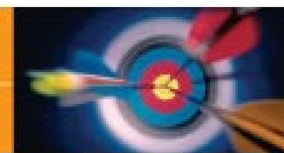
investor's eye



Index

- Pulse Track
- Stock Update >> Gateway Distriparks
- Stock Update >> Jaiprakash Associates
- Stock Update >> Alphageo India
- Stock Update >> Sun Pharmaceutical Industries

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Aban Loyd	03-Mar-05	330	**1,184**	1,760
BHEL	11-Nov-05	1,203	**2,153**	2,650
ICICI Bank	23-Dec-03	284	**584**	750
Infosys	30-Dec-03	689	**1,742**	1,870
Orient Paper	30-Aug-05	214	**423**	675

Pulse Track

June 2006 IIP grows at 9.6% ahead of expectations

The Index of Industrial Production (IIP) grew by a strong 9.6% year on year (yoy) for June 2006 against a consensus estimate of 9.2% yoy. Commendably the growth took place on the back of a high growth of 12.2% achieved in June 2005.

The manufacturing sector continued its growth momentum, growing at 10.5% yoy and that too on a higher base (the same had grown by 13.2% in June 2005). The mining production in the economy grew at 4.8% yoy and the electricity production grew at 4.5% yoy, also on a higher base of last year.

The index of capital goods grew by a strong 23.7%, underpinning the strong investment theme that is currently running through the Indian economy.

	Jun-06	Jun-05	May-06	Q1FY07	Q1FY06
IIP	9.6	12.2	10.0	10.1	10.4
Mfg	10.5	13.2	11.3	11.2	11.2
Mining	4.8	4.8	3.0	3.5	4.3
Electricity	4.5	9.6	4.7	5.1	7.7
Capital goods	23.7	13.5	20.5	22.9	13.6
Consumer goods	5.9	23.7	9.1	8.2	18.4
Consumer Non-durable	1.5	27.5	5.9	5.4	19.2
Consumer durables	19.9	12.8	18.3	16.5	16.3

Source: Ministry of Statistics and Programme Implementation

The growth in the manufacturing sector was led by higher production of paper and printing materials, basic chemicals, non-metallic minerals, basic metals, machineries and capital equipment and transport equipment.

Key constituents of manufacturing sector

In %		y-o-y growth		
	Weight	Apr-06	May-06	Jun-06
Beverages, tobacco and related	2.4	11.7	11.7	8.1
Textile (including wearing apparel)	2.5	9.5	9.8	11.6
Paper and printing	2.7	8.3	15.8	11.0
Rubber, plastic, petroleum and coal	5.7	4.9	11.3	9.9
Non-metallic mineral	4.4	15.4	7.4	18.2
Basic metal and alloy industries	7.5	20.7	21.2	19.5
Metal and parts	2.8	4.9	-10.8	6.9
Machinery and equipment	9.6	13.4	15.3	18.4
Transport equipment	4.0	16.3	26.7	22.9
Other manufacturing industries	2.6	36.0	29.2	25.8

Source: Ministry of Statistics and Programme Implementation

Sharekhan Ltd
A-206, Phoenix House, 2nd Floor, Senapati Bapat Marg, Lower Parel, Mumbai - 400013, India.

Gateway Distriparks

Cannonball

Stock Update

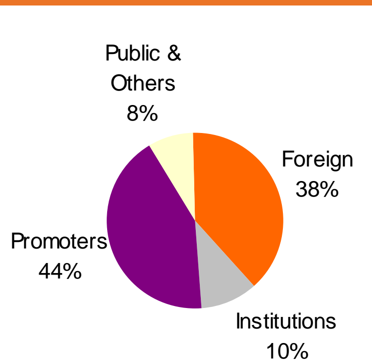
Price target lowered to Rs250

Buy; CMP: Rs169

Company details

Price target:	Rs250
Market cap:	Rs1,558 cr
52 week high/low:	Rs301/144
NSE volume: (No of shares)	1.5 lakh
BSE code:	532622
NSE code:	GDL
Sharekhan code:	GATEWAY
Free float: (No of shares)	5.2 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-17.0	-31.9	-31.0	-8.7
Relative to Sensex	-20.6	-23.7	-38.1	-37.6

Result highlights

- Gateway Distriparks Ltd (GDL) reported a consolidated net profit of Rs19.8 crore for Q1FY2007. The net profit is marginally below our expectation primarily because of a lower-than-expected realisation per twenty feet equivalent unit (TEU) during the quarter.
- The consolidated revenues for the quarter stood flat at Rs34.5 crore as the realisation per TEU dropped by 5.6% to Rs6,012. However the 6% increase in the volume restricted the drop in the revenues.
- The realisation per TEU fell as the share of the container freight stations (CFSs) at Chennai and Vizag in the total volume increased. Chnennai and Vizag have much lower realisation as compared to that of Rs7,000 per TEU for the Jawaharlal Nehru Port Trust (JNPT) CFS. The realsiation at even the JNPT CFS fell marginally.
- The operating profit margin (OPM) for the quarter declined by 4.2% points to 56.5%, as the realisation dropped. The fall in the OPM coupled with flat revenues resulted in a 7% drop in the operating profit for the quarter.
- However an eight-fold increase in the other income (on account of the investment of the proceeds from a global depository receipt [GDR] issue in bank deposits) helped the earnings before interest, depreciation, tax and amortisation (EBIDTA) to jump up by 20% year on year (yoy) to Rs26 crore.
- The company's interest expenses declined by 39.7% as it repaid a substantial part of its debt. The net profit for the quarter jumped by 15% to Rs19.8 crore.
- The quarter saw the launch of the rail container freight (RCF) service in May. Further GDL is planning to ramp up the capacity of its first ICD at Garhi and set up a second rail-linked ICD at Faridabad. This will enable GDL to be a significant player in the rail freight container business that offers integrated port based logistic services.

Result table (consolidated) Rs (cr)

Particulars	Q1FY2007	Q1FY2006	% yoy chg
Net sales	34.5	34.6	-0.1
Total expenditure	15.0	13.6	11.0
Operating profit	19.5	21.0	-7.1
Other income	6.5	0.7	834.3
EBIDTA	26.0	21.7	20.1
Interest	0.4	0.7	-39.7
PBDT	25.6	21.0	22.1
Depreciation	3.0	2.5	22.6
PBT	22.6	18.5	22.1
Tax	2.8	1.3	117.2
Deferred tax		0.0	
Reported profit after Tax	19.8	17.2	15.0
Margins			
OPMs (%)	56.5	60.7	-4.2
EBIDTA (%)	75.4	62.7	
EBT (%)	65.3	53.4	
EAT (%)	57.3	49.7	

GDL's Q1FY2007 results are marginally below our expectations primarily because of a drop in its realisation per TEU. The realisation per TEU fell as the share of CFSs at Chennai and Vizag in the total volume increased. Chennai and Vizag have much lower realisation as compared to Rs7,000 per TEU at the JNPT CFS. Even the realsiation at JNPT CFS fell marginally. On account of this we are downgrading our earnings estimates for FY2007 and FY2008 by 8.7% each. Our earnings per share (EPS) estimates now stand at Rs9.7 for FY2007 and Rs13.8 for FY2008.

We feel that the worst is over for GDL and expect its earnings growth to pick up primarily because of two reasons. First, from Q2FY2007 GDL will see a jump in its revenue with a ramp-up in the operations of the newly-started RCF service division. Secondly, the third container terminal at JNPT is likely to commence operations by September 2006 which will boost the volume of the high-margin Mumbai CFS. Hence we expect GDL to scale up its revenues and profits going forward.

With a buoyant economy and booming export-import trade, the under-penetrated container market in India is all set to witness a significant growth. This would require a higher capacity of container handling terminals at all ports in the country. By commissioning its third container terminal JNPT is all set to take the first mover advantage in this business. Since GDL is expanding the capacity at its Mumbai CFS, it is expected to be the prime beneficiary of the JNPT expansion. Further GDL is also entering the RCF service business, expanding the capacity of its Garhi ICD near Delhi and setting up its second ICD at Faridabad. In other words, GDL is all set to offer the complete range of port-related container logistic services.

We expect GDL's earnings to grow at a compounded annual growth rate (CAGR) of 33% over FY2006-08. At the current market price of Rs169, the stock is trading at 12.2x its FY2008E earnings; the valuation is attractive considering the strong 33% compounded annual growth expected and the substantial earnings that would accrue once the RCF business scales up. We remain positive on the company and maintain our Buy recommendation on the stock with a revised price target of Rs250. We have valued GDL's current business at 14x FY2008E earnings and its RCF business at 14x the discounted return (we have assumed return on equity of 12% on Rs360-crore investment in the RCF business) of the RCF business.

Volumes up 5.8%, however revenue flat

For Q1FY2007 GDL has registered a 5.8% growth in its volumes to 57,450TEUs. Even though the volumes have registered a growth, the same have in fact remained flat as the majority of the increase has come from the non-Mumbai CFSs like Chennai and Vizag, where the realisation is lower as compared to that in the Mumbai CFS. Hence the realisation per TEU fell by 5.6% to Rs6,012 per TEU during Q1. Consequently at Rs34.5 crore the revenues did not show any growth yoy.

Operating profit down 7%

As the realisation dropped, the OPM for the quarter fell 4.2% points to 56.5%. The fall in the OPM coupled with the flat revenues resulted in a 7% decline in the operating profit for the quarter.

Cost per TEU	Q1FY07	Q1FY06	% yoy chg
Employee expenses	265	394	-32.9
Transportation	849	615	38.1
Labour charges	211	214	-1.4
Other expenses	1293	1273	1.6
TOTAL cost per TEU	2618	2495	4.9
Realisation	6012	6370	-5.6
EBIDTA/TEU	3394	3866	-12.2
TEUs handled	57450	54300	5.8

Eight-fold rise in other income protects bottom line

Towards the end of FY2006 GDL had come out with a USD85-million GDR issue to fund its expansion plans. The issue proceeds of Rs375 crore were to be used to expand its JNPT-based CFS as well as the other CFSs and for the launch of RCF services. However as the majority of the funds were not utilised for the purpose, these funds were deposited in banks and the surplus cash that GDL had on its books was utilised to pay off the debt. Hence we have seen a very significant eight-fold jump in the other income for the quarter. This coupled with the almost 40% decline in the interest charge has protected the bottom line. The consolidated net profit for the quarter jumped by 15% yoy to Rs19.8 crore.

GDL's plan to expand at the JNPT CFS has hit rough weather, as the company has not made any significant headway in setting up a greenfield CFS at JNPT. However there are two positive developments on this front. First, GDL has expanded the capacity of its existing CFS at JNPT by 36,000TEUs to 216,000TEUs. Second, with huge cash of Rs300 crore on its books, GDL is now actively looking at acquiring an existing CFS at Nava Sheva. The company has started negotiations with some of the players already.

Upside from expansion at Mumbai CFS

JNPT is all set to commission its third container terminal at Nava Sheva. This will take JNPT's container handling capacity from the current 2.4 million TEUs to 3.6 million

TEUs. According to the port management, this additional capacity would present every CFS at Nava Sheva an opportunity to service additional 35,000TEUs in FY2007. However out of the nine odd CFSs at Nava Sheva not all have the capacity and support infrastructure to service the additional volume. With the opportune expansion of its Nava Sheva facility, GDL feels that it could easily handle a lot more than the 35,000 incremental TEUs. Hence with the additional volume coming from the high-margin Mumbai CFS, where the realisation is as high as Rs7,000 per TEU, we expect GDL's margins to expand on a sequential basis.

Q1FY2007 marred by lower volume growth

GDL's Q1FY2007 results are marginally below our expectations primarily because of a drop in the realisation per TEU. The realisation per TEU fell as the share of CFSs at Chennai and Vizag in the total volume increased. Chennai and Vizag have much lower realisation as compared to Rs7,000 per TEU at the JNPT CFS. Even the realsiation at JNPT CFS fell marginally. On account of this we are downgrading our earnings estimates for FY2007 and FY2008 by 8.7% each. Our earnings per share (EPS) estimates now stand at Rs9.7 for FY2007 and Rs13.8 for FY2008.

We feel that the worst is over for GDL and expect its earnings growth to pick up primarily because of two reasons. First, from Q2FY2007 GDL will see a jump in its revenue with a ramp-up in the operations of the newly started RCF services. Secondly, the third container terminal at JNPT is likely to commence operations by September 2006 which will boost the volume for GDL's high-margin Mumbai CFS. Hence we expect GDL to scale up its revenues and profitability going forward.

GDL to set up second rail-linked ICD at Faridabad

After getting the licence for providing RCF services, GDL has recently acquired a 50-acre land through its 100% subsidiary, Gateway Rail Freight Pvt Ltd (GRFPL). Through GRFPL, GDL is setting up its second rail-linked ICD, which will be on electric route connecting JNPT to northern India. We have not factored this in our estimates. The company already has one ICD at Garhi near Gurgaon from which it operates container rakes to JNPT.

For its RCF service business, GDL is currently evaluating quotations for the procurement of container wagons. As of now, the company has a tie-up with Container Corporation of India (Concor) wherein Concor supplies container rakes to GDL. The company expects to place order for wagons in the next six to eight months after carefully evaluating the quotations.

Valuation and View

With a buoyant economy and booming export-import trade, the under-penetrated container market in India is all set to witness a significant growth. This would require a higher capacity of container handling terminals at all ports in the country. By commissioning its third container terminal JNPT is all set to take the first mover advantage in this business. Since GDL is expanding the capacity at its Mumbai CFS, it is expected to be the prime beneficiary of the JNPT expansion. Further GDL is also entering the RCF service business, expanding the capacity of its Garhi ICD near Delhi and setting up its second ICD at Faridabad. In other words, GDL is all set to offer the complete range of port-related container logistic services.

We expect GDL's earnings to grow at a CAGR of 33% over FY2006-08. At the current market price of Rs169, the stock is trading at 12.2x its FY2008E earnings; the valuation is attractive considering the strong 33% compounded annual growth expected in its earnings in FY2007 and the substantial earnings that would accrue once the RCF business scales up. We remain positive on the company and maintain our Buy recommendation on the stock with a revised price target of Rs250. We have valued GDL's current business at 14x FY2008E earnings and its RCF business at 14x the discounted return (we have assumed return on equity of 12% on Rs360-crore investment in the RCF business) of the RCF business.

Earnings table Rs (cr)

Particulars	FY04	FY05	FY06	FY07E	FY08E
Net profit (Rs cr)	19.1	39.4	72.3	89.6	127.6
Shares in issue (cr)	6.4	7.5	9.2	9.2	9.2
EPS (Rs)	3.0	5.3	7.8	9.7	13.8
% yoy growth	*27.3*	*106.3*	*83.5*	*23.9*	*42.4*
PER (x)	56.6	32.2	21.6	17.4	12.2
Book value (Rs)	12.7	22.0	66.5	76.2	90.0
P/BV (Rs)	13.3	7.7	2.5	2.2	1.9
EV/EBIDTA (x)	40.0	24.9	13.9	12.6	8.3
RoCE (%)	24.4	26.4	19.7	15.0	18.6
RoNW (%)	23.5	23.8	11.8	12.8	15.4

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

Jaipraksh Associates

Ugly Duckling

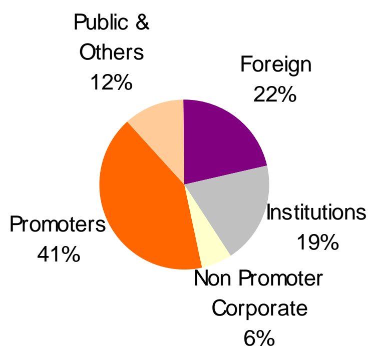
Stock Update

A mixed bag

Buy; CMP: Rs415

Company details	
Price target:	Rs562
Market cap:	Rs7,892 cr
52 week high/low:	Rs623/250
NSE volume: (No of shares)	3.1 lakh
BSE code:	532532
NSE code:	JPASSOCIAT
Sharekhan code:	JPASSO
Free float: (No of shares)	11.0 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-3.3	-25.9	-8.5	60.6
Relative to Sensex	-7.4	-17.0	-17.9	9.7

Result highlights

- Jaiprakash Associates Ltd's (JAL) Q1FY2007 operating profit at Rs213 crore is ahead of our expectations; however a higher tax charge has muted the net profit to Rs92 crore.
- JAL registered a growth of 10% in its revenues and the same stood at Rs895 crore for the quarter, mainly driven by a 32% growth in the cement division.
- The operating profit grew by an impressive 37.4% to Rs213 crore, as the operating profit margins (OPMs) expanded by 480 basis points to 23.8%.
- The earnings before interest and tax (EBIT) margins of the cement division jumped by 900 basis points to 25.7% during the quarter whereas the EBIT margins of the construction business fell by 370 basis points to 20%.
- Overall the profit before tax (PBT) grew by 47% year on year (yoy) to Rs141 crore. However the net profit registered only a meagre growth of 10% to Rs92 crore on account of a jump in the tax rate from 13% to 34.5%.

As mentioned earlier JAL's Q1FY2007 operating profit at Rs213 crore is ahead of our expectations. However a higher tax charge has muted the net profit to Rs92 crore. Consequently we are not changing our earnings estimates for JAL as the higher-than-expected operating profit is negated by a higher tax charge for the year. JAL has merged Jaypee Green, a real estate development company with itself. The merger ratio has been fixed at 2:1, which will entail issue of additional 25 million shares to the shareholders of Jaypee Green. We have estimated a value of Rs1,155 crore for the current land bank of Jaypee Green, based on the current land prices in Noida. We

Result table Rs (cr)

Particulars	Q1FY2007	Q1FY2006	% yoy chg
Net sales	895.0	817.0	9.5
Total expenditure	682.0	662.0	3.0
Operating profit	213.0	155.0	37.4
Other income	25.0	43.0	-41.9
EBITDA	238.0	198.0	
Interest	59.0	65.0	-9.2
Depreciation	38.0	37.0	2.7
PBT	141.0	96.0	46.9
Tax	51.0	9.1	460.4
Deferred tax	-2.0	3.0	-166.7
Profit after tax	92.0	83.9	9.7
Extraordinary items	-	330.1	
Reported profit after tax	92.0	414.0	-77.8
EPS	4.2	19.0	
Margin			
OPM (%)	23.8	19.0	
EBT (%)	15.8	11.8	
PAT (%)	10.3	50.7	

haven't taken into consideration the developmental gains of the same land bank. Any profits accruing from the development of the land could be positive in the medium term for JAL's shareholders.

Going forward, strong cement prices coupled with a decent volume growth will maintain the momentum in JAL's cement business, whereas the bulging Rs7,500 crore order book will drive the earnings of the construction business. The stock is trading at 12.7x FY2008E consolidated earnings and 6.5x enterprise value (EV)/earnings before interest, depreciation, tax and amortisation (EBIDTA), which is pretty attractive. We remain positive on JAL and maintain our Buy recommendation on the stock with a lowered price target of Rs562 per share. The price target is lower on account of the equity dilution from the merger of Jaypee Greens and the recently completed 165 million euros foreign currency convertible bond (FCCB) issue.

Net revenues jump by 10%

JAL's net revenues for the quarter jumped by 10% to Rs895 crore, on the back of a robust 32% growth in the cement revenues. The cement volumes grew by 9% yoy to 1.57 million tonne in Q1FY2007 on account of the strong demand in Uttar Pradesh, a key market for JAL. The cement realisations improved by a smart 21% yoy to Rs2,599/tonne during the quarter following the jump in the prices in the northern region.

Cement business driving growth

Particulars	Q1FY07	Q1FY06	% yoy chg
Volumes (mn tonne)	1.57	1.44	9.0
Realisations (Rs/tonne)	2,599	2,151	20.8
Cost (Rs/tonne)	1,796	1,645	9.2
EBITDA (Rs/tonne)	803	507	58.4

JAL's construction business reported a decline 5% yoy in its revenues, which stood at Rs520 crore. The decline in the revenues was due to its new projects being in the initial phase. The construction order backlog was Rs7,500 crore as on June 30, 2006.

Operating profit up 37.4%

JAL's operating profit for the quarter grew by an impressive 37.4% to Rs213 crore, as the OPMs expanded by 480 basis points to 23.8%. The EBIT margins of the cement division improved by 900 basis points to 25.7%. However the margins of the construction division segment proved to be dampener as the margins fell by 370 basis points to 20%. This was primarily due to the execution of projects ie Vishnu Prayag, Tehri and Tala, which were in the final stages during the quarter, wherein the margins were lower compared to the other underground works.

Segment results Rs (cr)

Particulars	Q1FY07	Q1FY06	% yoy chg
Cement	408.0	310.0	32.0
Construction	520.6	548.0	-5.0
EBIT (Rs m)			
Cement	105.0	52.0	102.0
Construction	104.1	130.0	-20.0
EBIT margins (%)			
Cement	19.0	16.8	
Construction	20.0	23.7	

Higher tax outgo subdues net profit growth

Despite the strong growth in the operating profit, the net profit was subdued, as the tax rate for the quarter jumped to 34.8% as against 12.6% in Q1FY2006. This resulted in a net profit growth of 10% for the quarter and the same stood at Rs92 crore.

Merger with Jaypee Green

JAL is in the process of merging Jaypee Green Ltd with itself after the approvals from all the regulatory authorities. Jaypee Green is basically the property development arm of the Jaiprakash group. The merger ratio has been fixed at 2:1 resulting in an incremental issue of 25 million shares. The incremental value attributable to JAL is approximately Rs1,155 crore, which has been arrived at on the basis of the current land prices prevailing in Noida. However we have not factored in the gains from the development of the Jaypee Green's land bank. Any profits accruing from the development of the land could be positive in the medium term for JAL's shareholders.

JAL to set up a 2-million-tonne cement plant in a JV with SAIL

JAL is in the process of setting up a 2-million-tonne cement plant in a joint venture (JV) with SAIL at Bhilai and Satna. JAL will hold a 74% stake in the JV while SAIL will hold the balance 26%. The cement plant is likely to be commissioned by June 2008.The acquisition will enhance JAL's presence in Bihar, Jharkhand and Orissa. We believe the plant would be value accretive to JAL's cement business over the next two years.

Commissioning of Vishnu Prayag

JAL has commissioned the 400MW Vishnuprayag hydropower plant on a build-operate-transfer (BOT) basis at Uttaranchal during the quarter. The project was completed at a cost of Rs1,900 crore funded by a debt-to-equity ratio of 70:30.

The company has signed a power purchase agreement (PPA) with the Uttar Pradesh Power Corporation Limited (UPCCL) at a 16% return on equity (ROE). However, the project is likely to have a ROE of 18-24% on account of higher plant availability and secondary generation.

Valuation and view

As mentioned earlier JAL's Q1FY2007 operating profit at Rs213 crore is ahead of our expectations; however a higher tax charge has muted the net profit to Rs93 crore. Consequently we are not changing our earnings estimates for JAL as the higher-than-expected operating profit is negated by the higher tax charge for the year. JAL has merged Jaypee Green, a real estate development company with itself. The merger ratio has been fixed at 2:1, which will entail issue of additional 25 million shares to the shareholders of Jaypee Green. We have estimated a value of Rs1,155 crore for the current land bank of Jaypee Green, based on the current land prices in Noida. We haven't taken into consideration the developmental gains of the same land bank. Any profits accruing from the development of the land could be positive in the medium term for JAL's shareholders.

Going forward, strong cement prices coupled with a decent volume growth will maintain the momentum in JAL's cement business, whereas the bulging Rs7,500 crore order book will drive the earnings of the construction business. The stock is trading at 12.7x FY2008E consolidated earnings and 6.5x EV/EBIDTA, which is pretty attractive. We remain positive on JAL and maintain our Buy recommendation on the stock with a lowered price target of Rs562 per share. The price target is lower on account of the equity dilution from the merger of Jaypee Green and the recently completed 165 million euros FCCB issue.

Earnings table Rs (cr)

Particulars	FY2005	FY2006	FY2007E	FY2008E
Net profit (Rs cr)	251.4	379.4	443.6	638.4
Share in issue (cr)	17.6	19.5	19.5	19.5
EPS (Rs)	15.1	19.5	22.8	32.8
% y-o-y chg	*24.0*	*29.0*	*17.0*	*44.0*
PER (x)	27.4	21.3	18.2	12.7
P/BV (x)	5.3	4.2	3.4	2.7
EV/Ebidta (x)	13.4	11.6	8.1	6.5
ROCE (%)	10.5	12.4	14.9	16.4
RONW (%)	20.6	24.4	25.2	24.5

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

Alphageo India

Emerging Star

Stock Update

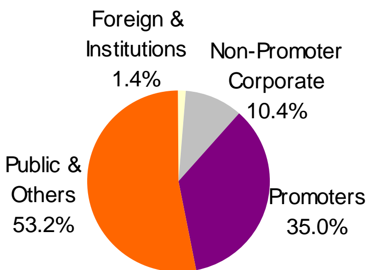
Book profits

Book Profit; CMP: Rs155

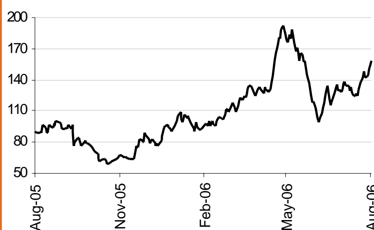
Company details

Price target:	Book profit
Market cap:	Rs78.2 cr
52 week high/low:	Rs198/58
BSE volume: (No of shares)	41,381
BSE code:	526397
Sharekhan code:	ALPHAGEO
Free float: (No of shares)	32 lakh

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	21.2	-16.0	62.1	81.6
Relative to Sensex	16.0	-5.8	45.5	24.1

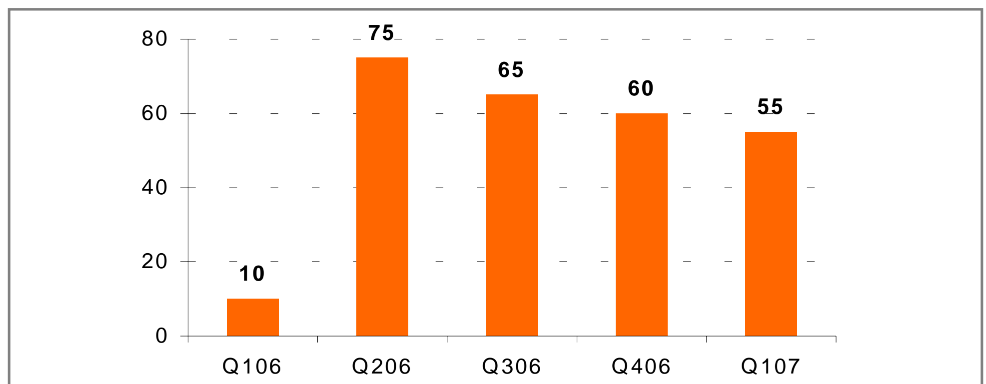
We had initiated coverage on Alphageo India on December 27, 2005 at a price of Rs81 with a price target of Rs135. The stock has reached our price target and we recommend investors to book profit at these levels. We are booking profit at this point for two reasons, as discussed below.

Recommended on Date	Recommended at Rs	Booked on Date	Booked at Rs	Appreciation (%)
27-12-2005	81	11-08-2006	155	91.4

Stagnant order backlog—impedes FY2008 earnings visibility

At the time of initiating coverage on Alphageo, the company had an order backlog of Rs75 crore which provided strong visibility to its earnings. However since then the company has not made much progress in expanding its order backlog. No doubt that the current order backlog at Rs55 crore is enough for the company to report very impressive revenue and profit growth in FY2007. We expect a growth of 93% in its revenues and that of 78% in its earnings in FY2007. However as almost Rs35 crore of the order backlog will be booked in FY2007, the revenue visibility for FY2008 is dim. The stagnancy in the order backlog for the last three quarters is compelling us to book profit at these levels.

Stagnant order backlog hurts FY2008 earnings visibility



Higher depreciation mutes net profit growth

So far Alphageo's performance has been excellent at the operating level. For example, the operating profit for Q1FY2007 grew by a whopping 480%. However the depreciation charge has been higher in the past few quarters due to the high depreciation of its newly acquired 3D survey equipment like sensors and recording equipment. The average economic life of these survey equipment is five to six years and hence a higher depreciation rate is justified, as it is like providing for replacement of these equipment. Also the interest cost rose substantially on account of the Rs28 crore debt that the company had taken to set 3D crew. The substantial increases in the interest and depreciation charges led to a slower growth of 370% in the net profit as compared to the 480% growth in the operating profit.

Weather conditions in north-east disrupt crew operations again

With the onset of the monsoon, the weather conditions in the north-east region of India have deteriorated and the company had to call off the operations of the crew in May 2006. The work is likely to resume in November 2006. We have already factored in our estimates this break in the operations. To optimally utilise its crew in the period of non-operation (July to November 2006), Alphageo is trying to get some orders in the western areas of Rajasthan. However it has not received any confirmation yet and will get the same only in the next few months.

Risk from high interest charge and depreciation

Owing to the shut-down of the crew's operations, the company is likely to report losses for the next two quarters, as it will continue to incur the fixed charges like interest (Rs1 crore per quarter) and depreciation (Rs2.45 crore per quarter) charges during this period, irrespective of the size of revenue booking. However in Q4FY2007, when all the crews would be operational again, Alphageo's revenue and earnings would register a quantum jump. We have factored this in our estimates.

Possible equity dilution for setting up another 3D crew

With the completion of its first 3D contract, the company has gained in its arsenal the required pre-qualification and experience to execute these highly skilled 3D orders.

In view of the huge order for 3D survey in NELP V and the recently announced NELP VI, we believe AGL has tremendous growth opportunities. However as Alphageo current 3D crew is already booked till June 2007, in order to expand its order book substantially and capture the growth opportunities, it will have to set up another 3D survey crew. To capitalise on the huge opportunity presented by NELP V and NELP VI, the company plans to set up one more 3D survey crew by the end of FY2007. To fund this expansion the company is looking to mobilise funds through an equity issue. We don't expect it to go for the debt route as its debt/equity ratio is already high at 1.35. However nothing has been finalised yet and we expect the company will take another six to eight months to come to a decision.

Valuation justified, give lower earnings visibility

At the current market price of Rs155, the stock is discounting its FY2007 earnings by 11.2x. On account of the lower visibility of its earnings in FY2008, we are a bit concerned and believe that the stock is fairly valued. The stock is trading near our price target of Rs135. We suggest that investors book profit at these levels.

We believe AGL has tremendous growth opportunities in view of the huge order for 3D survey in NELP V and the recently announced NELP VI. Also with the completion of its first 3D contract, the company will have the required pre-qualification and experience to execute these highly skilled 3D orders. However we would like more clarity on its strategy with regard to new orders, new crew and funding mode. We shall have a relook at the stock only after gaining clarity on these issues.

Earnings table Rs (cr)

Particulars	FY2004	FY2005	FY2006	FY2007E
Net profit (Rs cr)	3.1	3.3	4.2	6.9
Share in issue (cr)	0.5	0.5	0.5	0.5
EPS (Rs)	6.1	6.6	8.5	13.9
% y-o-y growth	*164.0*	*4.0*	*30.0*	*63.0*
PER (x)	23.4	21.6	16.7	10.2
Book value (Rs)	30.8	37.3	45.9	59.7
P/BV (x)	4.6	3.8	3.1	2.4
EV/EBIDTA (x)	10.8	10.8	8.6	4.0
Dividend yield (%)	0.0	0.0	0.0	0.0
ROCE (%)	43.4	37.5	27.0	32.2
RONW (%)	22.9	19.3	20.4	26.3

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

Sun Pharmaceutical Industries

Ugly Duckling

Stock Update

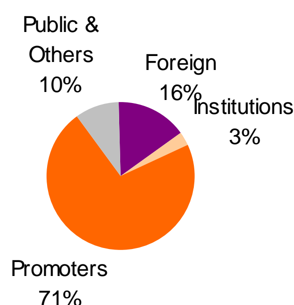
Price target revised to Rs1,000

Buy; CMP: Rs807

Company details

Price target:	Rs1,000
Market cap:	Rs15,015 cr
52 week high/low:	Rs935/552
NSE volume: (No of shares)	1.5 lakh
BSE code:	524715
NSE code:	SUNPHARMA
Sharekhan code:	SUNPHARM
Free float: (No of shares)	5.3 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	10.4	-8.4	4.6	34.5
Relative to Sensex	5.7	2.6	-6.1	-8.1

Result highlights

- Sun Pharmaceuticals' consolidated net sales grew by 31.1% year on year (yoy) to Rs511.6 crore in Q1FY2007. The strong growth was driven by an increase of 59.3% in formulation exports and a 15.5% growth in the domestic formulation business.
- Caraco Pharma's performance was impressive in view of the fierce competition in the US market. It recorded sales of $24.8 million and a net profit of $5.1 million.
- Lower raw material costs boosted the company's operating profit margin (OPM), which expanded by 260 basis points to 35.4% in Q1FY2007, causing the operating profit (OP) to increase by 41.4% to Rs181.1 crore.
- The company's profit after tax (PAT) increased by a strong 29.9% yoy to Rs176.7 crore in the quarter, despite a lower other income, a higher depreciation and a higher share of minority interest.
- At the current market price of Rs807, Sun Pharma is valued at 23.6x FY2007 and 20.0x FY2008 fully diluted earnings. The valuations, we believe, do not fully capture the value that Sun Pharma could command with a ramp-up in its overseas business, continued momentum in the domestic formulation space, a de-risked business model and the positive contributions of its acquisitions. In view of the consistent growth and sustainable margins, we remain positive on the company's future prospects and maintain our Buy recommendation with a revised price target of Rs1,000.

Result table (consolidated) Rs (cr)

Particulars	Q1FY2007	Q1FY2006	% yoy chg
Net sales	511.6	390.2	31.1
Pre-R&D expenditure	270.5	235.6	14.8
EBIDTR	241.1	154.6	56.0
R&D expenses	60.0	26.5	126.8
Operating profit	181.1	128.1	41.4
Other income	27.4	28.4	-3.5
EBITDA	208.5	156.5	33.2
Interest expense	0.0	0.0	-
Depreciation	20.2	11.9	69.2
PBT	188.3	144.6	30.3
Taxes	0.2	3.3	-95.4
PAT	188.2	141.3	33.2
Minority interest	11.5	5.2	118.7
PAT after minority interest	176.7	136.1	29.9
EBIDTR margin (%)	47.1	39.6	
OPM (%)	35.4	32.8	
PAT margin (%)	34.5	34.9	
EPS (Rs)	9.5	7.3	29.5

Sun Pharma's Q1FY2007 results were above expectations. On a consolidated basis, the net sales increased by a robust 31.1% to Rs511.6 crore. The strong growth was driven by an increase of 59.3% in the formulation exports and a 15.5% growth in the domestic formulation business. A lower raw material cost caused the OPM to improve by 260 basis points to 35.4% in the quarter. Consequently, the OP grew by 41.1% to Rs181.1 crore. Despite a lower other income and a higher depreciation, the PAT for the quarter stood at Rs176.7 crore, an increase of 29.9% yoy.

Strong exports and continued momentum in domestic formulations drive revenue

Sun Pharma's consolidated sales grew by a robust 31.1% to Rs511.6 crore in Q1FY2007. The growth came on the back of a 59.3% surge in the formulation exports to Rs160.1 crore and a 15.5% growth in the domestic formulations to Rs291.8 crore.

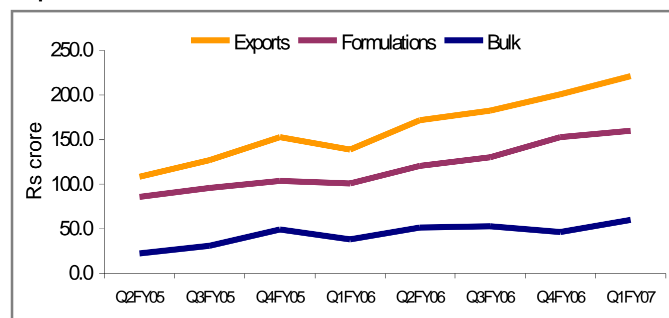
Sales break-up

Particulars	Q1FY07	Q1FY06	% yoy chg
Domestic	313.9	275.6	13.9
Formulations	291.8	252.6	15.5
Bulk	21.8	23.0	-5.1
Others	0.3	0.0	733.3
Exports	220.9	138.7	59.3
Formulations	160.1	100.5	59.3
Bulk	60.1	38.2	57.5
Others	0.7	0.0	-

Sun Pharma's domestic formulation business registered a growth of 15.5% yoy in Q1FY2007 despite a high base on account of spill-overs related to the value-added tax (VAT). The domestic growth was led by the sale of products in the company's core therapeutic areas of cardiology, psychiatry, neurology, gastroenterology and diabetology, which accounted for over 70% of the domestic formulation sales. The company launched 16 new products in the domestic market in Q1FY2007, which also fuelled its growth. Sun Pharma continues to enjoy its numero uno position with psychiatrists, neurologists, cardiologists and diabetologists in India.

Sun Pharma's export business continued to grow strongly in the quarter, with exports of both active pharmaceutical ingredients (APIs) and formulations growing by 57.5% and 59.3% to Rs60.1 crore and Rs160.1 crore respectively. Commensurate with its strategy, the company continued to focus on the high-margin export business, which constituted 41.3% of total sales in Q1FY2007 as compared to only 33.5% in the corresponding quarter of the previous year.

Exports and formulation sales on the rise

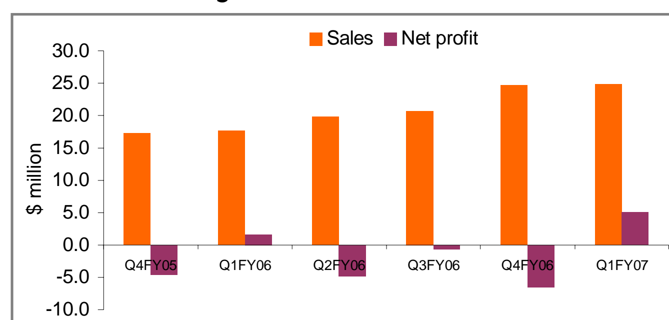


However, in line with the company's focus on formulations, its API sales in the domestic market declined by 5.1% to Rs21.8 crore, as it employed a greater proportion of its APIs for captive use rather than selling them externally.

Caraco stages an impressive performance

Sun Pharma's US subsidiary, Caraco Pharma, staged an impressive performance by registering a revenue growth of 40.9% to $24.8 million. The subsidiary's net profit grew by an astounding 218.8% to $5.1 million in the quarter. Caraco Pharma's performance was particularly commendable in view of the strong competitive scenario and pricing pressures being witnessed in the US generics market. Caraco Pharma's strong performance was driven by the rising sales of generic Ultracet, for which it enjoys the 180-day exclusivity. However, with the entry of new players the competition for Ultracet is expected to intensify going forward, leading to strong pricing pressures and reducing market shares. Sun Pharma plans to strengthen its US business through Caraco Pharma by launching new products in the US markets.

Caraco Pharma stages a turn-around



Lower material costs lead to 260-basis-point expansion in OPM

Sun Pharma's OPM improved by 260 basis points in the quarter to 35.4%. The margin expansion was driven by a significant reduction in the company's material cost, which constituted 27.8% of its net sales in Q1FY2007 as compared to 32% of the net sales in Q1FY2006. The savings in the raw material cost were due to a higher captive use of the APIs and a depreciating rupee, which inflated the value of the closing inventory. The drop in the raw material cost was high enough to offset the higher research and development (R&D) spend and the higher staff cost. The

improvement in the margins caused the OP to grow by 41.4% to Rs181.4 crore in Q1FY2007. The operating performance of the company was impressive in light of the continued investments (to the tune of $3-4 million per quarter) made to turn around the recently acquired Valeant and Able facilities, without deriving proportionate revenues.

Cost break-up

Particulars	Q1FY07	Q1FY06	% yoy chg
Adjusted raw material cost	142.19	124.8	13.9
% of net sales	*27.8*	*32.0*	
Staff cost	61.96	36.56	69.5
% of net sales	*12.1*	*9.4*	
Other indirect taxes	12.97	11.73	10.6
% of net sales	*2.5*	*3.0*	
Other expenditure	113.42	88.97	27.5
% of net sales	*22.2*	*22.8*	
Recurring R&D expenses	60.0	26.5	126.8
% of net sales	*11.7*	*6.8*	

Net profit grows by 29.9% to Rs176.7 crore, despite lower other income

Sun Pharma's net profit for Q1FY2007 stood at Rs176.7 crore, up by 29.9% yoy. The growth in the profit was strong despite a lower other income (down by 3.5%), a substantially higher depreciation (up by 69.2%) and a higher share of minority interest (at Rs11.5 crore versus Rs5.2 crore in Q1FY2006) recorded in the quarter. The other income was lower on account of the foreign exchange translation losses on the foreign currency convertible bonds (FCCBs). These losses are likely to be reversed upon conversion of the FCCBs into equity shares. The earnings for the quarter stood at Rs9.5 per share.

R&D demerger on track

Sun Pharma's proposed demerger of its innovative R&D unit into a separate company is progressing well and is on track. The company expects the demerger to be completed by October 2006. The demerger, once effected, will de-risk the company's business from the uncertainties and costs related to innovative R&D. The company is expecting to save around Rs70-80 crore of innovative R&D expenses after the spin-off which it intends to utilise in accelerating its pace of generic filings in the regulated markets. The move will enable Sun Pharma to enhance its focus on innovative R&D and explore more opportunities in this space; it will also provide a huge trigger for the unlocking of value going forward.

Strong ANDA pipeline to fuel growth

With 50 pending abbreviated new drug application (ANDA) approvals (15 from Caraco Pharma and 35 from Sun Pharma), Sun Pharma has one of the strongest pipeline of filings in the Indian pharmaceutical industry. The quality of the filings also remains exciting, with a mix of orals and complex formulations such as injectables and nasal sprays, with some of the filings being Para IV first-to-file. Out of the 50 pending approvals, the company has already received ten tentative approvals. The company plans to file an additional 30 ANDAs in FY2007 and spend an amount equivalent to 10-11% of its turnover on R&D.

Sun Pharma's R&D efforts are progressing well, with its new chemical entity (NCE) entering Phase II clinical trials and INDs for two novel drug delivery systems (NDDS) expected to be filed soon.

Scouting for acquisitions in the USA

With its war chest of $400 million (post-R&D demerger) of cash, Sun Pharma is actively scouting for a large-ticket acquisition in the US market. The management has indicated that the strength of the product pipeline and the customer relationships will be the key to evaluating any potential acquisition opportunity. Historically, Sun Pharma is known to have acquired distressed assets and turned them around. Hence, we do not believe that any new acquisition will start making positive contributions in the near term and therefore our estimates do not reflect the upside from any potential acquisitions.

Valuation & view

Sun Pharma has maintained its consistency in reporting strong results quarter after quarter. Going forward, we expect the ramp-up in the US business and the continued momentum in the domestic formulation business to drive growth. With a strong ANDA pipeline, we are likely to see an accelerated pace of new product launches, which will drive the US business. The outlook for the company's domestic business also remains bright as it operates in niche, high-margin lifestyle segments, which are growing at higher-than-industry rates. With the de-merger of the innovative R&D, Sun Pharma will be insulated from the inherent risks and uncertainties involving the innovative R&D process. In view of the above, we believe that the company's valuations will improve going forward.

At the current market price of Rs807, Sun is valued at 23.6x FY2007 and 20.0x FY2008 fully diluted earnings. These valuations, we believe, do not fully capture the value that Sun Pharma could command with a ramp-up in its overseas business, continued momentum in the domestic formulation space, a de-risked business model and the positive contributions of acquisitions. In view of the consistent growth and sustainable margins, we remain positive on the company's future prospects and maintain our Buy recommendation with a revised price target of Rs1,000.

Valuation table (consolidated) Rs (cr)

Particulars	FY04	FY05	FY06	FY07E	FY08E
Net sales	983.0	1185.3	1735.8	2089.6	2409.3
PAT	315.7	396.2	573.2	710.5	837.2
Shares in issue (cr)	9.3	18.6	18.6	20.7	20.7
EPS (Rs)	34.0	21.4	30.9	34.3	40.4
PER (x)	23.7	37.8	26.2	23.6	20.0
Book Value/ share	87.9	60.9	87.1	169.9	204.8
P/BV (x)	9.2	13.2	9.3	4.8	3.9

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Apple Green

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Marico Industries
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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
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