investor's eye

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Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Aban Offshore	03-Mar-05	330	**1,199**	1,760
HLL	24-Nov-05	172	**244**	300
ICICI Bank	23-Dec-03	284	**647**	770
Orient Paper	30-Aug-05	214	**614**	800
UltraTech	10-Aug-05	384	**850**	1,000

Sharekhan Ltd
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ORG Informatics

Emerging Star

Stock Update

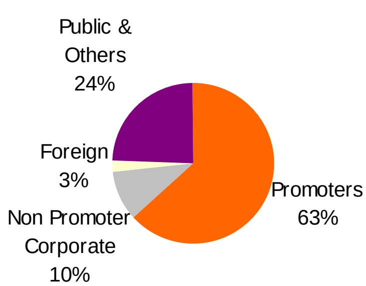
Price target revised to Rs190

Buy; CMP: Rs89

Company details

Price target:	Rs190
Market cap:	Rs103 cr
52 week high/low:	Rs196/70
BSE volume: (No of shares)	32,054
BSE code:	517195
Sharekhan code:	SARAELE
Free float: (No of shares)	43 lakh

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	8.5	4.1	-32.7	-39.7
Relative to Sensex	2.4	-23.0	-40.0	-59.3

The key takeaways from the latest annual report of ORG Informatics are given below.

- **Significant scale-up in operations:** ORG Informatics' consolidated revenues have grown at a compounded annual growth rate (CAGR) of 75.7% over the past three years. The management expects the mega orders bagged in the last fiscal and a healthy order pipeline to further boost its growth momentum in the current fiscal.
- **Improving profitability:** The robust growth in revenue has been accompanied by consistent improvement in the operating profit margin (OPM) due to the reoriented business strategy to focus on the high-value solution and service business.
- **Better operational metrics:** It generated free cash flow of Rs12.2 crore in FY2006. The return ratios have also improved dramatically with the return on average capital employed (RoACE) and return on average net worth (RoANW) at 37.5% and 43.2% respectively. The debt/equity ratio stood at comfortable level of 0.46 times.
- **Reduction in promoter holding is a concern:** On the flip side, the promoter holding has declined by 10 lakh shares to 74.6 lakh equity shares (63.8% stake holding).
- **Re-iterate Buy recommendation:** At the current market price the stock trades at 7.6x FY2007 and 5.6x FY2008 estimated earnings. We maintain our Buy recommendation on the stock with a revised price target of Rs190 (12x FY2008E earnings per share, including the convertible warrants in the equity base).

Growing exponentially

ORG Informatics continued to grow exponentially and reported an 81.6% jump in its net revenues to Rs155.2 crore during FY2006. In fact, the revenues have increased at a CAGR of 75.7% over the past three years (FY2003-06). The earnings grew 222.3% to Rs8.1 crore in FY2006. The earnings have grown at a CAGR of 414% over the past two years after the turn-around in FY2004. The company had reported a net loss of Rs0.7 crore in FY2003.

Earnings table

Year ended 31st March	FY2005	FY2006	FY2007E	FY2008E
Net sales (Rs cr)	85.5	155.2	356.5	426.2
Net profit (Rs cr)	2.7	8.1	16.1	21.6
No. of shares (crs)	1.1	1.4	1.4	1.4
EPS (Rs)	2.4	5.9	11.8	15.8
y-o-y change (%)	*33.1*	*146.2*	*98.6*	*34.1*
PER (x)	37.0	15.0	7.6	5.6
Price/BV (x)	8.9	4.0	2.3	1.6
EV/EBIDTA(x)	18.6	7.8	4.6	3.7
Dividend yield (%)	0.0	0.0	0.0	0.0
RoCE (%)	18.7	37.5	44.6	38.4
RoNW (%)	28.3	43.2	40.2	33.3

The significant scale-up of operations (and the turn-around) has been possible largely due to the strategic alliance (with the stake sale) with Global Asia Partners (GAP), a US-based venture fund. The board of directors has acknowledged the same in the annual report. Under the guidance of Ajoy Khandheria, the managing director & chief operating executive of ORG Informatics (and a nominee of GAP), the company reoriented its business strategy to enhance its focus on higher-value solution and service business including the fast growing network engineering space in the telecommunication industry. As per the annual report, GAP would continue to play a major role in enhancing the stakeholders' value.

Healthy order book provides strong growth visibility

During the last fiscal, the company bagged some mega orders, notable among them was the Rs421-crore order from the state-owned Mahanagar Telephone Nigam. There are no specific details related to the pending order book at the end of the fiscal. However, as per the annual report, the mega deal bagged in the last fiscal and a healthy pipeline of some more large-sized orders would drive the growth in the current year. In fact, the management believes that a platform has been built on which the company can embark on its journey of much higher growth rates.

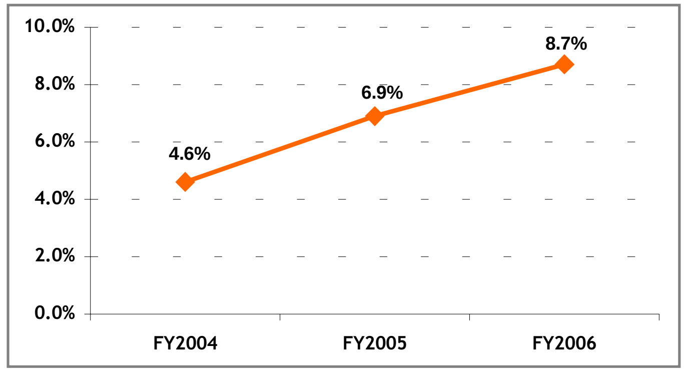
In terms of segment-wise outlook, the telecom business segment continues to remain attractive due to the robust growth in the telecom subscriber base in the Indian subcontinent, Africa and the other parts of Asia. The company is tapping the overseas opportunity in the telecom sector through its wholly-owned subsidiary, ORG Telecom. In the system integration and service segment, the company aims to leverage the enhanced size of operations to attract and win larger sized deals.

As part of its overall growth strategy, the company is also actively looking at the inorganic route to further enhance its scale of operations and range of services. To fund the inorganic initiatives and the increased working capital requirements, the board is proposing an enabling resolution to raise up to $15 million (possibly by dilution of equity).

Margins improve

In addition to the buoyant growth in the revenues, the company has also witnessed a significant improvement in its OPM. The OPM has expanded by 176 basis points up to 8.7% for FY2006. On absolute terms, the operating profits grew by 127.5% to Rs13.5 crore in FY2006. Going forward also, the efforts to continuously move up the value chain—in terms of high value service and solution offerings—could positively affect the overall profitability.

Improving profitability



Operational metrics

The net cash generated from operating activities (after adjusting for working capital changes) increased from Rs4.3 crore in FY2005 to Rs12.2 crore in FY2006. Overall, the cash and cash equivalents increased from Rs3 crore to Rs11.5 crore in the last fiscal.

The return ratios have also improved dramatically on the back of the strong top line growth coupled with the improvement in the margins. The RoACE more than doubled to 37.5% as compared with 18.7% in the previous year. Likewise, the RoANW grew from 28.3% in FY2005 to a healthy figure of 43.2% in FY2006.

The debt/equity ratio has also shown a significant improvement, dropping from 1.05x in FY2005 to 0.46x as on FY2006. This is important considering the company is in expansion mode and the improved gearing will only help to raise more debt to meet its working capital requirements.

The company's ability to roll over cash earnings has seen a significant improvement, as reflected by the decline in its cash conversion cycle. The company's cash conversion cycle has improved from 116 to 108 days in the last fiscal.

Concerns

Variation between provisional and audited results

The net revenues as per the audited accounts stood at Rs155.2 crore as compared with Rs156.9 crore reported in the provisional results for the full year ended March 2006. Similarly, at Rs8.1 crore the earnings as per the audited accounts were also lower than the provisional earnings of Rs8.6 crore. The variation between the provisional and audited results was largely due to the changes made as per the auditors' suggestions.

Reduction in promoter's stake

The promoter's holding has reduced to 63.8% from 74.6% at the end of the previous year. Though this can be partly explained by the expansion in the equity base, the absolute number of shares held by promoters has reduced from 84.9 lakh shares to 74.6 lakh equity shares.

Valuations

To summarise, ORG Informatics has grown at an exponential rate over the past couple of years. According to the annual report, the platform has been built in terms of both the scale of operations and the range of service offerings. Moreover, the healthy pending order backlog and the order pipeline are likely to further boost the growth momentum. On the flip side, the decision to raise funds through a possible equity dilution could result in lower growth in earnings per share and drag down the key operational metrics (like the return ratios) in the medium term.

At the current market price the stock trades at 7.6x FY2007 and 5.6x FY2008 estimated earnings. We maintain our Buy recommendation on the stock with a revised price target of Rs190 (12x FY2008 earning per share, including the convertible warrants that have been issued).

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

Tata Tea

Apple Green

Stock Update

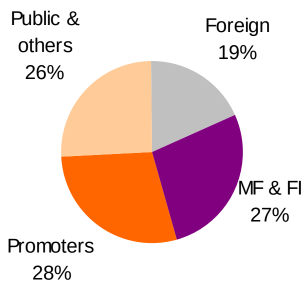
Price target lowered to Rs970

Buy; CMP: Rs764

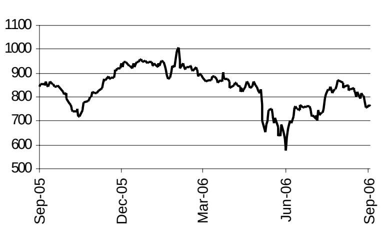
Company details

Price target:	Rs970
Market cap:	Rs4,278 cr
52 week high/low:	Rs1,047/560
NSE volume: (No of shares)	2.64 lakh
BSE code:	500800
NSE code:	TATATEA
Sharekhan code:	TATATEA
Free float: (No of shares)	4.0 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-11.7	35.5	-11.8	-7.8
Relative to Sensex	-16.6	0.2	-21.4	-37.8

Key points

- Tata Tea Ltd (TTL) would be raising Rs420-460 crore through the preferential allotment of shares and warrants to its promoter, Tata Sons. We expect the allotment to result in equity dilution of 10-11% for TTL. However, it is not clear as to how much funds will be raised through direct equity and how much through warrants.
- TTL requires Rs1,100 crore for various acquisitions that it has done over the past few months. We expect the company to raise the balance amount required by selling its investments in group companies as well as its North India Plantation Operations.
- We expect TTL to raise short-term debt of Rs320-550 crore depending upon the amount of the warrants and their conversion period.
- We have lowered our earnings per share (EPS) estimates for the stock to take into account the short-term debt along with the equity dilution. Accordingly we have revised our EPS estimates from Rs57 to Rs49.5 for FY2007 and from Rs64.5 to Rs59.5 for FY2008, ie a dilution of 13.4% and 7.7% respectively. We have not taken the numbers of Energy Brands Inc into account.
- We expect the lack of clarity with regard to the stock's earnings to continue till the management of the company clears the cloud over the funding structure for its inorganic expansion.
- Taking both the above factors into account, we are lowering our price target on the stock to Rs970 per share.
- Over the long term, we expect TTL to be a good candidate for re-rating as:
  - it becomes a pure play on the branded fast moving consumer goods (FMCG) business, and
  - it reduces its exposure to low-yielding investments in the group companies and invests in high-growth companies like Energy Brands Inc.

Earnings table

Particulars	FY2005	FY2006	FY2007E	FY2008E
Net profit (Rs cr)	243.4	293.9	306.2	369.2
Shares in issue (Cr)	5.6	5.6	5.9	6.2
EPS (Rs)	43.4	52.5	49.5	59.7
% y-o-y growth	*28.3*	*20.8*	*-5.6*	*20.6*
PER (x)	17.6	14.6	15.4	12.8
Book value (Rs)	271.1	280.1	309.1	372.8
P/BV (x)	2.9	2.8	2.6	2.1
EV/EBIDTA (x)	10.6	10.2	6.7	5.7
EV/Sales (x)	1.9	1.8	1.7	1.5
RoCE (%)	14.0	13.9	13.9	14.3
RoNW (%)	17.0	19.0	17.3	16.8

To raise funds through preferential allotment—10.5% dilution

TTL will be raising Rs420-460 crore through the preferential allotment of shares and warrants to its promoter, Tata Sons. However, it is not clear as to how much funds will be raised through direct equity and how much through warrants.

We expect the allotment to result in equity dilution to the extent of 10-11% for TTL based on the 26-week average share price of Rs793.

Balance to come through sale of investments

TTL requires a total Rs1,100 crore for investing in various acquisitions and investments that it has committed over the last couple of months.

Invest in	Rs crore
US-based Energy Brands Inc	890.0
Rights issue of Tata Coffee's partly convertible debentures	125.0
Consolidated Coffee Inc (holding company for Eight O'clock Coffee)	92.0
Total	**1,107.0**

Thus, TTL would have to raise another Rs640 crore to fund these investments. The balance amount may be raised by selling its investments in group companies as well as its North Indian Plantation Operations.

Dilution and short-term borrowings to pull down earnings

We expect TTL to raise short-term debt of Rs550 crore as the money on warrants may come over a period of time.

We have lowered our EPS estimates for the stock to take into account the short-term debt along with the equity dilution. Accordingly we have revised our EPS numbers from Rs57 to Rs49.5 for FY2007 and from Rs64.5 to Rs59.5 for FY2008, ie a dilution of 13.4% and 7.7% respectively. We have not taken the numbers of Energy Brands Inc into account.

Valuation and view

We have lowered our price target on the stock to Rs970 per share to take into account two things:

- the reduced earnings as mentioned above, and,
- the lack of clarity on the funding structure which may impart volatility to the stock's earnings

We may revise our numbers again as the funding structure becomes clear and as the synergy between TTL and Energy Brands Inc unfolds.

Price target revised to Rs970

Particulars	Rs per share	Comments
Value of TTL	714.5	@12x FY2008
Value of EBI	230.9	@2.2x CY2006 revenues
Total	945.4	
Add: Investments	24.2	
Total	969.6	

However, over the long term, we expect TTL to be a good candidate for re-rating as:

- it becomes a pure play on the branded FMCG business, and
- it reduces its exposure to low-yielding investments in the group companies and invests in high-growth companies like Energy Brands Inc.

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

Sharekhan Stock Ideas

Evergreen

HDFC Bank
Infosys Technologies
Reliance Industries
Tata Consultancy Services

Apple Green

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

Cannonball

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

Emerging Star

3i Infotech
Aban Offshore
Cadila Healthcare
KSB Pumps
Marksans Pharma
Navneet Publications (India)
New Delhi Television
Orchid Chemicals & Pharmaceuticals
ORG Informatics
Solectron Centum Electronics
Television Eighteen India
Thermax
TVS Motor Company
UTI Bank
Welspun Gujarat Stahl Rohren

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
Orient Paper and Industries
WS Industries India

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