investor's eye

Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Bharti	8-Jan-07	625	**809**	1,100
Glenmark	17-Jul-08	599	**588**	754
HDFC	19-Nov-07	2,700	**2,327**	2,912
L&T	18-Feb-08	3,536	**2,577**	4,044
Orbit	17-Dec-07	800	**223**	808

Hindustan Unilever

Apple Green

Stock Update

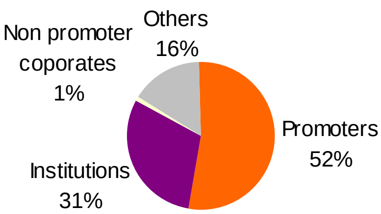
Tackling surge in input cost head-on

Buy; CMP: Rs249

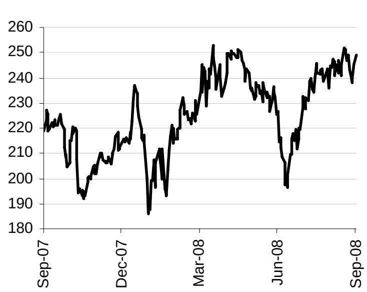
Company details

Price target:	Rs280
Market cap:	Rs54,306 cr
52 week high/low:	Rs256/170
NSE volume: (No of shares)	4.5 lakh
BSE code:	500696
NSE code:	HINDUNILVR
Sharekhan code:	HLL
Free float: (No of shares)	104.3 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	0.7	7.3	10.3	18.0
Relative to Sensex	4.2	14.5	16.5	35.5

Key points

- To combat the surge in its input cost, Hindustan Unilever Ltd (HUL) has implemented a two-pronged strategy of increasing the prices of its products and cutting the pack sizes of its prominent detergent brands. The company has implemented price hikes in the range of 11-20% in its key detergent brands.
- Prices of some of the key inputs in detergents, such as linear alkyl benzene (LAB) and caustic soda flakes, have increased significantly. Caustic soda prices have gone up by 35.4% to Rs31.3 per kg in August 2008, compared to Rs23.0 per kg in April 2008.
- Thus, we believe that price hikes implemented by the company would partly offset the cost inflation and minimise the pressure on the margin of the soap and detergent business to some extent.
- Though crude palm oil prices have softened by 25.7% (2,500 MYR per tonne at the beginning of September 2008 vs 3,363.8 MYR per tonne in July 2008), the prices of the other key inputs, such as LAB and caustic soda flakes, and auction tea have hardened significantly. We believe that the company would continue to make big investments in advertising and brand building activities to counter the launches in soap and shampoo categories from its major competitor, ITC, and to sustain its market share. Thus, the overall margin of the company would remain under pressure going forward.
- At the current market price of Rs249.3, the stock is trading at 22.7x its CY2009E earnings per share (EPS) of Rs13.1. We maintain our Buy recommendation on the stock with a price target of Rs280.

HUL implements a two-pronged strategy

To combat the surge in its raw material cost, HUL has implemented a two-pronged strategy of increasing the prices of its products and reducing the pack sizes of its prominent detergent brands. The company has cut down the package size of *Surf Excel* from 500gm to 475gm and increased the price of the same by Rs6 to Rs55 (the

Valuation table

Particulars	CY2005	CY2006	CY2007	CY2008E	CY2009E
Net profit (Rs crore)	1310.7	1539.7	1769.1	2076.2	2391.5
% y-o-y growth	*10.8*	*17.5*	*14.9*	*17.4*	*15.2*
Shares in issue (crore)	220.12	220.7	217.7	217.8	217.8
EPS (Rs)	6.0	7.0	8.1	9.5	11.0
PER (x)	41.9	35.7	30.7	26.2	22.7
Book value (Rs)	10.5	12.3	6.6	9.1	13.1
P/BV (Rs)	22.2	18.8	35.1	25.5	17.7
EV/EBIDTA (x)	33.8	29.4	26.0	21.8	18.7
RoCE (%)	54.8	72.6	102.2	143.8	120.4
RoNW (%)	59.6	61.2	85.0	121.2	98.9

price of a 500gm *Surf Excel* pack has been hiked by18.4% to Rs58). The company has also increased the price of *Surf Excel* by 11.4% to Rs156 for a pack of 1.5kg.

On the other hand, the company has reduced the pack size of *Wheel* (green) 600gm and 300gm while leaving their prices unchanged at Rs20 and Rs10 respectively. This has resulted in a price hike of 20% in the mass category brand.

Price hikes implemented

Detergents	Current (Rs)	Previous (Rs)	% chg
Surf Excel (475 gm)	55	49	18.4
Surf Excel (1.5 Kg)	156	140	11.4
Surf Excelmatic (500 gm)	82	82	0.0

Pack-size cut

Detergents	Current size (gm)	Previous size (gm)	Price
Wheel (green)	250	300	Rs10
Wheel (green)	500	600	Rs20

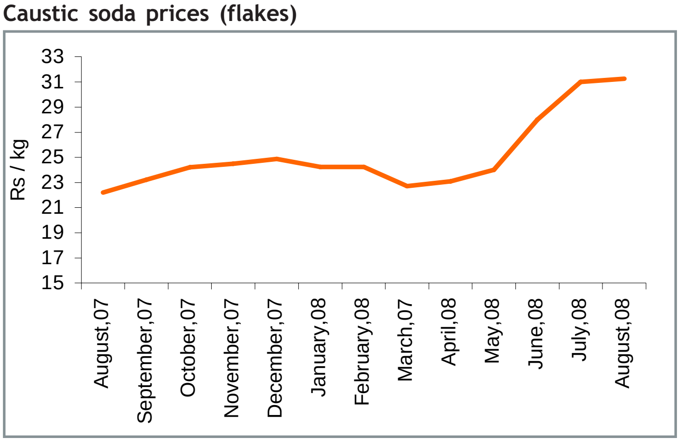
Source: Sharekhan research

Rationale behind the price hike

- *Surge in prices of key raw materials exerts pressure on margins*

  LAB is one of the main components of detergents. The recent rally in crude oil prices has resulted in a substantial hike in the prices of LAB, exerting pressure on the margins of the company's soap and detergent business.

Caustic soda prices (flakes)



On the other hand, caustic soda flake prices have increased significantly by 35.4% to Rs31.3 per kg from Rs23.0 per kg in April 2008. Global caustic soda prices saw an uptrend recently on the back of the temporary shutdown in manufacturing facilities and disruptions in the transport system in USA in the wake of hurricane Gustav. However, the prices may remain firm in the near future before the production and supply of global caustic soda normalise.

- *Strategy to improve soap and detergent margin*

  Despite the prudent price hikes implemented in the previous couple of quarters, the profit before interest and tax (PBIT) margin of the soap and detergent segment declined by 116 basis points in Q2CY2008. We believe the price hikes implemented by the company recently would partly offset the cost inflation and also minimise the pressure on the soap and detergent margin to some extent.

Outlook and valuation

Though crude palm oil prices have softened by 25.7% in recent times, the prices of the other key inputs, such as LAB and caustic soda flakes, and auction tea have hardened significantly. We believe the company would continue to make big investments in advertising and brand building activities to counter the launches in soaps and shampoos from its major competitor, ITC, and to sustain its market share. Thus, the overall margin of HUL would remain under pressure going forward.

On the other hand, in the current economic conditions, we might see discretionary spending by consumers affecting the volume growth of the company. Though HUL has appropriately positioned itself catering to all segments of consumers, profitability growth is going to be tougher to achieve going forward. At the current market price of Rs249.3, the stock is trading at 22.7x its CY2009E EPS of Rs13.1. We maintain our Buy recommendation on the stock with a price target of Rs280.

Gateway Distriparks

Cannonball

Stock Update

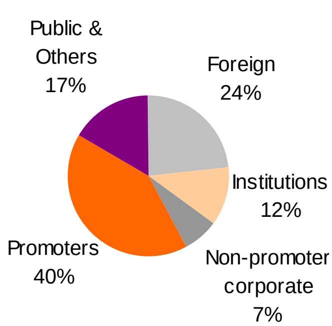
Annual report review

Buy; CMP: Rs87

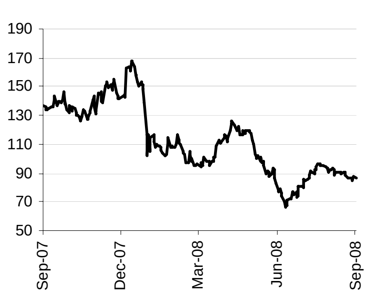
Company details

Price target:	Rs236
Market cap:	Rs1,017 cr
52 week high/low:	Rs174/65
NSE volume: (No of shares)	4.7 lakh
BSE code:	632622
NSE code:	GDL
Sharekhan code:	GATEWAY
Free float: (No of shares)	6.8 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-5.1	1.4	-7.7	-35.2
Relative to Sensex	-1.8	8.2	-2.5	-25.6

We recently studied the latest annual report (for FY2008) of Gateway Distriparks Ltd (GDL). We present the highlights of the report below.

- Financial year 2008 proved to be a mixed year for GDL as the company's top line saw a strong growth in this period on the back of an excellent volume growth. However, a change in the revenue mix in favour of the new businesses and the lower-margin container freight station (CFS) of Punjab Conware led to a decline in the profitability of the company during the year.

- Despite challenges, the company expects the growth in the container traffic to continue in FY2009 and is in the process of expanding the capacity at its CFS at Visakhapatnam and setting up a new CFS at Kochi. Its inland container depots (ICDs) at Ludhiana and Faridabad are also expected to become operational in the next couple of years. Besides, the company would continue to aggressively expand its fleet in the rail business and has already placed orders for ten more trains.

- The net cash flow from operations after working capital adjustments remained healthy for the company at Rs80.75 crore. The working capital management has improved as the net working capital cycle reduced to a negative 17.5 days in FY2008 as against a positive 14.6 days last year. On account of a strong capital expenditure (capex) owing to its entry into new businesses and a decline in its profitability, the return ratios dipped during the year. The return on capital employed (RoCE) dropped by 1.9% to 12.5% while the return on net worth (RoNW) dipped by 1.3% to 11.1% during FY2008. The current debt/equity ratio is comfortable at 0.3x and despite its big capex plans, we expect the ratio to be maintained going forward.

- Increased volumes in the core business, combined with the deployment of more rails on the export-import (EXIM) route, are expected to strengthen the performance of GDL going forward. At the current levels, the GDL stock is trading at 9.3x FY2010E earnings. We maintain our Buy recommendation on the stock with a price target of Rs236.

Valuation table

Particulars	FY2007	FY2008	FY2009E	FY2010E
Net profit (Rs cr)	77.0	72.0	93.8	109.6
EPS (Rs)	8.4	6.2	8.1	9.5
% yoy growth	*5.5*	*-25.6*	*30.3*	*16.8*
PER (x)	10.6	14.2	10.9	9.3
Book Value (Rs)	67.0	55.9	61.1	67.5
P/BV (Rs)	1.3	1.6	1.4	1.3
EV/EBIDTA (x)	7.6	10.7	7.1	6.0
RoCE (%)	14.4	17.5	16.4	16.7
RoNW (%)	12.4	14.5	13.3	14.0

FY2008: Strong volume growth but low yield on new businesses suppresses margins

For FY2008 GDL has reported a top line growth of 68.7% achieved on the back of a brilliant 53% growth in its overall volumes due to the addition of Punjab Conware and Garhi ICD. During the year, the company started to provide end-to-end logistic solutions from the Garhi ICD, via rail transportation services, through an agreement with Container Corporation of India. As a result, the Garhi ICD in Delhi witnessed a 78% jump in its volumes during the year.

Volumes

Business	FY2007	FY2008	% growth
CFS			
Navi Mumbai	171,279	251,728	47.0
Chennai	41,473	62,553	50.8
Vishakhapatnam	10,661	15,631	46.6
Kochi		922	-
CFS-Total	**223,413**	**330,834**	**48.1**
ICD-Garhi	17,078	30,375	77.9
Rail (Domestic)		6,291	-
Rail - total	**17,078**	**36,666**	**114.7**
Total	**240,491**	**367,500**	**52.8**

Change in revenue mix, losses of new businesses affect margins

Despite a strong volume growth, the operating performance of the company was below expectations because of a lower yield and a slower than expected ramp-up in the new businesses. The company invested a total of Rs222.98 crore during the year towards capex. The bulk of this investment was made in the container rail business (Rs125.4 crore) while about Rs58.5 crore and Rs38.04 crore were spent on the CFS and road transportation businesses respectively. The rail and road transportation businesses are more capital intensive because of which and certain teething problems the consolidated margin and return ratios of the company dropped in FY2008. To illustrate, a total of Rs163.4 crore was spent on the container rail and road transportation businesses during the year but these investments together resulted in an incremental top line of just Rs53.8 crore.

Segmental performance Rs (cr)

Particulars	FY2008	FY2007
Revenues		
CFS	206.2	156
Container Rail	28.1	0.0
Road Transportation	25.7	0.0
Others	14.0	8.6
Total	274.0	164.7
Inter-segmental revenues	0.0	0.3
Net sales	274.0	164.4

Segmental performance Rs (cr)

Particulars	FY2008	FY2007
PBIT		
CFS	87.6	75.8
Container Rail	-8.8	0.0
Road Transportation	-1.5	-1.7
Others	1.7	0.0
Total	78.9	74.1
PBIT margins (%)		
CFS	42.5	48.5
Container Rail	-31.4	-
Road Transportation	-6.0	-
Others	12.1	0.0

Furthermore, GDL pays an annual royalty to the Punjab government for managing the Punjab Conware CFS at Jawaharlal Nehru Port Trust (Rs7.92 crore in FY2008), which further affected the earnings before interest, tax, depreciation and amortisation (EBITDA) margin during the year.

Reduction in EBIDTA per TEU of the CFS business

Particulars	FY2007	FY2008	% growth
Total TEU handled	223,413	330,834	48.1
EBIDTA (Exc inv income)	81.1	109.7	35.3
EBIDTA per TEU (Rs)	3,628.7	3,315.3	-8.6

As a result, the operating profit margin (OPM) reported a decline of 1,270 basis points year on year to 37.7%. Higher interest cost and depreciation charge further affected the profitability as the consolidated profit dropped by 6.5% to Rs72 crore in FY2008.

Operational highlights

The net cash flow from its operations remained healthy for the company at Rs80.75 crore. The working capital management improved as the net working capital cycle reduced to a negative 17.5 days in FY2008 as against a positive 14.6 days in the last year. On account of a strong capex and a decline in profitability, the return ratios dipped during the year. The RoCE declined by 1.9% to 12.5% while the RoNW dropped by 1.3% to 11.1% during the year.

Future outlook

CFS business

Though the company does see challenges ahead on account of the slowing global economy, it is quite confident that the growth witnessed in the container traffic in FY2008 would continue into the next year as well. As a road to expansion, GDL is now in the process of expanding capacity at its CFS at Visakhapatnam and setting up a new CFS at Kochi.

Inland container depots business

The company's ICDs at Ludhiana and Faridabad are expected to be operational in FY2009 and FY2010 respectively. These two ICDs together with the ICD near Gurgaon will cater to the northern Indian hinterland and boost the company's volumes going forward.

Rail business

GDL has already deployed twelve trains so far in the rail business; out of these six are deployed on domestic routes while three each are deployed on reefer and EXIM routes. Going forward, the capex exercise in the rail business would continue with the company planning to add 22 more trains in its next phase of expansion to be implemented over the next couple of years. GDL has already placed orders for ten more trains, which would be delivered during the current financial year. About Rs300 crore is expected to be spent on this business in the next two years. The overall capex over the next couple of years is likely to be about Rs400 crore.

Though a substantial part of this capex is likely to be funded through internal accruals in view of the company's healthy cash flows, the company would need to finance the rest through debt. However, considering its comfortable balance sheet status currently (a debt: equity ratio of 0.3x), we do not foresee any pressure on the balance sheet going forward and expect the debt: equity ratio to remain at these levels going forward too.

Valuation and view

Increased volumes in the core business, combined with the deployment of more rails on the EXIM route, are expected to strengthen the performance of GDL going forward. At the current levels, the GDL stock is trading at 9.3x FY2010E earnings. We maintain our Buy recommendation on the stock with a price target of Rs236.

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

Sharekhan Stock Ideas

Evergreen

Housing Development Finance Corporation
HDFC Bank
Infosys Technologies
Larsen & Toubro
Reliance Industries
Tata Consultancy Services

Apple Green

Aditya Birla Nuvo
Apollo Tyres
Bajaj Auto
Bajaj Finserv
Bajaj Holdings & Investment
Bank of Baroda
Bank of India
Bharat Bijlee
Bharat Electronics
Bharat Heavy Electricals
Bharti Airtel
Canara Bank
Corporation Bank
Crompton Greaves
Elder Pharmaceuticals
Glenmark Pharmaceuticals
Grasim Industries
HCL Technologies
Hindustan Unilever
ICICI Bank
Indian Hotels Company
ITC
Mahindra & Mahindra
Marico
Maruti Suzuki India
Lupin
Piramal Healthcare (Nicholas Piramal India)
Punj Lloyd
Ranbaxy Laboratories
Satyam Computer Services
State Bank of India
Tata Motors
Tata Tea
Wipro

Cannonball

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

Emerging Star

3i Infotech
Aban Offshore
Alphageo India
Axis Bank (UTI Bank)
Balaji Telefilms
BL Kashyap & Sons
Cadila Healthcare
Jindal Saw
KSB Pumps
Navneet Publications (India)
Network 18 Fincap
Nucleus Software Exports
Opto Circuits India
Orchid Chemicals & Pharmaceuticals
Patels Airtemp India
Television Eighteen India
Thermax
Zee News

Ugly Duckling

Ashok Leyland
BASF India
Ceat
Deepak Fertilisers & Petrochemicals Corporation
Genus Power Infrastructures
ICI India
India Cements
Indo Tech Transformers
Ipca Laboratories
Jaiprakash Associates
KEI Industries
Mahindra Lifespace Developers
Mold-Tek Technologies
Orbit Corporation
Punjab National Bank
Ratnamani Metals and Tubes
Sanghvi Movers
Selan Exploration Technology
SEAMEC
Shiv-Vani Oil & Gas Exploration Services
Subros
Sun Pharmaceutical Industries
Surya Pharmaceutical
Tata Chemicals
Torrent Pharmaceuticals
UltraTech Cement
Union Bank of India
Unity Infraprojects
Wockhardt
Zensar Technologies

Vulture's Pick

Esab India
Orient Paper and Industries
WS Industries India