investor's eye

Visit us at www.sharekhan.com November 09, 2006

Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
BEL	26-Sep-06	1,108	**1,117**	1,525
India Cements	28-Sep-06	220	**219**	315
ITC	12-Aug-04	69	**187**	220
SE Asia Marine	12-Oct-06	190	**174**	270
Solectron	08-Dec-03	99	**235**	315

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

Pulse Track

Infrastructure index up 9.9% for September 2006

The index of six core infrastructure industries grew by 9.9% year on year (yoy) for September 2006, much higher than the growth rate of 6.3% reported for September 2005. The higher numbers were partially influenced by a lower base effect during September 2005 in certain sectors.

The growth was strong in refined petroleum products, electricity and cement, which reported double-digit growth rates and also in finished steel (carbon), while only coal production reported a marginal decline.

- The production of petroleum refinery products grew by 13.5% yoy, a reflection of the new refining capacities commissioned over the last year.
- The crude production grew by 9.3% yoy mainly due to a lower base in September 2005 as production was disrupted due to the Bombay High accident.
- Electricity generation was up by 11.5% yoy mainly due to a lower base effect, as there was a marginal decline of 0.7% yoy in September 2005, albeit the month-on-month production remains unchanged.
- The cement production showed a strong growth of 15.9% yoy partly influenced by a lower base effect as production was only up by 4.9% yoy during September 2005. During August-September 2005, the production of cement was lower as the higher stocks were carried forward from July 2005, which resulted from the lower sales in that month due to heavy floods in various parts of India.
- Commendably, the finished steel (carbon) production showed a growth of 8.4% yoy even on a higher base as the same had grown by 23.3% yoy in September 2005. The higher production was achieved on the back of increased capacity and higher utilisation level.

September 2006 IIP growth expected to be strong

We expect the Index of Industrial Production (IIP) to report a strong growth in line with the growth in the Infrastructure Index, which contributes 26.7% to the IIP. The growth in the other major constituent industries like automobiles has been strong during September 2006, which reinforces the expectation of a strong growth in the IIP. The vehicle sales have been robust for all three major sectors, commercial vehicles, passenger vehicles and two-wheelers, with all reporting a strong growth for September 2006. The capital goods sector is also expected to record a strong growth.

Growth in sales of (Sept 2006)	% yoy
Commercial vehicles	32.8
Passenger vehicles	20.4

Sector	Weight	% y-o-y change			% m-o-m	% change	
	(%)	Aug-06	Sep-05	Sep-06	change	YTD FY06	YTD FY07
Crude petroleum	4.2	12.1	-7.4	9.3	4.1	-5.0	4.1
Petroleum ref products	2.0	12.1	4.9	13.5	-1.4	-0.7	12.3
Coal	3.2	0.2	4.3	-0.6	0.3	6.0	5.3
Electricity	10.2	4.1	-0.7	11.5	0.0	4.7	6.7
Cement	2.0	2.2	4.9	15.9	10.2	11.4	10.0
Finished steel (carbon)	5.1	6.3	23.3	8.4	16.5	13.7	7.2
Overall	26.7	5.5	6.3	9.9	5.6	6.1	7.3

Source: Economic Adviser to the Ministry of Commerce & Industry

Hindustan Lever

Apple Green

Stock Update

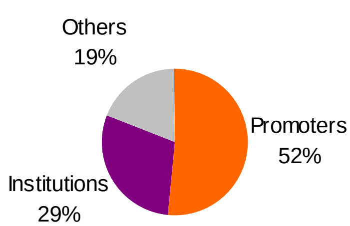
Price hike to ease margin pressure

Buy; CMP: Rs250

Company details

Price target:	Rs280
Market cap:	Rs55,160 cr
52 week high/low:	Rs296/168
NSE volume: (No of shares)	8.9 lakh
BSE code:	500696
NSE code:	HINDLEVER
Sharekhan code:	HLL
Free float: (No of shares)	107.2 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	0.5	10.6	-11.5	48.4
Relative to Sensex	-4.9	-7.1	-16.6	-6.9

HLL raises prices of key products

There has been a buzz in the last few days that Hindustan Lever Ltd (HLL) has increased prices in the soap and laundry categories and in some skin and oral care products. The company is believed to have taken price hikes in *Lux*, *Breeze*, *Hamam*, *Lifebuoy*, *Rexona* and *Dove* brands of soaps; *Wheel* and *Surf* brands of laundry; and a few stock keeping units (SKUs) of *Fair & Lovely*, *Lakme* and *Pepsodent*. The average price hike is believed to be between 5-8%.

...to mitigate input cost in HPC products

The key raw materials for the HPC segment, namely oil and LAB, have witnessed price increases since the beginning of the year. For example, palm oil, which is one of the raw materials used by the fast moving consumer goods (FMCG) companies for soaps and detergent, is up 21% since the beginning of the year. LAB prices too have gone up 11% year on year. The price hike will enable HLL to offset inflation in input cost by passing it on to the consumers.

...also to aid investment in brand building exercise

In Q3CY2006 the margins of the soap & detergent business, and personal care segment declined by 76 basis points and 136 basis points respectively, largely on account of an increase in the ASP spends, which ballooned 230 basis points to 11.1%. The increase in prices will also aid continuous investment in the brand building exercise and ease the resultant margin pressure.

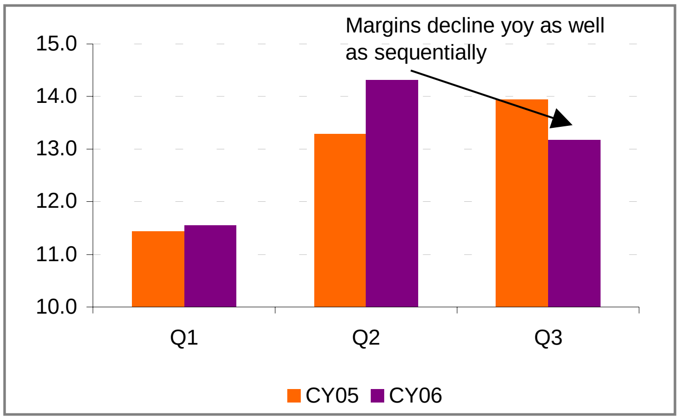
Impact on margins

The price increases should ease the margin pressure over the next few quarters. On the rough-cut calculation, a 4% improvement in the prices in the soap & detergent segment and a 2% price hike in the personal care segment along with a sequential 5% increase in the raw material prices for the soap & detergent segment lead to a 7.1% sequential increase in the profit before interest and tax (PBIT) and an 80-

Earnings table Rs (cr)

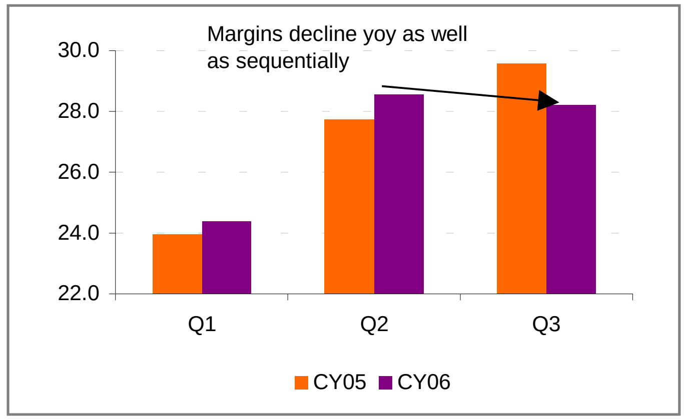
Particulars	CY2004	CY2005	CY2006E	CY2007E
Net profit (Rs cr)	1,182.7	1,310.7	1,568.7	1,870.4
% y-o-y growth	*-31.4*	*10.8*	*19.7*	*19.2*
Shares in issue (cr)	220.1	220.1	220.1	220.1
EPS (Rs)	5.4	6.0	7.1	8.5
% y-o-y growth	*-31.4*	*10.8*	*19.7*	*19.2*
PER (x)	46.5	42.0	35.1	29.4
Book value (Rs)	9.5	10.5	12.6	16.1
P/BV (Rs)	26.3	23.9	19.8	15.5
EV/EBIDTA (x)	37.3	36.5	32.8	27.2
Dividend yield (%)	2.0	2.0	2.0	2.0
RoCE (%)	45.8	68.7	66.1	61.9
RoNW (%)	56.5	56.8	56.6	52.8

PBIT margins—soaps and detergent (%)



Source: Company, Sharekhan Research

PBIT margins—personal care (%)



Source: Company, Sharekhan Research

basis-point sequential increase in the margins. Our CY2006 earnings per share (EPS) estimates too would be 2.1% higher, though we have not incorporated the same in our estimates.

Valuation and view

This is not the first time in the year that HLL has increased its prices. The price increases vindicate our view that the company is regaining its pricing power, which coupled with the strong volume growth should help it report a good growth in its earnings. At the current market price of Rs250 the stock discounts its CY2007E EPS of Rs8.5 by 29.4x. We maintain our Buy recommendation on HLL with a price target of Rs280.

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

International Combustion (India)

Cannonball

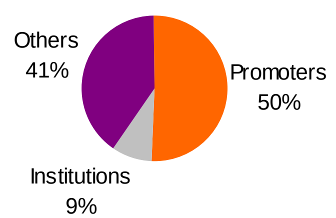
Stock Update

Robust performance

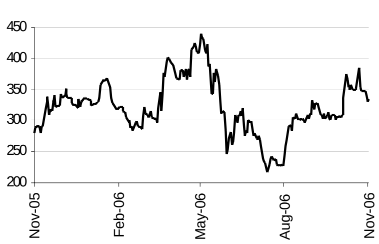
Buy; CMP: Rs335

Company details	
Price target:	Rs519
Market cap:	Rs76 cr
52 week high/low:	Rs460/202
BSE volume: (No of shares)	6,120
BSE code:	505737
Sharekhan code:	INTLCOMB
Free float: (No of shares)	11.2 lakh

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	8.3	48.2	-17.8	12.5
Relative to Sensex	2.4	24.5	-22.6	-29.4

Result highlights

- The revenues of International Combustion India Ltd (ICIL) grew by 28.0% year on year (yoy) to Rs20.3 crore in Q2FY2007, in line with our estimates. The growth was strong due to the good performance of the gearbox & geared motor drive system division (GMGBD).
- The revenues of the GMGBD grew by 43.1% yoy to Rs5.5 crore, ahead of our estimates. The revenues of the heavy engineering division (HED) grew by 24.1% yoy to Rs15.0 crore, in line with our estimates.
- The operating profit margin (OPM) of the company improved by 460 basis points yoy to 21.1% in Q2FY2007. The margin expansion was driven largely by the leverage effect that came into play with lower employee cost and other expenses. Consequently, the operating profit grew by 64% to Rs4.3 crore.
- The OPM of the HED grew by 460 basis points yoy to 30.6%. The GMGBD had reported negative margins in the first quarter and in this quarter its margins bounced back to 23.4% on the back of healthy revenues. Though on a year-on-year (y-o-y) basis the same were down 240 basis points.
- The other income grew to Rs0.3 crore from Rs0.1 crore in Q2FY2006 and the interest cost declined by 63.2% yoy to Rs0.1 crore. The net profit grew by 64.4% yoy to Rs2.2 crore, in line with our estimates.
- The outstanding order book stands at Rs51 crore after a growth of 59% yoy. The current order backlog stands at 0.8x its FY2006 revenues, imparting a strong visibility to the earnings.
- ICIL is currently trading at a price/earnings ratio (PER) of 7.1x its FY2008E earnings and 4.4x its FY2008E enterprise value (EV)/earnings before interest, depreciation, tax and amortisation (EBIDTA). We maintain a Buy recommendation on the stock with a price target of Rs519.

Result table Rs (cr)

Particulars	Q2FY2007	Q2FY2006	% yoy change
Net sales	20.3	15.8	28.0
Total expenditure	16.0	13.2	20.9
Operating profit	4.3	2.6	64.0
Other income	0.3	0.1	172.7
Provisions & write-offs	0.5	0.0	
PBIDT	4.1	2.7	50.0
Depreciation	0.7	0.4	53.5
Interest	0.1	0.2	-63.2
PBT	3.4	2.1	59.5
Tax	1.2	0.8	51.3
PAT	2.2	1.3	64.4
EPS	9.6	6.1	56.4
Margins (%)			
OPM	21.1	16.5	460 bps
PBIDT	20.1	17.2	290 bps
PAT	10.7	8.3	240 bps

Revenue growth of 28.0% yoy

The revenues of ICIL grew by 28.0% yoy to Rs20.3 crore in Q2FY2007 on the back of the strong performance of the GMGBD. The revenues of the GMGBD grew by 43.1% yoy to Rs5.5 crore, bouncing back after a spill-over of order worth Rs1.2 crore from the last quarter. The revenues of the HED grew by 24.1% yoy to Rs15.0 crore.

OPM improved by 460 basis points yoy to 21.1%

The OPM of the company improved by 460 basis points yoy and 270 basis points sequentially to 21.1% in Q2FY2007. The margin expansion was driven largely by the leverage effect that came into play with the lower employee cost and other expenses. The employee cost as a percentage of the net sales was down 170 basis points to 12.5% while the other expenses were down 320 basis points to 14.9%. The raw material cost as a percentage of net sales was slightly higher at 51.4% compared with 51.2% in Q2FY2006.

Particulars	Q2FY2007	Q2FY2006	change in basis points
Material cost	51.4	51.2	20.0
Employee expenses	12.5	14.2	-170.0
Other expenses	14.9	18.1	-320.0
Total expenditure	78.9	83.5	-460.0
Operating profit	21.1	16.5	460.0

Net profit up 64.4% yoy to Rs2.2 crore

ICIL's other income grew to Rs0.3 crore from Rs0.1 crore in Q2FY2006 and interest cost declined by 63.2% yoy to Rs0.1 crore. This along with the robust margin expansion led to a 64.4% y-o-y growth in the net profit to Rs2.2 crore, in line with our estimates. The Q1FY2007 results had been below our estimates but the resounding performance of Q2FY2007 has compensated for the slack performance in the first quarter.

Strong order backlog of Rs51.0 crore

ICIL boasts of a healthy order book with orders of Rs51.0 crore, a growth of 59.4% yoy. The execution cycle for the order book is approximately 7-8 months. The current order backlog stands at 0.8x its FY2006 revenues, imparting a strong visibility to the earnings.

B-2000 series and the Danfoss Bauer opportunity—teething problems in FY2007 but expect a robust FY2008

ICIL had introduced the B-2000 series (licenced from Danfoss Bauer GMBH) in the domestic market in January 2006. The B-2000 series is getting an encouraging response in the market, based on the inquiries generated so far. It has already won and executed an order worth Rs2 crore from Jindal Steel. Currently, ICIL is sourcing B-2000 from The Danfoss facility in Germany with an intention to manufacture in India. This however doesn't affect our forecast for the GMGBD division. On the full year basis, we don't see this affecting our earnings estimates. On the back of the positive response received from the market, we are sure that FY2008 will be a robust year for the B-2000 series.

One of our investment arguments for ICIL was its tie-up with Danfoss Bauer for outsourcing certain products, including the B-2000 series. On a conservative basis, we have taken an incremental top line of Rs3-4 crore from this opportunity. Any further increase will make way for a positive surprise on the top line.

Valuations

Indian steel majors like SAIL and Tata Steel are ramping up their capacities to meet the rising demand for steel at home. It is estimated that 50 million tonne of steel-making capacity will be added by the Indian steel industry over the next three years. Similarly, the sugar industry in India is on a high with huge capital expenditure (capex) plans. Majority of the companies in the sector have announced their capex plans to be implemented over the next few years. Just like steel and sugar, ICIL's other end-user industries, like chemicals, non-ferrous metals, and mineral and mining, are at an influx point of capacity addition. This translates into a huge opportunity for the company's products like sizers, screeners and feeders. ICIL with its market leadership position and quality product offerings is well placed to capitalise on the opportunity.

ICIL is currently trading at a PER of 7.1x its FY2008E earnings and 4.4x its FY2008E EV/EBIDTA. We maintain a Buy recommendation on the stock with a price target of Rs519.

Earnings table (stand-alone)

Particulars	FY2005	FY2006	FY2007E	FY2008E
Net profit (Rs cr)	2.2	5.7	9.5	11.3
Share in issue (cr)	0.2	0.2	0.2	0.2
EPS (Rs)	10.3	24.0	39.9	47.2
% y-o-y growth	*144.0*	*133.1*	*66.4*	*18.4*
PER (x)	32.6	14.0	8.4	7.1
Book value (Rs)	69.2	101.1	138.5	183.2
P/BV (x)	4.8	3.3	2.4	1.8
EV/Ebidta (x)	13.3	7.2	5.4	4.4
Dividend yield (%)	0.7	0.7	0.7	0.7
ROCE (%)	13.8	28.9	33.9	30.8
RONW (%)	9.4	17.5	22.9	21.6

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
Bajaj Auto
Balrampur Chini Mills
Bank of Baroda
Bank of India
Bharat Bijlee
Bharat Electronics
Bharat Heavy Electricals
Canara Bank
Corporation Bank
Crompton Greaves
Elder Pharmaceuticals
Grasim Industries
Hindustan Lever
Hyderabad Industries
ICICI Bank
Indian Hotels Company
ITC
Mahindra & Mahindra
Marico Industries
Maruti Udyog
Lupin
Nicholas Piramal India
Omax Autos
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

Ahmednagar Forgings
Ashok Leyland
BASF India
Deepak Fertilisers & Petrochemicals Corporation
Genus Overseas Electronics
HCL Technologies
ICI India
India Cements
Jaiprakash Associates
JM Financial
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

Vulture's Pick

Esab India
Orient Paper and Industries
WS Industries India

Home

Disclaimer

"This document has been prepared by Sharekhan Ltd.(SHAREKHAN) This Document is subject to changes without prior notice and is intended only for the person or entity to which it is addressed to and may contain confidential and/or privileged material and is not for any type of circulation. Any review, retransmission, or any other use is prohibited. Kindly note that this document does not constitute an offer or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction.

Though disseminated to all the customers simultaneously, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is from publicly available data or other sources believed to be reliable. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. We do not represent that information contained herein is accurate or complete and it should not be relied upon as such. This document is prepared for assistance only and is not intended to be and must not alone betaken as the basis for an investment decision. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

SHAREKHAN & affiliates may have used the information set forth herein before publication and may have positions in, may from time to time purchase or sell or may be materially interested in any of the securities mentioned or related securities. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind. Any comments or statements made herein are those of the analyst and do not necessarily reflect those of SHAREKHAN."