investor's eye

Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Balaji Tele	9-July-07	231	**242**	303
ICICI Bank	23-Dec-03	284	**967**	1,173
JP Associates	30-Dec-03	125	**954**	1,061
Ranbaxy	24-Dec-03	533	**408**	500
Satyam	30-Dec-03	181	**421**	538

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

Jindal Saw

Emerging Star

Stock Idea

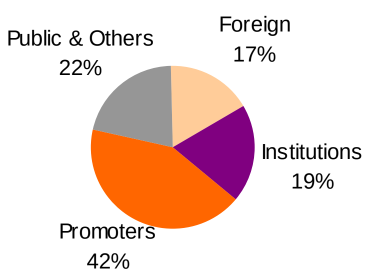
Opportunities in the pipeline

Buy; CMP: Rs635

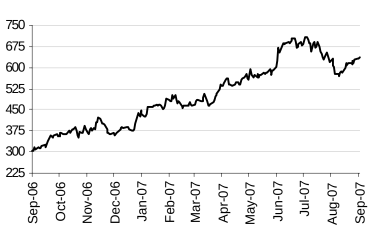
Company details

Price target:	Rs830
Market cap:	Rs3,071 cr
52 week high/low:	Rs728/300
NSE volume: (No of shares)	58,521
BSE code:	500378
NSE code:	JINDALSAW
Sharekhan code:	JINDALSAW
Free float: (No of shares)	2.8 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	4.7	-3.1	30.8	107.0
Relative to Sensex	-11.9	-15.9	8.0	72.2

Key points

- **De-risked business model:** Jindal Saw Ltd (JSL), the largest pipe manufacturer in the country, is expected to make the most of a huge opportunity in the pipe sector due a global surge in E&P activities and a strong domestic demand. JSL is present in almost all pipe segments, which makes it a de-risked and strong play on the booming Indian pipe sector.
- **Strong order book:** It enjoys a strong order book of $700 million, ie almost 1.1x its FY2006 sales from Indian operations. Executable by May 2008 this strong order book and the buoyancy in the pipe industry provide good visibility to its future earnings.
- **Margin expansion:** We expect a sharp improvement in the margins of JSL going forward due to the sell-off of its US business (which was less profitable), better product mix in favour of seamless and ductile iron pipes, and greater operating efficiencies. The OPM of the company is expected to improve from 10.6% in FY2006 to 15.2% in FY2009.
- **US sell-off positive:** We regard the sell-off of the US operations as a positive for the company, since its lower margin was dragging the company's overall profitability. Moreover, JSL has been able to get a good price from the stake sale and the transaction would lead to a post-tax inflow of $275 million. The company would utilise part of this to repay some amount of debt and expand its capacity.
- **Attractive valuations:** Considering its strong growth potential, sharp improvement in its margin and the buoyancy in the pipe segment, we believe the stock is trading at very attractive valuations. We expect the profits of the company to grow at a CAGR of 40% over FY2006-09. At the current market price of Rs635, the stock is discounting its FY2009E earnings by 7.6x and is available at an EV/EBIDTA of 3.6x, which is lower than that of its peers. We, therefore, recommend a Buy on JSL with a price target of Rs830.

Company background

JSL, part of the Jindal group, was incorporated in 1984. Over the years, JSL has transformed itself from a single product maker into a multi-product company, with presence in large diameter pipes (both LSAW and HSAW), seamless pipes, and ductile iron (DI) pipes.

Key financials

Particulars	FY2005	FY2006	FY2007E	FY2008E	FY2009E
Net sales (Rs cr)	2,313.6	3,855.7	4,963.1	3,870.7	5,086.8
Net profit (Rs cr)	99.1	169.1	284.6	291.0	465.7
EPS (Rs)	17.7	30.1	50.7	51.9	83.0
% y-o-y change	*73.6*	*70.6*	*68.4*	*2.2*	*60.0*
PER (x)	35.9	21.1	12.5	12.2	7.6
P/B	4.2	3.5	2.8	1.2	1.0
EV/EBIDTA	16.1	10.9	8.7	5.2	3.6
RoCE (%)	17.8	18.9	20.6	16.1	19.3
RoNW (%)	11.7	16.6	22.7	9.5	13.5

The company's manufacturing facilities are located at three places: Kosi Kalan in Uttar Pradesh for the manufacture SAW pipes, Nashik in Maharashtra for seamless pipes, and two manufacturing bases at Mundra in Gujarat. Its clients include all major domestic oil and gas companies, and international majors like CNPC (China), AGIP, Qatar Petro, and Shell among others.

Investment arguments

Strong growth in the pipe sector

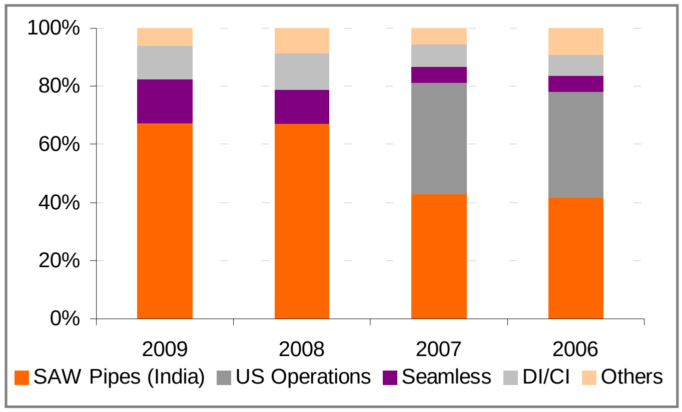
Given the rising demand for crude and the resulting upsurge in the fuel's prices, exploration and production (E&P) activities have received a major boost globally in the past few years. Worldwide, plans are afoot to lay down more than 240,000 kilometre of pipelines in the next few years. Bulk of this demand is accruing from the USA, the Middle East and Asia. Even the domestic pipe market continues to grow at a rapid pace, given the sharp rise in E&P activities and under-penetration of pipe infrastructure in the country. The penetration of pipe infrastructure in India is just about 33% compared with 59% of the USA and about 75% of France. India currently has an oil and gas pipeline network of about 26,000 kilometre. Considering the already announced plans, there would be an addition of almost 18,000 kilometre of pipelines in the next four to five years. GAIL India itself has line up a capital expenditure plan of Rs18,000 crore and would be almost doubling its existing pipe network of 5,400 kilometre while Reliance Industries would be adding 5,000 kilometre of pipeline in the next five years. Also, there exists huge potential in the water transportation segment, which is expected to witness a strong growth too, considering the government's thrust on improving the country's water infrastructure.

We expect Indian pipe makers to not only ride on the domestic boom but also make the most of the huge global opportunity (worth almost $12 billion), considering that they have already won accreditations from global companies, enjoy lower conversion costs and are located close to high growth regions like the Middle East. JSL, being the largest pipe maker in the country, is expected to make the most of this huge opportunity and be one of the prime beneficiaries of this boom.

De-risked business model

We particularly like JSL's diversified business model. JSL is present across pipe segments, namely SAW pipes (both LSAW and HSAW), seamless pipes and DI pipes. The diversification helps the company to cater to almost all the user segments, with clients in oil and gas exploration, transportation, water transportation and sewerage applications; while it also immunes the company against a slowdown in one particular segment.

Changing product mix



Source: Sharekhan Research

Strong order book

JSL is sitting on a strong order book of $700 million, which is executable in the next eight to nine months. Out of this, about $525 million pertains to the LSAW segment, $75 million to the HSAW segment, $60 million to the seamless pipes segment and $40 million to the DI/CI segment. The company has strong presence in the Middle East and most of the LSAW orders are from the export markets. The strong order book of JSL, which is about 1.1x sales of its Indian operations, provides good visibility to its earnings.

Margins to improve substantially

We expect significant improvements in JSL's overall margins due to the following reasons.

a) *US sell-off:* The US operations of the company were yielding lower margins (in the region of 8-9% against about 14-15% in its Indian operations). This was on account of a lot of inefficiencies in its manufacturing processes and lack of modernisation due to financial constraints. The sell-off of the US business would straightaway improve the overall margins of the company.

b) *Better capacity utilisation:* The strong demand for pipes, both globally and domestically, would trigger an overall improvement in its capacity utilisation, particularly in the DI pipes and seamless segments. This would lead to better operational leverage.

c) *Setting up of a sintering facility and a CPP:* Last year the company set up a sintering facility, which helped it to improve the margins of its DI pipes from about 13-14% in FY2006 to about 18% currently. Further, by December 2007 the company is installing a captive power plant (CPP) which would help it to reduce its power cost to about Rs2 per unit, thereby improving its DI margins further.

d) *Better product mix:* Seamless and DI pipes enjoy higher margins as compared with the SAW pipes. Going forward, we expect the contribution of both these segments to the overall revenue mix to improve, which should trigger a further margin expansion. We expect the contribution of the seamless pipes to increase from 5.4% in FY2006 to 15.3% in FY2009. Because of lower utilisation and efficiencies, the company was also enjoying lesser margins in its seamless pipes division. With higher utilisation and better operational efficiencies, the margins of the seamless division are expected to improve from the current level of about 13-14% to 22-23% in FY2009.

Considering the above, we expect JSL's overall operating profit margin (OPM) to improve from 10.6% in FY2006 to 15.2% in FY2009E.

Capacity expansions

JSL is also undertaking a capacity expansion exercise. The company would be expanding its current capacity of 1.25mmtpa by another 0.7mmtpa to 1.95mmtpa over the next two years. It plans to spend approximately Rs700 crore towards capacity expansions. Further, the company would be spending close to Rs75 crore for the installation of a waste heat recovery power plant.

Expansion plans

	Current (tpa)	Proposed (tpa)	Expanded (tpa)	Remark capacity
LSAW	800,000	200,000	1,000,000	By September 2008
HSAW	150,000	350,000	500,000	200,000tpa by March 2008; 150,000tpa by September 2008
Seamless	100,000	150,000	250,000	By June 2008
DI/CI	200,000	0	200,000	De-bottlenecking to improve utilisation
Total	**1,250,000**	**700,000**	**1,950,000**	

US operations sold off

JSL had, in August 2007, sold off its investment in the US subsidiary and received total cash of USD275 million. US revenues accounted for about 36% of its total FY2006 revenues for the company. The US subsidiary had a capacity to manufacture 1.2mmtpa plates and 0.5mmtpa pipes. The US operations were less profitable as compared with its Indian operations. This was because of lower efficiencies and lack of modernisation in plants. We believe that the sell-off of the stake in the US subsidiary was a positive move for the company, considering the cash it generated from the transactions. Also, the sell-off would boost the overall margins of the company.

Investment concern

Steel prices on a rise

Steel is the primary raw material for the pipe manufactures, accounting for bulk of the raw material cost. The steel prices have consistently gone up in the last couple of years. Usually the entire quantity of steel requirement is booked at the time when the order is secured. Hence, the exposure to steel prices is just between the period of bidding for the order and forward booking of steel.

Valuations and view

Considering its leadership position, de-risked business model, margin improvement and strong growth prospects ahead, we believe that its stock's valuations are very attractive. Also, after the sale of its US operations, the company is sitting on a huge cash pile which would partly be utilised for debt repayments and capacity expansions. The company had also raised about Rs360 crore last year through the foreign currency convertible bond route to fund its expansion plans. High cash position and debt repayment would strengthen the balance sheet size of the company, while interest cost would come down significantly too.

Peer comparison

	PER			EV/EBIDTA		
	FY07	FY08	FY09	FY07	FY08	FY09
Jindal Saw	12.5	12.2	7.6	8.7	5.2	3.6
Maharashtra Seamless	18.2	13.6	11.1	11.8	8.3	6.5
PSL	23.4	14.3	8.6	12.5	8.7	6.3
Man Inds	17.0	12.7	8.8	9.5	7.2	4.8

We expect the overall revenues of the company to grow at a compounded annual growth rate (CAGR) of 9% between FY2006 and FY2009, and profits to grow at a CAGR of 40% over the same period. Adjusting for the US sales, we expect the sales to increase at a CAGR of 27% over the same period. At the current levels, the stock is trading at compelling valuations: it is discounting its FY2009E earnings by 7.6x and is available at an enterprise value (EV)/earnings before interest, depreciation, tax and amortisation (EBIDTA) of 3.6x. This also makes it the most attractive stock in the pipe sector. We, therefore, recommend a Buy on the stock with a price target of Rs830.

Financials

Profit & loss account

Rs (cr)

Particulars	FY05	FY06	FY07E	FY08E	FY09E
Net sales	2,313.6	3,855.7	4,963.1	3,870.7	5,086.8
Operating expenses	2,046.4	3,445.9	4,413.1	3,325.7	4,313.4
Operating profit	267.2	409.8	550.1	545.0	773.4
Other income	17.7	43.2	50.0	65.0	75.0
EBIDTA	285.0	453.0	600.1	610.0	848.4
Depreciation	35.4	51.9	59.0	77.1	83.4
Interest	99.7	145.0	116.2	92.0	59.5
PBT	149.8	256.1	424.8	440.9	705.6
Tax	50.7	87.0	140.2	149.9	239.9
PAT	99.1	169.1	284.6	291.0	465.7

Balance sheet

Rs (cr)

Particulars	FY05	FY06	FY07E	FY08E	FY09E
Share capital	147.1	148.4	148.4	156.1	156.1
Reserves & surplus	700.4	871.8	1,105.0	2,911.1	3,292.7
Shareholders fund	847.5	1,020.2	1,253.4	3,067.2	3,448.8
Total debt	997.7	1,380.0	1,600.0	700.0	700.0
Total liabilities	**1,845.2**	**2,400.1**	**2,853.4**	**3,767.2**	**4,148.8**
Gross block	830.9	958.7	1,375.4	1,835.4	1,985.4
Net fixed assets	639.0	715.1	1,072.8	1,455.7	1,522.3
Capital work in progress	89.5	166.6	60.0	50.0	0.0
Investments	96.2	96.5	96.5	83.0	83.0
Current assets	1,575.1	2,700.5	3,187.2	3,519.1	4,232.6
Current liabilities	494.8	1,202.0	1,486.4	1,263.9	1,612.5
Net current assets	1,080.3	1,498.5	1,700.8	2,255.2	2,620.1
Misc exp not w/o	0.0	0.0	0.0	0.0	0.0
Deferred tax liability	-59.9	-76.6	-76.6	-76.6	-76.6
Total assets	**1,845.2**	**2,400.1**	**2,853.4**	**3,767.2**	**4,148.8**

Valuations

Particulars	FY05	FY06	FY07E	FY08E	FY09E
EPS	17.7	30.1	50.7	51.9	83.0
PER	35.9	21.1	12.5	12.2	7.6
P/B	4.2	3.5	2.8	1.2	1.0
EV/EBIDTA	16.1	10.9	8.7	5.2	3.6
EV/Sales	1.9	1.2	1.0	0.7	0.5
M Cap/Sales	1.5	0.9	0.7	0.9	0.7

Key ratios

Particulars	FY05	FY06	FY07E	FY08E	FY09E
OPM (%)	11.6	10.6	11.1	14.1	15.2
EBIDTA (%)	12.3	11.7	12.1	15.8	16.7
PAT (%)	4.3	4.4	5.7	7.5	9.2
RoCE (%)	17.8	18.9	20.6	16.1	19.3
RoNW (%)	11.7	16.6	22.7	9.5	13.5
Debt equity (X)	1.2	1.4	1.3	0.2	0.2

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

Esab India

Vulture's Pick

Stock Update

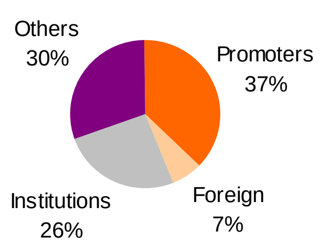
Subdued response to open offer

Buy; CMP: Rs470

Company details

Price target:	Rs575
Market cap:	Rs723 cr
52 week high/low:	Rs505/286
NSE volume: (No of shares)	19,941
BSE code:	500133
NSE code:	ESABINDIA
Sharekhan code:	ESAB
Free float: (No of shares)	1.0 cr

Shareholding pattern



Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	0.9	12.7	49.4	41.1
Relative to Sensex	-12.7	-1.6	14.7	2.2

Key points

- ESAB India's parent company had made an open offer to the shareholders of ESAB India for acquiring 58.01 lakh equity shares, which amounted to 37.69% of the equity share capital, at the rate of Rs505 per share.
- The shareholder response to the offer was lukewarm as only 28.09 lakh equity shares were tendered during the offer period. This shows high confidence in the company by its existing shareholders.
- Post offer, the shareholding of the parent company increased to 55.56% as against 37.31% prior to the offer. Consequently, public shareholding decreased from 62.69% to 44.44%.
- After conclusion of the offer, the parent company wanted to hold 75% of the equity capital however, a subdued response to the offer is a testimony to the growing confidence of the existing shareholders in the company. ESAB India has recently expanded its product range and capacities indicating the management's confidence in the increasing demand for the company's products. The company has also reported a spectacular growth in both its revenues and earnings in the first half of CY2007.
- We expect order inflows and robust product demand to continue for the company owing to planned investment in core infrastructure sectors like roads, ports, airports and construction in India.

We remain confident of the company's growth prospects and reiterate our Buy recommendation with a price target of Rs575. At the current market price of Rs470 per share the stock is quoting at 12.6x CY2007E earnings and 10.6 CY2008E earnings. In terms of enterprise value (EV)/earnings before interest, depreciation, tax and amortisation (EBIDTA) the stock is trading at 7.3x CY2007E and 5.4x CY2008E.

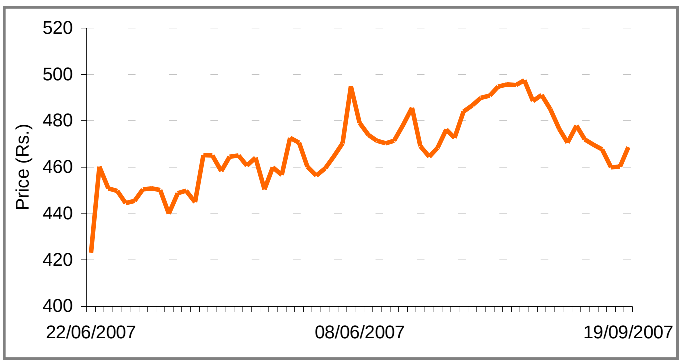
Earnings table

Particulars	CY2004	CY2005	CY2006	CY2007E	CY2008E
Gross sales (Rs cr)	213.6	271.6	327.3	419.9	482.9
Net sales (Rs cr)	187.1	238.2	287.2	368.7	424.0
Net profit (Rs cr)	20.4	35.2	42.6	57.4	68.6
% y-o-y growth	-	*73*	*21*	*35*	*20*
Shares in issue (cr)	1.54	1.54	1.54	1.54	1.54
EPS (Rs)	13.2	22.8	27.7	37.2	44.5
% y-o-y growth	-	*73*	*21*	*35*	*20*
PER (x)	35.6	20.6	17.0	12.6	10.6
Book value (Rs)	26.0	22.2	49.9	80.9	125.4
P/BV (Rs)	26.0	11.2	9.4	5.8	3.7
EV/EBIDTA (x)	21.9	12.6	10.8	7.3	5.4
EV/Sales (x)	3.8	2.9	2.4	1.7	1.4
RoCE (%)	74.6	113.9	108.1	83.6	62.4
RoNW (%)	50.8	103.1	55.5	46.1	35.5

Subdued response to the offer

Exelvia Group India BV (the acquirer) and Charter Plc and ESAB Holdings (persons acting in concern [PAC]) in order to increase their stake in the company had made an open offer to the shareholders of ESAB India for acquiring 30.78 lakh equity shares, which was 20% of the equity share capital, at the rate of Rs426 per share. However, in the offer document the management had categorically stated no intentions to de-list its shares from the bourses. The announcement of the open offer acted as a trigger for the stock with its price moving up by 8.8% in a single trading session. With prevailing market price being higher than the offer price, the acquirers were forced to revise the offer price to Rs505 per share. Subsequently, the acquirers also revised the target number of shares to 58.01 lakh, which is 37.69% of the equity capital.

Price movement post offer announcement



Inspite of revising the offer price to Rs505 per share, which was at a premium to the market price of the share, the offer did not get an encouraging response from its shareholders. The shareholders tendered only 28.08 lakh shares, which was only 18.25% of the total equity capital as against 37.69% that the company had targeted. Consequently, the public shareholding came down from 62.69% to 44.44% of the total paid up equity capital. The total payment made to the shareholders was Rs141.85 crore.

The subdued response to the offer is a testimony of the shareholder confidence in the company's growth prospects.

Offer details

Particulars	Proposed offer (Revised)		Actual	
Price (Rs)	505		505	
Shares acquired by the acquirer	58,01,564		28,09,089	
Shares in %	37.69		18.25	
Size of the open offer (Rs crore)	292.97		141.85	
	Pre	**Post**	**Pre**	**Post**
Pre and post offer shareholding of public	9649820	3848256	9649820	6840731
Shares in %	62.69	25.00	62.69	44.44

Future outlook and valuations

ESAB India has recently expanded its production capacity and product line. The new plant for manufacturing welding and cutting equipment at Irungattukottai and the new MIG line at Khardah, went into commercial production in Q1CY2007. The company has also entered into technology transfer agreements with Esab group companies to set a flux cored wire production capacity at Irungattukottai. The flux cored wire project and additional capacities in some of the existing lines are scheduled to go on stream in CY2007.

We expect order inflows and robust demand to continue for the company on the back of planned investment in core infrastructure sectors like roads, ports, airports and construction in India.

We remain confident of the company's growth prospects and reiterate our Buy recommendation with a price target of Rs575. At the current market price of Rs470 per share the stock is quoting at 12.6x CY2007E earnings and 10.6x CY2008E earnings. In terms of EV/EBIDTA the stock is trading at 7.3x CY2007E and 5.4x CY2008E.

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

Information Technology

Sector Update

Two-pronged impact of Fed cut

The recent rate cut by the US Federal Reserve has affected the Indian technology stocks in two ways. First, it is a positive development in terms of the remedial steps taken to avoid a possible slowdown in the US economy. On the other hand, the move has weakened the US Dollar against all the other currencies including the Indian Rupee.

In fact, the rupee has breached the psychologically important benchmark of Rs40/US Dollars. This has dented the sentiments towards the tech stocks. Moreover, with the appreciation coming at the fag end of the quarter, it would also severely affect the performance in the second quarter.

Q2 earnings could be lower by 1.5-2.5%

The average realisation could be around 1-1.5% lower than Rs40.6 that was considered in the second quarter results preview note released earlier this month. However, given the changed scenario the earnings estimates for Infosys Technologies and Satyam Computer Services could be lower by 1.5-2.5% compared with our estimates.

Under pressure

	Infosys	Satyam
Original estimates	1,127	374.0
Revised estimates*	1,111	365.0
% chg	-1.5	-2.4

*Possible revision

On the positive side, the consensus opinion of the leading technology companies seems to suggest an expected range of Rs39-41 for the rupee against the dollar. This essentially means that a possible breach of the Rs40 mark is not an unexpected event and the Indian companies have been preparing for the same.

Valuation

In the near term, the technology stocks could remain under pressure due to continued strengthening of the rupee. In such a scenario, it is preferable to find shelter in companies with aggressive foreign exchange hedging and/or limited exposure to billing in US Dollars. Consequently, we maintain our positive view on HCL Technologies and 3i Infotech.

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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)
Jindal Saw
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