	0.2	0.1	130.9	397.2
Interest	0.0	0.0	0.0	---	---
Depreciation	2.7	1.9	2.6	44.0	1.9
PBT	13.9	11.8	19.1	17.9	-27.2
Tax	1.8	1.6	3.1	14.4	-41.3
Profit after tax	12.1	10.2	16.0	18.4	-24.5
Equity	31.1	31.1	31.1		
EPS (Rs)	3.9	3.3	5.1		
Margins (%)					
OPM	17.6	21.3	24.3		
NPM	13.1	16.1	18.0		

Revenue growth ahead of expectations

The sequential growth of 3.6% is ahead of expectations, especially given the fact that the company usually tends to show a negative sequential growth in Q1. That's because the revenues in the SI business record an exceptionally robust growth in Q4, leading to a steep sequential decline in Q1. In case of the SDS business also, the growth generally tends to pick up only from Q2 onwards. Thus, the sequential growth of 7.3% in the SDS business in Q1FY2008 was far better than the 2.1% increase in Q1FY2007 and the 0.2% rise in Q1FY2006. The revenue growth is line with the management's claim of strong growth visibility in the current fiscal.

Revenue growth (% qoq change)



Margins under pressure

After three consecutive years of a strong expansion in its OPM (up from 14.9% in FY2004 to 22.4% in FY2007), the aggressive investments (in the both manpower and physical infrastructure) and the steep appreciation in the rupee are estimated to result in a decline in its margins in FY2008.

The company is investing in its sales and marketing infrastructure-for example, it is adding 10-12 direct sales force to its existing sales team of 24 employees during the current year. Moreover, it is also investing around Rs40 crore in boosting the seating capacities (this includes plans to set up new centres in Coimbatore and Hyderabad). The same would be partially offset by better revenues mix (the contribution from the relatively higher margin SDS business to increase to 88% in FY2008 from 85% in FY2007), higher billing rates and overall efficiency gains. To factor in the increased investment in the business and the rupee's appreciation, we have assumed a decline of 100 basis points in the OPM during FY2008.

Segmental performance

In terms of segmental performance, the sequential growth of 7.3% in the SDS business was ahead of expectations. However, the steep sequential decline of 470 basis points in the segmental margins was disappointing (and was partially dented by the rupee's appreciation).

Segmental results (Rs cr)

Particulars	Q1FY08	Q1FY07	Q4FY07	% yoy	% qoq
Revenues					
- System integration	13.5	7.0	15.7	92.7	-13.8
- Software services	78.9	56.5	73.5	39.7	7.3
Segment (PBIT)					
- System integration	1.7	0.1	4.6	1380.0	-62.9
- Software services	13.8	13.5	16.3	2.5	-15.5
PBIT margins (%)					
- System integration	12.6	1.6	29.4		
- Software services	17.5	23.9	22.2		

On the other hand, the SI revenues declined by 13.8%. The segmental margins were significantly lower at 12.6% as compared with 29.4% in Q4FY2007 but far better than 1.6% in Q1FY2007.

Valuation

At the current market price the stock trades at 14.2x FY2008 and 11.3x FY2009 estimated earnings. We maintain our Buy call on the stock with a revised price target of Rs370.

Earnings table

Particulars	FY06	FY07	FY08E	FY09E
Net sales (Rs cr)	235.6	308.0	396.0	487.3
Net profit (Rs cr)	34.3	52.1	63.7	79.7
No of shares (cr)	3.1	3.1	3.1	3.1
EPS (Rs)	11.0	16.7	20.4	25.6
% y-o-y change	*30.6*	*51.8*	*22.2*	*25.2*
PER (x)	26.3	17.3	14.2	11.3
Price/BV (x)	13.7	9.7	7.0	5.1
EV/EBIDTA(x)	19.0	12.9	10.4	8.1
Dividend yield (%)	2.2	2.4	2.8	3.1
RoCE (%)	57.5	62.0	55.0	50.6
RoNW (%)	98.6	84.0	65.4	54.9

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

Apollo Tyres

Apple Green

Stock Update

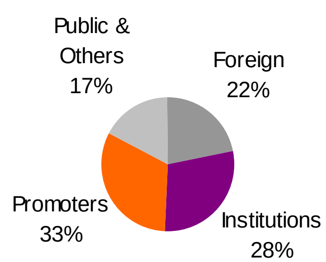
On a fast track

Buy; CMP: Rs375

Company details

Price target:	Rs425
Market cap:	Rs1,671 cr
52 week high/low:	Rs408/248
NSE volume: (No of shares)	61,539
BSE code:	500877
NSE code:	APOLLOTYRE
Sharekhan code:	APOLLOTYR
Free float: (No of shares)	3.1 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	23.6	21.5	9.7	59.3
Relative to Sensex	17.0	10.4	2.0	10.9

Result highlights

- Apollo Tyres rendered a brilliant performance in Q1FY2008 on the back of a strong top line growth and an improvement in the operating profit margin (OPM).
- The top line grew by 15.4% to Rs874.1 crore, led by a volume growth of 5% and a realisation growth of about 9.9% during the quarter. Though the original equipment (OE) business witnessed a slowdown during the quarter, the replacement business remained strong.
- The OPM improved to 11.5% from 7.5% Q1FY2007 on the back of softer raw material prices, improvement in price realisations and increasing operating efficiencies. Consequently, the operating profit increased by 77% to Rs100.4 crore. The net profit for the quarter grew by 187.6% to Rs46.8 crore.
- On a consolidated basis, the net revenues rose by 22% to Rs1,150 crore while the net profit improved by 369% year on year (yoy) to Rs54.6 crore, indicating a sharp improvement in the performance of its subsidiary, Dunlop South Africa.
- Dunlop South Africa is performing very well as its earnings before interest, depreciation, tax and amortisation (EBIDTA) margin reached the level of 11% during the quarter. It recorded a growth of about 40% in its net sales to about Rs275 crore in the same period. However, the same was achieved on a low base due to a very low-key performance in the same quarter last year.
- Though the sales volumes of Apollo Tyres would be affected in the current fiscal as a result of the slowdown in the OE sales, we believe that the replacement sales for tyre makers would continue to remain strong, considering that the

Result table Rs (cr)

Particulars	Q1FY2008	Q1FY2007	% yoy chg
Net sales	**874.1**	**757.3**	**15.4**
Expenditure	773.7	700.5	
RM consumed	568.6	536.0	
Change in stock	-7.4	-15.5	
Staff cost	53.6	48.5	
Other expenses	158.9	131.4	
Operating profit	**100.4**	**56.7**	**77.0**
Other income	5.8	0.1	
EBIDTA	106.2	56.8	86.9
Interest	14.7	13.5	
PBDT	91.5	43.3	111.4
Depreciation	20.7	19.0	
PBT	**70.8**	**24.3**	**191.5**
Tax	24.1	8.0	
Profit after tax	**46.8**	**16.3**	**187.6**
EPS	10.1	4.2	137.6
OPM (%)	11.5	7.5	
PATM (%)	5.3	2.1	

automobile industry, especially the commercial vehicle segment, has been recording a good growth for five straight years. Also, the fall in rubber prices augurs well for the tyre makers as it should help them maintain the high levels of margins.

- At the current market price of Rs375, the stock discounts its FY2009E earnings by 10.5x and quotes at an enterprise value (EV)/EBIDTA of 4.8x. We maintain our Buy recommendation on the stock with a price target of Rs425.

Strong top line growth led by tonnage and realisation growth

Apollo Tyres has reported a very strong top line growth for Q1FY2008. Its net sales grew by 15.4% to Rs874.1 crore and were higher than our expectations. The sales growth was backed by a strong volume growth of about 5% and a realisation growth of about 10%. Though the OE business witnessed a slowdown, the replacement business remained strong. The contribution of the replacement sales to the overall mix rose from 69% in Q1FY2007 to 71% while that of the OE remained stagnant at 22%.

Price hikes effected in last one year spur margins

The OPM improved by 400 basis points yoy and by 50 basis points sequentially to 11.5%, on the back of a fall in the raw material cost and price hikes. The raw material cost as a percentage of sales declined to 64.5% from 69.4% last year, mainly as the tyre companies were able to pass on the rubber price increase in the last one year. Consequently, the operating profit grew by 77% to Rs100.4 crore in Q1FY2008.

The other income was higher due to an interest income of Rs5 crore on income tax refund while the interest and depreciation charges were slightly higher due to the capital expenditure (capex) programme of the company. Consequently, the net profit for the quarter rose by a brilliant 187.6% to Rs46.8 crore.

Consolidated performance even better

The performance of Apollo Tyres' subsidiary, Dunlop South Africa, has shown a significant improvement in the recent times. The consolidated sales of the company grew by 22% to Rs1,150 crore while its profits improved by 369% yoy to Rs54.6 crore in the quarter. The company's subsidiary is performing extremely well, as it has recorded a sharp improvement in its profitability due to rising efficiencies and the price hikes effected in the past one year. The company recorded a growth of about 40% in its net sales to about Rs275 crore in Q1FY2008. However, the growth was achieved on a low base due to a very low-key performance in the same quarter last year. The EBIDTA margin of the subsidiary reached the level of 11% during the quarter.

Capex plans

Apollo Tyres has got a huge capex programme for this year, as it is looking to spend a total of about Rs400 crore. The bulk of this amount would be spent on setting up of a new greenfield plant in Tamil Nadu to manufacture tyres for trucks and bus radials. This plant is expected to start operations by the end of FY2009. Further, the company might spend about Rs80 crore on the off-the-road (OTR) tyres venture being set up in collaboration with Bharat Earth Movers. However, this may get postponed, as the two parties have not yet agreed on the pricing formula. The balance amount shall be spent on capacity expansions and de-bottlenecking at the existing plants.

Valuations and view

Considering the strong growth seen in the medium and heavy commercial vehicle segment over the past two years, we expect the replacement demand for tyres to be healthy going forward. This would help fuel future growth even though the OE sales are expected to slow down, particularly in the current year. The consolidated performance is also improving with Dunlop South Africa recording a strong growth in the past couple of quarters. At the current market price of Rs375, the stock is trading at 10.5x its FY2009E earnings and an EV/EBIDTA of 4.8x. We maintain our Buy recommendation on the stock with a price target of Rs425.

Earnings table

Particulars	FY05	FY06	FY07	FY08E	FY09E
Net sales (Rs cr)	2235.8	2613.6	3284.3	3741.2	4180.2
Net profit (Rs cr)	67.6	78.2	113.4	150.8	179.9
Shares in issue (cr)	5.0	5.0	5.0	5.0	5.0
EPS (Rs)	13.4	15.5	22.5	29.9	35.7
% y-o-y growth	*-4.0*	*15.6*	*45.1*	*33.0*	*19.3*
PER (x)	26.0	25.8	16.2	12.5	10.5
Book value (Rs)	114.4	125.8	194.2	246.9	282.1
P/BV	3.3	3.0	1.9	1.5	1.3
EV/EBITDA	18.9	10.7	6.6	5.6	4.8
Mcap/Sales	0.8	0.7	0.6	0.5	0.5
RoCE (%)	13.1	12.7	17.6	17.2	17.8
RoNW (%)	12.6	11.6	11.9	12.1	12.7

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

Mahindra & Mahindra

Apple Green

Stock Update

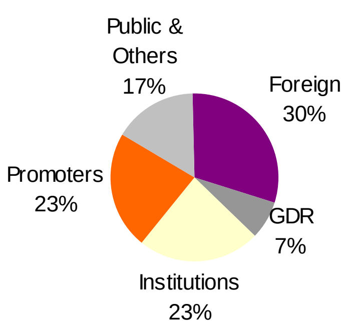
Q1FY2008 results: First-cut analysis

Buy; CMP: Rs753

Company details

Price target:	Rs913
Market cap:	Rs18,448 cr
52 week high/low:	Rs1,002/562
NSE volume: (No of shares)	8.3 lakh
BSE code:	500520
NSE code:	M&M
Sharekhan code:	M&M
Free float: (No of shares)	17.2 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	8.3	2.2	-14.6	36.4
Relative to Sensex	2.5	-7.1	-20.6	-5.0

Result highlights

- The Q1FY2008 results of Mahindra & Mahindra are below our expectations. The stand-alone net sales of the company grew by 16.8% to Rs2,612.8 crore in the quarter. This growth was led by an overall volume growth of 13.6% in the same period. The automotive segment recorded a volume growth of 24%; the sales volume of the farm equipment (FE) segment was flat.
- On a segmental basis, the automotive revenues rose by 21% to Rs1,504.5 crore. The FE division reported a revenue growth of 9.7%. The profit before interest and tax (PBIT) margin in the automotive segment was affected by 110 basis points due to the strengthening of the rupee and the consequent lower export realisation that affected the profit during the quarter. The FE division was able to maintain the PBIT margin at 13.4%. Consequently, the overall operating profit margin (OPM) declined by 150 basis points to 10.6%, leading to an operating profit growth of only 2.5%.
- On account of an increase in the interest expenditure and higher depreciation the adjusted net profit grew by 6.8% to Rs192.75 crore. After taking into account the extraordinary items (voluntary retirement scheme expenses, special dividend income) the reported profit after tax (PAT) declined by 6.4% to Rs191.16 crore.
- On a consolidated basis, the gross revenues grew by 40.7% to Rs5,879.2 crore in Q1FY2008 while the profit before tax (PBT) and exceptional items grew by 11.7% to Rs535.7 crore.
- We expect FY2008 to be the year of consolidation for the company as new product launches would take place only in FY2009. We will present our full result update on the company after attending the post-result conference call of the company. At the current market price of Rs753, the stock discounts its consolidated FY2009 earnings estimate by 9.3x. We maintain our Buy recommendation on the stock with a sum-of-the-parts price target of Rs913.

Result table Rs (cr)

Particulars	Q1FY08	Q1FY07	% change
Net sales	**2612.8**	**2236.3**	**16.8**
Total expenditure	2335.7	1966.0	18.8
Operating profit	**277.1**	**270.2**	**2.5**
Interest gross	-5.1	-14.7	
PBDT	282.2	284.9	-0.9
Depreciation	57.1	46.3	
Other income	31.61	20.31	55.6
PBT	**256.7**	**258.9**	**-0.8**
Tax	64.0	78.4	
Adjusted PAT	**192.7**	**180.5**	**6.8**
Extraordinary items	-1.6	23.6	
Reported PAT	**191.2**	**204.2**	**-6.4**
OPM (%)	10.6	12.1	

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

Hindustan Zinc

Viewpoint

High zinc price improves overall performance

CMP: Rs709

Result highlights

- In Q1FY2008, the revenues of Hindustan Zinc (HZL) grew by 22% year on year (yoy) to Rs1,970 crore on the back of higher zinc prices and increased volumes. However in terms of sequential growth, the sales of the company dropped by 3% mainly because of the fall in the production of refined zinc refined metal by 4% quarter on quarter (qoq) to 92,631 tonnes. The company sold 54,835 tonnes of zinc concentrates and 13,651 tonnes of lead concentrates during the quarter. The concentrate sales revenue at $80 million during the quarter was higher than that of Q4FY2007 when the concentrate market was tight.
- The earnings operating profit soared by 15% yoy and 3% qoq to Rs1,436 crore mainly due to increased realisation and improved efficiency. The company is in the lowest decile of the cost curve across the globe. The operating margins contracted by 437 basis points yoy to 73% mainly because of a 92% increase in selling and other expenses due to the rising freight cost.
- The interest outgo declined by 74% yoy whereas the depreciation cost increased by 22% yoy, as the company commissioned a 38.4 megawatt (MW) wind energy plant in the last quarter.
- The profit of the company grew by 36% yoy because of the other income of Rs130.48 crore on account of one time reversal of earlier year liability relating to royalty payments to the government. The adjusted net profit grew by 21% yoy to Rs1,055 crore.

Project status

- HZL is setting up a 170,000 tpa zinc smelter and a 80MW power plant at Chanderiya. The power plant is expected to be commissioned by December 2007, three to four months ahead of schedule.
- The company has a debottlenecking project that will increase the capacity of Chanderiya and Debari smelter by 88,000 tonnes by FY2009.
- The company has a wind energy project of 148.8MW of which 38.4MW was commissioned in the last quarter.

Result table

Particulars	Q1FY08	Q1FY07	Q4FY07	%yoy chg	%qoq chg
Net sales	1,970	1,610	2,021	22	-3
Expenditure	534	366	621	46	-14
Operating profit	1,436	1,244	1,400	15	3
Other income	270	47	74	474	265
EBIDTA	1,706	1,291	1,474	32	16
Interest	7	27	-2	-74	-450
PBDT	1,699	1,264	1,476	34	15
Depreciation	45	37	45	22	0
PBT	1,654	1,227	1,431	35	16
Tax	469	353	492	33	-5
PAT	1,185	874	939	36	26
Extraordinary	130.5	0	0		
Adjusted PAT	1,054.5	874	939	21	12
EPS	24.9	20.7	22.2	21	12
OPM (%)	72.9	77.3	69.3		
PATM (%)	54	54	46		
Zinc refined metal	92,631	82,257	96,298	13	-4
Lead refined metal	13,651	10,459	12,536	31	9
Zinc concentrate (DMT)	54,835	56,000	70,301	-2	-22
Lead concentrate(DMT)	13,651	10,517	14,757	30	-7
Zinc Price ($/tonne)	3685	3275	3462	13	6
Lead Price ($/tonne)	2184	1119	1751	95	25

The remaining 110.4MW is on schedule and is expected to complete by June 2008.

- The above projects will increase the company's capacity by 65% to 658,000 tonnes and also reduce the cost of production.

About the company

HZL is the largest integrated zinc producer in the country with a capacity to produce 400,000 tonnes of zinc and 50,000 tonnes of lead with a 68% market share. The company is targeting a capacity of 1 million tonne of zinc and 0.1 million tonne of lead by 2010. The company, currently, has a total indicated reserve base of approximately 54.1 million tonne with average zinc grade of 8.7% and lead grade of 2.1%, which can take care of production for the next 18 to 20 years.

Key highlights

- The company is committed to exercise the call option and increase its stake further by 26% for which an independent valuer has been appointed by the government.
- The company has allocated a coalmine with HZL share of reserves being approximately 32 million tonne in consortium with 5 other companies. The company expects mining to start after 2 to 3 years.
- The company is continuously exploring the Rampura Agucha mine to enhance the reserves.

Outlook

HZL trades at an enterprise value (EV)/EBIDTA of 3.7x and a price to earnings ratio (P/E) of 6.5x based on June 2007 ttm earnings. We believe with a strong volume growth and reducing cost of production, the company will continue to remain in the high growth trajectory. We believe in view of the strong capital expenditure (capex) plans announced by the company and reducing cost of production by setting up of captive power plant.

Great Eastern Shipping Company

Viewpoint

Capex plan of $470 million in the next two years

CMP: Rs334

We attended the conference call of Great Eastern Shipping company (GESCO) to discuss the Q1FY2008 results. We present the key takeaways from the call.

In Q1FY2007, the company's revenue from freight and charter increased by 47% year on year (yoy) to Rs637.1 crore because of the increase in revenue days of owned tonnage and the inchartered tonnage, which grew to 3,978 days and 349 days respectively in Q1FY2008 from 3,612 days and 88 days in Q1FY2007. The increased time charter yield (TCY) of the vessels, with the dry bulk TCY growing by 84% to US$28,446 per day also contributed to the rise in the revenue from freight and charter.

The operating income in the quarter increased by a decent 34% to Rs312.7 crore. However, the operating margin declined by 460 basis points to 49.1%, as the total expenses grew by 61.6% yoy to Rs324.4 crore in Q1FY2008. The rise in the total expenses was because of the huge rise in chartered hire expenses (which shot up to Rs100.2 crore in Q1FY2008 from Rs15.1 crore in Q1FY2007), increase in the direct operating expenses (a 35.6% year-on-year [y-o-y]) and a rise in the staff cost (34% yoy to Rs53.4 crore).

The net profit of the company for the quarter grew to Rs305.6 crore on the back of an interest cost of Rs31.4 crore (a space 14.6% y-o-y climb deletion), depreciation expense of Rs83.6 crore (a 18% y-o-y increase) and a tax provision of Rs9.3 crore (compared with Rs7.3 crore in Q1FY2007). The extra-ordinary item contributed another Rs115.4 crore to the net profit because of adoption of revised accounting standard AS11 issued by the ministry of company affairs. After taking this Rs115.4 crore into account, the net profit of the company soared by 75% yoy to Rs421 crore.

Three vessels of the company had 77 days of dry-docking in Q1FY2008. According to guidance given by the company, Q2FY2008 will have around 130-140 days of dry-docking, which will be the highest for FY2008. In Q1FY2008, 38% of revenue days were on spot.

According to the company, the average current spot freight rate for a very large crude carrier (VLCC) is around Rs20,000 to Rs25,000 per day, which is similar to the freight rates of Suezmax. The spot rates for dry bulk vessels such as Panamax and Supramax are around Rs60,000 and Rs45,000 respectively. The dry bulk segment contributes around 25% to the company's revenues.

The current net asset value (NAV) of the company is Rs450 per share.

The company took a delivery of a newly built medium range product tanker "Jag Pushpa" and a 1997-built Handymax dry bulk carrier renamed "Jag Riddhi" during Q1FY2008.

During the quarter, the Company contracted to sell its 1992-built single hull VLCC "Ardeshir H Bhiwandiwala", which is likely to be delivered to the buyer around Q2FY2008. The Company also delivered its 1992-built single hull Suezmax "Jag Laadki" during the quarter, which was contracted for sale in the previous quarter.

The company has planned a total capital expenditure of around $470 million. After the end of Q1FY2008, the company has contracted to buy one more 2000-built double hull Suezmax tanker and one Supramax dry bulk carrier (2001-built) from the second hand market. The company also plans to add about 0.68 million dead weight tonnage (mn dwt) by buying the following vessels:

- Five new building product tankers to be delivered between Q2 FY2008 & mid CY2009
- Two Suezmax tankers (2000-built, double hull) to be delivered in Q2 of FY2007-08
- One Supramax dry bulk carrier (2001-built) to be delivered in Q3 of FY2007-08

The company has a fleet of 46 vessels comprising 34 tankers (13 crude oil tankers, 19 product tankers & 2 LPG carriers) and 12 dry bulk carriers (1 Capesize, 2 Panamax, 6 Handymax & 3 Handysize) with an average age of 12.2 years aggregating a total of 3.22 mn dwt.

The Company has no plans, as of now, to enter container shipping and will continue to focus on the current vessel profile.

The company feels that the freight rates of crude oil tankers have almost bottomed out and can move northward in the coming quarters due to decline in crude inventory in the US and increase in oil production by the organisation of petroleum exporting countries (OPEC).

As of now, 58% of company's vessels are double hull and by CY2010, the company expects to have 100% double-hull vessels.

Valuation

At market price of Rs334, the stock is trading at 5.8x its FY2007 earnings and price/NAV multiple of 0.74x its FY2007. GESCO is the largest private sector shipping company in India. The company has an edge over its peers owing to its expertise in applying the vessels (either on spot or in time charter), favourable outlook in crude oil tankers, the ongoing boom in the dry bulk business and timely expansions.

Results table Rs (cr)

Particulars	Q1FY2008	Q1FY2007	% yoy chg
Freight & charter hire	637.1	433.8	46.9
Staff cost	53.4	39.8	34.1
Repairs & maintenance	26.9	34.2	-21.4
Direct operating expenses	106.3	78.4	35.6
Hire of chartered ships	100.2	15.1	563.6
Other expenses	37.6	33.1	13.5
Total expenses	324.4	200.7	61.6
Operating income	312.7	233.1	34.1
Other income	117.2	113.6	3.2
PBIDT	429.9	346.7	24.0
Interest	31.4	27.4	14.6
PBDT	398.5	319.3	24.8
Depreciation	83.6	70.9	17.8
PBT	314.9	248.4	26.8
Provision for taxes	9.3	7.3	26.2
PAT	305.7	241.1	26.8
Extra-ordinary items	115.4	0.0	
Reported PAT	421.0	241.1	74.7
Adj EPS	20.1	15.8	
Margins (%)			
OPM (%)	49.1	53.7	
PATM (%)	48.0	55.6	

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

Sharekhan Stock Ideas

Evergreen

HDFC Bank
Infosys Technologies
Reliance Industries
Tata Consultancy Services

Apple Green

Aditya Birla Nuvo
ACC
Apollo Tyres
Bajaj Auto
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
HCL Technologies
Hindustan Unilever
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
Gateway Distriparks
International Combustion (India)
JK Cement
Madras Cement
Shree Cement
Tourism Finance Corporation of India
Transport Corporation of India

Emerging Star

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Aban Offshore
Alphageo India
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Orchid Chemicals & Pharmaceuticals
ORG Informatics
Tata Elxsi
Television Eighteen India
Thermax
UTI Bank

Ugly Duckling

Ahmednagar Forgings
Ashok Leyland
Aurobindo Pharma
BASF India
Ceat
Deepak Fertilisers & Petrochemicals Corporation
Genus Power Infrastructures
Hexaware 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
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Vulture's Pick

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WS Industries India