investor's eye

Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Balaji Tele	9-July-07	231	**242**	303
HUL	24-Nov-05	172	**202**	280
ICICI Bank	23-Dec-03	284	**862**	1,173
JP Associates	30-Dec-03	125	**910**	1,061
Madras Cement	17-Nov-05	1,498	**3,455**	3,700

Thermax

Emerging Star

Stock Update

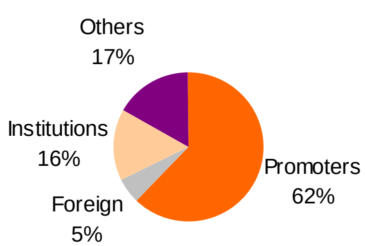
Price target revised to Rs700

Buy; CMP: Rs610

Company details

Price target:	Rs700
Market cap:	Rs7,268 cr
52 week high/low:	Rs674/280
NSE volume: (No of shares)	65,496
BSE code:	500411
NSE code:	THERMAX
Sharekhan code:	THERMAX
Free float: (No of shares)	4.5 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-4.7	38.3	59.9	106.1
Relative to Sensex	-2.3	32.8	43.9	58.8

Result highlights

- Continuing its growth run, Thermax reported an increase of 101% year on year (yoy) in its consolidated sales to Rs713.6 crore during Q1FY2008.
- The operating profits jumped by 106.8% yoy to Rs76.5 crore. Increased raw material cost and higher proportion of lower margin project business restricted the operating profit margin (OPM) growth only to 30 basis points to 10.7% in Q1FY2008.
- The energy business recorded a robust growth of 101% yoy in revenues and bettered the profit before interest and tax (PBIT) margins by 70 basis points to 11.3%. Environment business also reported PBIT margins improvement by 130 basis points and contributing Rs119.2 crore to the top line.
- The consolidated net profit grew by a whopping 114.5% to Rs55.9 crore in Q1FY2008 much ahead of street expectations.
- In order to meet the rising demand company plans commissioning of two more manufacturing facilities in Salvi (Gujarat) and Zehjiang (China) which phase-wise will be fully operational between March-June 2008.
- The consolidated order book at the end of Q1FY2008 stood at Rs3,057 crore which is equivalent to 1.3x its FY2007 net revenues, which gives a clear visibility of earnings.

We remain positive on the stock in light of (1) company's guidance of over 40% growth in revenues for FY2008, (2) strong order book of Rs3,057 crore backing the growth expectation, (3) growth in captive power plants, (4) capacity addition to

Results table Rs (cr)

Particulars	Q1FY2008	Q1FY2007	% yoy chg
Net sales	713.6	355.2	101.0
Total expenditure	637.2	318.2	100.2
Operating profit	76.5	37.0	106.8
Other income	10.3	6.6	55.1
EBIDTA	86.7	43.6	98.9
Interest	0.4	0.1	355.6
Depreciation	5.3	3.9	34.2
PBT	81.0	39.6	104.8
Tax	25.4	13.6	86.4
PAT	55.6	25.9	114.5
Extraordinary items	0.0	0.0	-
Reported PAT	55.6	25.9	114.5
EPS	4.7	2.2	114.5
Margins			
OPM (%)	10.7	10.4	
PATM (%)	7.8	7.3	

meet the demand and (5) surge in demand on the back of expansion in capacities from the sectors it caters to like cement, ferrous metals, petroleum etc.

With impressive first quarter growth we expect Thermax' earnings to grow at a compounded annual growth rate (CAGR) of 41.3% over FY2007-2009E. We are revising our FY2008E earnings (7.6%) to Rs25.2 per share and introducing our FY2009E earnings at Rs35.1 per share. We have valued the stock at 20x FY2009E earning and revising our price target to Rs700. We maintain our Buy recommendation.

At current market price of Rs610 the stock is trading at 24.2x FY2008 and 17.4x FY2009 earnings estimates. In terms of enterprise value (EV)/earnings before interest, depreciation, tax and amortisation (EBIDTA) the stock is quoting at 15.8x FY2008E and 11.2x FY2009E.

Growing robustly

In the first quarter of FY2008, Thermax recorded a robust growth of 101% yoy in its consolidated sales to Rs713.6 crore as against Rs355.2 crore in Q1FY2007. The growth has been driven by the increased demand for its energy products like boiler and heaters. The environment business also recorded growth of 35.6% in its revenues to Rs119.2 crore. In the current quarter the company also saw an increased sales from exports, which contributed 27% of the sales in Q1FY2008 as against 19% in the corresponding quarter last year.

OPM expanded by 30 basis points, net profit at Rs55.6 crore

Due to high proportion of revenues from the project business and change in product mix, the margins remained subdued in the first quarter and the operating profit margin (OPM) expanded marginally by 30 basis points yoy to 10.7%. The material cost-to-net sales ratio increased by 670 basis points yoy to 64.7% of net sales. On the other hand employee cost as a percentage of sales decreased by 370 basis points. Other expenses-to-net sales also decreased by 330 basis points yoy resulting in a marginal decrease in the total cost.

Cost analysis (%)

% of sales	Q1FY08	Q1FY07	Change (basis points)
Material cost	64.7	58.0	670
Employee cost	8.1	11.8	-370
Other expenses	16.4	19.7	-330
Total cost	89.3	89.6	-30

The net profit for Q1FY2008 increased by a whopping 114.5% yoy to Rs55.6 crore led by a 55% yoy increase in other income which came on the back of soaring cash balance and forex gains.

Segmental analysis

Thermax business is broadly divided into two major segments: energy business and environment business.

Energy business: Growth driver

Energy business has been the growth driver for the company. It had reported a growth of 101% yoy in its revenues. The PBIT margins also saw an increase by 70 basis points to 11.3% from 10.6% in Q1FY2007. Products like boilers, heater and captive power plants are the major products in the energy business.

Environment business: Growing rapidly

Environment business has been growing impressively too, reporting a growth of 35.6% yoy in revenues to Rs119.2 crore in Q1FY2008. This segment has been seeing improving PBIT margins that expanded further by 130 basis points to 9.6% as compared to 8.3% in the corresponding quarter last year.

Segment analysis Rs (cr)

Particulars	Q1FY08	Q1FY07	% yoy chg
Revenue			
Energy	614.3	305.8	101.0
Environment	119.2	87.9	35.6
PBIT			
Energy	69.3	32.3	114.3
Environment	11.5	7.3	57.4
PBIT margin (%)			
Energy	11.3	10.6	
Environment	9.6	8.3	

Healthy order book of Rs3,057 crore

The consolidated order book of Thermax at the end of Q1FY2008 stands at Rs3,057 crore which is equivalent 1.3x its FY2007 revenue providing clear visibility of earnings. In the current order book the company has 85% of the order for the energy business and remaining in the environment business. In terms of project to products, 78% of the orders in the current order book are for projects and the balance for products. Currently company has orders worth Rs850 crore for its cogen division (part of energy business).

The company expects increased in demand from the mid-sized cement plants on the back of capacity expansion plan over the next few years.

Expanding capacity

In order to meet the surging demand the company is setting up two manufacturing facilities at Salvi (Gujarat) and

Zehjiang (China). The production at Salvi plant would be commissioned phase-wise from July 2007. The management has indicated that revenue from this plant would show only from the next year. The capital outflow expected for Salvi facility is about Rs175 crore. According to the management China constitutes 50% of the total world market for boilers and heaters, hence also a big market to be tapped. The new plant in China would be operational by June 2008. The China plant would be catering to the local markets, exporting to the nearby countries. The capital outflow is expected to the tune of USD8 million. The total capex under implementation is around Rs450 crore.

Valuation

We remain positive on the stock in light of (1) company's guidance of over 40% growth in revenues for FY2008, (2) strong order book of Rs3,057 crore backing the growth expectation, (3) growth in captive power plants, (4) capacity addition to meet the demand and (5) surge in demand on the back of expansion in capacities from the sectors it caters to like cement, ferrous metals, petroleum etc.

With impressive first quarter growth we expect Thermax' earnings to grow at a CAGR of 41.3% over FY2007-2009E.

We are revising our FY2008E earnings (7.6%) to Rs25.2 per share and introducing our FY2009E earnings at Rs35.1 per share. We have valued the stock at 20x FY2009E earning and revising our price target to Rs700. We maintain our Buy recommendation.

At current market price of Rs610 the stock is trading at 24.2x FY2008 and 17.4x FY2009 earnings estimates. In terms of EV/EBIDTA the stock is quoting at 15.8x FY2008E and 11.2x FY2009E.

Earnings table

Particulars	FY05	FY06	FY07	FY08E	FY09E
Net sales (Rs cr)	1265.7	1624.3	2324.8	3264.0	4405.1
Net profit (Rs cr)	70.3	102.5	199.2	299.7	418.6
Share in issue (cr)	11.9	11.9	11.9	11.9	11.9
EPS (Rs)	5.9	8.6	16.7	25.2	35.1
% y-o-y growth	*15.8*	*45.9*	*94.3*	*50.5*	*39.7*
PER (x)	103.4	70.9	36.5	24.2	17.4
Book value (Rs)	30.7	32.4	43.5	61.8	90.0
P/BV (x)	19.8	18.8	14.0	9.9	6.8
EV/Ebidta (x)	58.9	36.1	21.5	15.8	11.2
Dividend yield (%)	2.0	0.6	1.0	1.0	1.0
RoCE (%)	24.0	37.2	59.7	63.9	64.1
RoNW (%)	15.0	22.3	32.8	37.1	36.6

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

Banking

Sector Update

RBI uncomfortable with IHC structures

The Reserve Bank of India (RBI) has expressed concerns over the intermediate holding company (IHC) structures planned by Indian banks. It has released a discussion paper with a view to review its suitability in the Indian context. RBI has kept the discussion panel open for the next three weeks. RBI's main concerns are regarding regulatory supervision, risk assessment and legal aspects involving the parent, IHC and other subsidiaries.

ICICI Bank and SBI had planned for IHC

The country's two largest banks, public sector leader State Bank of India (SBI) and private sector leader ICICI Bank, have both announced plans to set up IHC for asset management and insurance ventures. Hence any new development on this regard mainly impacts the above two banks.

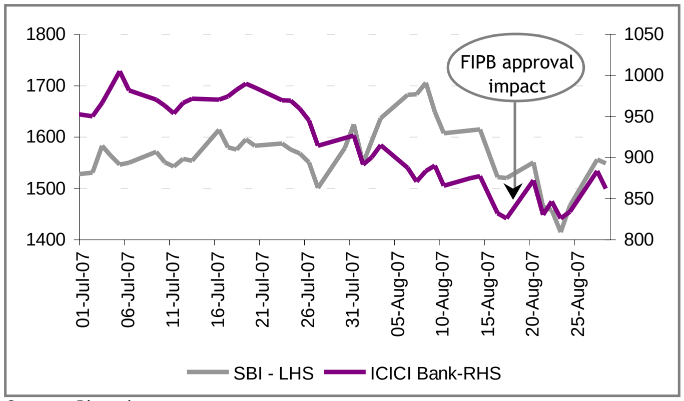
No major impact expected due to RBI's stance

ICICI Bank: Our valuations for ICICI Bank's expected holding company is at $9.7 billion lower than the market valuations of $11 billion (benchmark valuations for 5.9% stake sale to foreign investors at Rs2,650 crore translates into a $11 billion value for the holding company). The difference in valuations translates to around Rs48 per share of ICICI Bank. The stock had moved up by Rs47 on August 20, 2007 after it received the Foreign Investment Promotion Board (FIPB) approval over the weekend on August 17, 2007. Hence, the downside is likely to be Rs40-50 if the holding company formation doesn't materialise in the near term. In the longer term if the IHC structure is not given a green signal by RBI then ICICI Bank would have to continue to fund its insurance subsidiary from the fresh capital that it has raised during CY2007. The value in the insurance companies would continue to grow but the value unlocking would get delayed.

SBI: For SBI also, we have not factored in any value unlocking from the holding company formation and hence don't expect valuations to suffer much. SBI had seen a decline of only Rs8 (0.5%) on August 28, 2007 as the value unlocking has mainly been priced into ICICI Bank, which had received the firm commitments from certain foreign investors. We have assigned a value of $6.2 billion to the insurance and asset management businesses of SBI translating into Rs277 per share of SBI.

Our price targets for ICICI Bank and SBI at Rs1,173 and Rs1,780 don't factor in any upside from the holding company formation and subsequent value unlocking from the stake sale. However, after RBI's recent stance the sentiments have suffered but unlikely to translate into a sharp decline in the stock prices, hence we maintain a Buy on these two companies.

Last two months price movement for SBI & ICICI Bank



Source: Bloomberg

RBI in favour of simple BHC/FHC structure without IHC

The paper mentions that RBI is in favour of Indian banks adopting the bank holding company (BHC) or financial holding company (FHC) structure without the presence of IHC. But for the BHC/FHC structure to be functional in India, we need statutory changes and new legislations. This would be a long drawn process and can be a long-term solution. As RBI is not in favour of the IHC structure and the discussion paper is open for three weeks, the formation of the IHC for the above two banks is likely to be put on hold atleast in the near term.

Holding company structures prevalent in the financial world

Internationally there are mainly two holding company models for bank related conglomerates such as the BHC model and the FHC model. BHCs are companies that own or control one or more banks while FHCs are companies that own or control one or more banks or non-bank financial companies.

The RBI paper mentions that the typical structure for banks currently in India is the bank subsidiary model (annexure - 1), under which non-banking activities are carried out by separate subsidiaries floated by the bank. Other models that are prevalent in the financial world are the financial conglomerate models with holding company at the top (annexure - 2) and the financial conglomerate model with holding company at he top as well as an intermediate holding company (annexure - 3).

Motivations behind formation of these new structures

To raise capital for the insurance subsidiaries whose unprecedented growth is becoming a burden on the parent's capital commitments for these subsidiaries on a regular basis.

In terms of existing instructions, a bank's aggregate investment in the financial services companies including subsidiaries is limited to 20% of the paid up capital and reserves of the bank. In a BHC/FHC structure, this restriction will not apply as the investment in subsidiaries and associates will be made directly by the BHC/FHC.

Amendments to bank laws and separate acts may be required

To develop a BHC in India it would require banking laws to be amended, but allowing FHC, which put another level of ownership between the parent bank and its financial subsidiaries, might require a separate act.

RBI's main concern areas

Regulatory issues: The structure of a holding company makes it harder for the central bank to supervise non-banking firms in the group. Cross holdings among bank holding companies would create regulatory problems, while intermediate holding companies could create significant difficulties in supervision. RBI feels that a proper legal framework needs to be created before such new holding company structures are a reality in India.

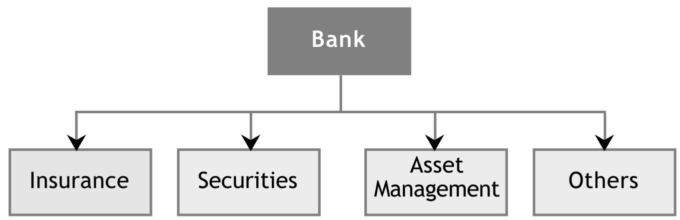
Assessment of risk: RBI feels that the multi layer holding structure with some unregulated entities (like the IHC) would make it difficult for the regulator to obtain desired information and hence the risk assessment of the entire financial conglomerate would not be comprehensive and effective. Excessive leverage that may be created by the step down subsidiaries also remains a concern.

Legal issues: RBI has also stated that although the FIPB and Insurance Regulatory and Development Authority of India (IRDA) have cleared the air regarding indirect foreign holdings being over 26% in insurance companies, the decision is open to legal review.

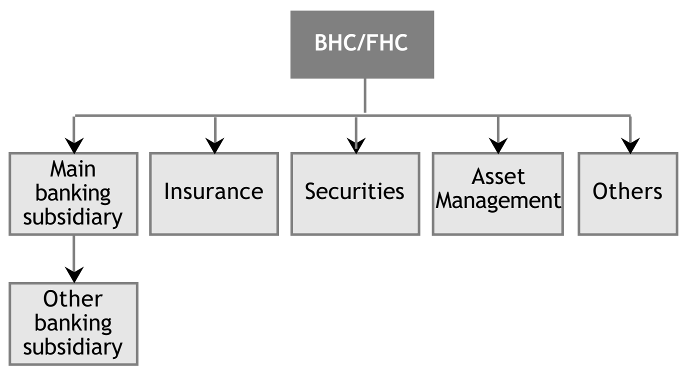
Conclusion

If ICICI Bank is unable to go ahead with its plans of forming a IHC this would likely result in a downside of Rs50 for ICICI Bank of which we have seen the stock correct by Rs21.5 (2.4%) on August 28, 2007. For SBI we had seen a decline of only Rs8 (0.5%) on August 28, 2007 as the value unlocking has mainly been priced into ICICI Bank, which had received the firm commitments from certain foreign investors. Since there are regulatory hurdles currently present in the BHC/FHC model, which the RBI prefers without the IHC model, a no to the proposed IHC structure would basically make the banks to fund their subsidiaries as they were doing prior to the plans of forming an IHC. Hence, in the near term the stocks are unlikely to get any boost from the development on the holding company front.

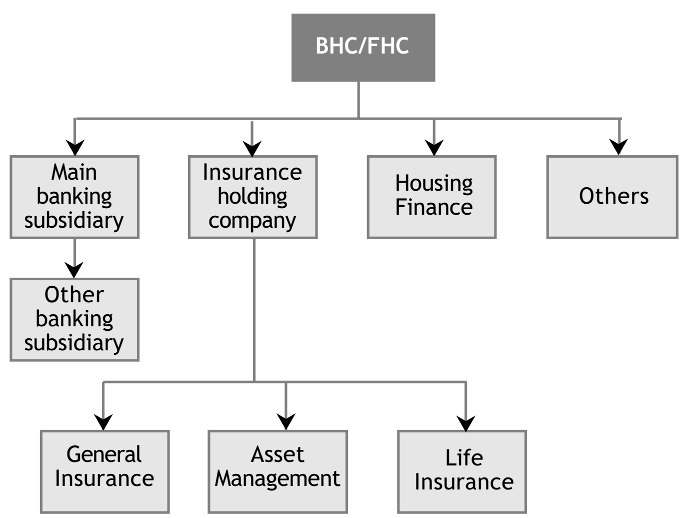
Annexure - 1



Annexure - 2



Annexure - 3



HCL Infosystems

Viewpoint

Technically sound

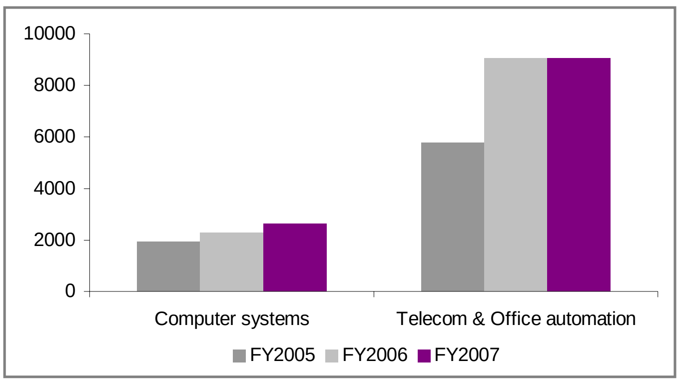
CMP: Rs188

The key highlight of the analyst meet hosted by HCL Infosystems are given below.

Revised agreement with Nokia dents FY2007 performance

HCL Infosystems (HCLI) reported a tepid growth of 3.5% in its gross revenues to Rs11,855 crore for the fiscal ended June 2007. The growth was largely driven by a revenue growth of 13.9% in the computer systems segment to Rs2,614.5 crore. On the other hand, the revenues from the telecommunications & office automation (telecomm) segment remained flat at Rs9,049.5 crore largely due to the revision of agreement with Nokia.

Telecom segment revenues remained flat (in Rs crore)



For the uninitiated, as per the revised agreement between HCLI and Nokia for the distribution of latter's mobile handsets, the two partners had agreed to bifurcate the geographical territories based the criteria that the volume of the business gets divided equally (around 50% each). The gradual transfer of the distribution business to Nokia was initiated from the first quarter of FY2007 and would be fully completed by the second quarter of FY2008.

The Nokia distribution business accounted for bulk of the revenues in the telecommunication and automation segment (and around 65-70% of the total turnover in FY2006). Consequently, the phased transfer of certain geographies back to Nokia dented the growth in its telecomm business segment. However, the company was able to show flat revenues in the telecomm business due to significant growth in the volumes of handsets sold and also an improvement in the contribution of high value handsets. Moreover, the growth in non-Nokia products was also robust on the back of an enhanced product portfolio.

Back to growth path in FY2008

With the adverse impact of the revised agreement with Nokia largely reflected in its performance, the telecomm segment expected to show growth in the current fiscal. The growth would also be aided by the fact that HCLI would

Result table

(Rs crore)	Q4FY07	Q4FY06	% yoy chg	FY2007	FY2006	% yoy chg
Gross sales	3108.3	3149.7	-1.3	11855.4	11455.0	3.5
Net sales	3864.5	3098.1	24.7	11685.3	11368.3	2.8
Expenditure	3748.9	2995.3	25.2	11281.8	10990.9	2.6
Operating profit	115.6	102.8	12.5	403.5	377.4	6.9
Forex	6.6	-6.5	-	19.0	-14.4	-
Other income	9.3	6.6	40.9	31.5	33.9	-7.1
Interest	3.8	0	-	10.5	-0.9	-
Depreciation	4.2	3.1	35.5	14.8	12.4	19.4
PBT	123.5	99.8	23.7	428.7	385.4	11.2
Tax	38.8	29.8	30.0	112.8	104.9	7.5
PAT	84.8	70	21.1	316.0	280.5	12.6
Equity Cap	33.8	33.8		33.8	33.8	
EPS (Rs)	5.0	4.1		18.7	16.6	
Margins (%)						
OPM	3.0	3.3		3.5	3.3	
NPM	2.2	2.3		2.7	2.5	

be the sole billing agent for sale of Nokia handsets through large retail chains (such as Reliance) throughout India.

Apart from this, the company has significantly enhanced the portfolio of non Nokia products. It has tied up with Apple and Kodak to distribute their products in India. HCLI has also extended its relationship with Worldspace (direct sales) and DishTV (providing after service servicing at 17 locations across India).

Computer systems, focus on laptops and system integration (SI) projects

Despite increasing competition, HCLI has been able to maintain its dominance in the desktop personal computer segment and has improved its market share over the past three years. The aggressive foray into the fast growing laptop segment (especially at lower price points) has also boosted the performance of computer systems business. HCLI has increased its market share to 4.7% in CY2006 and 7.4% in Q1CY2007, up from 1.2% in CY2005.

Going forward, the company is betting on the system integration (SI) segment to drive growth in the computer systems business division over the next 3-5 years. It has already established a strong SI practice in certain verticals such as telecommunications, banking, e-governance and power; and has reported some large order wins. For instance, the Rs500 crore order from BSNL to implement the convergent billing system. Consequently, the company had a pending order book of Rs1100 crore in the SI business as against revenues of around Rs250 crore for the full year FY2007. HCLI intends to ad other industry vertical like retail, media, healthcare and transportation to tap the huge estimated IT spending in these industries in the coming years. The management expects the contribution from the computer systems business division to increase to around 50% over the next five years (up from around 22.4% in FY2007).

Valuation

At the current market price the stock trades at reasonably attractive valuations of 10x FY2007 and around 8.5x FY2008 rough earning estimates. The company has given dividend of 100% in the past nine consecutive quarters and the dividend yield works out to around 4.3% at the current levels, which should provide some cushion to the downside risk in the stock.

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
ACC
Apollo Tyres
Bajaj Auto
Bank of Baroda
Bank of India
Bharat Bijlee
Bharat Electronics
Bharat Heavy Electricals
Bharti Airtel
Canara Bank
Corporation Bank
Crompton Greaves
Elder Pharmaceuticals
Grasim Industries
HCL Technologies
Hindustan Unilever
ICICI Bank
Indian Hotels Company
ITC
Mahindra & Mahindra
Marico
Maruti Suzuki India
Lupin
Nicholas Piramal India
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
Gateway Distriparks
International Combustion (India)
JK Cement
Madras Cement
Shree Cement
Tourism Finance Corporation of India
Transport Corporation of India

Emerging Star

3i Infotech
Aban Offshore
Alphageo India
Axis Bank (UTI Bank)
Balaji Telefilms
Cadila Healthcare
Federal-Mogul Goetze (India)
KSB Pumps
Marksans Pharma
Navneet Publications (India)
Network 18 Fincap
Nucleus Software Exports
Orchid Chemicals & Pharmaceuticals
ORG Informatics
Tata Elxsi
Television Eighteen India
Thermax

Ugly Duckling

Ahmednagar Forgings
Ashok Leyland
Aurobindo Pharma
BASF India
Ceat
Deepak Fertilisers & Petrochemicals Corporation
Genus Power Infrastructures
Hexaware Technologies
ICI India
India Cements
Indo Tech Transformers
Jaiprakash Associates
KEI Industries
NIIT Technologies
Punjab National Bank
Ratnamani Metals and Tubes
Sanghvi Movers
Saregama India
Selan Exploration Technology
South East Asia Marine Engineering & Construction
Subros
Sun Pharmaceutical Industries
Surya Pharmaceuticals
UltraTech Cement
Union Bank of India
Universal Cables
Wockhardt
Zensar Technologies

Vulture's Pick

Esab India
Orient Paper and Industries
WS Industries India