investor's eye

Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Ashok Leyland	23-May-06	38	**39**	53
Elder Pharma	26-Apr-06	298	**290**	410
Subros	26-Apr-06	206	**199**	370
TVS Motor	03-Apr-06	140	**126**	210
WS Industries	02-Dec-05	51	**57**	112

Omax Auto

Apple Green

Stock Update

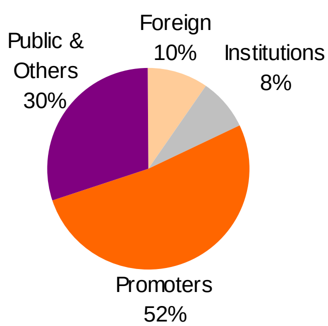
Profit margins below expectations

Buy; CMP: Rs82

Company details

Price target:	Rs178
Market cap:	Rs175 cr
52 week high/low:	Rs174/80
NSE volume: (No of shares)	44,195
BSE code:	520021
NSE code:	OMAXAUTO
Sharekhan code:	OMAX
Free float: (No of shares)	1.0 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-25.8	-37.6	-40.4	-20.8
Relative to Sensex	-13.0	-34.8	-47.3	-48.0

Result highlights

- Omax Auto's Q4FY2006 net sales were flat at Rs142 crore. The earnings before interest, depreciation, tax and amortisation (EBIDTA) margin for the quarter declined by 230 basis points to 8.1% mainly due to an increase in the employee and fuel costs. The profit after tax (PAT) for the quarter is down by 7% to Rs4.95 crore.
- For the full year, the sales have registered a growth of 9.2% to Rs578 crore. Exports for FY2006 were at Rs27 crore as compared with Rs15 crore in the previous year.
- The operating profit for the year rose marginally by 1% to Rs49.8 crore, as the operating profit margin (OPM) declined from 9.3% to 8.6%. The net profit for the year was flat at Rs20.04 crore as compared with Rs20.29 crore in FY2005.
- The company is aiming to double its exports in the next two years. The domestic operations are expected to recover with the stabilisation and improvement of the performance of its Bangalore and Binola plants. We are upgrading the earnings estimate for FY2007 by 6.4% to Rs14.9 and introducing our earnings estimate for FY2008 at Rs20.8.
- At the current market price of Rs82, the stock trades at 4.1x its FY2008E earnings. We maintain our Buy call on the stock with a price target of Rs178.

Net revenues grew by 9.2% to Rs578.6 crore

The net revenues for FY2006 have grown by 9.2% to Rs578.6 crore. The exports for the year stood at Rs27 crore (5% of the total sales) as compared with Rs15 crore in the corresponding period last year. The exports were lower than estimated as the order from Arvin Meritor was delayed during the year.

Operating profit flat; margins drop 70 basis points

The operating profit for the year was flat at Rs49.8 crore, whereas the OPM declined by 70 basis points to 8.6%. The margins contracted due to a 20% rise in the staff cost and a 29% rise in the other expenses mainly due to the under utilisation at the company's two new plants and higher power and fuel costs.

Result table Rs (cr)

Particulars	Q4 FY2006	Q4FY2005	% yoy chg	FY2006	FY2005	% yoy chg
Net sales	142.0	141.5	0.4	578.6	529.8	9.2
Operating expenses	130.6	126.9	2.9	528.8	480.3	10.1
Operating profit	11.5	14.7	-21.9	49.8	49.5	0.6
Other income	3.3	1.4	130.8	7.5	5.9	26.6
EBIDTA	14.8	16.1		57.3	55.4	3.3
Interest	4.0	2.8	42.0	10.7	8.0	33.9
Depreciation	3.5	6.6	-46.6	16.1	17.1	-6.1
PBT	7.2	6.7	8.4	30.5	30.3	0.6
Tax	2.3	1.4		10.4	10.0	
PAT	4.9	5.3	-7.0	20.0	20.3	-1.2
EBITDA (%)	8.1	10.4		8.6	9.3	
EPS	2.3	2.5		9.4	8.9	

Net profit for FY2006 remains flat

The net profit stood at Rs20.04 crore, as compared with Rs20.29 crore in the previous year.

Outlook

The management is expecting a revival in the domestic sales and profitability following the stabilisation of the new units at Bangalore and Binola. The company has received orders from TVS Motors, Delphi, Denso and New Holland Tractors. We have estimated a growth of 15% in its domestic sales.

The management has downgraded its export target for FY2007 from Rs80 crore to Rs50 crore, due to the delay in the flow of order from Arvin Meritor. It is targeting exports of Rs100 crore for FY2008.

On the cost front, the company is planning to reduce its power and fuel costs by replacing diesel generation sets with a low-cost fuel. It also plans to control the employee cost by increasing automation, productivity and reducing contract workers.

The company has set up a subsidiary called Omax Steels at a cost of Rs5.57 crore. Omax Steels is expected to commence operations from September 2006 onwards. Omax Auto would consume one-third of the subsidiary's produce. Omax Steels is projected to achieve sales of Rs25 crore in FY2007, Rs70 crore in FY2008 and Rs100 crore in FY2009.

Earnings revision

We have marginally upgraded our earnings estimate for FY2007 from Rs14 per share to Rs14.9. We also introduce our earnings estimate for FY2008 at Rs20.8.

Valuations

We believe that the company would benefit from the strong growth in the two-wheeler industry. We expect it to take advantage of the outsourcing opportunity. Though the export business has been a laggard, we expect the export revenues to rise in the coming years.

At the current levels, the stock discounts its FY2008E earnings by 4.1x and enterprise value by 3.2x. The stock appears to be attractive at these levels and we maintain our Buy recommendation with a price target of Rs178.

Earnings table

Year ended 31st Mar	FY2004	FY2005	FY2006E	FY2007E
Net sales (Rs cr)	394.3	529.8	578.6	684.3
% y-o-y growth		*34.4*	*9.2*	*18.3*
Net profit (Rs cr)	19.5	20.3	20.0	39.8
Share in issue (Rs cr)	2.2	2.3	2.3	2.3
EPS (Rs)	9.0	8.9	9.4	18.6
% y-o-y growth		*-0.6*	*5.0*	*98.4*
PER (x)	9.6	9.6	9.2	4.6
Book value (x)	34.6	43.9	52.8	69.1
P/BV (x)	2.5	2.0	1.6	1.2
EV/EBITDA (x)	6.2	5.4	5.9	3.7
Dividend yield (%)	2.0	2.3	2.3	2.6
RoCE (%)	20.0	16.8	13.4	19.9
RoNW (%)	32.1	23.2	18.8	30.5

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

Lupin

Apple Green

Stock Update

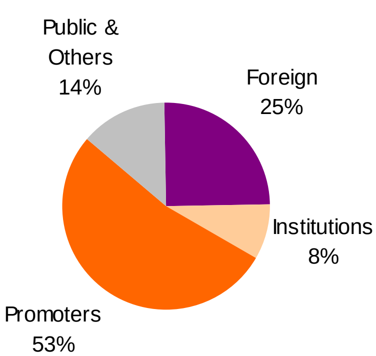
Lupin to market Cefdinir suspensions

Buy; CMP: Rs982

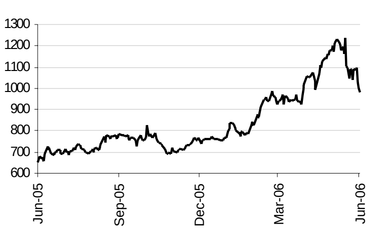
Company details

Price target:	Rs1,130
Market cap:	Rs3,942 cr
52 week high/low:	Rs1,270/527
NSE volume: (No of shares)	33,315
BSE code:	500257
NSE code:	LUPIN
Sharekhan code:	LUPLTD
Free float: (No of shares)	1.9 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-13.4	8.4	30.6	64.3
Relative to Sensex	1.5	13.3	15.3	7.7

Event

Lupin has announced that the US Food and Drug Administration (US FDA) has approved the company's abbreviated new drug application (ANDA) for Cefdinir suspension 125mg/5ml.

Background

Cefdinir is a third-generation cephalosporin administered orally to treat a wide variety of bacterial infections. It is currently off patent and being marketed by only the innovator company, Abbot Laboratories, under the brand name ***Omnicef***. We believe that the ***Omnicef*** dosages cumulatively have a market size of US$634 million in the USA. Out of this, we believe, the 125mg/5ml suspension has a market of US$137 million.

What does this mean for Lupin?

Lupin is the only company till date to have received the generic approval for the manufacture of Cefdinir. We estimate competition from at least two other players in the next couple of months in the Cefdinir market in the USA. However we expect the early entry of Lupin to help the company to gain a significant share in the genericised market. We estimate a share of 40% of the estimated generic market (the market is expected to be 40% genericised) for Lupin and a price erosion of 80% for the generic Cefdinir suspension. (We base our estimates on the assumption that there will be in all five players in the market including Abbot Laboratories.) As a result we expect the sales of the Cefdinir suspension in the USA to contribute Rs13.2 crore and Rs11.1 crore to the top line of Lupin in FY2007 and FY2008 respectively. **Also the sales are expected to contribute Rs4.6 crore and Rs2.8 crore to the bottom line in FY2007 and FY2008 respectively.**

Strong development in the US market

Lupin is increasing the number of its products in the US market. It launched a total of seven products in the USA in FY2006. Quite a few of these launches have come post-November 2005. As a result, the sales of the products are yet to peak in the US market. The company intends to launch close to seven other products in FY2007. During FY2006 Lupin filed 18 ANDAs, taking the total number of filings to 35. This shows the increased focus of the company towards regulated markets.

Outlook

Overall, the company has grown in FY2006. The domestic sales have improved due to the launch of new molecules and the sales in the regulated markets have received a major boost. The company is on the look-out for acquisitions in the regulated markets to further consolidate its position. Lupin's new chemical entities also hold good out-licencing potential. We estimate Lupin to earn Rs75.6 per share in FY2008. We have not taken the benefits and costs of the Dafra acquisition in our estimates as we await clarity on the nature of the acquisition. At the current market price of

Rs982, the stock is trading at 13.0x FY2008 earnings estimate. We believe the company is on growth track and should yield good results in the future. Hence we maintain our Buy recommendation on Lupin with the price target of Rs1,130.

Valuation table Rs (cr)

Particulars	FY2004	FY2005	FY06E	FY07E	FY08E
Net sales	1,304.2	1,321.6	1,769.5	1,972.3	2,200.5
PAT	152.2	88.1	176.0	239.0	303.5
EPS (Rs)	37.9	22.0	43.8	59.6	75.6
PE	25.9	44.7	22.4	16.5	13.0
EV/EBIDTA	15.3	29.9	14.6	10.9	8.9
BV/share	111.6	124.7	168.6	228.1	303.7
P/BV	8.8	7.9	5.8	4.3	3.2
Cash EPS	45.2	30.2	53.9	70.2	87.1
Cash PE	21.7	32.5	18.2	14.0	11.3

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

Welspun India

Emerging Star

Stock Update

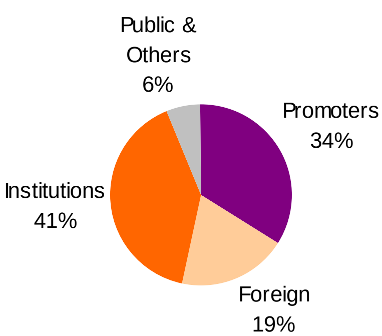
Earnings to grow at a CAGR of 52%

Buy; CMP: Rs97

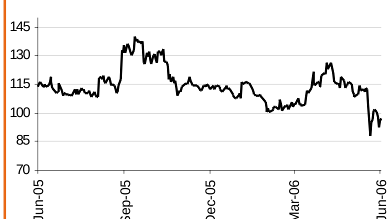
Company details

Price target:	Rs140
Market cap:	Rs699 cr
52 week high/low:	Rs145/83
NSE volume: (No of shares)	72,268
BSE code:	514162
NSE code:	WELSPUNIND
Sharekhan code:	WELSPUN
Free float: (No of shares)	4.8 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-16.9	-8.0	-15.9	-14.6
Relative to Sensex	-2.5	-3.9	-25.7	-44.0

Result highlights

- Welspun India Ltd (WIL) has reported a profit after tax (PAT) of Rs10.71 crore for Q4FY2006 and Rs41.55 crore for FY2006. The earnings per share for Q4FY2006 stood at Rs1.35 and that for FY2006 at Rs5.35.
- The sales grew by 38.9% from Rs147.61 crore in Q4FY2005 to Rs205.10 crore in Q4FY2006. The exports grew by 37.5% from Rs135.59 crore in Q4FY2005 to Rs186.41 crore in Q4FY2006.
- The operating profit grew at a lower pace of 20.4% from Rs26.11 crore in Q4FY2005 to Rs31.42 crore in Q4FY2006 mainly on account of the increased staff cost and other expenditure. The PAT stood at Rs10.71 crore in Q4FY2006 as against Rs10.17 crore in Q4FY2005, a growth of merely 5.1% on account of the higher depreciation and interest cost.
- WIL's net sales have grown by 37.2% from Rs476.31 crore in FY2005 to Rs653.73 crore in FY2006, led by a 37.5% growth in exports. However, the PAT growth was muted at 7.7% year on year (yoy) for FY2006 and the same stood at Rs41.55 crore in FY2006 as against Rs38.58 crore in FY2005.
- WIL spent Rs575 crore for capital expenditure (capex) for the phase I of its expansion, which has already gone on stream and the benefits of of the same will be reflected in FY2007. WIL has lined up a capex of Rs650 crore for phase II, most of which would be completed by Q4FY2007.
- WIL will be a key beneficiary of the growth in the home textiles exports as its product offerings will include terry towels where it is a leading player as well as bed linen and decorative linen items, making it a complete home textiles shop. We expect WIL's revenues to grow at a compounded annual growth rate (CAGR) of 48% over FY2006-08 and the earnings to grow at a CAGR of 52% over the same period from Rs41.2 crore in FY2006 to Rs95.9 crore in FY2008.

Result table Rs (cr)

Particulars	Q4FY06	Q4FY05	% yoy chg	FY2006	FY2005	% yoy chg
Domestic sales	18.69	12.02	55.5	81.32	60.14	35.2
Exports sales	186.41	135.59	37.5	572.41	416.17	37.5
Net sales	205.10	147.61	38.9	653.73	476.31	37.2
Expenditure	173.67	121.50	42.9	530.90	368.81	43.9
Operating profit	31.42	26.11	20.4	122.84	107.50	14.3
Other income	9.51	6.44	47.7	23.37	7.42	215.0
PBIDT	40.93	32.55	25.8	146.21	114.92	27.2
Interest	10.19	8.13	25.4	34.32	27.71	23.9
Depreciation	14.90	7.30	104.2	48.61	26.58	82.9
PBT	15.85	17.12	-7.5	63.28	60.63	4.4
Tax	5.14	6.95	-26.0	21.73	22.05	-1.4
PAT	10.71	10.18	5.2	41.55	38.58	7.7
EPS Rs	1.35	1.90	-28.9	5.25	5.70	-7.9
OPM (%)	15.32	17.69	-13.4	18.79	22.57	-16.7
PATM (%)	5.22	6.89	-24.3	6.36	8.10	-21.5

- At the current market price of Rs97, WIL is trading at 7.7x its FY2008E earnings and 6.7x its FY2008E enterprise value (EV)/earnings before interest, depreciation, tax and amortisation (EBIDTA). We maintain a Buy on WIL with a price target of Rs140.

Net sales grew by 38.9% in Q4FY2006

WIL has reported a 38.9% growth in its net sales to Rs205.10 crore in Q4FY2006 as against Rs147.61 crore in Q4FY2005, backed by a strong growth in exports and an increase in the domestic revenues. The exports continued to show a healthy growth and the same stood at Rs186.41 crore in Q4FY2006 as against Rs135.59 crore in Q4FY2005, a growth of 37.5% yoy. For the reported quarter, the domestic sales growth of 55.5% helped the company report a higher overall growth in its sales. The domestic revenues stood at Rs18.69 crore in Q4FY2006 as against Rs12.02 crore in Q4FY2005. The phase I of the expansion at Anjar went on stream in Q3FY2006 and the effect of the same has been reflected in the strong revenue growth.

Operating profit grew by 20.4% to Rs31.42 crore

For Q4FY2006, WIL's operating profit grew by 20.4% to Rs31.42 crore from Rs26.11 crore in Q4FY2005. The growth in the operating profit was lower than that of the sales mainly as a result of higher other expenditure on account of the start up costs for the newly commissioned capacities in Q3FY2006. The other expenditure as a percentage of sales increased from 31.76% in Q4FY2005 to 38.87% in Q4FY2006. The staff costs went up by 52.3% from Rs10.89 crore in Q4FY2005 to Rs16.58 crore in Q4FY2006 on account of the additional staff at the new facility. However, there was a cost saving on the raw materials front of 546 basis points. The raw materials cost as a percentage of sales fell to 37.72% in Q4FY2006 from 43.18% in Q4FY2005. The operating margins declined by 237 basis points from 17.69% in Q4FY2005 to 15.32% in Q4FY2006.

Cost analysis (%)

% to sales ratios	Q4 FY06	Q4 FY05	% chg	FY06	FY05	% yoy chg
Raw materials	37.72	43.18	-12.7	34.17	40.56	-15.8
Staff cost	8.09	7.37	9.6	8.96	6.48	38.2
Other expenditure	38.87	31.76	22.4	38.09	30.38	25.4

PAT growth stands muted at 5.2% to Rs10.71 crore

The 20.4% growth in the operating profit was not reflected in the profit after tax as a result of more than a proportionate growth in the interest cost and depreciation. The interest and financial costs grew to Rs10.19 crore in Q4FY2006, an increase of 25.4% yoy. At the same time the depreciation grew by 104.2% from Rs7.3 crore in Q4FY2005. The steep rise in the depreciation cost was mainly on account of the commencement of the company's phase I expansion of the capacities at Anjar. As a result the Q4FY2006 PAT stood at Rs10.71 crore, a growth of merely 5.2% yoy.

FY2006: A growth of 37.2% in sales, 7.7% in PAT

WIL's net sales have grown by 37.2% from Rs476.31 crore in FY2005 to Rs653.73 crore in FY2006, led by a 37.5% growth in the exports. For FY2006, the exports stood at Rs572.41 crore as against Rs416.17 crore in FY2005. The domestic sales also grew significantly from Rs60.14 crore in FY2005 to Rs81.32 crore in FY2006.

The operating profit margin (OPM) for the year dipped by 378 basis points from 22.57% in FY2005 to 18.79% in FY2006 mainly on account of a more than proportionate increase in the staff cost and other expenditure. The staff cost increased by a whopping 89.6% from Rs30.88 crore in FY2005 to Rs58.56 crore in FY2006 as a result of the recruitment at the additional facility of the newly commissioned plant. The staff cost as a percentage of sales increased to 8.96% in FY2006 from 6.48% in FY2005. The increase in the per unit cost of power was also an important factor for the increase in the other expenditure. The power cost was Rs4 per unit in FY2006 as against Rs2.5 per unit in FY2005. Thus the operating profit grew at a lower pace of 14.3% from Rs107.5 crore in FY2005 to Rs122.84 crore in FY2006. The PAT growth was also muted at 7.7% yoy for FY2006 and the same stood at Rs41.55 crore in FY2006 as against Rs38.58 crore in FY2005. The same was on account of a higher depreciation charge and an increase in the interest cost.

Phase I of the expansion on stream, phase II to be operational by Q4FY2007

WIL's Rs575 crore phase I of the expansion has gone on stream in H2FY2006. The present terry towel capacity stands at 24,000 tonne per annum and the bed linen capacity stands at 35 million metres per annum. The benefits of these capacities going on stream will be reflected in FY2007. The phase II of the expansion, which will result in the terry towel capacity going up to 34,000 tonne per annum and the introduction of a new product line of decorative beddings is expected to go on stream by Q4FY2007. The phase II of the expansion project is expected to cost Rs650 crore.

Details of Capex Program

Particulars	Size	Capacities on completion of Phase I	Phase II
Terry towels	Tons pa	24000	34000
Bed linen	mn meters pa	35	40
Decorative beddings	mn pieces pa		1.44

WIL, a leading player in the growing home textiles segment

WIL is Asia's largest and is among the world's top 5 exporters of terry towels with its present capacity of 24,000 tonne per annum , which is slated to increase up to 34,000 tonne with the completion of the phase II of the expansion. The company has also entered the sheeting segment with the commencement of its new 35 million metres per annum bed linen capacity. FY2007 will see WIL increasing its product offerings in the home textiles segment by introducing decorative bedding items. Thus WIL's product portfolio will consist of all the major offerings in the home textiles segment. Home textiles is emerging as the sunshine segment of the Indian textile industry. The exports to the USA from India have witnessed a healthy growth in 2005. The exports of bed sheets to the USA have grown by over 50% whereas that of pile towels has grown by 24% in 2005 in the post-quota regime. The trend for 2006 is also encouraging with the exports of towels growing by more than 50% in the January-April 2006 period on a year-on-year basis. WIL will be a key beneficiary of this growth as it can leverage its leading position in the terry towels segment for exports of new product offerings like bed linen and decorative linen items.

Earnings to grow at a CAGR of 52% over FY2006-08, operating margins to be stable

We expect WIL's revenues to grow at a CAGR of 48% over FY2006-08 and the earnings to grow at a CAGR of 52% over the same period from Rs41.2 crore in FY2006 to Rs95.9 crore in FY2008. We are not factoring any significant margin improvement, as WIL's product offerings would now include bed linen items, which have lesser margins than that of the terry towels segment. We expect WIL's operating margins to remain stable in the range of 18.5-19% over the next two years.

Valuation

At the current market price of Rs97, WIL is trading at 7.7x its FY2008E earnings and 6.7x its FY2008E EV/EBIDTA. We believe WIL will be one of the key beneficiaries of the growth in the home textiles exports as its product portfolio includes terry towels as well as the bed linen items. We maintain a Buy on WIL with a price target of Rs140.

Earnings table

Particulars	FY04	FY05	FY06P	FY07E	FY08E
Net profit (Rs cr)	30.5	38.6	41.2	64.2	95.9
Shares in issue (cr)	4.6	5.6	7.5	7.7	7.7
EPS (Rs)	4.0	5.0	5.4	8.4	12.5
% y-o-y chg		*26.6*	*6.9*	*55.6*	*49.5*
PER (x)	24.4	19.2	18.0	11.6	7.7
BV (Rs)	50.6	65.5	76.7	85.8	97.8
P/BV	2.1	1.6	1.3	1.2	1.0
EV/EBIDTA	8.2	10.0	12.7	10.2	6.7
ROCE (%)	16.0	12.5	8.1	8.5	10.1
RONW (%)	13.9	12.8	8.8	10.4	13.7

India's exports of home textiles and terry towels to the USA

Product#	Calendar Years 2003	2004	2005	Jan-Apr 06	% Change 2003-04	2004-05	Jan-Apr 06*	India's % share of total US imports 2005
Pillow cases	12.7	14.5	22.0	7.0	14.8	51.6	13.7	15.9
Cotton sheets	59.2	71.0	111.8	34.3	19.9	57.5	14.1	13.1
Bedspreads	17.0	13.6	20.9	5.7	-20.1	53.4	48.6	4.5
Pile towels	29.7	37.5	46.4	21.1	26.1	24.0	50.9	17.9

Source: Otexa

Quantity in million meters sq

* Change over YoY Jan-Apr

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

Nagarjuna Construction Company

Viewpoint

Constructing the growth path

CMP: Rs352

We attended the conference call of Nagarjuna Construction Company (NCC) and following are the key takeaways of the same.

- NCC basically operates under 5 construction verticals like roads and bridges, water, industrial, irrigation and electricals. In FY2006, the company reported a growth of around 55% in its revenues and a growth of 81% in its net profit. Its earnings before interest, depreciation, tax and amortisation (EBIDTA) margins were 8.9%.
- The company's current order book stands at Rs5,428 crore, which is 3x its FY2006 revenues and provides a strong earnings visibility for the next two years. The roads and water segments currently account for 70% of the company's order book. The management expects the order backlog to jump to Rs7,000 crore at the end of FY2007.
- The company has made an early foray in the Build-Operate-Transfer (BOT) / Build-Operate-Own-Transfer (BOOT) space in the form of joint ventures and being part of a consortium. The total size of the BOT orders is Rs2,563 crore and NCC's share in these projects is close to Rs1,000 crore or approximately 40%. BOOT/BOT offers a healthy margin of 11% and the company is steadily increasing its share in this space.
- The company has a land bank of 130 acres, and the market value of the same is close to Rs200 crore, which the company intends to utilise for real estate development. The management expects the revenues from the real estate segment to double to Rs100 crore in FY2007. As the EBIDTA margins in the segment are very high, this shall result in improving the overall margins for the company.
- For FY2007 the management has given a guidance of Rs3,000 crore of revenues and it expects the EBIDTA margin for the year to improve on the back of the BOT projects and higher revenues from the real estate segment.

The recent spurt in the construction activity and the government's continued thrust on infrastructure creation has provided the company with humungous opportunities and the company, with the set of right strategies and tie-ups is trying to capitalise on the same. Hence the outlook for the company remains positive. Based on the consensus estimates, the stock is trading at 18x its FY2007 earnings and 12x its FY2008 earnings.

Company background

The company operates in 5 verticals in the construction space as detailed below.

Roads and bridges

This is basically the bread and butter segment for NCC accounting for a lion's share of 43% in the company's order book.

Water

NCC provides services like turnkey implementation of rural, urban and industrial water supply projects and the implementation of water treatment plants and sewage treatment plants from their concept to commissioning. The segment constitutes 25% of the company's current order book.

Industrial

In this vertical the company has projects like construction for NTPC and the construction of Metro Bhavan for the Delhi Metro and this segment constitutes around 17% of the current order book backlog and has EBIDTA margins of around 7-8%.

Irrigation & hydropower

Under this segment NCC recently entered into a joint venture in Muscat with a local company and this tie-up gave early results when the company secured an order worth Rs116 crore from Muscat Municipality. This is the first international project bagged by the company.

Electricals

The company's current order book has a 4% contribution from this segment. The Mandalapalli APTRANSCO project and the internal electrification of the IGI airport terminal, New Delhi are some of the prestigious projects that have come NCC's way.

Key positives

Strong financial performance for the year

NCC has been the beneficiary of the uptick in the construction and infrastructure activities in the country and has reported an impressive growth of around 55% in its revenues. This coupled with an improvement in its EBIDTA margin has resulted in a net profit growth of 81%. With a strong order backlog of Rs5,428 crore, which is 3x its FY2006 revenues, and the continuous emphasis on high-margin segments like the BOT and real estate, the strong financial performance is likely to continue.

Order book of Rs5,428 crore provides strong earnings visibility

The company's current order book stands at Rs5,428 crore, which is 3x its FY2006 revenues, and provides strong earnings visibility for the next two years. The roads and water segments currently account for 70% of the company's order book. The company received fresh orders worth Rs6,300 crore in FY2006 and expects to receive fresh orders worth Rs4,600 crore in FY2007. The company's guidance to record nearly Rs3,000 crore of revenues in FY2007, leads us to expect that the company will enter FY2008 with a strong order book of nearly Rs7,000 crore.

BOT—the growth driver

The company has identified BOT as the main formula for its growth. The total size of the BOT orders is Rs2,563 crore and NCC's share in these projects is close to Rs1,000 crore or approximately 40%. BOOT/BOT offers a healthy margin of 11% and the company is steadily increasing its share in this space. It has been bidding for the BOT/BOOT projects on joint venture basis. The reason for going into joint ventures is the low net worth of the company, which makes it unable to satisfy the pre-qualification requirement of such projects on a stand-alone basis. The key feature, which makes this model (BOOT/BOT) attractive, is that it is a high-margin and controlled risk model. The margins in this area are a robust 11%. With the government inviting and encouraging private participation in infrastructure, this space holds great opportunity for the company and NCC already seems to be making a good pitch.

Recent GDR issue will enable NCC to bid for BOT projects on a stand-alone basis

To avail the opportunity in the BOT/BOOT segment, which demands high net worth as a pre-qualification, the company recently issued global depository receipts (GDRs) worth USD120 million (inclusive of a greenshoe option for USD15 million), which resulted in an equity dilution of 29.5%. The increased capital base would help it to bid for the coming opportunities on a stand-alone basis. The company's major projects are on the verge of financial closure, so this makes the company ready to initiate new projects and the benefits of the same would start reflecting in the top line and the bottom line.

Higher share of revenues from real estate to expand margins

NCC started the activities of the real estate division in 1996. The company has acquired properties for the construction and sale of independent houses, multi-storied apartments and commercial complexes. The company has bagged a housing complex project from the government of Jharkhand to build a National Games housing complex at Ranchi for the forthcoming National Games in 2007 in the city. The total project cost is Rs276 crore and the company has to develop, design, finance and construct 1,800 dwelling units over a period of 27 months. Out of these, 1,200 dwelling units have to be completed within 16 months (by June 2007) for providing accommodation to the athletes participating in the National Games. After the games are over, the company would have to provide 12% of the developed area to the government and would be free to sell the remaining dwelling units in the open market.

The company has a land bank of 130 acres, and the market value of the same is close to Rs200 crore, which the company intends to utilise for real estate development. The management expects the revenue from the real estate segment to double to Rs100 crore in FY2007. As the EBIDTA margins in the segment are very high, this shall result in improving the overall margins for the company.

New initiatives to bolster revenues

Sensing an opportunity from the government target of 50,000MW by hydel power, the company has started a new dedicated division for the sector, named as the irrigation and hydropower division. Recently the company's joint venture in Muscat with a local company secured an order worth Rs116 crore. This order marked the company's entry into the Gulf region, which is considered as a prestigious pie for the construction players. In order to find out other such opportunities in the region the company has also opened an office in Dubai.

Outlook remains positive

The government in its Union Budget has unambiguously stated that infrastructure tops its priority list. To achieve the targeted growth of 8% in the country's gross domestic product, a substantial ramp-up in the infrastructure spend is inevitable. Recently the Prime Minister stated that India's need for investment in infrastructure is a mouth-watering figure of $150 billion or Rs675,000 crore. This leaves no doubt that there is an exciting time ahead for the construction players of the country. With the kind of projects coming up in various segments like housing, power, roads, special economic zones etc, the visibility of the earnings for this sector is very high. The same could be sensed from the strong order book, which the industry players are currently relishing. Sensing the tremendous growth, NCC has rightly increased its capital expenditure outlay From Rs93 crore in FY2006 to Rs150 crore in FY2007. These funds will be spent on new machinery and equipment. With a strong order book of Rs5,428 crore, NCC is all set to deliver continuous impressive performance. Further the company's strategy to move towards the high-margin segment will improve its overall EBIDTA margin and hence the outlook on the earnings front for NCC remains positive.

NCC's net profit to grow at a CAGR of a 53%

Based on consensus estimates, NCC's revenues are expected to growth at a compounded annual growth rate (CAGR) of 81% over FY2006-08 and with the improvement in its EBIDTA margins the net profit is expected to grow at a CAGR of 53%. However with the recent GDR issue, which resulted in an equity dilution of 29.5%, its earnings per share will grow at a comparatively slower pace of 39%.

Consensus estimates

Particulars	FY2005	FY2006	FY2007E	FY2008E
Revenue (Rs cr)	1,188.0	1,840.0	2,735.0	4,199.0
% y-o-y chg		*55*	*49*	*54.0*
EBIDTA	90.7	164.0	279.0	409.0
% y-o-y chg		*81.0*	*70.0*	*47.0*
EBIDTA (%)	7.6	8.9	10.2	9.7
PAT	57.0	103.0	162.0	240.0
% y-o-y chg		*81.0*	*57.0*	*48.0*
EPS		12.1	15.9	23.4

Source: Consensus estimates

Valuations

Based on consensus estimates, the stock is trading at 18x its FY2007 earnings and 12x its FY2008 earnings. The valuation appears reasonable as compared to its peers, who also are expected to record similar earnings growth. Any upside from here will be the function of higher-than-expected earnings growth for Nagarjuna or any kind of re-rating in the valuation commanded by the sector itself.

Comparative valuation

	PE			EV/EBITDA			% EPS
	2006	2007	2008	2006	2007	2008	(CAGR)
NCC	29.1	17.7	12.0	23.0	13.9	9.5	36.3
HCC	37.4	25.6	16.7	21.9	15.2	11.4	49.4
IVRCL	24.1	15.2	11.1	22.4	14.0	1.0	47.4
Madhucon	5.4	19.0	10.8	20.7	10.6	6.6	81.4

Source: Consensus estimates

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

Dr Reddy's Laboratories

Viewpoint

Results below expectations

CMP: Rs1,340

Result highlights

- Dr Reddy's consolidated net sales showed a rise of 64% year on year (yoy) to Rs697.4 crore. The numbers include the sales of the acquired business in Mexico and close to one-month sales of Betapharm that cumulatively contributed close to Rs150 crore to the top line.
- The company's gross margins were down from 47.8% in Q4FY2005 to 42.1% in Q4FY2006. The decrease in the gross margins was attributed to the lower sales proportion of the high-margin branded formulations business and the declining margins of the US generics business.
- The research & development (R&D) expense was higher by merely 1.3% yoy due to its de-risked model.
- The company showed earnings before interest, tax, depreciation and amortisation (EBITDA) loss of Rs8.6 crore as against a loss of Rs26.5 crore in Q4FY2005. The higher amortisation expenses related to the acquisitions increased the net loss further.
- The company had a deferred tax write-back of Rs6.2 crore as against a deferred tax write-back of Rs12.7 crore in Q4FY2005. At the net level the company reported a loss of Rs23.5 crore as compared to a loss of Rs52 crore in Q4FY2005.
- The company had extraordinary expenses in Q4FY2005 that included a Rs27.7 crore write-off related to the Trigenesis acquisition.
- The company's board has recommended a 1:1 issue of bonus shares and a 100% dividend.

Net sales rise but gross margins see a decline in Q4FY2006

The consolidated net sales of Dr Reddy's rose by 64% yoy to Rs697.4 crore. However this includes the sales of the newly acquired businesses of Betapharm (one-month sales) and Roche-Mexico (entire quarter sales) that cumulatively amount to around Rs150 crore. Hence on a like-to-like basis the sales grew by 28.7% yoy. The domestic formulations saw a rise of 53% yoy while the exports to North America

Results table (consolidated) Rs (cr)

	Q4FY2006	Q4FY2005	% yoy chg	FY2006	FY2005	% yoy chg
Net sales	697.4	425.2	64.0	2426.7	1947.2	24.6
COGS	403.6	221.8	82.0	1241.7	938.6	32.3
Gross profit	293.8	203.4	44.4	1185.0	1008.6	17.5
Gross margin (%)	42.1	47.8		48.8	51.8	
SG&A expenses	227.9	172.1	32.4	802.9	681	17.9
EBITDR	59.2	40.4	46.5	454.9	331.9	37.1
EBITDR margin (%)	8.5	9.2		18.1	16.6	
R&D Expenses	67.8	66.9	1.3	215.3	252.6	-14.8
Total expenditure	699.3	460.8	51.8	2259.9	1872.2	20.7
Other income	-4.9	16	-130.6	85.4	53.2	60.5
Forex Loss	1.8	6.9	-73.9	12.6	48.9	-74.4
EBITDA	-8.6	-26.5	-67.5	239.6	79.3	202.1
EBITDA margin (%)	-1.2	-6.0		9.5	4.0	
Depreciation	16.2	8.7	86.2	42	35	20.0
PBT	-24.8	-35.2	-29.5	197.6	44.3	346.0
Tax	-6.2	-12.7		25.8	-9.4	
PAT	-18.6	-22.5	-17.3	171.8	53.7	219.9
NPM	-2.7%	-5.1%		6.8%	2.7%	
Extraordinary income	-4.9	-29.5		-8.8	-32.5	
Reported PAT	-23.5	-52.0	-54.8	163.0	21.2	668.9

rose by 82%. The Custom Pharmaceutical Services (CPS) contributed an additional Rs100 crore in Q4FY2006.

Although the sales increased by 64% yoy, the gross profit rose at a lower pace of 44% yoy. The gross margin stood at 42.1% as compared to 47.8% in Q4FY2005. This 570-basis-point decline in the gross margin was due to a higher proportion of low-margin revenues. The sales from Mexico and the CPS business that enjoy a low 25-35% gross margins contributed to a significant part of the sales. The sales of branded formulations that are a high-margin business formed a smaller pie of the total sales. The decline in the sales of the high-margin formulations in Russia and the declining margin of the US generic business added to the effect.

Adjusted net loss stands at Rs57.4 crore for Q4FY2006

The company saved on R&D spends which increased marginally by 1.3% yoy. Dr Reddy's reported net loss stood at Rs23.5 crore for Q4FY2006. During the quarter Q4FY2005 it had extraordinary expenses that included a Rs27.7 crore write-off related to the Trigenesis acquisition.

Research and development

Drug Discovery

Dr Reddy's, with the help of strategic deals, has de-risked its R&D model. It de-merged its drug discovery research unit to form Perlecan Pharma and sought external funding to develop the New Chemical Entities (NCEs) that were undergoing development. Its NCE programme is well underway and going strongly after it transferred 4 NCEs to Perlecan Pharma during FY2006. The company also expects the key anti-diabetic molecule Balaglitazone to enter Phase III trials by the end of the year. Balaglitazone is being developed in collaboration with Rheoscience where Rheoscience will carry out and bear the expenses for the Phase-III clinical trials of Balaglitazone and Dr Reddy's will pay a predetermined sum for its share of the development costs.

Generic filings

On the generic side, it has a total of 49 abbreviated new drug applications (ANDAs) pending approval with 10 tentative approvals already obtained. The company intends to file 12-15 ANDAs over the course of the year. Dr Reddy's had earlier entered into a $56-million agreement with ICICI Venture for the development and commercialisation of ANDAs to be filed in 2004-05 and 2005-06. As part of the deal ICICI Venture will fund the development, registration and legal costs related to the commercialisation of the ANDAs on a predetermined basis and will be paid royalty by Dr Reddy's on the net sales for a period of five years. In the first phase ICICI Venture will fund US$22.5 million with an option to invest an additional US$33.5 million in the second phase.

Consolidation in process

Europe

The company is consolidating its presence in the key markets of Europe and the USA. In Europe, the closing of the Betapharm acquisition is underway. The German market is expected to grow at a healthy rate of 10% despite the recent price erosion. The company believes that in the best possible scenario these price cuts will have a neutral impact on Betapharm, as the company will not have to distribute free samples in this geography. Although Betapharm has steadily grown at a 20%+ rate over the last few years, we expect the growth of the company to be smaller this year despite 20 new product launches expected as the pricing pressure in Germany intensifies.

USA

The company is targeting some big molecules in the USA this year. With the key molecules being Simvastatin (authorised generic status), Fexofenadine (Allegra) and Ondansetron (Zofran), the company is targeting a cumulative market size of US$12 billion this year. Dr Reddy's has already received tentative approvals for 10 drugs in this market and will be filing 12-15 ANDAs this year. We believe that in this scenario of decreasing generic gross margins (approximately 42-48%), the possible para IV exclusivity of Zofran and the exclusivity for Allegra will result in a leap in the margins.

Outlook

Overall, we believe that FY2007 could become the year of huge profits for Dr Reddy's. The key contributors will be profits from Betapharm, profits from the authorised exclusivity on Zocor and the possible profits on Zofran. In addition to these, the cost-cutting efforts and the reduction in the R&D spend will add to the bottom line. We believe that Dr Reddy's is at the point of inflection and the ability to consolidate a huge acquisition like Betapharm and the efficiency in launching key products in the USA will determine the future profitability of the company.

Valuation table* Rs (cr)

Particulars	FY04	FY05	FY06	FY07E	FY08E
Net sales	1,927.5	1,947.2	2,426.7	5,676.4	4574.7
Net profit	258.1	21.2	163.0	708.9	547.2
Shares in issue	7.7	7.7	7.7	7.7	7.7
EPS	33.6	2.8	21.3	92.4	71.3
PE	40.1	488.4	63.5	14.6	18.9
BV/ share	253.4	287.0	289.8	311.1	403.5
Price/BV	5.3	4.7	4.7	4.3	3.3

*Consensus estimates

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