investor's eye

Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Aban Loyd	03-Mar-05	330	**879**	1,760
Bajaj Auto	15-Nov-05	1,873	**2,490**	3,500
BHEL	11-Nov-05	1,203	**1,828**	2,650
Infosys	30-Dec-03	689	**1,610**	1,865
Orient Paper	30-Aug-05	214	**393**	675

Sharekhan Special

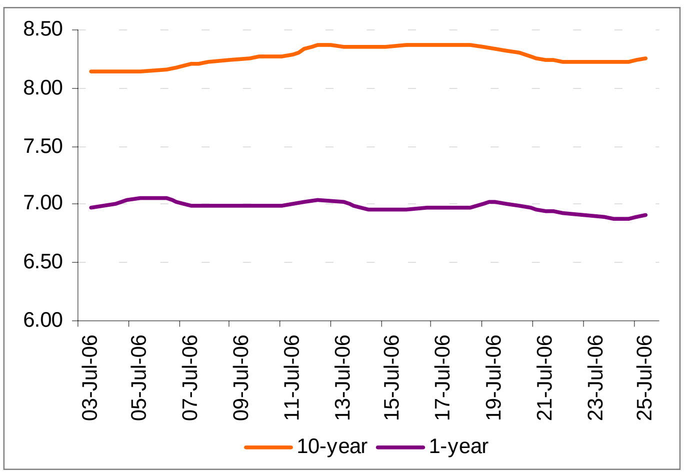
Monetary policy review

The Reserve Bank of India (RBI) has raised the repo and reverse repo rates by 25 basis points each in the first quarter review of its Monetary Policy for 2006-07. The rate hikes were expected looking at the tightening of the interest rates globally.

The salient features of the first quarter review are as follows.

- The reverse repo rate has been increased by 25 basis points to 6% and the repo rate to 7%, effective from July 25, 2006
- The bank rate has been kept unchanged at 6.0%
- The cash reserve ratio (CRR) too remains unchanged at 5.0%, though the RBI will continue to pursue its medium-term objective of a 3% CRR

G-sec yields remain flat post the interest rate hike



Source: Bloomberg

The last rate hike was effected on June 09, 2006 following the increase in the interest rates globally, mainly to protect the foreign exchange reserves and prevent the depreciation of the Indian Rupee.

While the increase in the interest rates has been in line with expectations, we believe that the overall language of the policy statement is less hawkish this time as compared with that of the previous statements. The strong growth in the domestic economy, the performance on the external trade, the strong performance of the corporate sector and the role of the financial sector in recognising the same have all been fairly praised by the central bank. The softened stance can also be gauged from the following excerpt from the policy statement:

"The response of our monetary policy to global developments should be pre-emptive at signs of heightened uncertainties but should also be willing to discern possible trends towards normalcy. Thus, monetary policy may not be unidirectional for a prolonged period, recognising that the pace of changes in the global economic and financial environment is far more rapid now than ever before."

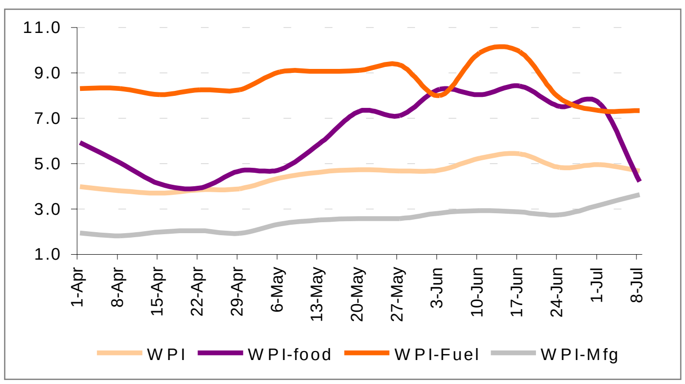
—First Quarter Review of Annual Monetary Policy for the Year 2006-07, RBI

Inflation in comfort zone—food article prices add to concerns

The headline inflation rate has remained below 5%, within the prescribed range of 5.0-5.5% for the year till date. While most of the rise in the inflation rate has been contributed by the increased prices of petroleum products, the increase in the price of food articles has added to the concerns, as we had mentioned in our Sharekhan Special report, "Monetary policy preview" dated July 24, 2006.

The progress of the south-west monsoon and its impact on the *kharif* crops will have to be closely monitored going forward, as a below-normal monsoon could stoke inflation. Thus, the incomplete pass-through of the rising oil prices and the progress of the monsoon are the key concerns with regard to inflation. However, despite these worries, inflation should remain within the targeted range of 5.0-5.5% by the end of FY2007.

Inflation—year till date (y-o-y change)



Source: Ministry of commerce and industry

Domestic liquidity situation remains comfortable

The domestic liquidity situation has remained comfortable in the year till date. The excess liquidity in the system (as reflected in the reverse repo balances, the market stabilisation scheme bonds and the central government's cash balances with the RBI) averaged at Rs88,000 crore for Q1FY2007 compared with an average of Rs65,174 crore during Q4FY2006.

A couple of news articles in recent times have mentioned that the liquidity in the banking sector has been tightening of late. Their view is based on the sequential growth in the deposits mobilised by the banking sector during Q1FY2007 compared with that in Q1FY2006.

The RBI reports the monetary data on every second and fourth fortnight of the month. However, the data needs to be analysed with the caveat that while Q1FY2006 had data for eight fortnights, Q1FY2007 has data related to only seven fortnights. However looking at the data relating to the fortnight ended July 7, 2006 the data is in fact stronger compared on both sequential and year-on-year basis.

Growth in money supply and deposits

	q-o-q basis		y-o-y basis	
	Q1FY07	Q1FY06	Q1FY07	Q1FY06
Money supply	3.3	1.7	18.8	13.8
Deposits	3.2	1.1	20.7	14.9

Source: RBI

Loan growth continues over higher base

The non-food credit of the SCBs grew by a strong 32.9% year on year for the first quarter of the year. The growth was achieved on a higher base, as the non-food credit had grown by 31.0% in the same quarter last year. Even on a sequential basis, the growth in non-food credit was at 2.6% compared with a 1.8% growth in the same quarter last year.

Economy's growth rate maintained at 7.5-8.0%

The RBI has maintained its target of 7.5-8.0% y-o-y growth in the gross domestic product (GDP) for FY2006-07. Of the three key components of the GDP, viz agricultural, industry and services, the industry and service sectors have performed strongly over the first two months of the year.

The Index of Industrial Production (IIP) has grown by 9.8% in the year till date compared with a 9.5% growth in the same period last year. Within the IIP, the manufacturing sector has recorded a 10%+ growth for two consecutive months (April and May) in FY2007 after a period of nearly ten months. The growth in the leading indicators, like cement dispatches and the sales of two-wheelers and commercial vehicles, show that the growth in the manufacturing sector would continue in the coming months.

The buoyancy in the service sector is visible from the growth in the earnings of Indian Railways, subscriber additions by telecom players, increased inflow of tourists into India and the flurry of activity in the financial sectors like banking and insurance.

However, the growth in the agriculture output remains a bit uncertain. For July 2006, which is the most crucial month for the *kharif* crops, the India Meteorological Department has predicted a rainfall 97% of the long-period average, which is near normal (98% and above is normal). Till July 12, nearly one-fifth of the rain dependent areas in India had received a deficient rainfall, but with the ongoing wet spell over the central parts of the country, the situation is expected to improve.

Industrial outlook survey draws positive picture

The RBI's Industrial Outlook Survey has indicated that the business confidence level sustained in the April-June 2006 quarter. The companies covered under the survey have indicated smooth availability of credit in keeping with the increased demand for the same. The performance indicators, like order books, production and capacity utilisation, are expected to be above their respective levels in the preceding quarter.

The expectations for the July-September 2006 quarter are even higher than that achieved in the April-June 2006 quarter.

Further policy move based on inflation and global factors

While the domestic growth remains strong and the liquidity remains comfortable, in future the stance of monetary policy will be based on the movement in inflation and changes in the global factors.

As mentioned before, the rising crude prices and the incomplete pass-through of the same to the consumers coupled with the rising food article prices pose a risk to inflation, which has remained comfortable till date. Inflation in the food articles is likely to ease as the monsoon advances further and remains near normal.

As we had mentioned in our "Monetary policy preview" report, the increase in the interest rate hikes effected by the other central banks like European Central Bank and the US Federal Reserve to keep a tight rein on inflation in their respective economies would be the key thing to watch out for going forward.

Orient Paper and Industries

Vulture's Pick

Stock Update

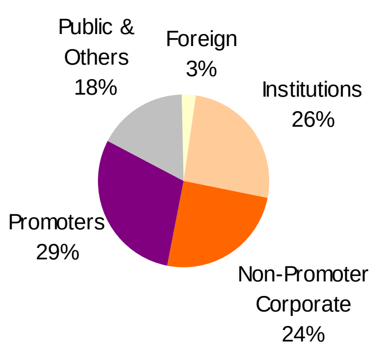
A dream run

Buy; CMP: Rs386

Company details

Price target:	Rs675
Market cap:	Rs573 cr
52 week high/low:	Rs567/146
NSE volume: (No of shares)	25,195
BSE code:	502420
NSE code:	ORIENTPPR
Sharekhan code:	ORIENTPAP
Free float: (No of shares)	1.0 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	7.0	-4.3	51.6	150.6
Relative to Sensex	8.6	10.6	40.3	79.3

Result highlights

- In Q1FY2007 Orient Paper & Industries Ltd (OPIL) earned a net profit of Rs25.8 crore and the same is marginally below our expectation. However the sheer performance of the cement business (earnings before interest and tax [EBIT] per tonne of cement at Rs851 in Q1FY2007 as against Rs206 per tonne in Q1FY2006) would entail an earnings upgrade.
- The company's revenues for the quarter grew by 28.6% to Rs258 crore whereas its earnings grew by a staggering 902%.
- The revenue growth was driven by the cement division, whose revenue grew by 43% to Rs142 crore.
- The other two divisions, ie the paper and fan divisions, delivered a decent performance, registering a revenue growth of 9% and 27% respectively.
- The operating profit for the quarter grew by an astonishing 144% to Rs53.4 crore as the cement division's EBIT almost tripled to Rs47.5 crore, signifying the effect of higher cement prices on the division's profitability. The EBIT of the paper division also registered a 50% growth.
- The operating profit margin (OPM) for the quarter improved by 980 basis points to 20.7%, driven by the stellar performance of the cement division.
- The performance at the operating level was sweetened by a 19% decline in the interest charge and a 3% decline in depreciation. As a result the net profit for the quarter jumped by a staggering 902% to Rs25.8 crore.

Result table Rs (cr)

Particulars	Q1FY2007	Q1FY2006	% yoy chg
Net sales	**258.4**	**201.0**	**28.6**
Total expenditure	205.0	179.1	14.4
Operating profit	**53.4**	**21.9**	**144.1**
Other income	1.4	0.5	193.6
PBIDT	54.8	22.3	145.2
Interest	9.2	11.3	-18.9
Depreciation	6.4	6.6	-3.0
PBT	**39.2**	**4.4**	**792.3**
Tax	13.4	1.8	637.4
PAT	**25.8**	**2.6**	**901.9**
EPS	17.3	1.7	
Margins			
OPM (%)	20.7	10.9	
EBIDTA (%)	21.1	11.1	
PBT (%)	15.1	2.2	
PAT (%)	0.0	0.0	

OPIL is witnessing better times, as its cement division is delivering a stellar performance and the other divisions are also playing their supporting roles well. Going forward, a strong pick-up in the consumption of cement in Andhra Pradesh and Maharashtra, and the resultant revival in cement prices are expected to help the company maintain the performance of its cement division. The paper division is expected to improve its performance on the back of a higher growth in paper consumption whereas the fan business will leverage on its export credential (it supplies to retail giant Wal-Mart) to ramp up and get a strong foothold in the export market. In a nutshell, the key drivers of OPIL's growth are intact and hence the outlook for the company's future remains positive. All the three businesses are peaking simultaneously with the cement business driving the growth.

However the stock price doesn't seem to be discounting the effect of all these developments. At the current market price of Rs386, the stock is discounting the FY2007E earnings by 7.7x and the FY2008E earnings by 5.7x. On an enterprise value (EV)/tonne basis, the stock is trading at a valuation of US$48 per tonne of cement which is even lower than the replacement cost of a new cement plant. We believe such a discount is unwarranted, considering that the various earnings growth triggers are on the verge of unfolding. Also, thanks to the cash and cash equivalents of Rs100 per share on its books (25% of the current market price), the stock offers a decent margin for safety. We thus expect OPIL's valuation to improve and maintain our Buy recommendation on the stock with the price target of Rs675.

Cement, the key growth driver

OPIL's cement division, which contributed 48% to the revenues during FY2006, now contributes 55% to the revenues. The division has single-handedly managed the Q1FY2007 show for OPIL, as the 28.5% revenue growth in the quarter was driven largely by this division. The divsion's revenue grew by a smart 42% to Rs142 crore. The growth in the cement division is due to a strong pick-up in the both cement prices and cement demand in its key markets of Maharashtra and Andhra Pradesh. The quarter marked a huge growth of 49% in cement realisation, which stood at Rs2,537 per tonne or Rs126 per bag.

Segmental Results

Particulars	Q1FY2007	Q1FY2006	% yoy chg
Revenue	258.0	201.1	28.5
Paper & board	68.1	62.3	9.3
Cement	142.0	99.1	42.9
Electric fans	48.7	38.4	27.0
Knowhow & service fees		1.3	-100.0

Particulars	Q1FY2007	Q1FY2006	% yoy chg
EBIT	56.0	19.3	189.4
Paper & board	8.8	5.8	50.1
Cement	47.5	12.0	296.5
Electric fans	-0.8	0.3	-356.3
Knowhow & service fees	0.5	1.2	-55.4
EBIT margin (%)			
Paper & board	12.9	9.4	3.5
Cement	33.5	12.1	21.5
Electric fans	-1.7	0.8	-2.5
Knowhow & service fees		93.1	
Cement dispatches (metric tonne)	558100	581470	-4.0
Realisation per tonne (Rs/tonne)	2537	1704	48.9
EBIT per ton (Rs/tonne)	851	206	313.1

Operating profit up 144% and net earnings up 902%

As the cement division's top line recorded a hefty growth, its profitability also jumped manifold with the quarter witnessing an astonishing 296% growth in the division's EBIT, that stood at Rs47.5 crore. The paper division also delivered a decent performance as it reported a 50% increase in its EBIT. Overall, OPIL's operating profit for the quarter grew by an astonishing 144% to Rs53.4 crore. The performance at the operating level was sweetened by a 19% decline in the interest charge and a 3% decline in depreciation. As a result the net profit for the quarter jumped by a staggering 902% to Rs25.8 core.

Outlook—positive as all three businesses are peaking simultaneously

Going forward, a strong pick-up in the consumption of cement in the key markets of Andhra Pradesh and Maharashtra, and the resultant revival in the cement prices are expected to help OPIL maintain the performance of its cement division. The paper division is expected to improve its performance on the back of a higher growth in paper consumption whereas the fan business will leverage on its export credential (it supplies to retail giant Wal-Mart) to ramp up and gain a strong foothold in the export market. All the three businesses are peaking simultaneously with the cement business driving the growth. In a nutshell, the key drivers of OPIL's growth are intact and hence the outlook for the company's future remains positive.

Valuations extremely attractive—maintain Buy with price target of Rs675

However the stock price doesn't seem to be discounting the effect of all this on OPIL's earnings. We expect OPIL's earnings growth to gain momentum with the earnings growing at a CAGR of almost 60% over FY2006-08E. At the current market price of Rs386, the stock is discounting the FY2007E earnings by 7.7x and the FY2008E earnings by 5.7x. On an EV/tonne basis, the stock is trading at a valuation of US$48 per tonne of cement which is lower than even the replacement cost of a new cement plant. We believe such a discount is unwarranted, considering that the various earnings growth triggers are on the verge of unfolding. Also, thanks to the cash and cash equivalents of Rs100 per share on its books (25% of the current market price), the stock offers a decent margin for safety. We thus expect OPIL's valuation to improve and maintain our Buy recommendation on the stock with the price target of Rs675.

Earnings table

Year ended Mar 31	FY04	FY05	FY06	FY07E	FY08E
Net profit (Rs cr)	-7.7	2.7	39.9	74.5	101.4
% y-o-y growth		*-135.6*	*1364.1*	*86.5*	*36.1*
Shares in issue (cr)	1.5	1.5	1.5	1.5	1.5
EPS (Rs)	-5.2	1.8	26.9	50.2	68.3
% y-o-y growth		*-135.6*	*1364.1*	*86.5*	*36.1*
PER (x)	-74.8	210.0	14.3	7.7	5.7
Book value (Rs)	2.2	4.1	12.9	58.5	122.1
P/BV (Rs)	173.6	94.7	29.9	6.6	3.2
EV/EBIDTA (x)	15.7	15.0	8.4	6.0	4.6
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
RoCE (%)	8.5	9.9	18.4	24.1	26.3
RoNW (%)	-20.1	6.7	97.2	66.5	48.2

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

Godrej Consumer Products

Apple Green

Stock Update

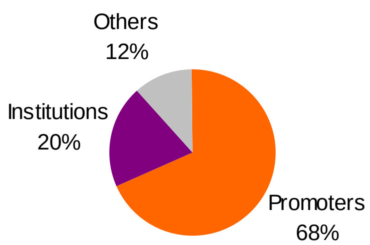
Subdued performance

Buy; CMP: Rs621

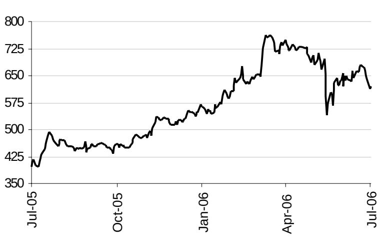
Company details

Price target:	Rs820
Market cap:	Rs3,509 cr
52 week high/low:	Rs799/378
NSE volume: (No of shares)	15,119
BSE code:	532424
NSE code:	GODREJCP
Sharekhan code:	GODRCON
Free float: (No of shares)	1.8 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-3.6	-17.8	10.3	63.6
Relative to Sensex	-2.2	-5.0	2.1	17.1

Result highlights

- Godrej Consumer Products Limited's (GCPL) stand-alone revenues grew by 14.3% year on year (yoy) to Rs191.6 crore in Q1FY2007, marginally below our expectations. The hair colour business reported a subdued growth of 9.9% yoy, which was a key reason for the lower-than-expected revenue growth.
- The company's operating profit (OP) grew by a meagre 7.4% yoy to Rs35.5 crore in Q1FY2007, below our expectations. The operating profit margins (OPM) contracted by 110 basis points to 18.6%. The lower operating profit growth was attributable to a sharp 47.7% rise in the advertising and sales promotion (ASP) spends and the change in the revenue mix in favour of the low-margin toilet soaps business.
- The hair colour business was mainly impacted by the restructuring initiatives of the company like the launching of new products and variants, improving packaging etc. GCPL streamlined the inventory in its supply chain; in the process, the sales of about 30 days were affected. However, the company is confident of making up for the lost sales and achieving growth rates matching the industry rates in the coming quarters.
- GCPL's consolidated revenues stood at Rs237.6 crore, the operating profit stood at Rs42.1 crore and the net profit stood at Rs34.1 crore. The OPM at 17.7% were lower than the stand-alone margins on account of Keyline, since the latter has lower OPM at 14.3%, owing to its low-margin product portfolio.
- In Q1FY2007, Keyline posted revenues of Rs46.0 crore, an operating profit of Rs6.6 crore and a net profit of Rs3.6 crore. The performance of Keyline was certainly below expectations. But all the arguments for acquiring Keyline hold valid and the same shall play out in the coming quarters.

Result table Rs (cr)

Particulars	Q1FY2007	Q1FY2006	% yoy chg
Net sales	191.6	167.7	14.3
Expenditure	156.1	134.6	16.0
Operating profit	35.5	33.1	7.4
Other income	0.8	0.3	170.0
PBIDT	36.4	33.4	8.8
Interest	0.8	0.9	-12.1
Depreciation	2.6	2.7	-1.9
PBT	32.9	29.8	10.4
Tax	2.4	2.7	-9.7
PAT	30.5	27.1	12.4
EPS (Rs/share)	5.4	4.8	12.5
OPM (%)	18.6	19.7	-110 bps
PBTM (%)	17.2	17.8	-60 bps
PATM (%)	15.9	16.2	-30 bps

- We are modifying our FY2007 and FY2008 estimates to factor in the acquisition of Rapidol. Further, we have fine-tuned our earnings forecast for Keyline due to the slower offtake, delayed integration and aggressive brand spends. Consequently the consolidated net profit is revised downward by 11.8% for FY2007E to Rs150.0 crore and by 10.5% for FY2008E to Rs184.3 crore. In the wake of the earnings revision, we have downgraded our price target by 10% to Rs820, discounting its FY2008E consolidated earnings by 25x at the revised target price.

Revenues grow by 14.3% yoy—marginally below expectations

GCPL's own brand business has reported a strong 19% growth in Q1FY2007, as the toilet soaps business has grown ahead of the market growth at 21% yoy and the toiletries business has grown at 41% yoy. However, the hair colour business has reported a relatively subdued growth of 9.9% yoy and the contract manufacturing revenues were wiped out this quarter. Consequently, GCPL's stand-alone revenues grew by 14.3% yoy to Rs191.6 crore in Q1FY2007, marginally below our expectations.

Revenuew break-up

In Rs crore	Q1FY2007	Q1FY2006	% yoy chg
Godrej brands	188.0	157.5	19.4
Soaps	126.5	104.2	21.4
Hair colours	47.3	43.0	9.9
Toiletries	13.2	9.4	41.0
Liquid detergents	1.0	0.9	9.8
Contract manufacturing	0.0	6.7	-100.0
By-products	3.6	3.5	2.9
Revenue	191.6	167.7	14.3

OPM contracted by 110 basis points to 18.6%--below our expectation

The OPM contracted by 110 basis points to 18.6% in Q1FY2007 and consequently the operating profits grew by a meagre 7.4% yoy to Rs35.5 crore. The contraction in the margins was partly attributable to a sharp 47.7% rise in the ASP spends and a change in the revenue mix in favour of the low-margin toilet soaps business. Since the low-margin toilet soaps business grew faster than the hair colour business, the margin pressure was evinced in the quarter under review. The material cost as a percentage of sales though flat on a year-on-year (y-o-y) basis at 49% have increased significantly on a sequential basis (only 43.2% in Q4FY2006) due to the hardening of palm oil and vegetable oil prices—a key ingredient for fast moving consumer goods (FMCG) companies.

Cost analysis

As a % of net sales	Q1FY2007	Q1FY2006	Change in basis points
Material cost	49.3	49.7	-40.0
Employee expenses	5.4	5.8	-40.0
Advert/publ expenses	9.4	7.3	210.0
Other expenses	17.3	17.4	-10.0
Total expenditure	81.4	80.3	110.0
Operating profit	18.6	19.7	-110.0

Segmental results

Soap segment continued its growth momentum—gained market share

The revenues of the soap segment grew by 13.9% yoy to Rs129.5 crore on the back of a 21.4% value growth in the Godrej brand toilet soaps. The growth of the branded toilet soaps category was above the industry growth of 8.0% in the quarter and this helped GCPL to increase its market share by 90 basis points yoy and by 10 basis points quarter on quarter (qoq) to 9.5%. Contract manufacturing was absent this quarter due to the strong demand for GCPL's own brand soaps. Thus, despite a 21.4% yoy growth in the Godrej brand toilet soaps, the soap segment's growth itself was restricted at 13.9% yoy, but was healthy and in line with our expectations.

Personal care segment—hair colour reported lacklustre performance

The revenues of the personal care segment consisting of hair colours, toiletries and liquid detergents, grew by 15.1% yoy to Rs62.1 crore. GCPL's hair colour sales reported a subdued performance, thus restricting the growth to a meagre 15.1% yoy. The hair colour business grew by 9.9% yoy to Rs47.3 crore, against the industry rate of 28.9% yoy. The sales of hair colours during the quarter were mainly impacted by the initiatives of the company to re-stage the category by launching new products and variants and improving the packaging of the existing products under the category. As part of this initiative, GCPL streamlined the inventory in its supply chain; in the process, sales of about 30 days were affected. This impacted the profit before interest and tax (PBIT) margins as hair colours enjoy higher margins. The PBIT margins of the personal care segment shrank by 30 basis points yoy to 38.7%. However, the management is confident of making up for the lost sales in the coming quarters and the company shall achieve our full year forecast of Rs197.2 crore in the revenues, a growth of 20.0% yoy.

Segment result

Particulars	Q1FY2007	Q1FY2006	% yoy chg
Revenues (Rs crore)	191.6	167.7	14.3
Soap	129.5	113.8	13.9
Personal care	62.1	53.9	15.1
PBIT (Rs crore)	40.6	36.2	12.3
Soap	16.6	15.1	9.4
Personal care	24.0	21.0	14.4
PBIT (%)	21.2	21.6	-40.0
Soap	12.8	13.3	-50.0
Personal care	38.7	39.0	-30.0

Net profit growth at Rs30.5 crore—below our expectation

The net profit grew by 12.4% yoy to Rs30.5 crore in Q1FY2007--below our expectation. This is attributable to the lower-than-expected sales growth triggered by the subdued performance of the high-margin hair colour category. This coupled with a jump in the ASP spends resulted in a drop in the OPM and a lower-than-expected growth in the net profit.

Pick-up in performance is likely in subsequent quarters

GCPL has indicated that the slow growth in the hair colour category is temporary in nature owing to the implementation of structural changes. The company is confident of making up for the lost sales and achieving growth rates matching the industry rates in the coming quarters. The company also believes that the underlying growth momentum in the hair colour category is strong.

In the wake of the hardening of vegetable oil and crude prices, the company has hinted at a price hike of up to 15% depending on the product category. This will help in overcoming the cost pressure as is evident by the 580 basis points quarter-on-quarter (q-o-q) jump in the raw material to sales. We believe that GCPL will certainly report a sharp pick-up in its performance in the subsequent quarters and hence we have maintained our stand-alone estimates.

Consolidated profit stood at Rs34.1 crore

GCPL's consolidated result captures the performance of Keyline brands. For Q1FY2007, GCPL's consolidated revenues stood at Rs237.6 crore, the operating profit stood at Rs42.1 crore and the net profit was Rs34.1 crore. The OPM at 17.7% were lower than the stand-alone margins on account of Keyline. The UK subsidiary reported lower OPM than GCPL at 14.3%, owing to its low-margin product portfolio and dragging down the OPM on a consolidated basis. Keyline also has higher interest costs (being a leveraged transaction) and a higher tax rate of 30%. As a result the net profit margins are even lower at 7.9% as compared to 15.9% for the stand-alone company.

For Q1FY2007, Keyline posted revenues of Rs46.0 crore, an operating profit of Rs6.6 crore and a net profit of Rs3.6 crore. Keyline reported a flattish revenue growth, certainly below expectations. But all the arguments for acquiring Keyline hold valid (like cross introduction of products, exploring the benefits of low cost manufacturing) and the same shall play out in the coming quarters.

Acquisition of Rapidol

During the quarter, GCPL entered into an agreement for the acquisition of the South African hair colour business of Rapidol, UK as well as its subsidiary Rapidol International. Rapidol had a turnover of 52 million South African Rand (Approx Rs33 crore) in 2005, PBIT margins of 18-20% and PAT margins of 12.6-14%. At Rs49-50 crore lock, stock and barrel, Rapidol International is attractively valued at 1.5x revenues (2005). We like the idea of acquiring Rapidol as it gives GCPL a direct entry into the large ethnic hair colour markets of South Africa via a profit making company. It also yields ownership of the strong ethnic hair colour brands INECTO and SOFLENE and the existing manufacturing base in Pinetown (near Durban), South Africa. Above that, GCPL has not gone overboard in making this acquisition.

Huge opportunities ahead—GCPL well placed to capitalise

GCPL is a distant number two at 9.5% in the Rs4,500 crore toilet soaps category. This gives the company sufficient room for growth within the category. GCPL has been adding over 100 basis points of market share annually. GCPL is also the market leader with a 40% share in the hair colour business. This market is at a nascent stage with it being one tenth that of the toilet soaps business as against 10x that it ideally is globally. Although international players are also getting aggressive in this category, we expect GCPL to grow at approximately 20% annually.

Valuations

We like GCPL considering: (1) The huge opportunity in its existing product portfolio; (2) the constant lookout for newer product categories to continue momentum; (3) its commitment to grow as is evident through the Rs100 crore capital expenditure; (4) the overall buoyancy in the existing product categories; (5) its growing appetite for risk as is visible through the back-to-back acquisitions of Keyline and Rapidol; and (6) the company's rising international aspirations. All these reasons reinforce our confidence that GCPL will continue to grow at double-digit rates. The dividend payout ratio of 50% maintained in Q1FY2007 also indicates the commitment and confidence of the management.

We are modifying our FY2007 and FY2008 consolidated forecasts to factor in the acquisition of Rapidol whose numbers will be consolidated for seven months. Further, we have fine-tuned our earnings forecast for Keyline, due to the slower offtake, delayed integration and aggressive brand spends. Consequently the consolidated net profit is revised downward by 11.7% for FY2007E to Rs150.0 crore and by 10.5% for FY2008E to Rs184.3 crore. In the wake of the earnings revision, we have downgraded our price target by 10% to Rs820, discounting its FY2008E consolidated earnings by 25x at the revised target price.

Earnings table (consolidated)

Particulars	FY2006	FY2007E	FY2008E
Net profit (Rs cr)	119.4	150.0	184.3
Share in issue (cr)	5.6	5.6	5.6
EPS (Rs)	21.1	26.6	32.6
% y-o-y growth	*0.0*	*23.6*	*22.8*
PER (x)	29.4	23.4	19.0
Book value (Rs)	13.2	23.8	40.4
P/BV (x)	46.9	26.1	15.4
EV/Ebidta (x)	25.6	19.1	15.4
Dividend yield (%)	2.3	2.3	2.3
ROCE (%)	91.2	72.9	70.3
RONW (%)	151.8	108.4	79.3

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

Marico Industries

Apple Green

Stock Update

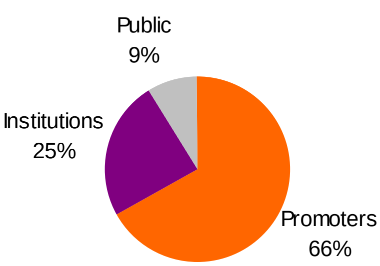
Q1FY2007—first cut analysis

Buy; CMP: Rs459

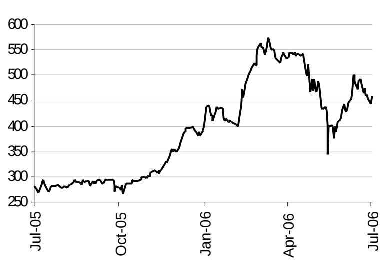
Company details

Price target:	Rs634
Market cap:	Rs2,662 cr
52 week high/low:	Rs586/263
NSE volume: (No of shares)	33,198
BSE code:	531642
NSE code:	MARICO
Sharekhan code:	MARICO
Free float: (No of shares)	1.9 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	3.1	-16.4	13.7	60.4
Relative to Sensex	4.5	-3.4	5.3	14.8

Result highlights

- Marico's Q1FY2007 net revenues grew by 37.7% year on year (yoy) to Rs372.8 crore, ahead of our estimates. The strong top line growth was driven by a 25% growth in Marico's focused brands portfolio and aided by the contribution of brands *Nihar*, *Manjal*, *Camelia* & *Aromatic* acquired last year.
- The operating profit margin expanded by 420 basis points to 15.1% on account of the material costs and employee expenses as a percentage of sales being lower. Consequently the operating profit grew by 90.1% yoy to Rs56.3 crore, ahead of our estimates.
- The interest cost for Q1FY2007 grew by a whopping 472.6% yoy to Rs4.8 crore, on account of the debt taken to acquire *Nihar*. Even the depreciation cost jumped by 174.2% yoy to Rs11.2 crore on account of the write-off of the intangible assets.
- Higher interest and depreciation slowed down the profit before tax growth, which grew at 65.4% to Rs41.4 crore, but still ahead of our expectation.
- Marico exhausted its minimum alternate tax credit in FY2006, which resulted in a higher tax provisioning. Consequently the taxes went up 236.1% yoy with the effective tax rate doubling to 26.8%.
- The net profit before extraordinary items grew by 39.4% yoy to Rs30.3 crore, ahead of our expectation. The net profit after extraordinary items grew by 45.7% yoy to Rs30.3 crore.

Result table Rs (cr)

Particulars	Q1FY2007	Q1FY2006	% yoy chg
Net sales	372.8	270.8	37.7
Total expenditure	316.5	241.2	31.2
Operating profit	56.3	29.6	90.1
Other income	1.1	0.3	224.2
PBIDT	57.3	29.9	91.6
Depreciation	11.2	4.1	174.2
Interest	4.8	0.8	472.6
PBT	41.4	25.0	65.4
Tax	11.1	3.3	236.1
PAT (before extraordinary)	30.3	21.7	39.4
Extraordinary items	0.0	-0.9	-
PAT (after extraordinary item)	30.3	20.8	45.7
EPS	5.2	3.7	39.4
OPM (%)	15.1	10.9	420 bps

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

Nucleus Software Exports

Viewpoint

On a growth path

CMP: Rs335

Result highlights

- The revenue of Nucleus Software Exports grew by 18.2% quarter on quarter (qoq) and by 51.5% year on year (yoy) to Rs49.8 crore in Q1FY2007. The sequential growth was driven largely by the unexpected jump of 30.3% qoq in the product revenues to Rs24.2 crore. On the other hand, the sequential growth of 7.1% in the project revenues was in line with expectations.
- The earnings before interest, depreciation, tax and amortisation (EBIDTA) margin plummeted by 300 basis points qoq to 29% on the back of the salary hikes and robust recruitment during the quarter. The company added 352 employees in Q1, an increase of 33% over the base of 1,068 employees at the beginning of the first quarter. However, the management reiterated its guidance of maintaining the EBITDA margin at over 30% for the full year FY2007.
- The consolidated earnings grew at a relatively higher growth rate of 21.4% qoq and 56.1% yoy to Rs13.4 crore. The earnings growth was boosted by the higher other income of Rs2.2 crore (up from Rs0.6 core in Q1FY2006 and Rs0.5 crore in Q4FY2006) and a relatively lower tax rate.
- The order backlog stood at Rs131 crore, which is flat on a sequential basis. During the quarter, the company added four new clients and sold six modules of its flagship product, FinnOne.
- At the current market price, the stock trades at 14.6x FY2006 earnings and around 10.5x FY2007 rough-cut earning estimates.

Consolidated results

(Rs crore)	Q1FY07	Q1FY06	Q4FY06	% yoy	% qoq
Net revenue	49.8	32.8	42.1	51.5	18.2
EBIDTA	14.4	10.8	13.5	33.7	6.9
APAT	13.4	8.6	11.0	56.1	21.4
Equity capital	16.1	16.1	16.1		
EPS	8.3	5.3	6.8		
Margins (%)					
GPM	41.5	48.8	48.1		
OPM	29.0	32.8	32.0		
NPM	25.8	25.6	25.9		

Order pipeline is robust

During the quarter, the company added four new clients including a large financial institution from Japan, one client in Sri Lanka and two in India (Indiabulls and Cholamandalam DBS). Notwithstanding the stagnant order backlog, the management indicated that it is witnessing strong traction from newer geographies like Africa (where it is implementing the first order for its flagship product in Nigeria) and Europe (from auto finance companies after the successful implementation of its product for General Motors Acceptance Corporation [GMAC] in Italy).

Moreover, the record recruitment of 352 employees (largely for the product business) also indicates the company's growing confidence in the growth visibility of its product business. For the year, the company is targeting to add 500 employees (of which 350 would be deployed in the product business, including around 100 for product development and 250 in implementation).

Margins decline sharply

An aggressive salary hike (an average of over 20% raise given to the offshore employees till the middle management level, amounting to additional expenses of Rs2 crore) and the record high recruitment depressed the gross profit margin by 660 basis points to 41.5% on a sequential basis, in spite of the favourable impact of depreciation in the rupee and increase in the contribution from the product business (up 48.6% from 44.1% in Q4FY2006). However, the impact of the same on the EBIDTA margin was limited to 300 basis points due to the saving of 360 basis points qoq in the selling, general and administrative expenses as a percentage of sales.

The EBIDTA margin is likely to remain under pressure in Q2, as the company would give annual salary hikes to the onsite employees and senior management with effect from July 2006.

On the positive side, the management is confident of maintaining the EBIDTA margin at over 30% for the full year FY2007. This implies a significant improvement in the margins in the second half of the year. The company hopes to achieve the same through better employee utilisation and higher proportion of revenues from the high-margin product business.

Other highlights

- The order backlog stood at Rs131 crore, which includes product orders worth Rs81 crore and projects worth Rs50 crore. The pending order book from the GMAC deal stood at Rs33 crore (included in the product order book).
- Cash and cash equivalents stood at Rs77.4 crore, amounting to cash of Rs48 per share. The company is investing Rs20 crore in the developing phase II of its facilities in Noida that would accommodate 800 employees.
- The attrition rate was at a comfortable level of 14%.
- The receivables days at 59 continue to be below the 60-day benchmark set by the management. The absolute amount of receivables stood at Rs32 crore.
- The company hopes to achieve its first product order in the USA during the current year. It is currently adding functionalities to its lending product to suit the US markets. Nucleus has adopted a strategy to tap developed markets through partnership with large system integrators and local distributors.

Valuation

At the current market price the stock trades at 14.6x FY2006 earnings and around 10.5x FY2007 rough-cut earning estimates.

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Sharekhan Stock Ideas

Evergreen

- HDFC Bank
- Infosys Technologies
- Reliance Industries
- Tata Consultancy Services

Apple Green

- Aditya Birla Nuvo
- Associated Cement Companies
- Bajaj Auto
- Balrampur Chini Mills
- Bharat Bijlee
- Bharat Heavy Electricals
- Corporation Bank
- Crompton Greaves
- Godrej Consumer Products
- Elder Pharmaceuticals
- Grasim Industries
- Hindustan Lever
- Hyderabad Industries
- ICICI Bank
- Indian Hotel Company
- ITC
- Mahindra & Mahindra
- Marico Industries
- Maruti Udyog
- MRO-TEK
- Lupin
- Nicholas Piramal India
- Omax Auto
- Ranbaxy Laboratories
- Satyam Computer Services
- Sintex Industries
- SKF India
- State Bank of India
- Sundaram Clayton
- Tata Motors
- Tata Tea
- Unichem Laboratories
- Wipro

Cannonball

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

Emerging Star

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

Ugly Duckling

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

Vulture's Pick

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

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