investor's eye

Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
F-M Goetze	18-Jan-07	385	**334**	559
HCL Tech	30-Dec-03	206	**697**	720
HLL	24-Nov-05	172	**195**	280
India Cements	28-Sep-06	220	**196**	315
SKF	23-Dec-04	141	**311**	406

Gateway Distriparks

Cannonball

Stock Update

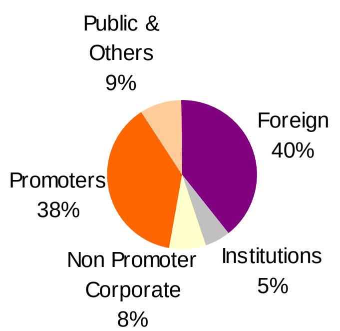
Results below expectations

Buy; CMP: Rs173

Company details

Price target:	Rs250
Market cap:	Rs1,597 cr
52 week high/low:	Rs301/144
NSE volume: (No of shares)	6.9 lakh
BSE code:	532622
NSE code:	GDL
Sharekhan code:	GATEWAY
Free float: (No of shares)	5.7 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-13.1	6.9	1.2	-22.5
Relative to Sensex	-22.5	-13.5	0.6	-18.8

Result highlights

- Gateway Distriparks Ltd (GDL) reported a net profit of Rs18.8 crore for Q3FY2007, which is below our expectations.
- The revenues increased by 20% year on year (yoy) to Rs41.7 crore led by a strong volume growth of 112%, 51.5% and 392.9% at Garhi, Chennai and Vizag container freight stations respectively and a realisation growth of 9% year on year.
- The operating profit declined by 2.4% yoy to Rs20.3 crore and the margins were under tremendous pressure on account of the strong competition and lower realisations at Chennai and Vizag. This consequently led to the margins declining by 1,130 basis points quarter on quarter (qoq) to 48.7%.
- The other income grew by 109% yoy to Rs5.4 crore due to the interest income on the higher surplus cash of Rs200 crore during the quarter.
- Depreciation grew by 36% yoy due to the amortisation of Snowman's goodwill during the quarter.
- The tax rate for the quarter was at 14.5% as the company had 80IA benefits for its investments in inland container depot (ICDs). As a result the pre-exceptional net profit grew by 5.0% yoy to Rs18.8 crore in Q3FY2007.
- During the quarter GDL acquired Snowman Frozen Foods, a cold chain logistic services business, at a cost Rs48.1 crore. The company incurred an expenditure of Rs2.1 crore for the acquisition, which has been treated as extraordinary expenditure. Thus the post-exceptional profit stood at Rs16.7 crore.

Result table (Rs crore)

Particulars	M9FY07	M9FY06	% yoy	Q3FY07	Q3FY06	% yoy
Net sales	114.4	105.1	8.9	41.7	34.7	20.3
Total expenditure	52.7	40.0	31.9	21.4	13.9	54.5
Operating profit	61.7	65.1	-5.2	20.3	20.8	-2.4
Other income	17.9	4.9	264.2	5.4	2.7	103.8
EBIDTA	79.6	70.0	13.7	25.7	23.5	9.6
Interest	0.9	1.9	-50.8	0.2	0.6	-64.3
PBDT	78.7	68.1	15.5	25.5	22.9	11.4
Depreciation	9.7	7.8	23.6	3.6	2.7	35.8
PBT	69.0	60.2	14.5	21.9	20.2	8.2
Tax	8.7	7.4	17.8	3.1	2.3	33.0
Reported profit after tax	60.3	52.9	14.0	18.8	17.9	5.0
Extraordinary	2.1	0.0		2.1	0.0	
Adjusted PAT	16.7	17.9	-6.8	16.7	17.91	
OPMs (%)	53.9	61.9		48.7	60.0	
EBIDTA (%)	60.2	63.6		54.6	62.9	
EBDT (%)	59.5	61.9		54.1	61.4	
EBT (%)	52.1	54.8		46.5	54.3	
EAT (%)	45.6	48.1		39.9	48.0	

- Snowman moves close to 9,000 tonne of frozen and chilled products across India and provides the entire spectrum of supply chain solutions with HLL being one of its major clients. We believe this acquisition will enable the company to cash in on the growth in the nascent food retailing market in India.
- The company has recently won the bid for a 15-year operations and management (O&M) contract of the Punjab Conware container freight station (CFS) at the JNPT port. GDL will be able to expand the volumes at the Punjab Conware CFS considering the dominant position of the company at the port and its expertise in operating CFS' and ICDs.
- We maintain our positive outlook on the company, as GDL will be one of the prime beneficiaries of the growth in container traffic, which currently just accounts for 10% of the total cargo. The company's strategy to become an integrated player by entering into rail-based container movement will help the company to offer better services to its clients. With the large players like Reliance and the AV Birla group betting huge on food retailing, the company's strategy to enter the cold chain business comes at a right time and will add significant value to the company's business going ahead. At the current market price of Rs173, the stock discounts its FY2007 earnings per share (EPS) by 20x and FY2008 EPS by 14x. We believe that the valuations are attractive and thus maintain our Buy recommendation on the stock with a price target of Rs250.

Net revenues grow by 20% on the back of strong volumes

The net revenues of GDL for Q3FY2007 grew by a healthy 20.3% yoy to Rs41.7 crore on the back of the strong volumes at the Garhi ICD, and the Chennai and Vizag CFS. The volumes at these stations grew by 112%, 51.5% and 392.9% to 5,816 twenty-feet equivalent units (TEUs) , 10,122TEUs and 2,233TEUs respectively. But the volumes at the Mumbai CFS witnessed a dip on account of the higher dwelling time of 11 days as against 9.3 days at the JNPT, which stood at 39,203TEUs. The overall realisations grew by 9% yoy to Rs6,829 per TEU. The realisations at the Garhi ICD jumped by 46% yoy as the ICD has started providing end-to-end logistics services. The realisations at Chennai and Vizag witnessed a decline as the company has given discounts to its clients in order to achieve higher volumes.

TEU	Q3FY07	Q3FY06	% yoy	Q2FY07	% qoq
Mumbai	39203	45419	-13.7	43671	-10.0
Delhi	5816	2743	112.0	3725	56.0
Chennai	10122	6680	51.5	10212	-1.0
Vizag	2233	453	392.9	2889	-23.0
Total	57374	55295	3.8	60497	-5.0

Realistions	Q3FY07	Q3FY06	% yoy	Q2FY07	% qoq
Mumbai	7868	6613	19	7213.0	9
Delhi	7146	4892	46	7516.8	-5
Chennai	3527	4823	-27	3123.8	13
Vizag	2723	2914	-7	3212.2	-15
Total	7268.10	6266.39	16	6350.4	14

Revenues	Q3FY07	Q3FY06	% qoq	Q2FY07	% qoq
Mumbai	30.84	30.04	3	31.50	-2
Delhi	4.16	1.34	210	2.80	48
Chennai	3.57	3.22	11	3.19	12
Vizag	0.61	0.13	361	0.93	-34
Total	41.70	34.65	20	38.42	9

Operating margins under pressure

The operating profit at Rs20.3 crore for the quarter was marginally lower on a year-on-year (y-o-y) as well as a sequential basis. The operating margins came under tremendous pressure on account of the strong competition at JNPT, which contributes close to 70% of the volumes. The operating margins stood at 48.7%, which translates into a y-o-y decline of 1,130 basis points.

Flat performance at the operating level depresses net profit

The other income grew by 109% yoy to Rs5.4 crore due to the interest income on the higher surplus cash of Rs200 crore during the quarter. Depreciation grew by 36% yoy to Rs3.6 crore due to the amortisation of Snowman's goodwill during the quarter. The tax rate continued to stand low at 14.5% due to the 80IA benefits availed by the company. The net profit increased marginally by 5% yoy to Rs18.8 crore whereas on a sequential basis the company witnessed a decline in its net profit.

Snowman acquisition provides entry into cold chain business

During the quarter the company acquired Snowman Frozen Foods Ltd for a net cash consideration of Rs48 crore. Post-acquisition, the company will hold a 50.1% stake in Snowman Frozen Foods Ltd while Mitsubishi Logistics Corporation will hold the balance stake. Snowman moves close to 9,000 tonne of frozen and chilled products across India and provides the entire spectrum of supply chain solutions with HLL being one of its major clients. This augurs well for the company as it comes at a time when food retailing is emerging as a huge business opportunity in India with majors like Reliance and the AV Birla group joining the fray. Thus we believe this acquisition will enable the company to cash in on the growth in the nascent food retailing market in India.

Punjab Conware contract--struck at the right time

GDL won the operations and management (O&M) contract for the Conware CFS from the Punjab State government in the last quarter. The CFS, which is located just 7km from the JNPT port, is currently being utilised at just one-third of its capacity of 150,000TEUs. GDL will have to incur an additional capital expenditure of Rs20 crore to improve the efficiency of the CFS, which we believe will improve the volumes to 60,000TEUs in FY2008 and 70,000TEUs in FY2009.This will also lead to the earnings before interest, tax, depreciation and amortisation (EBITDA) per TEU increasing to Rs3,000-3,200 during the same period.

To leverage the growth in the increasing volumes at the JNPT port, GDL has been scouting for opportunities to ramp up its capacity from the current 216,000TEUs. The company's plan to set up a new CFS was unsuccessful on account of unavailability of land. Thus this contract comes at the right time for GDL, as it will give the much needed volume growth to the company going forward.

Outlook

Taking cognisance of the tough competition in the industry and consequently the pressure on the margins, we are downgrading our FY2007 and FY2008 earnings estimates by 11% and 8% respectively.

But we maintain our positive outlook on the company, as GDL will be one of the prime beneficiaries of the growth in container traffic, which currently just accounts for 10% of the total cargo. The company's strategy to become an integrated player by entering into rail-based container movement will help the company to offer better services to its clients. With the large players like Reliance and the AV Birla group betting huge on food retailing, the company's strategy to enter the cold chain business comes at a right time and will add significant value to the company's business going ahead. At the current market price of Rs173, the stock discounts its FY2007 EPS by 20x and FY2008 EPS by 14x. We believe that the valuations are attractive and thus maintain our Buy recommendation on the stock with a price target of Rs250.

Earnings table

Particulars	FY04	FY05	FY06	FY07E	FY08E
Net profit (Rs cr)	19.1	34.9	73.0	79.6	111.5
Shares in issue (Cr)	6.4	7.5	9.2	9.2	9.2
EPS (Rs)	3.0	4.7	7.9	8.6	12.1
% y-o-y growth	*27.3*	*82.7*	*109.2*	*9.0*	*40.0*
PER (x)	58.0	37.2	21.8	20.0	14.3
Book value (Rs)	12.7	22.0	62.4	71.0	83.1
P/BV (Rs)	13.6	7.8	2.8	2.4	2.1
EV/EBIDTA (x)	40.9	24.4	15.2	16.2	10.0
RoCE (%)	24.4	27.1	20.0	14.4	17.5
RoNW (%)	23.5	21.1	12.7	12.2	14.5

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

Hindustan Lever

Apple Green

Stock Update

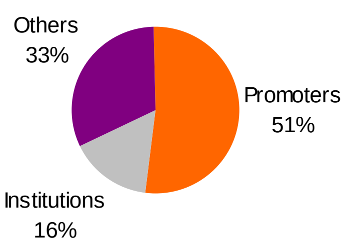
A little cold

Buy; CMP: Rs195

Company details

Price target:	Rs280
Market cap:	Rs42,919 cr
52 week high/low:	Rs296/180
NSE volume: (No of shares)	7.9 cr
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	-10.0	-17.8	-16.0	-14.5
Relative to Sensex	-10.5	-22.7	-32.7	-40.4

Result highlights

- The Q4CY2006 net profit of Hindustan Lever Ltd (HLL) grew by 10.15% year on year (yoy) to Rs483.0 crore, which was below our expectations.
- The net revenues grew by 6% yoy on the back of a 7% year-on-year (y-o-y) growth in the home and personal care (HPC) segment, which comprises the soap and detergent, and personal care businesses.
- The profit before interest and tax (PBIT) margin showed a contraction of 40 basis points to 18.1%.The contraction in the PBIT margin was attributable to the lower growth in the personal care segment as well as higher input cost.
- The soap and detergent business has shown a growth of 10% whereas the personal care product business has reported a lower growth of 2.5%. The growth was lower in the personal care product business mainly on account of a shorter winter season in 2006 and the high base effect of Q4CY2005 (the sales of personal care products were higher due to the relaunch of *Clinic* shampoo in the quarter).
- The beverage business has shown a growth of 8.6% yoy whereas the processed food business has grown by 18% yoy.
- The operating profit margin (OPM) of HLL contracted by 36 basis points to 15.84% on a y-o-y basis due to a higher raw material cost. The selling and administrative expenses as a percentage of sales were maintained at 9% compared with 11% for M9CY2006, which helped it to prevent further erosion in the margin.

Result table (Rs crore)

Particulars	CY2006	CY2005	% yoy	Q4CY06	Q4CY05	% yoy
Net sales	12103.4	11060.6	9.4	3156.1	2974.3	6.1
Total expenditure	10455.3	9617.2	8.7	2656.1	2492.5	6.6
Raw material	6734.7	6162.1	9.3	1711.5	1605.6	6.6
Employee expenses	642.8	591.3	8.7	133.6	110.4	21.0
Selling & administrative expenses	1272.9	1005.7	26.6	284.0	265.4	7.0
Other expenses	2036.9	1858.1	9.6	527.0	511.1	3.1
Operating profits	1648.1	1443.3	14.2	500.0	481.8	3.8
Other income	354.5	304.8	6.3	107.0	64.2	66.6
EBIDTA	2002.6	1748.1	4.6	607.0	546.0	11.2
Interest	10.7	19.2	-	1.8	3.6	-
PBDT	1991.8	1728.9	15.2	605.2	542.4	11.6
Depreciation	130.2	124.5	4.6	34.2	31.6	8.2
PBT	1861.7	1604.5	16.0	570.9	510.8	11.8
Tax	309.3	253.0	22.2	82.4	49.3	67.1
Deferred tax	12.8	-3.0	-	5.2	23.0	-
Reported profit after tax	1539.7	1354.5	13.7	483.4	438.5	0.2
Extraordinary items	315.7	53.6	489.1	27.8	82.4	-
Adj PAT after extraordinary item	1855.4	1408.1	31.8	511.2	520.9	-1.9
EPS	7.0	6.2	13.7	2.2	2.0	10.2
Equity	220.1	220.1	-	220.1	220.1	-
Operating margins(%)	13.60	13.00	60bps	15.8	16.2	-36bps

- The soap and detergent segment has been able to maintain its earnings before interest and tax (EBIT) margin at 15.6% yoy whereas the EBIT margin in the personal care product range has shown an improvement of 30 basis points to 31.9%.
- At the current market price of Rs195, the stock is quoting at 23x its CY2007E earnings per share (EPS) of Rs8.5. We maintain our Buy recommendation on the stock with a price target of Rs280.

Net sales grow by 12.2%

HLL's net sales grew by 6% yoy for Q4CY2006 on the back of a 7% y-o-y growth in the home and personal care (HPC) segment, which comprises the soap and detergent, and personal care businesses.

Segment revenue (Rs crore)

Particulars	CY06	CY05	% yoy	Q4CY06	Q4CY05	% yoy
HPC	8,955.7	7,913.6	13.2	2,321.5	2,168.1	7.1
Beverages	1,330.7	1,277.5	4.2	367.0	338.8	8.3
Processed foods	384.5	313.7	22.6	102.2	86.5	18.2
Ice creams	137.1	98.2	39.6	26.3	17.2	52.9
Exports	1,278.9	1,347.8	-5.1	347.3	357.3	-2.8
Others	180.2	250.5	-28.0	60.3	55.3	9.0
Total	12,267.1	11,201.2	9.5	3,224.6	3,023.2	6.7

HPC records strong growth-10.8% in volume terms

The soap and detergent business has shown a growth of 10% whereas the personal care product business has reported a lower growth of 2.5%. The growth was lower in the personal care product business mainly on account of a shorter winter season in 2006 and the high base effect of Q4CY2005 (the sales of personal care products were higher in Q4CY2006 due to the relaunch of *Clinic* shampoo in the quarter). Adjusting for the disposal of the Nihar brand, the personal care product segment grew by 5.3% in the December quarter.

Segmental results—HPC business

Particulars	CY06	CY05	% yoy	Q4CY06	Q4CY05	% yoy
Revenue						
Soaps and detergents	5595.5	4961.7	12.8	1428.1	1296.9	10.1
Personal products	3359.8	2951.9	13.8	893.4	871.3	2.5
Total	8955.3	7913.6	13.2	2321.5	2168.2	7.1
PBIT						
Soaps and detergents	773.1	683.7	13.1	222.7	203.5	9.4
Personal products	943.1	845.2	11.6	284.6	275.1	3.5
Total	1716.2	1528.9	12.3	507.3	478.6	6.0

Particulars	CY06	CY05	% yoy	Q4CY06	Q4CY05	% yoy
PBIT margins (%)						
Soaps and detergents	13.8	13.8	-	15.6	15.7	-
Personal products	28.1	28.6	-	31.9	31.6	-
Total	19.2	19.3	-	21.9	22.1	-

The soap and detergent segment has been able to maintain its EBIT margin at 15.6% yoy whereas the EBIT margin of the personal care product range has shown an improvement of 30 basis points to 31.9%. The company has been able to offset the increase in the input cost with selective price hikes across different categories.

We believe the personal care segment would pick up growth in the coming quarters.

The company has recently launched the *Ponds* top end range and also plans to launch the hair care products of its premium brand, *Dove*. We believe the management is focused more on brand extensions and renovations than on new innovative launches and exploring new arenas of growth. The only new launch in recent times has been the water purifier (*Pure it*), which is going to hit the market in 2007.

Food business—revenues and profitability going strong

The food business reported a strong growth of 25% yoy for the quarter backed by a strong growth in both the business segments, viz processed foods and ice creams.

The processed food business recorded a strong growth of 18% with all the key brands, viz *Kissan*, *Annapurna* and *Knorr*, growing strongly during the quarter. The processed food business improved its profitability substantially with a PBIT of Rs6.4 crore compared with a loss of Rs3.4 crore in Q4CY2005.

The ice cream business reported a strong growth of 53% yoy. Here also the profitability improved with a PBIT of Rs2.8 crore against a loss of Rs1.2 crore in Q4CY2005.

Segmental results—food business

Particulars	CY06	CY05	% yoy	Q4CY06	Q4CY05	% yoy
Revenues (Rs cr)						
Processed Foods	384.5	313.7	22.6	102.2	86.5	18.2
Ice Creams	137.1	98.2	39.6	26.3	17.2	52.9
Total	521.6	411.9	26.6	131.1	104.5	25.5
PBIT (Rs cr)						
Processed Foods	12.9	-16.1		6.4	-3.4	
Ice Creams	18.7	5.1		2.8	-1.2	
Total	31.6	-11.0		9.2	-4.6	
PBIT margins (%)						
Processed Foods	3.4	-5.1		6.3	-3.9	
Ice Creams	13.6	5.2		10.6	-7.0	
Total	6.1	-2.7		7.0	-4.4	

Beverages—catching up growth

The sales in the beverage segment grew by 8.6% as the revenues from the branded tea business returned to the growth path in the quarter. The EBIT margin was lower due to higher tea prices.

Segmental results—beverages business

(Rs crore)	CY06	CY05	% yoy	Q4CY06	Q4CY05	% yoy
Revenues	1330.7	1277.5	4.2	367.0	338.0	8.6
PBIT	220.5	241.8	-8.8	72.2	67.8	6.5
PBIT margins (%)	16.6	18.9	-12.5	19.7	20.1	-1.9

Price increase helps mitigate rising crude prices without affecting growth

The OPM contracted by 36 basis points to 15.84% on a y-o-y basis due to a higher raw material cost. A lower growth in the personal care product segment, which is a high-margin business, was responsible for the lower margin to some extent. The selling and administrative expenses as a percentage of sales were maintained at 9% compared with 11% for M9CY2006, which helped prevent further erosion in the margin. The recent price increases by HLL have helped the company to meet the rising crude oil prices, which increased the raw material, packaging and freight costs.

Cost as % of sales

	CY06	CY05	Change in bps	QCY06	Q4CY05	Change in bps
Raw material cost	55.6	55.7	-6.0	54.2	54.0	24.0
Employee expenses	5.3	5.3	-3.0	4.2	3.7	52.0
Advertising and promotion	10.5	9.1	142.0	9.0	8.9	8.0
Other expenses	16.8	16.8	3.0	16.7	17.2	-49.0
Total cost	86.4	87.0	-56.0	84.2	83.8	35.0

Net profit grows by 10.15%

For the quarter the company reported a net profit of Rs483 crore versus Rs438.5 crore in the corresponding quarter of the previous year (pre-exceptional items), up by 10.15%. The exceptional items (net of tax) for the December quarter of 2006 comprise: (1) a profit of Rs36.74 crore arising from the divestment of a 51% stake in a subsidiary; (2) a Rs21.89 crore reduction in the liability for retirement benefits arising due to the revision in interest rates and a lower annuity cost; and (3) Rs30.88 crore spent in restructuring the food business.

Valuations

At the current market price of Rs195, the stock is quoting at 23x its CY2007E EPS and 20.8x CY2007E enterprise value/earnings before interest, depreciation, tax and amortisation. We maintain our Buy recommendation on the stock with a price target of Rs280.

Valuation table

Particulars	CY04	CY05	CY06E	CY07E
Net profit (Rs crore)	1,182.7	1,310.7	1,539.7	1,870.4
% y-o-y growth		*10.8*	*17.5*	*21.5*
Shares in issue (crore)	220.1	220.1	220.1	220.1
EPS (Rs)	5.4	6.0	7.0	8.5
% y-o-y growth		*11.1*	*16.7*	*21.4*
PER (x)	36.1	32.5	27.9	22.9
Book value (Rs)	9.5	10.5	12.5	16.0
P/BV (Rs)	20.5	18.6	15.6	12.2
EV/EBIDTA (x)	28.9	28.1	24.5	20.8
Dividend yield (%)	2.6	2.6	3.1	3.1
RoCE (%)	45.8	68.7	66.8	62.4
RoNW (%)	56.5	56.8	56.1	53.2

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

Automobile

Sector Update

Racing ahead despite hardening rates

The automobile industry has begun CY2007 on a positive note with a strong volume growth of 14.8% for the first month of the year, January. However, there are some concerns on the horizon. Will the growth sustain on the high base of last year? How would the rising interest rates affect the demand in future? In this report, we have tried to assess the impact of the high base effect and rising interest rates on the demand for automobiles.

Along with the interest rates, the auto finance rates too are on their way up. In the last two months we have witnessed three upward revisions in the car financing rates. The average loan rates have gone up to around 15% from about 12.5% in December 2006.

The interest rates for vehicle loans are not fixed on a rate card but are negotiable. The interest rates depend on not only what a bank charges but also the customer's profile, subsidies from the manufacturer as well as the dealer, and finance commissions.

Growth in auto sales

Category	YTD 2007	YTD 2006	% yoy
Passenger vehicles			
Passenger cars	1,029,459	847,580	21.5
Total passenger vehicles	1,277,735	1,063,256	20.2
Commercial vehicles			
M&HCVs	235,396	170,293	38.2
LCVs	178,735	133,981	33.4
Total commercial vehicles	414,131	304,274	36.1
Three-wheelers	455,933	349,952	30.3
Two-wheelers			
Motorcycles/Step-throughs	5,977,055	5,096,136	17.3
Total two-wheelers	7,100,443	6,231,891	13.9
Grand total	9,248,242	7,949,373	16.3

Passenger cars sales may dip

The sales of passenger cars have grown at a compounded annual growth rate (CAGR) of 13.6% over the last five years. The passenger car segment has been registering good growth rates due to the rising income levels and improving lifestyle of Indians, improving infrastructure of the country, easy availability of finance, introduction of newer models, attractive pricing and various sales incentives. Around 75% of the car sales have been financed by bank loans.

The rates of car financing have gone up by around 250 basis points in the last two months from 12-12.5% in December 2006 to 14.5-15%.

Higher interest rates to affect car sales

The interest rates on car loans have surged by more than 200 basis points in the past two months. The rising interest rates would have a dampening impact on the industry, though we believe that the same would be felt more in case of the entry level passenger vehicles. Financiers are working out methods to lessen the intensity of the impact by extending the loan period, so that the monthly cash outflow of consumers does not get affected.

Effect of rise in interest cost on cars

	Scenario 1	Scenario 2
On road cost	400,000	400,000
% financing	85	85
Loan amount	340,000	340,000
Interest rate	12	15
Tenure (yrs)	3	3
Tenure	36	36
EMI	**11,293**	**11,703**
Annual repayment cost	**135,514**	**140,438**
% Increase in monthly installments		3.6

No slowdown expected in commercial vehicles

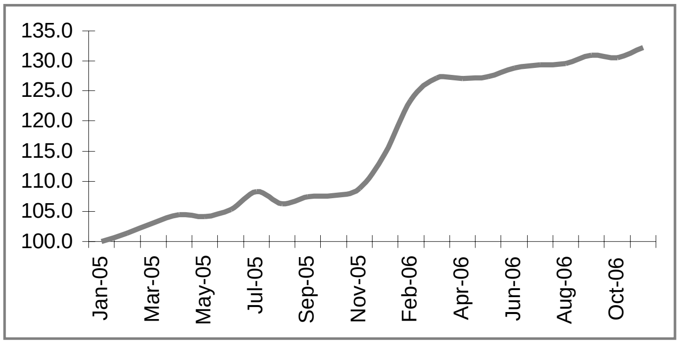
The commercial vehicle segment has grown at a CAGR of 21.1% in the last five years. The growth in the segment continues to be strong due to the rising gross domestic product, higher spending on road infrastructure, ban on overloading of vehicles and replacement of older vehicles. We expect the strong growth in this segment to continue.

Financing of commercial vehicles remains a highly competitive business and the interest rates in the commercial vehicle financing segment have not risen to the same extent as in the passenger car financing segment. To compensate for the rising costs, the freight rates have also risen. With the demand outlook remaining strong, we believe fleet operators would compensate for any increase in the interest rates by increasing their freight rates. Therefore, we do not expect any slowdown in the offtake of commercial vehicles due to the rising rates.

Effect of rise in interest rate on commercial vehicles

	Scenario 1	Scenario 2
On road cost	1,000,000	1,000,000
% financing	85	85
Loan amount	850,000	850,000
Interest rate	10.5	11.5
Tenure (yrs)	4	4
Tenure	48	48
EMI	**21,763**	**22,176**
Annual repayment cost	**261,154**	**266,108**
% increase in monthly instalments		1.9

Continuing growth in truck freight (Base: January 2005)



Growth in two-wheelers to moderate

In the two-wheeler segment, the motorcycle sub-segment, which has been growing at a CAGR of 23.5% over the last five years, seems to be taking a breather. Such high growth rates as registered in the recent past appear unsustainable. From here onwards we expect the motorcycle sub-segment to grow at a more sustainable rate of 15-17%.

Rising inventory level with the dealers

Our channel checks indicate a higher than normal level of inventory with the two-wheeler dealers. February is usually a slack month for auto offtakes, however some other reasons for the rising inventory level could be the slowdown and the aggressive competition in the industry. The inventory levels have risen also because the peak season is over and buying decisions have been postponed with the Union Budget due at the end of this month and several festivals falling in March and April. The dealers are almost carrying 30-35 days of inventory as opposed to 20-25 days of stock.

For instance, Hero Honda Motors, the market leader, has been carrying a higher inventory for the past 12 months and hence a higher than normal inventory should not come as a surprise. The actual impact of a slowdown can only be ascertained after March and April with the end of the festive season, which is considered an auspicious time for purchasing vehicles. Hence, the dealers have been keeping a higher level of inventory in anticipation of a strong demand during this period.

Financiers reducing exposure to states like UP in two-wheelers

We also believe that some of the banks like ICICI Bank and HDFC Bank have been reducing their exposure to loans for two-wheelers in rural areas, particularly in states like Uttar Pradesh. The financiers are shying away from these areas due to higher cases of delinquency in these regions. Many dealers in these regions do not register vehicles and give them to customers on temporary registration, making it easier for the customers to avoid payments.

Rising interest rates unlikely to affect demand

We have tried to analyse the impact of the rising interest rates on the sales of motorcycles. In the last two months, the interest rates have moved up from 9-9.5% to 11-11.5% currently.

Effect of rise in interest rates on motorcycles

	Scenario 1	Scenario 2
On road cost	50,000	50,000
% financing	85	85
Loan amount	42,500	42,500
Interest rate	9	11
Tenure (yrs)	3	3
Tenure (in months)	36	36
EMI	**1,351**	**1,391**
Annual repayment cost	**16,218**	**16,697**
% Increase in monthly installments		3.0

In case of two-wheelers, the increase in the equated monthly installment (EMI) due to the rising interest rate has been negligible and hence the hardening rates are not expected to have any adverse impact on the demand. A 100-basis-point rise in the interest rate results in just a 1.5% increase in the monthly installment. Our calculations show that a 200-basis-point increase in the interest rates would raise the EMI of a consumer by just Rs40, which should not have any significant impact on the sales of automobiles.

Industry momentum to continue

We expect the current growth momentum to continue in the sector. The entry-level segment of passenger cars is expected to be adversely affected by the rising interest rates. The interest rates in the commercial vehicle segment have not risen as much as in the other segments. Besides the rising freight rates would compensate for the increase in the cost of financing commercial vehicles. The growth rate in the motorcycle segment is slowing down and the rising interest rates would have a minimal impact on the demand for this class of vehicles.

Sharekhan Stock Ideas

Evergreen

HDFC Bank
Infosys Technologies
Reliance Industries
Tata Consultancy Services

Apple Green

Aditya Birla Nuvo
ACC
Apollo Tyres
Bajaj Auto
Balrampur Chini Mills
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
Hindustan Lever
Hyderabad Industries
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ITC
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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
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Ugly Duckling

Ahmednagar Forgings
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BASF India
Ceat
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