investor's eye

Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Bajaj Auto	15-Nov-05	1,873	**2,651**	3,500
BHEL	11-Nov-05	1,203	**1,883**	2,650
Infosys	30-Dec-03	1,378	**2,801**	3,324
Ranbaxy	23-Dec-03	534	**369**	600
TV18	23-May-05	280	**440**	704

Sintex Industries

Apple Green

Stock Update

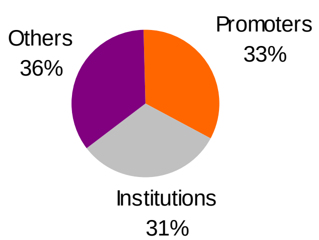
Back in the reckoning

Buy; CMP: Rs151

Company details

Price target:	Rs192
Market cap:	Rs1,491 cr
52 week high/low:	Rs258/98
NSE volume: (No of shares)	42,732
BSE code:	502742
NSE code:	SINTEX
Sharekhan code:	SINTEX
Free float: (No of shares)	6.6 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-24.8	-29.8	-8.7	46.1
Relative to Sensex	-7.2	-20.9	-12.8	4.0

We recently spoke to the management of Sintex Industries (Sintex) and have also gone through their recently released annual report. The highlights of the same are presented below.

Growth momentum continued in FY2006

Sintex grew at an impressive rate of 29.6% in FY2006, maintaining the growth momentum built in the previous five years. The company reported gross revenues of Rs914 crore, which is just a shade lower than the magical figure of Rs1,000 crore and yet impressive. Its plastic business continued to be its mainstay, contributing 71% of the revenues in FY2006. The textile business accounted for the balance revenues. The revenue mix of 71:29 in FY2006 was more or less stable as compared with that in the previous year.

The plastic business grew at a whopping 28% in FY2006, reporting revenues of Rs607.9 crore. The strong growth was achieved on the back of a higher offtake of its pre-fabricated structures and building products (39.2% up) and custom molding products (63% up). The water tank business, however, continued to go down the hill due to severe competition and price cutting from the unorganised players. The gradual shift taking place in the product mix of the plastic division was visible in FY2006 with the prefab and custom molding products adding three and six percentage points of share in plastic revenues respectively. The change in the product mix was in line with our assumption that the prefab and custom molding products would grow into core products.

Performance of plastic business

In Rs crore	FY2004	% share	FY2005	% share	FY2006	% share
Water tanks	146.0	38	136.1	29	116.1	20
% y-o-y chg	-		*-6.8*		*-14.7*	
Prefab structures	140.0	36	230.8	49	321.3	52
% y-o-y chg	-		*64.9*		*39.2*	
Custom molding	100.0	26	104.6	22	170.5	28
% y-o-y chg	-		*4.6*		*63.0*	
Plastics revenue	386.0		471.5		607.9	
% y-o-y chg	-		*22.2*		*28.0*	

The textile business grew by 31% and reported revenues of Rs249.3 crore in FY2006. The growth in its volumes was moderate at 6.7% to 1.8 crore metre, but the realisation bucked the trend by growing at 28% to Rs129 per metre. The volumes to the Canclini joint venture witnessed an impressive growth of 225% to 0.3 crore metre, but at the expense of the non-Canclini business that saw a moderate volume drop of 6.4%. The sales to the Canclini joint venture reached Rs88.1 crore in FY2006, after a stupendous growth of 180.8% in line with our estimates. The non-Canclini business was affected by capacity constraint. The company proposes to resolve the capacity problem by setting up new capacities in the FY2007-08 period.

Performance of textile business

	FY2004	FY2005	FY2006
Textiles volumes (In metre)	**13452000**	**16938000**	**18075000**
% y-o-y chg	-	*25.9*	*6.7*
In Canclini	-	960000	3120000
% y-o-y chg	-	-	*225.0*
In non-Canclini	13452000	15978000	14955000
% y-o-y chg	-	*18.8*	*-6.4*
Textile realisation (Rs/metre)	**93.1**	**101.2**	**129.5**
% y-o-y chg	-	*8.6*	*28.0*
In Canclini	-	327.0	282.5
% y-o-y chg	-	-	*-13.6*
In non-Canclini	93.1	87.6	97.5
% y-o-y chg	-	*-5.9*	*11.3*
Textile revenue (Rs crore)	**125.3**	**171.4**	**234.0**
% y-o-y chg	-	*36.8*	*36.6*
In Canclini	-	31.4	88.1
% y-o-y chg	-	-	*180.8*
In non-Canclini	125.3	140.0	145.9
% y-o-y chg	-	*11.7*	*4.2*

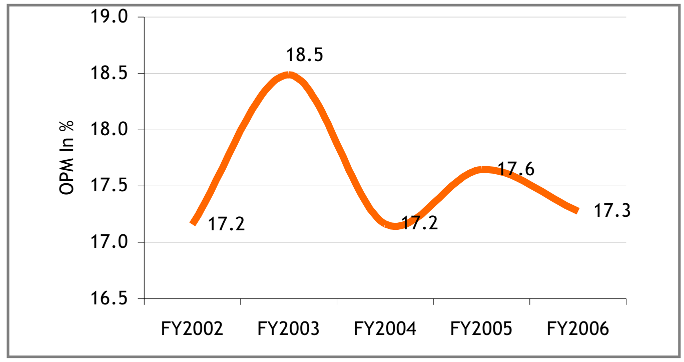
Margins were stable in 17-18% range

The rising share of the prefab structured products in the plastic business during FY2006 mitigated the impact of the rising polymer prices in the same period to a large extent. Typically prefab structures have a lower polymer content owing to the nature of the product in which they find use: sanitation products, school buildings etc. For custom molding products Sintex has long-term supply contracts with a price variation clause in place and hence these products have a marginal impact on its margins. In the textile business, cotton prices were benign throughout the year owing to a bumper crop. The realisation saw a good improvement on the back of the value-added finishes and styles introduced in FY2006. To sum it up, the rising importance of the prefab products in its scheme of things, the benign raw material prices and efficient cost management kept the margins stable at 17.3% in FY2006 as compared with 17.6% in the previous year. Even on a segmental basis, the margins were more or less steady for both the divisions.

Cost matrix

In % of sales	FY02	FY03	FY04	FY05	FY06
Variable expenditure	71.8	71.8	73.3	73.7	74.0
Raw material cost	64.4	63.8	64.6	67.7	67.1
Power & fuel cost	5.7	5.3	5.0	3.9	4.0
Other manufacturing expenses	0.4	0.2	0.4	0.4	0.4
Selling expenses	1.3	2.4	3.3	1.7	2.4
Fixed expenditure	11.0	9.7	9.5	8.6	8.7
Employee cost	5.8	5.3	5.0	4.7	4.4
Administration expenses	5.2	4.4	4.5	4.0	4.3

Margins moving within narrow band



Healthy cash flow of Rs158.5 crore generated during the year

The strong growth in the revenues of the textile and plastic businesses coupled with the stable margins yielded a healthy cash flow of Rs158.5 crore during the year. The drawdown of inventory and debtors by nine days each to 41.3 days and 63.9 days respectively freed a lot of cash during the year. Sintex invested a hefty Rs165 crore in setting up prefab and profile plants in Salem, Baddi and Kutch. It incurred capital expenditure (capex) in augmenting its textile capacity from 1.4 crore metre to 1.8 crore metre.

Improving turnover ratios

In no of days	FY2003	FY2004	FY2005	FY2006
Inventory turnover	58.5	53.6	50.5	41.3
Debtor turnover	80.0	79.6	73.1	63.9
Current asset turnover	164.7	164.8	172.9	215.3
Current liabilities turnover	88.5	91.3	90.2	87.2
Net current asset urnover	92.6	89.2	98.6	143.2

* reflects cash in hand of Rs355 crore as a result moved up sharply

Strong financials

In FY2006, Sintex raised Rs260 crore using the equity route (warrants and foreign currency convertible bonds or FCCBs*) as part of its huge capex plan that is spread over three years. Un-used cash and cash equivalents stood at Rs509 crore in FY2006 which shall take care of its growth plans, both organic and inorganic. The debt: equity ratio is at 1.3x (including the FCCB issue), leaving a huge scope for leveraging the balance sheet in case of any big inorganic opportunity. Even the return ratio is comfortably placed with the return on capital employed at 14.0%, up 130 basis points as compared with that in the previous year. Sintex is operating at an asset turnover of 1.8x, the highest reported in the recent past.

* Sintex raised US$50 million by way of an FCCB issue. The FCCB holders have an option to convert the FCCBs into shares at a conversion price of Rs183.6 per share at any time on or after December 4, 2005 and up to September 14, 2010. The FCCBs can be redeemed in whole at the option of the company at any time on or after April 24, 2008. If converted on the due date, ie October 25, 2010, the conversion will take place at a 140.1% premium to the principal amount.

Improving financial position

	FY2003	FY2004	FY2005	FY2006
Leverage factor (x)	1.5	1.6	1.5	1.5
Debt Equity (x)	0.7	0.8	0.7	1.3*
Asset Turnover (x)	1.2	1.1	1.3	1.8
ROCE (%)	10.5	12.7	12.7	14.0
RONW (%)	6.2	9.5	9.9	18.1

* debt includes FCCB issue

Benefits of Rs250-crore capex factored in our estimates

To maintain its growth momentum, Sintex has drawn up a Rs250-crore capex plan. It is ramping up its capacities in both the plastic and textile businesses, and looking at saving costs by switching to a gas-based power plant.

Sintex commercialised its Salem, Kutch and Baddi facilities to manufacture plastic products in FY2006. It is planning to construct facilities in Nagpur (costing Rs40 crore) and Kolkata (costing Rs40 crore) in FY2007. The plan is in line with its aim of creating a nationwide presence and serving markets through regional plants. The company will make a national roll-out of underground tanks in FY2007; these tanks would be manufactured in joint venture with Containment Solutions.

In the textile business, the company will de-bottleneck the manufacturing capacity at the Kalol plant and augment it from 1.4 crore metre to 1.8 crore metre by December 2006. This will be ramped up to 2.4 crore metre in December 2007. Further, power costs in the textile business are substantial with the company operating on furnace oil. Sintex therefore aims to switch to gas-based power by August 2007 which shall entail substantial cost savings. The capex in the textile business is pegged at Rs140 crore over the next two years.

Eyeing acquisitions in plastic business, confident post-Zeppelin acquisition

Sintex sealed the acquisition of Zeppelin Mobile Systems Ltd (ZMSIL) in May 2006. It acquired a 75.0% stake in ZMSIL, the Indian operations of Germany-based company Zaplin, for a consideration of Rs17.3 crore. ZMSIL is into designing and manufacturing of BT shelters and commands a 25.0% share of India's Rs160-crore shelter market. After the acquisition of ZMSIL, Sintex will command a dominant 50% share of the shelter market. Apart from this, Sintex can leverage on the rich product portfolio and technology strength of ZMSIL to consolidate its position in the Indian market. The company is keen to seal more such acquisitions in the plastic space, especially in the prefab structures and custom molding product segments. Sintex had liquid assets worth Rs500 crore on its balance sheet in FY2006, thanks to the US$50 million that it raised by making the FCCB issue in FY2006.

Key initiatives taken

In plastic business

1. Sintex has designed and developed a total solution offering small and medium prefabricated structures and building products. It has aggressively marketed the utility and financial benefits of these products. The result is that the demand for prefabs has grown across school buildings, army shelters, remote housing and BT shelters.

2. Sintex has invested heavily in the manufacture of lightweight technical engineering products, custom molded products and auto ancillary products. The company believes that the use of technical products will become the order of the day in the coming years (rampant use expected in auto, auto ancillary, farm equipment sectors). It has already tied up with Cummins, General Electric, New Holland, Coca Cola and Pepsi for these products. Sintex plans to ramp up the business from the existing clients through joint development of new product lines and larger business from the existing product lines.

3. Sintex has introduced power utility products in generation, transmission, distribution and electrification sectors. Recently, the company has got a trial order from Rajasthan to supply polymeric insulators, insulators boxes and cross arms. The company believes that power utility products is a big opportunity and aims to make significant inroads into this space.

In textile business

1. Sintex has climbed up the value chain by introducing jacquard, dense populin and coated fabric in FY2006. It has also introduced special fabrics for sportswear, military and fabrics 'nano care' finishes. This will certainly help Sintex to enter the high-end, high-growth segments and catapult it to a different league of textile manufacturers altogether.

2. In FY2006 Sintex strengthened its ties with Canclini by supplying almost 0.3 crore metre of fabric in a year. The company thus demonstrated its ability to meet high quality standards. This opens a window of opportunity to supply value-added fabrics other than structured fabrics to the Canclini joint venture.

3. Sintex also strengthened its position in the international market through consistent supply of good quality fabrics. It made significant inroad into brands like Ann Taylor and Marks Spencer, as is quite evident from the volume growth. Also, Sintex added reputed clients like Gap in the year under review.

Outlook

Sintex maintains a positive outlook for both the plastic and the textile division, in light of the buoyancy in the demand for its products and its perfect plan to capitalise on the resulting opportunity. The company believes niche businesses like those of prefab structures and custom molding products will turn into mega opportunities in the coming years. In prefabs, 11 state governments have shown interest in procuring the company's products as compared with an abysmal two in FY2005, making prefabs an integral constituent of the company's portfolio. Even the custom molding business is making rapid strides with Cummins Inc USA nominating Sintex as the sole Asian outsourcing partner for products used in generators and fuel injection system. Sintex believes that its other nascent tie-ups like those with New Holland Tractors and GE Communication will shape up like the one with Cummins Inc. In textiles, Sintex is close to announcing another Canclini type joint venture. The tie-up would help the company to gain a foothold in the high-end European structured fabric market. Sintex is confident of surpassing Rs1,500 crore in gross revenues in FY2008E, growing at a compounded annual growth rate (CAGR) of 25% over the next two years.

Valuations

The outlook for the company's business, as shared by it in its annual report, is in consonance with our expectations. Since there has been no material change in our assumptions after the review of the annual report, we maintain our earnings estimates for FY2007 and FY2008 at Rs9.3 per share and Rs12.5 per share respectively. In our Stock Update report on the company dated May 03, 2006, we had recommended a Hold on the stock (after it had achieved our price target of Rs192.5) because we believed it was reasonably valued then. But thereafter, the stock has corrected by 30% to its current level of Rs151.0 and is now trading at attractive valuations of price/earnings ratio of 12.3x FY2008E and enterprise value/earnings before interest, depreciation, tax and amortisation of 7.5x FY2008E. These valuations should be seen in conjunction with the facts that the company's earnings are expected to grow at a healthy CAGR of 23% in future and that the inorganic growth trigger is long overdue. We maintain a Buy on Sintex with our old price target of Rs192, at which the stock would discount its FY2008E earnings by 15.5x.

Earnings table

Particulars	FY03	FY04	FY05	FY06	FY07E	FY08E
Net profit (Rs cr)	22.6	33.6	50.3	81.1	112.2	149.9
Share in issue (cr)	7.3	7.3	9.2	9.9	12.0	12.0
EPS (Rs)	3.1	4.6	5.4	8.2	9.3	12.5
% y-o-y growth	*21.4*	*48.9*	*17.8*	*51.2*	*13.4*	*33.6*
PER (x)	62.9	42.2	35.9	23.7	20.9	15.6
Book value (Rs)	26.7	23.1	35.1	43.8	67.4	79.0
P/BV (x)	7.3	8.4	5.6	4.5	2.9	2.5
EV/EBIDTA (x)	20.3	18.2	16.4	13.5	12.5	9.5
Dividend yield (%)	0.2	0.3	0.4	0.5	0.5	0.5
ROCE (%)	10.5	12.7	12.7	14.0	15.0	17.3
RONW (%)	6.2	9.5	9.9	18.1	13.5	15.5

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

Nicholas Piramal India

Apple Green

Stock Update

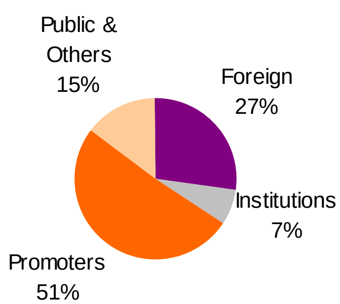
On a growth trajectory

Buy; CMP: Rs175

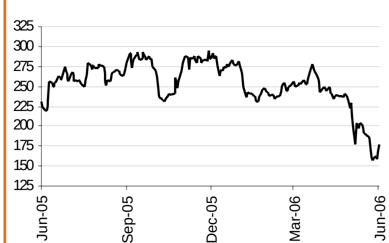
Company details

Price target:	Rs380
Market cap:	Rs3,722 cr
52 week high/low:	Rs301/150
NSE volume: (No of shares)	99,503
BSE code:	500302
NSE code:	NICOLASPIR
Sharekhan code:	NICHPI
Free float: (No of shares)	10.3 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-25.3	-32.1	-39.9	-31.6
Relative to Sensex	-7.8	-23.5	-42.6	-51.3

Event

Nicholas Piramal India Ltd (NPIL) has announced the acquisition of Pfizer Inc's manufacturing facility located at Morepeth, UK.

Background

NPIL has emerged as one of the largest players in the custom manufacturing business over the years. The acquisition announced by the company is backed by a supply contract worth $350 million and effective up till November 2011. The acquisition cost has not been disclosed. We expect this deal to be a strategic move for NPIL as the acquisition will elevate the company to the tenth position in the global custom manufacturing business. Here are the details of the deal.

Key benefits to NPIL from the deal

- Thanks to the deal NPIL will emerge as the largest contract manufacturer of Pfizer Inc, triggering off a relationship that would lend enormous stability to its future business prospects.
- The UK-based facility is one of the major sourcing hubs for Pfizer Inc's worldwide business, producing a range of products associated mainly with pain control, arthritis and ulcer prevention. It is also one of the major high-quality facilities of Pfizer Inc having supply chain capabilities that cover active pharmaceutical ingredients (APIs), finished dosage and packing & distribution. This gives NPIL an entry into 106 countries (including the USA, Europe and Japan) where Pfizer Inc currently has operations.
- The transaction includes a supply agreement of $350 million till November 2011, which translates into revenues of approximately Rs1,600 crore for the company accrueable over the next five years. This tantamounts to a formidable revenue addition of approximately Rs300 crore per annum to the company's global custom manufacturing business over the above-mentioned period. That is an increase of 130% over its FY2006 revenue figure of Rs216 crore.
- The acquired facility has strong technical transfer capabilities and new launch expertise. NPIL will be able to use the high technological know-how of the plant for its production at its other facilities across the world.
- The facility has spare capacities in all the divisions, namely APIs, formulations and packaging. NPIL will be able to leverage the excess capacities for meeting its supply contracts with the other drug-makers.
- With this transaction, the company is expected to clock a turnover in excess of $200 million and is all set to become one of the global leaders in the custom manufacturing business.

Acquisition on an asset purchase basis

NPIL Pharmaceuticals, the company's UK subsidiary, has entered into an agreement to acquire the facility based in Morepeth, Northumberland on an asset purchase basis. The transaction includes the above-mentioned supply agreement, the facility's fixed assets and certain current assets. NPIL plans to fund the acquisition from its internal accruals though it has a mandate to raise $1.5 billion. The facility will be integrated with its UK operations. NPIL expects to close the deal on June 19, 2006.

In line with NPIL's long-term strategic goals

The deal extends the company's inorganic growth strategy of establishing a global footprint for its custom manufacturing business. NPIL earlier acquired Rhodia's inhalation anaesthetic business in December 2004 and Avecia's custom manufacturing business in December 2005.

It also furthers NPIL's relationship with Pfizer Inc which started in December 2005 when the company secured a seven-year manufacturing-related research and development service contract for the latter's animal health division. Thus NPIL is on its way to becoming the preferred partner of choice for innovator pharmaceutical companies across the world.

Positive outlook for NPIL

The company achieved a sales turnover of Rs1,580 crore in FY2006, registering a healthy growth of 21% over the previous year. The operating profit grew by 7.3% to Rs210 crore whereas the net profit grew by 21.2% to Rs120 crore. The deal will add approximately Rs1,600 crore to NPIL's revenues over the next five years and the company expects the earnings before interest, tax, depreciation and amortisation margin to be in line with what it is earning currently. We expect this deal to give a positive outlook to the company's future business prospects.

Valuations

The current market price of Rs175 discounts the company's FY2008E earnings by 11.1x. Taking into consideration the strong revenue flows that will accrue on the back of this acquisition, the valuation looks attractive. We maintain our Buy recommendation on the stock with the price target of Rs380.

Earnings table Rs (cr)

Year ended Mar 31	FY05	FY06	FY07E	FY08E
Net revenues	1,397.0	1,582.5	1,766.4	2,066.7
Adjusted profit	164.3	120.7	265	330.7
Share in issue	20.9	20.9	20.9	20.9
Adjusted EPS	4.7	6.1	12.7	15.8
PER(x)	37.4	28.7	13.8	11.1
Book value (Rs/share)	26.5	52	64.6	80.5
Price/BV (x)	6.6	3.4	2.7	2.2

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

Solectron Centum Electronics

Emerging Star

Stock Update

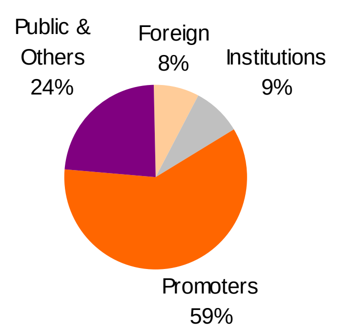
Hold on to it

Hold; CMP: Rs158

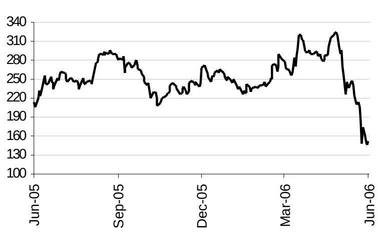
Company details

Price target:	Rs215
Market cap:	Rs234 cr
52 week high/low:	Rs340/145
NSE volume: (No of shares)	27,942
BSE code:	517544
NSE code:	SOLECTCENT
Sharekhan code:	SOLECTCENT
Free float: (No of shares)	60 lakh

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-49.4	-46.0	-42.9	-30.9
Relative to Sensex	-37.5	-39.1	-45.5	-50.8

Result highlights

- Solectron Centum Electronics reported a robust jump in its revenues to Rs33.7 crore during the fourth quarter, amounting to a growth of 63.3% quarter on quarter (qoq) and that of 171.8% year on year (yoy). The revenue growth was driven largely by the spectacular performance of its electronic manufacturing service (EMS) business; the performance of its component business continues to remain muted.
- The operating profit margin (OPM) plummeted to 12.5% as compared to 27.4% in Q4FY2005 and 16.5% in Q3FY2006. The key reasons for the steep decline in the margins are the rising contribution of the low-margin EMS business to the total turnover and the competition-led pricing pressure in the component business. But despite the margin pressure, the company was able to report a healthy growth of 42.7% yoy in its operating profit during the fourth quarter.
- However, its earnings declined by 37.2% yoy to Rs2.3 crore on the back of higher depreciation charges and an increase in the tax rate (as there are no benefits of accumulated losses and depreciation available now).
- For the full year, the revenues grew exponentially by 97.5% to Rs83.3 crore. The operating profits grew at a relatively lower (but healthy) rate of 45.2% due to a 640-basis-point decline in its margins. However, the earnings declined by 22.8% on the back of higher depreciation charges, the increase in the tax rate and a decline in the other income.
- Going forward, the company is estimated to show a robust growth of 64% in its revenues and of 33% in its earnings during the current fiscal. The EMS business is expected to maintain its growth momentum while the revival of the component business would be driven by the execution of a pending government order worth Rs35 crore.
- At the current price the stock trades at 17.7x FY2007 and 15.6x FY2008 estimated earnings. We recommend a Hold on the stock with a price target of Rs215.

Result table

Particulars	Q4FY06	Q4FY05	Q3FY06	% yoy chg	% qoq chg
Net sales	33.7	12.4	20.6	171.8	63.3
Total expenditure	29.5	9.0	17.3	227.8	70.5
Operating profit	4.2	3.4	3.3	23.5	25.7
Interest	0.2	0.0	0.0	-	-
Depreciation	1.0	0.2	0.8	323.6	34.3
Other income	0.4	0.2	1.4	85.7	-71.7
PBT	3.4	3.3	4.0	1.8	-14.1
Tax	1.1	-0.3	0.9	-485.5	19.1
Adj PAT	2.3	3.6	3.0	-37.2	-24.5
Equity share capital	14.8	14.8	14.8		
EPS (Rs)	1.5	2.5	2.0		
Margin (%)					
OPM	12.5	27.4	16.2		
NPM	6.7	28.8	13.7		

Segment-wise result analysis

The component business

The revenues from the component business declined by 30% yoy and improved marginally by 2% on a sequential basis. Given the lacklustre demand from its erstwhile parent (and the largest customer in the component business) C-MAC, the revenues have remained stagnant at around Rs8 crore for all the four quarters of FY2006. However, the situation is likely to improve in FY2007. The management expects to commence the execution of a Rs35-crore pending government order from the second quarter of this fiscal. We expect the revenues from the component business to grow by 40.6% to Rs45 crore in FY2007 (even after considering only partial execution of the government order).

In terms of profitability, the component business has shown a declining trend during the past five quarters. The profit before interest and tax (PBIT) margin at 29% is the lowest in the last ten quarters. On the positive side, the management expects the margins to improve during the current year on the back of the execution of its pending high-margin government order.

The EMS business

The revenues from the EMS business grew exponentially to Rs25.8 crore in Q4, as compared to just Rs1.1 crore in Q4FY2005 and Rs12.9 crore in Q3FY2006. In addition to the execution of the $20-million long-term order from ABB, the company is witnessing robust traction from some of the other clients like Visteon and Tejas Network.

To meet the growing demand, the company had installed its second printed circuit board (PCB) assembly line in September 2005. The management is confident of maintaining the growth momentum in the EMS business and has set up a third PCB assembly line recently. We expect the EMS revenues to grow by 78.7% to Rs91.7 crore in FY2007.

In terms of profitability, the margins have declined sequentially to 8% as compared to 17% reported in Q3FY2006. The margins are expected to improve as the operations of its third assembly line stabilises in the coming quarters. The management expects to maintain the PBIT margins in the range of 10-12% during the current year.

Segment results

(Rs cr)	Q4FY06	Q4FY05	Q3FY06	FY05	FY06
Sales					
- Components	7.9	11.3	7.8	37.3	32.0
- EMS	25.8	1.1	12.9	4.9	51.3
PBIT					
- Components	2.3	5.3	2.4	16.5	10.7
- EMS	2.1	-1.2	2.2	-2.0	6.9
PBIT (%)					
- Components	29.0	46.4	30.7	44.1	33.5
- EMS	8.1	-109.5	17.0	-40.3	13.4

Revision of estimates

Given the pressure on the margins, we are pruning down our earnings estimates to Rs13.2 crore for FY2007. Moreover, the earnings growth will also be affected by the higher tax rate due to the continued slowdown in the export income from the supply of components to C-MAC.

Long-term growth outlook remains encouraging

The recent lacklustre performance has been contributed by external uncontrollable issues like the delay from the customer's side in case of the government order and weakness in demand from C-MAC, which are temporary in nature. Over the longer term, we continue to be bullish on the growth prospects of both the businesses.

Exponential growth in EMS to continue: India is fast emerging as a global hub for providing contract manufacturing (or EMS) of information technology (IT) hardware. This is clearly reflected in the scramble by leading global EMS companies to set up manufacturing facilities in India. Apart from Solectron's presence in India (through majority holding in Solectron Centum), five other large global EMS companies such as Flextronics, Foxconn (Taiwan), Celestica (Canada), Jabil Circuit (US) and Elcoteq (Finland) have invested in setting up manufacturing facilities in India. According to estimates by a study done by E&Y-MAIT, the hardware contract manufacturing opportunity in India is estimated to grow at a CAGR of over 30% to $11 billion by 2010. We expect Solectron Centum to be one of the key beneficiaries of this huge opportunity and grow at a higher-than-industry growth rate over the next five years.

Trigger for growth in demand in the component business: In addition to the expected revival in the demand from C-MAC (which is largely exports), the growth in the EMS business of Solectron in particular (and India in general) will result in a robust demand for electronic components in the domestic market. Moreover, the manufacturing facilities set up by leading telecom players like Nokia, Motorola, Ericsson and Siemens (totaling to around $800 million of investment) in India will also aid the demand growth for the company's component business.

Valuation

At the current price the stock trades at 17.7x FY2007 and 15.6x FY2008 estimated earnings. The valuations are in line with those of comparable companies like Astra Microware Products (25.1x FY2007E and 18.5x FY2008E) and Avantel (18.4x FY2007E), which also cater to defence forces. However, the largest player in the sector, Bharat Electronics, is available at a much attractive valuation of around 10x its FY2008 consensus earning estimates (due to the steep correction). Consequently, we are revising downwards the price target for Solectron Centum to Rs215.

Notwithstanding the recent below-than-expected performance, we continue to be bullish on the long-term potential of the company's business. It would be advisable to hold on to the stock. The decision to upgrade the rating will depend on more clarity and progress on the following factors: the commencement of Rs35-crore high-margin government order, the revival of the demand for components from C-MAC and a possible new large contract in the EMS business.

Key financials

Year ended Mar 31	FY04	FY05	FY06	FY07E	FY08E
Net sales (Rs cr)	34.6	42.2	83.3	136.7	167.9
Net profit (Rs cr)	8.4	12.9	9.9	13.2	15.0
Shares in issue (cr)	1.5	1.5	1.5	1.5	1.5
EPS (Rs)	5.6	8.7	6.7	8.9	10.1
% y-o-y growth		*55.0*	*-23.0*	*33.0*	*14.0*
PER (x)	28.0	18.1	23.6	17.7	15.6
Book value (Rs)	14.6	20.5	27.2	35.0	44.0
P/BV (Rs)	10.9	7.7	5.8	4.5	3.6
EV/EBIDTA (x)	22.2	19.5	13.4	8.1	6.5
Dividend yield (%)	-	0.9	-	1.1	1.3
RoCE (%)	35.5	39.4	31.2	36.4	33.7
RoNW (%)	47.9	44.5	28.1	28.7	25.7

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

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