Index
• Stock Update >> Sintex Industries
• Stock Update >> Solectron Centum Electronics

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
• **Aban Loyd**	03-Mar-05	330	**1,197**	1,760
• **BHEL**	11-Nov-05	1,203	**2,238**	2,650
• **ICICI Bank**	23-Dec-03	284	**594**	750
• **Infosys**	30-Dec-03	689	**1,782**	1,870
• **Orient Paper**	30-Aug-05	214	**435**	675

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Sintex Industries

Apple Green

Stock Update

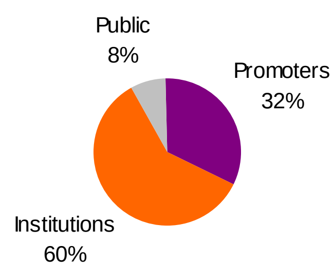
A whopping return of 1,581%

Book Profit; CMP: Rs185

Company details

Market cap:	Rs1,658 cr
52 week high/low:	Rs258/110
NSE volume: (No of shares)	68,351
BSE code:	502742
NSE code:	SINTEX
Sharekhan code:	SINTEX
Free float: (No of shares)	6.5 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	21.9	-20.4	-5.0	27.6
Relative to Sensex	6.6	-25.1	-17.1	-15.0

Organic growth of core business factored in current valuation

Sintex operates in the niche areas of prefab structures and structured fabrics and the businesses have huge untapped potential and the least competition. As part of its strategy to capitalise on the existing opportunities, Sintex has embarked upon a Rs250-crore capital expenditure (capex) plan to expand its textile and plastic capacities. The capex plan would be implemented over the next two years. The company is also working towards securing new clients and accounts, and enriching its product offerings. We maintain a positive outlook for its businesses of plastics and textiles. However the upside from the organic growth of its core business is already factored in the stock's current valuation of price/earnings ratio of 14.8x FY2008E earnings. In fact we have always maintained that our price target of Rs192.5 factors in the upside from the growth of its core business.

Even the earnings growth of 23% for the FY2006-08E period is not superior enough to warrant a valuation higher than that of the Indian stock market, which is available at 14.0x FY2008E with an earnings growth prospect of 24%. But these are not the only reasons why we are advising booking profit now.

Our price target of Rs192.5 anticipated inorganic growth

At the time of initiating coverage, Sintex had adopted the inorganic route to step on a high growth trajectory. The acquisition of Zeppelin Mobile Systems (ZMSL), which operated in the high-growth BT shelter category, was a step in this direction. Impressed by the management's prudence, agility and proactive nature in carrying out the ZMSL acquisition, we had even given the thumbs-up to the inorganic growth plan. Besides, Sintex had further strengthened its intention of growing through the inorganic route by earmarking Rs500 crore (raised through US$50-million foreign currency convertible bonds [FCCBs] and warrants issued to Warbug Pincus) for future acquisitions.

Well, ZMSL was acquired in Q4FY2005 with the management sending strong signals of going for more acquisitions in the following quarters. But we have waited patiently since then and watched in dismay the company's foiled acquisition attempts and unsuccessful takeover bids in international and domestic markets due to demanding valuations of the targeted assets and businesses. As a result, about Rs200-250 crore of liquid cash has got stuck on its balance sheet in the last five quarters and the same is lying unused. What's more, the company has also raised its equity capital by 65.2% from Rs14.6 crore in FY2004 to Rs24.1 crore in FY2007E (after taking into consideration the dilution caused by the FCCBs and warrants), partly frenzied by its inorganic growth aspirations.

But with no light visible at the end of the proverbial tunnel, we are unable to forecast with ease and precision the timing of the next acquisition and the possible upside from the same to the company's earnings.

The de-merger card fails to play out

Sintex was also toying with the idea of demerging its plastic and textile divisions into separate entities. We had approved of the proposal, as we'd expected the same to unlock the shareholders' value because the plastic business commands a premium valuation owing to its technology-intensive and capital-intensive nature. While the textile industry trades at 7-8x its one-year forward earnings estimate, the plastic business commands a valuation of 13-15x its one-year forward earnings estimate. Besides, Sintex earns 60-65% of its profit before interest and tax from the plastic division and the balance from the textile division. In the event of a de-merger, the plastic business would have realised the real value, generating upside to the overall valuation of the company. However there has been no activity on the de-merger front for quite some time now.

Book profit for 1,581% returns

As we said the upside from the organic growth of its core business is already factored in the stock's current price. Also it is not clear when the company shall make its next acquisition. Hence in view of our growing discomfort with regard to the company's inorganic growth plan and the risk of the unknown, we recommend investors to book profit at the current levels. Having said that, we do not wish to take away from the stock's impressive performance while under our coverage-it has given mind-blowing returns of 1,581% since it was recommended on August 14, 2003 at Rs11!!!

Valuations (stand-alone) Rs (cr)

Particulars	FY04	FY05	FY06	FY07E	FY08E
Net profit (Rs cr)	33.6	50.3	81.1	112.2	149.9
Share in issue (cr)	7.3	9.2	9.9	12.0	12.0
EPS (Rs)	4.6	5.4	8.2	9.3	12.5
% y-o-y growth	*48.9*	*17.8*	*51.2*	*13.4*	*33.6*
PER (x)	40.1	34.0	22.5	19.8	14.8
Book value (Rs)	23.1	35.1	43.8	67.4	79.0
P/BV (x)	8.0	5.3	4.2	2.7	2.3
EV/Ebidta (x)	17.4	15.6	12.9	11.9	9.0
Dividend yield (%)	0.3	0.4	0.5	0.5	0.5
ROCE (%)	12.7	12.7	14.0	15.0	17.3
RONW (%)	9.5	9.9	18.1	13.5	15.5

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

Solectron Centum Electronics

Emerging Star

Stock Update

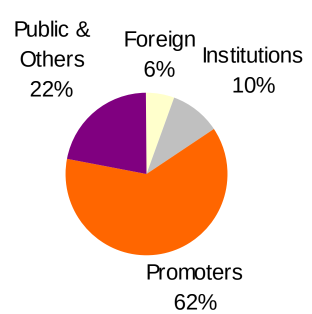
Management sounds optimistic

Hold; CMP: Rs169

Company details

Price target:	Rs215
Market cap:	Rs250 cr
52 week high/low:	Rs340/128
NSE volume: (No of shares)	28,541
BSE code:	517544
NSE code:	SOLECTCENT
Sharekhan code:	SOLECTCENT
Free float: (No of shares)	56 lakh

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	24.8	-34.0	-30.4	-33.0
Relative to Sensex	9.1	-37.9	-39.2	-55.4

The highlights from the latest annual report released by Solectron Centum are given below.

Components, growth expected to pick up

The component business (that primarily involves manufacturing of electronic products like hybrid microcircuits [HMC] and frequency controlled products [FCP]) reported a decline of 14.2% in revenues to Rs32 crore in the fiscal ended March 2006.

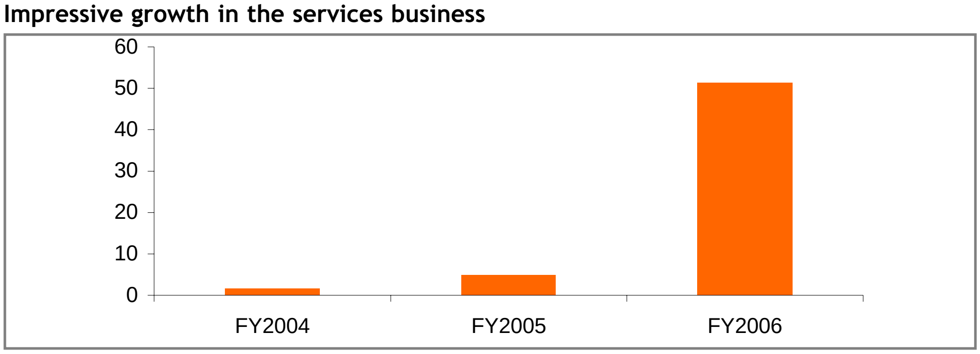
The performance was subdued largely due to the muted demand from its erstwhile parent group company, C-MAC, the major customer for FCP. In FY2005, C-MAC was divested by the US-based Solectron Corporation (that holds a 50.8% stake in Solectron Centum). Consequently, the transition and reorganisation within C-MAC resulted in a lower demand and a subsequent decline in the component business during the last fiscal. Moreover, the execution of an order worth Rs35 core from Indian Space Research Organisation (ISRO) was delayed from the customer's end.

However, as per the annual report, the situation is likely to improve significantly in the current fiscal. First, the demand for components from C-MAC is forecast to be strong. Second, the execution of the ISRO order is likely to commence in the current fiscal. Third, the benefits of the sales initiatives (and approval processes) with Indian telecom, defence and aerospace industries would also reflect in the current year's performance.

Services growing exponentially

Given the subdued performance of the component business, the revenue growth was primarily driven by the service business that grew by 956.1% to Rs51.3 crore. The electronic manufacturing service (EMS) business contributed Rs47 crore of revenues, up from Rs4.9 crore in FY2005. In the EMS business, the company's strategy is to address opportunities in the high-mix, low-volume businesses (higher value chain) such as power and industrials in the export markets and the telecom original equipment manufacturers (OEMs) in the domestic market.

Impressive growth in the services business



In the EMS business the profitability also depends on the ability to maintain high operational efficiencies. The company seems to be successful in the same as the margins at the profit before interest and tax (PBIT) level stood at a healthy rate of 13.4% for the service business. This is much higher than the global benchmark of 7-8% margin in the EMS business.

The outlook for the service business is also quite encouraging. The management expects to maintain the growth momentum and has commissioned additional capacities (second and the third assembly lines) during the year. It invested Rs11.5 crore in the service business in FY2006. In the current year also, the company expects to expand further beyond the existing facilities and possibly establish its operations at a new location. The management indicates that the demand scenario is favourable with players from the power and industrial sectors looking at outsourcing EMS in addition to the growing awareness among its traditional customer base of telecom, information technology and automotive sectors.

The repair and return services are also gaining momentum and contributed around Rs4 crore of revenues during FY2006. The company caries out the repair and return service business in five states of India for mobile phones and computer hard disks, and employs around 151 people. Nokia is one of its major customers in this business segment.

Other highlights

Investing for the future

During the last fiscal, Solectron has invested in both manufacturing facilities and human capital. It made capital expenditure (capex; including capital work in progress) of Rs17.3 crore in FY2006, with Rs11.5 crore in services and Rs5.8 crore in the components business. The gross block has increased by 48.4% to Rs50.9 crore and the major chunk of the capex (around Rs14 crore) has been spent on plant and machinery. The total employee base has also increased from 260 people in April 2005 to 700 employees in July 2006. This clearly reflects the management's confidence in the growth visibility.

Industry veteran Som Mittal joins the board

The Board of Directors of the company has inducted the industry veteran Som Mittal as an additional and independent director since February 2006. He is currently managing director of HP GlobalSoft and is a prominent personality in the Indian software and service industry.

Negative operating cash flow

Solectron reported a negative cash flow of Rs11.9 crore from its operating activities during FY2006. The cash flow has turned negative largely due to the enhanced working capital needs. The receivable days have increased to 80 days, up from 71 days in FY2005. The inventory levels also increased dramatically from Rs6.45 crore to Rs27.8 crore in FY2006. This is largely due to the working capital-intensive nature of the EMS business. The service business contributed 61.6% of the total turnover as compared with 11.5% in FY2005.

Valuation

To summarise, the company reported a robust revenue growth of 97.6% to Rs83.3 crore in spite of the weak performance from the component business. The service business primarily contributed to the growth with a ten-fold jump in the revenues to Rs51.3 crore. The growth opportunity is huge in the EMS business and the management expects the service business to maintain its growth momentum. To tap the same, it has invested substantially in expanding the manufacturing capacities. What's more heartening is the fact that the component business is forecast to revive in the current fiscal, on the back of renewed demand from C-MAC and the government organisations in the domestic market.

At the current market price the scrip trade at 19.1x FY2007 and 16.8x FY2008 estimated earnings. Despite the optimistic outlook highlighted in the annual report, we maintain our hold recommendation on the stock. The decision to upgrade the rating will depend on distinct signs of the revival of growth in the component business (like the commencement of the Rs35-crore high-margin government order and an increase in demand in the demand for components from C-Mac).

Earnings table Rs (cr)

Particulars	FY2005	FY2006	FY2007E	FY2008E
Net sales (Rs cr)	42.2	83.3	136.7	167.9
Net profit (Rs cr)	12.9	9.9	13.2	15.0
Shares in issue (cr)	1.5	1.5	1.5	1.5
EPS (Rs)	8.7	6.7	8.9	10.1
% y-o-y growth	*55.0*	*-23.0*	*33.0*	*14.0*
PER (x)	19.5	25.4	19.1	16.8
Book value (Rs)	20.5	30.9	38.7	47.7
P/BV (Rs)	8.3	5.5	4.4	3.6
EV/EBIDTA (x)	17.6	14.4	7.3	5.7
Dividend yield (%)	1.0	-	1.2	1.4
RoCE (%)	39.3	29.7	35.0	33.6
RoNW (%)	44.5	26.1	25.6	23.5

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
Bharat Bijlee
Bharat Heavy Electricals
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
Sintex Industries
SKF India
State Bank of India
Sundaram Clayton
Tata Motors
Tata Tea
Unichem Laboratories
Wipro

Cannonball

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

Emerging Star

3i Infotech
Aban Loyd Chiles 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
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Union Bank of India
Universal Cables
Wockhardt

Vulture's Pick

Esab India
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