Sharekhan valueline

UNION BUDGET 2004-2005

MARKET STRATEGY

A special report on what stand should you take in the current markets.

UPDATED RESULTS OF

- HINDUSTAN ZINC
- TATA TEA
- ONGC
- VSNL
- IVRCL
- TVS MOTORS
- EVEREADY INDUSTRIES
- WELSPUN INDIA

Plus Our Regular Features

- Stock Ideas
- Report Card
- Earnings Guide

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Disclaimer: Reports under Institutional Research section are for information only and are not recommendations of Sharekhan. We take no responsibility for investments made on this advice.

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Report Card: Stock Ideas Standing (as on June 30, 2004)

Company	Reco Price (Rs)	Reco Date	Current Reco	Price as on June 30, 2004 (Rs)	Gain / Loss (%)
EVERGREEN					
Hindustan Lever	160.0	16-Aug-02	Buy	127.3	-20.4%
HDFC Bank	358.0	23-Dec-03	Buy	369.7	3.3%
Infosys Technologies	5,513.0	30-Dec-03	Buy	5,522.9	0.2%
Reliance Industires	567.0	5-Feb-04	Buy	429.6	-24.2%
Wipro	584.3	30-Dec-03	Buy	532.1	-8.9%
APPLE GREEN					
ABB	216.7	20-Nov-02	Buy	672.1	210.2%
Bajaj Auto	1,130.0	23-Dec-03	Buy	884.6	-21.7%
Balrampur Chini Mills	125.0	16-Apr-02	Buy	290.1	132.1%
Corporation Bank	218.0	19-Dec-03	Buy	249.5	14.4%
Dr Reddy's Laboratories	1,415.0	24-Dec-03	Buy	735.4	-48.0%
Gammon India	462.0	12-Apr-04	Buy	347.8	-24.7%
Gujarat Ambuja Cement	287.0	31-Mar-04	Buy	284.5	-0.9%
Hero Honda Motors	422.0	23-Dec-03	Buy	507.5	20.3%
ICICI Bank	284.0	23-Dec-03	Buy	244.4	-13.9%
Ipca Labaratory	620.0	25-Mar-04	Buy	573.9	-7.4%
Marico Industries	77.0	22-Aug-02	Buy	121.6	57.9%
Mahindra & Mahindra	464.0	1-Apr-04	Buy	442.0	-4.7%
Maruti Udyog	360.0	23-Dec-03	Buy	402.6	11.8%
Nicholas Piramal	730.0	16-Mar-04	Buy	775.8	6.3%
Oriental Bank of Commerce	235.0	19-Dec-03	Buy	240.4	2.3%
Ranbaxy Laboratories	1,067.0	24-Dec-03	Buy	909.5	-14.8%
Sintex Industries	55.0	14-Aug-03	Buy	114.0	107.3%
State Bank of India	476.0	19-Dec-03	Buy	430.7	-9.5%
Tata Motors	473.0	29-Mar-04	Buy	380.2	-19.6%
EMERGING STAR					
Alok Textile Industries	57.0	21-Jan-04	Buy	50.2	-11.9%
Aurobindo Pharma	354.0	29-Mar-04	Buy	325.2	-8.1%
Moser Bear	310.0	12-Apr-04	Buy	179.5	-42.1%
Solectron Centum Electronics	98.8	08-Dec-03	Buy	60.8	-38.4%
Sterlite Industries	506.0	28-Apr-04	Buy	441.6	-12.7%
Tata Metaliks	42.0	30-Jun-03	Buy	63.1	50.4%
Welspun India	106.0	21-Jan-04	Buy	81.4	-23.2%
Welspun Gujarat Stahl Rohren	31.7	01-Apr-04	Buy	29.1	-8.1%
UGLY DUCKLING					
Andhra Bank	46.0	19-Dec-03	Buy	42.6	-7.4%
Bank of Baroda	175.0	19-Dec-03	Buy	150.1	-14.2%
Eveready Industries	25.8	24-Feb-04	Buy	32.1	24.7%
HCL Technologies	206.0	30-Dec-03	Buy	298.2	44.8%
iGate Global Solutions	353.0	30-Dec-03	Buy	226.5	-35.8%
Jaiprakash Associates	125.0	30-Dec-03	Buy	102.6	-17.9%
Orchid Chemicals & Pharmaceuticals	266.7	26-Dec-03	Buy	184.6	-30.8%
Punjab National Bank	180.0	19-Dec-03	Buy	282.0	56.7%
Satyam Computer Services	363.0	30-Dec-03	Buy	305.5	-15.8%
Sun Pharmaceutical Industries	302.0	24-Dec-03	Hold	366.2	21.3%
Tata Power Company	102.9	19-Oct-02	Buy	232.0	125.5%
Union Bank of India	46.0	19-Dec-03	Buy	57.8	25.7%
Wockhardt	248.0	24-Dec-03	Hold	255.0	2.8%
VULTURE'S PICK					
Indsil Electrosmelts	12.8	10-Mar-04	Buy	19.1	49.8%
Mahanagar Telephone Nigam	148.0	5-May-04	Buy	132.0	-10.8%
Esab India	60.0	21-May-04	Buy	52.8	-12.0%

Report Card: Stock Ideas Booked (to date)

Company	Recommended at (Rs)	Recommended on	Booked at (Rs)	Booked on	Appreciation (%)
Hindustan Construction Company	72.30	27-May-02	105.00	09-Jul-02	45.23
Electrosteel Castings	285.60	18-Jun-02	308.00	12-Aug-02	7.84
United Phosphorus	141.45	07-Sep-02	176.00	4-Dec-02	24.43
Apollo Tyres	121.00	19-Oct-02	145.25	12-Dec-02	20.04
Mahindra & Mahindra	94.75	18-Nov-02	131.45	29-May-03	38.73
Container Corporation of India	236.80	12-Nov-02	351.00	18-Jun-03	48.23
Voltas	50.15	14-Feb-03	118.40	21-Oct-03	136.09
Ingersoll-Rand (India)	224.45	30-Oct-02	250.35	22-Oct-03	11.54

Our Stock Clusters

We categorise all the scrips that are under coverage into six clusters. Each cluster represents a certain profile in terms of business fundamentals as well as the kind of returns you can expect over a certain time horizon. This helps you in identifying the stocks that fit your time horizons and return objectives best. Happy investing!

Evergreen

Dominant players with strong brands, robust management credentials, supernormal shareholder returns. Will steadily compound 18-20% per year for next five to ten years.

Apple Green

Potentially steady compounders, but five-to-ten-year graph bit unclear. Could gallop at 25-30% per year over the next two to three years.

Emerging Star

Young companies likely to rule chosen niches. Even better, the niches could balloon into full-blown markets. Potentially ten-baggers if you're patient.

Ugly Duckling

Trading below fair value or at huge discount to peer group. But something's cooking. Could double in two to three years time. Swans, anybody?

Vulture's Pick

Companies with valuable assets at throwaway prices. Buy & await predators. Startlingly high returns possible. Patience is vital, my dear.

Markets look to Budget for direction

Packed with government statements the coming fortnight shall determine the trend of the economy and the markets.

"Attitudes are more important than facts," is a quote which has remained etched in our memory since the halcyon MBA days. Time and again we have seen it stand out as an inference while analysing numerous phenomena across disciplines and events—whether in political, financial, organisational, psychological or interpersonal domain. Well, attitudes are playing a greater role once again in the run-up to the Union Budget 2005 (July 8, 2004). And if we further consider the fact that the Railway Budget (July 6) and the Economic Survey (July 7) are also due in the coming fortnight, then our observation acquires even greater importance.

What did the previous regime essentially change compared to the earlier administrations? If we look and analyse hard, nothing much on the factual front, besides altering the Foreign Policy, Defence and Oil Security models, and revving up the liberalisation process. Yet, towards the closing stages of that regime, the government came to be perceived as firm and purposeful and the markets were reacting to it with an equally firm attitude.

And then May 13 happened. Only six weeks have passed since then and the picture is quite different right now. And this change in picture, to surmise in one sentence, is all about a change in the attitude of the people in power, the press and the common man rather than any change in the India Shining story. The broad India story couldn't have changed all that drastically in less than two months!

A lot now depends on the new prime minister (PM) to bring back optimism in the whole system so that the India story retains its unique place in the mind of the people. Tough task that, given the fact that the PM heads a post-poll coalition. However his address to the nation in the previous week did point in the right direction. In the pipeline are three significant statements of intent with which the government can stem the lacklustre undertone that seems to have enveloped the economy. Suffice it to say that the whole country is awaiting the annual ritual with bated breath.

On the immediate neighbourhood front, the recent surge in terrorist killings in Jammu and Kashmir is a dangerous development. So are the new statements emanating from the Pakistani government's stable. With the road of peaceful co-existence yet to be taken, it would only be wise to serve a stern reminder to the terrorist groups and their masters across the border that the new Indian government intends to continue the pursuit of peace but only from the point of strength, lest these rogue entities develop mischievous ideas all over again.

The World Trade Organisation talks on the agricultural tariff related issues seem to be headed nowhere with participants issuing a lot of statements without coming to any concrete agreement. It seems that the world is waiting for elections due this year in a number of countries across the globe, including the USA, to be over before it gets down to the business of talking trade terms.

Finally, to an issue which has concerned us deeply—the health and the future of the Indian Railways. For years, the Indian Railways has formed the backbone of intra-country travel for the middle and the poor class in the country, besides serving as the network for transporting industrial and agricultural goods across the country's expanse.

However, sadly enough, the health of this giant is in shambles. Primarily because the politicians have used it for furthering their own interests, much to the detriment of the nation's interests. One is hard pressed to remember when did this critical cog in the country's development wheel last get a dynamic, efficient and effective minister to lead this organisation out of the rut it finds itself in.

The developments related to this organisation in the past five odd weeks prove what we are trying to say. Instead of making a genuine effort to make the lot of the Indian Railways better, the railway ministry currently seems to be more interested in improving the lot of all other industry constituents, the effect on the performance and health of the Indian Railways notwithstanding.

Perhaps the time has come for the government to do some hard thinking with regard to this hapless giant, which has been at the receiving end of the whims and fancies of shortsighted politicians and which seems to be hurtling towards a financial disaster. The Railway Budget on July 6 will hopefully signal the direction that the current regime has chalked out in this regard.

Yehi hai right time!

It has been six weeks since the crash of May 17, 2004. Whilst the march to power of the United Progressive Alliance (UPA), upsetting all kinds of prophecies —of psephologists and political pundits alike—symbolises the unpredictability of Indian democracy, the fallout on the investors has been rather harsh, to put it mildly. While Asian markets have fallen because of concerns of interest rate hikes by the US Federal Reserve, the Sensex has under-performed the MSCI Asia Index by 20% in 2004, mainly on concerns that economic reforms would see a slowdown given the composition of the post-poll coalition government at the centre, backed by Left parties.

Yet, there are reasons to bet on India

The correction in the market, in our opinion, provides enough reasons for a renewed interest going forward.

1. First and foremost, the worst fears on the exchange rate and interest rate front have already been factored in by Indian markets. Internationally too, markets appear to have factored in the change in the global interest rate scenario as seen by the reaction to the Federal Reserve's rate hike on June 30 and the bottoming out of commodity prices. The one-year forward rupee now trades at Rs46.47 per US dollar in the non-delivery forward (NDF) market vis-à-vis the current rate of Rs45.8 per dollar levels and the March level of Rs43.5 per dollar. As indicated by the NDF, the major correction in the exchange rates is now over and the market expects the rupee to depreciate only about another 1% in the year ahead. Despite concerns that capital inflows could slow, we concur with this view given the strong current account and merchandise export growth as well as easing of crude oil prices.

   Similarly, interest rates are up 0.7% from their bottom as the market has factored in rising global rates and higher inflation. Given the anticipated softening of commodity prices going forward and the government's pro-investment stance, we do not expect any significant changes in policy rates (bank rate and repo rate) though the market driven bond rates may see a further 1% rise.

2. The Indian market looks attractive in terms of the following **valuation** parameters:

   (i) *The PE and earnings growth relative to similar markets.* Annexure I compares the valuation of Indian markets relative to the Asian region and other similar markets. The table confirms the attractiveness of Indian markets on most parameters. Further, other large Asian markets like Korea and Taiwan are hugely dependent on China for growth—Chinese exports accounted for 38% and 68% of the growth in exports for Korea and Taiwan respectively, compared to a growth of 4.5% for India. Thus India is far more defensive at a time when Chinese growth is in question;

Annexure I: Relative valuations vis-à-vis other economies

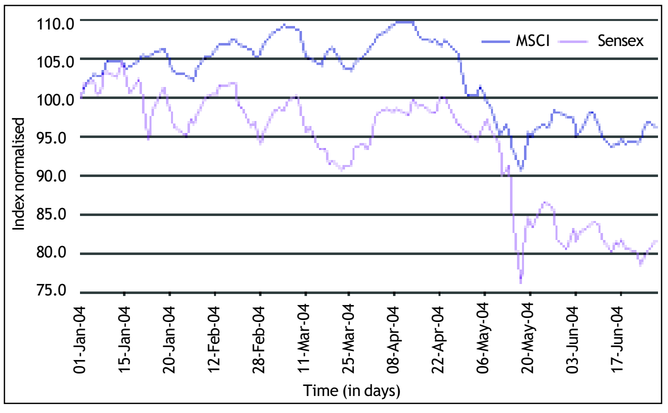
		P/BV (x)	P/E current (x)	P/E Fwd (x)	Div Yield (%)	Earning Yield (%)	Risk free rate (%)
Hong Kong	HSI	1.8	16.5	14.6	3.7	6.8	4.2
Korea	KOSPI	1.0	22.3	8.9	2.4	11.3	5.3
Singapore	STI	1.6	17.5	13.7	3.5	7.3	3.8
Taiwan	TWSE	1.7	20.2	13.3	2.1	7.5	2.9
Indonesia	JCI	1.7	11.2	11.2	2.4	8.9	11.9
Malaysia	KLCI	1.7	15.3	14.5	3.6	6.9	4.5
India	SENSEX	2.7	14.4	12.0	2.4	8.3	5.8
China	SHBSHR	1.5	71.0	56.9	2.1	1.8	4.8
Brazil	IBOV	1.1	11.0	9.8	28.7	10.2	24.9
Mexico	MEXBOL	2.2	13.7	12.9	2.0	7.8	7.3

Source: Bloomberg and BSE

   (ii) *Earnings yield as compared to bond yield.* Annexure I indicates that whilst the earnings yield is in the 8.3% region, the bond yield is 5.8%, thus proving the attractiveness of the stock market vis-à-vis the bond market;

   (iii) Performance of the Indian stock market relative to the MSCI Index since January this year as mentioned earlier implying potential to catch up (Annexure II).

Annexure II : MSCI Emerging Markets Vs the Sensex



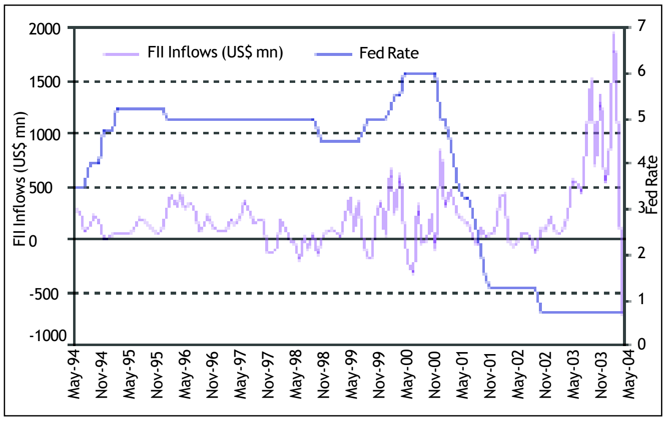
3. Concerns on foreign institutional investor (FII) flows are overdone. If we look at data of FII flows when the United Front government, backed by the Left was in power in 1996, the figure was a good US $3.05 billion (Annexure III). Similarly, if we look at the FII flow into India for the periods 1994-95 and 1999-2000, when the Federal Reserve had hiked interest rates in the USA (Annexure IV), the story was the same.

   Further, while FII flows during the January to March period of 2004 may look large at $3.18 billion, nearly 50% of it (US$1.48 billion) was sucked into IPOs. Therefore, the flow into the secondary market had started falling even prior to the announcement of the election result. As a corollary, therefore, the flow into secondary markets would increase as new issuances by Indian companies start waning, going forward.

Annexure III: FII Inflows during the United Front government tenure

Month	Net FII Inflows in mn US$	$ Rate
Jan-96	279.10	35.7
Feb-96	427.60	36.6
Mar-96	312.20	34.4
Apr-96	433.60	34.2
May-96	294.25	35.0
Jun-96	350.83	35.0
Jul-96	307.98	35.5
Aug-96	80.79	35.7
Sep-96	122.68	35.7
Oct-96	233.27	35.6
Nov-96	113.75	35.7
Dec-96	94.74	35.8
Total	**3050.80**	

Annexure IV : FII inflows vis-à-vis Federal rate changes



Source: Federal Reserve and SEBI

4. In contradiction to expectations, FII flows in June have been positive with FIIs pumping in $121.8 million into Indian markets till June 23. Similarly inflows into India dedicated country funds have been positive in June.

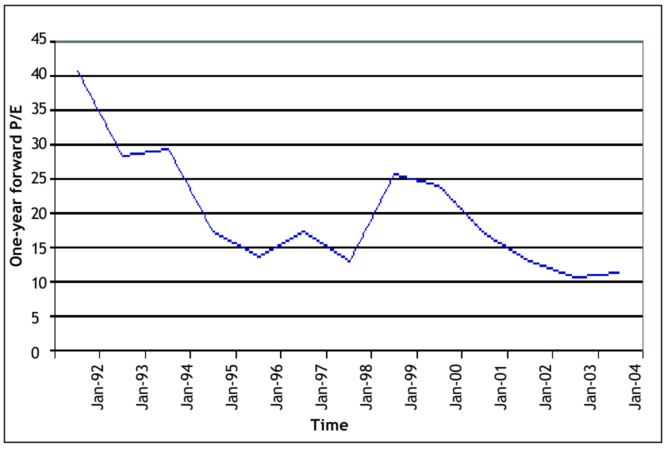
5. The report card of the new government so far has been better than expected. Whilst we would prefer to wait for the Union Budget to signal a firm direction about the way forward, for the economy and the country, some actions —listed below—by this government does provide enough reasons to feel assured that the objective of this government is to maintain the tempo of reforms:
   - Statement on VAT implementation in 2005;
   - No roll-back of oil price hikes;
   - Maintaining the momentum on airport privatisations and
   - JNPT and Cochin port terminal privatisation.

Valuation downside limited, focus on earnings

The downside for the Sensex going forward is limited. The chart of the Sensex on one-year prospective earnings (Annexure V) shows that the market PE multiple normally bottoms at about 10-11x (based on one year forward earnings). At current levels, the Sensex is trading at about 11x FY05 earnings indicating that valuations are close to the bottom. The index EPS and PE multiple are, however, based on consensus earnings growth estimates of 20% for FY05 and carry the risk of earnings growth not playing out as per consensus. However, even if we consider the earnings growth at half the consensus estimate of 20% (that is, 10%), we get the following prospective downside picture for the Sensex:

	FY04	FY05E	FY06E
Sensex EPS	387	425-464	468-557
EPS growth	19.8	10-20	10-20

Annexure V: One-year forward P/E



Source: BSE

That is, with earnings growth pegged at 10%, the Sensex EPS for FY2005 would come to 425 and with a 10 PE, the lowest possible Sensex level would be 4250, which would be a 13% fall from current levels—this being the maximum possible fall from current levels.

Conclusion: go for selective buying

The bottomline from the valuations perspective, therefore indicates that the Indian stock market has almost bottomed out. While there may be some risk to FY05 earnings for the broad market, selective buying of stocks with strong earnings growth could yield good return from a three-six month perspective. Included in this strategy is a list of seventeen stocks, which, in our opinion, provide the best avenue for investing with this perspective in mind. Our basic objective has been to pick companies which would be least affected by the environmental factors in their quest for profitable growth, if not aided by it.

Happy Investing!

Stocks recommended

HDFC Bank

- Thrust on retail lending, which gives highest returns—RoE to expand to 29% by FY 2005.
- Strong improvement in deposit mix, which will reduce the cost of deposits.
- Footprint expansion continues with 910 ATMs across the country and more to be added.
- We maintain a Buy.

Bajaj Auto

- Distribution reach expanded to tackle tightening competition.
- Capital expenditure of Rs108 crore on three new launches.
- Going forward, exports would be the growth driver. A new plant is coming up in Indonesia.
- Likely to get the contract to replace approximately 15,000 three-wheelers in Indonesia.

Gujarat Ambuja Cement

- Cement demand and price to remain firm over the medium term.
- Expect further expansion in the EBITDA margin due to high price realisation.
- Declining capital expenditure to improve the return ratios and to help repay debt.
- Subsidies Ambuja Cement Eastern (ACEL) and Ambuja Cement Rajasthan (ACRL) add to consolidated revenues.

Hero Honda Motors

- The agriculture-led economic growth of FY2004 to have a positive fallout on two-wheeler demand.
- The indisputable rural market franchise—the biggest market in India.
- To benefit from wide gap in launch schedule by competitors.

Tata Motors

- Revenue growth to remain at 20% on the back of its portfolio of vehicles in high-growth categories.
- Capital expenditure plan of Rs1,200 crore on product development and capacity expansion.
- Exports account for 7.6% of its total revenues, up from 5.2% a year ago and set to rise to 14%.
- High operating leverage in commercial vehicles (Cvs) to lead to profits growing faster than volumes.

Sintex Industries

- The textile as well as the plastics divisions of the company are on a roll.
- Strategic focus on the margin game for the former and the volume game for the latter.
- A product pipeline of over fifty products for the plastics division.

Mahindra and Mahindra

- M&M's operating margins expanded 3.60% year-on-year to 11.3% in Q4FY2004.
- High cash flow generated due to strong volume growth.
- M&M's exports in the automotive segment rose 51% in FY2004. We expect export growth to remain strong.
- Farm equipment segment to perform due to agri-friendly policy of the UPA government.
- The tractor division has already seen a turnaround.

Maruti Udyog

- The volume growth of 30% coupled with a margin expansion has increased the company's cash balance to Rs1,800 crore as at end-FY2004.
- MUL's tie-up with SBI for financing of car loans aided a strong growth in sales.
- The company has planned capital expenditure of Rs3,500 crore to expand the manufacturing facility.
- Re-positioning of the A2 segment (replacing 800 model with Alto) and the A3 segment.

Nicholas Piramal

- Working towards becoming numero uno in contract manufacturing and is in talks with three of the world's 20 largest pharma companies for custom manufacturing.
- Nicholas Piramal has become the fourth largest company in the domestic formulations market, with a share of 4.4%.
- The company's 3,074-strong field force is the largest in the domestic market.
- Presence in all categories like API, formulation and generics.

Marico Industries

- Market leadership status in coconut oils and hair oils cannot be ignored for long.
- New businesses in hair care and skin care expected to generate profits from FY2005 onwards.
- The company is expanding into overseas markets like Bangladesh, Pakistan and the Gulf region.
- Profit growth continues to be strong despite substantial investments in new products and services.

Welspun India

- An annualised earnings growth of 49% over FY2003-07, on a revenue compounded annual growth rate (CAGR) of 37%.
- Planned capacity expansion would make it one of the world's top three manufacturers of terry towels.
- Quarterly results have seen operating margins remaining stable, despite average cotton prices being much higher than last year.
- Outlook for the coming quarters looks robust, with a huge order book.

Alok Industries

- Among the first to identify huge export opportunity in home textiles space post-2005 and has expanded and modernised its facilities well ahead of its peers.
- Venture into high value-added home textiles and furnishing segment is off to a good start.
- Steady rise in utilisation levels from this plant expected in the coming quarters, reflecting a strong order book.

Tata Metaliks

- Extremely high efficiencies, OPM improving form 18.9% in 2003 to 26.4% in 2004.
- Capacity increase, installation of Hot Blast Stoves in order to raise the capacity of the blast furnace from 143,000 TPA to 165,000 TPA.
- Company going in for an aggressive organic as well as inorganic pursuit of profitable growth.
- For Q4FY2004 the company reiterated the above points in its results with sales growth of 10% year-on-year and 21% increase in net profits.

Jaiprakash Associates

- Poised for earnings compounded annual growth rate (CAGR) of 15% over FY2003-06, on the back of a Rs9, 200 crore order book
- Recent foray into build-operate-transfer (BOT)-based project execution assures stable returns and annuity earnings over long periods.
- Savings in power costs and an expansion-driven volume growth in the cement business.
- Merger of the cement business will allow JPC's losses of over Rs310 crore to be set off and thereby afford tax benefits.

MTNL

- The new interconnection (IUC) regime benefits MTNL by way of termination charges on local, NLD and ILD calls.
- Given its ownership of last-mile copper, revenue share with third party broadband access providers to go up.
- A 200 bps cut in licence fee would save MTNL Rs110 crore, which amounts to 5% of the company's FY2004 EBITDA.
- We recommend a buy on basis of huge cash flow the company is generating.

Esab India

- Cost cutting—all kinds of costs subjected to tough Standard Operating Procedures (SOPs).
- Change in positioning from low-margin high-volume products to quality and high-margin products.
- Working capital management improved through write-off of inventories, non-recoverable dues and right sizing of manpower.
- Double digit manufacturing sector growth to help the company's business of electrodes and welding/cutting equipment.
- The Q1CY2005 already indicates the strong turnaround in the performance.

Jain Irrigation Systems

- Task force on micro irrigation envisages an investment of Rs61,500 crore in micro irrigation systems (MIS) over the next eight years.
- The commitment to implement the task force's report is visible in recent tenders floated by the government of Andhra Pradesh (AP).
- (JISL), the undisputed leader in MIS, would be one of the biggest beneficiaries of this boom.
- The use of other divisions like pipes for gas transportation to add to the margins.

Key financials

Company	CMP (Rs)	Target Price (Rs)	% Return	EPS (Rs) FY04E	EPS (Rs) FY05E	EPS (Rs) FY06E	EPS Growth (%) FY05/FY04	EPS Growth (%) FY06/FY05	PE (x) FY04E	PE (x) FY05E	PE (x) FY06E
HDFC Bank	371.6	425.0	14.4	23.3	30.6	-	31.3	-	15.9	12.1	-
Bajaj Auto	895.9	1,325.0	47.9	73.0	79.7	87.9	9.2	10.3	12.3	11.2	10.2
Gujarat Ambuja	284.7	375.0	31.7	18.8	23.8	28.6	26.6	20.2	15.1	12.0	10.0
Hero Honda	504.7	556.0	10.2	36.5	43.0	48.2	17.8	12.1	13.8	11.7	10.5
M & M	448.7	588.0	31.1	28.4	36.0	43.5	26.8	20.8	15.8	12.5	10.3
Maruti Udyog	405.3	636.0	56.9	21.5	31.5	42.4	46.5	34.6	18.9	12.9	9.6
Tata Motors	389.4	594.0	52.5	22.7	33.8	40.2	48.9	18.9	17.2	11.5	9.7
Sintex Ind	114.0	250.0	119.3	22.9	36.6	44.8	59.8	22.4	5.0	3.1	2.5
Nichloas Piramal	789.7	1,050.0	33.0	58.8	67.6	88.3	15.0	30.6	13.4	11.7	8.9
Marico	120.9	195.0	61.4	10.0	12.1	14.0	21.0	15.7	12.1	10.0	8.6
Welspun India	80.3	195.0	142.8	7.1	6.9	13.3	(2.8)	92.8	11.3	11.6	6.0
Alok industries	50.0	120.0	140.2	7.4	12.0	16.2	62.2	35.0	6.8	4.2	3.1
Tata Metaliks	63.8	150.0	135.1	11.2	16.5	-	47.3	-	5.7	3.9	-
Jaiprakash	104.5	193.0	84.7	13.6	18.2	22.6	33.8	24.2	7.7	5.7	4.6
MTNL	130.1	180.0	38.4	19.7	21.0	22.1	6.6	5.2	6.6	6.2	5.9
Esab India*	55.0	90.0	63.6	0.5	7.1	-	1,320.0	-	110.0	7.7	-
Jain Irrigation	83.2	150.0	80.4	1.4	8.8	14.9	528.6	69.3	59.4	9.4	5.6

Welspun India

Emerging Star

Result Update

June 30, 2004

A well-knit company

Buy; CMP: Rs81

Welspun India has reported a 105% rise in profit before tax (PBT) for Q4FY2004. The rise has been led by a sharp 34% rise in net revenues (including export incentives). Most highlighting feature in the quarterly result has been the fact that operating margins have remained stable, in spite of average cotton prices being much higher than last year. This has underscored the fact that business is resilient to increase in raw material costs. We maintain our Buy call.

PBT jumps 105%

On the back of a strong 34% rise in net revenues (revenues inclusive of export incentives), Welspun India has reported a strong 105% jump in PBT. Operating margins have remained stable, in spite of a sharp rise in average cotton cost. Welspun India continues to operate at full capacity and the growth in quarterly result reflects the increase in capacity last year by 2,000 tonne. Overall, for the full year, the results were in line with our estimates.

Robust outlook

The outlook for the coming quarters looks robust, with a huge order book. Welspun India expects to generate incremental revenues through outsourced capacities as its new project goes on stream. The domestic branded business of the company also seems to be fairly on track.

No risk to estimates

Our estimates factor in a 4% consequent drop in prices for FY2005 and FY2006. We believe that in spite of our conservative estimates, we expect operating margins to remain stable in the coming quarters, on the back of changing product mix, sharp drop in cotton prices and benefits of backward integration going forward.

We maintain our Buy call

Welspun India is our top pick in the textiles sector. We believe that the company is slated to become an Asian home textiles giant, sooner than later. Increasing penetration with global retailers, huge demand potential, better and wider product offerings, underpin our bullishness on the stock. We maintain Buy rating on the stock, trading at a price-to-earnings ratio of 11x and 6x, FY2005E and FY2006E earnings.

Year to 31 March (Rs cr)	4QFY03	FY2003	1QFY04	2QFY04	3QFY04	4QFY04
Net Sales	88.7	301.0	73.6	85.1	91.4	117.0
% change	12.0%	15.8%	31.9%	33.4%	-1.5%	31.9%
Other Income	1.5	2.2	0.3	2.1	1.6	3.8
Total Income	90.2	303.3	73.9	87.2	93.0	120.8
Total Expenditure	71.9	237.2	55.7	67.0	72.5	97.0
Operating Profit	18.3	66.1	18.2	20.2	20.5	23.8
Operating Margins (%)	20.6%	22.0%	24.7%	23.8%	22.4%	20.3%
Interest	6.3	24.9	6.0	6.4	5.9	5.2
PBDT	12.0	41.3	12.2	13.8	14.7	18.6
Depreciation	4.6	14.2	3.8	3.7	3.9	3.4
PBT	7.4	27.1	8.4	10.2	10.8	15.2
Tax	-0.2	0.0	0.3	0.2	0.1	6.8
Deferred Tax	-0.1	4.7	2.2	2.4	2.3	0.4
Reported Profit After Tax	7.7	22.4	6.0	7.6	8.4	8.0
% change	243.5%	78.4%	4.9%	69.6%	28.9%	3.9%

Year to 31 March (Rs cr)	2003	2004	2005	2006	2007
CMP (Rs)	78.0	78.0	78.0	78.0	78.0
EPS (Rs)	4.9	7.1	6.9	13.3	16.5
P/e (x)	16.0	11.0	11.3	5.8	4.4
Book Value (Rs.)	44.8	50.5	65.5	77.8	91.5
Market Capitalisation (Rs cr)	359.0	359.0	463.0	463.0	463.0
P/BV (Rs.)	1.7	1.5	1.2	1.0	0.8
Enterprise Value (Rs cr)	555.4	537.8	879.4	871.8	740.7
EV/ EBITDA	8.7	7.0	9.5	4.5	3.4
EV/ Sales	1.8	1.5	2.0	1.0	0.7
RoCE (%)	12.90%	15.90%	9.20%	16.30%	19.50%

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

Eveready Industries

Ugly Duckling

Result Update

June 29, 2004

Consolidation time

Buy; CMP: Rs33

Eveready Industries has announced its results for FY2004, as tabulated below.

Figures in Rs cr

Particulars	FY2004E ended Mar 31, 2004	Q4FY2004 ended Mar 31, 2004	Q4FY2003 ended Mar 31, 2003	Change (%)	FY2004 ended Mar 31, 2004	FY2003 ended Mar 31, 2003	Change (%)	FY2005E ended Mar 31, 2005
Sales	916.0	192.9	204.2	(5.5)	880.5	859.0	2.5	1,025.0
Other Income	15.0	2.1	11.0	(80.9)	12.6	19.9	(36.7)	15.0
Turnover	931.0	195.0	215.2	(9.4)	893.1	861.0	3.7	1,040.0
Total Expenditure	829.0	232.7	246.8	(5.7)	828.3	786.3	5.3	917.0
Operating Profit	87.0	(37.7)	(31.6)	19.3	52.2	72.7	(28.1)	123.0
Interest	56.5	1.8	(0.7)	-	42.2	60.2	(29.9)	55.0
Depreciation	30.5	8.3	7.5	10.7	32.0	31.4	1.9	30.0
PBT	15.0	(47.8)	(38.4)	24.5	(9.4)	1.0	-	53.0
Tax	-	(8.6)	(11.8)	(27.1)	(9.0)	(10.1)	-	16.0
PAT	15.0	(39.2)	(26.6)	47.4	(0.4)	11.1	-	37.0
Equity	55.8	55.8	55.8		55.8	55.8		55.8
EPS (Rs)	2.7	-	-		-	2.0		6.6
OPM (%)	9.5	(19.5)	(15.5)		5.9	8.5		12.0
NPM (%)	1.6	(20.3)	(13.0)		-	1.3		3.6

Eveready Industries has turned in numbers well below our estimates, both in terms of the top line and the bottom line. If we look at the segment-wise results, the reason becomes quite apparent. An even poorer than estimated performance by the tea division. We had estimated this division to turn in a loss of Rs10 crore at the profit before interest and tax (PBIT) level, the top line being Rs330 crore. However the actual performance has been a loss of Rs25 crore at the PBIT level, the top line being Rs302 crore.

The main story of the company having a strong operating and financial run starting FY2005, however, remains intact. Tea prices have recorded a strong recovery at the auctions in the current year and Eveready, with the quality of its produce enjoying the highest premium rating, stands to reap maximum benefits as a result. Moreover the management has gone on record about its intention to tap its strong distribution network to launch a number of non-durable products starting this financial year.

Splitting of the company

With the fortunes of the tea division reviving after a long gap of over four years, the management has decided to split the company along two business lines: the fast moving consumer goods (FMCG) business and the bulk tea business. The FMCG company, which would retain the Eveready Industries name, would handle the batteries, flashlights and packet tea business lines besides getting into new non-durable product categories. The bulk tea business would be hived off into Mcleod Russel, the erstwhile tea business unit of the company.

While the details of the scheme are yet to be outlined by the management, the equity of Rs55.8 crore would be evenly split into Rs27.8 crore for each new company, the face value being Rs5 for each share of each company, against the earlier Rs10 for each share of the company. The total capital employed of Rs900 crore would be split into Rs490 crore for the FMCG business and Rs410 crore for the bulk tea business. The break-up of debt allocation is yet to be declared and would be evident in the Balance Sheet for FY2004. It is obvious, therefore, that while the call on the positive financial performance of the unified company in FY2005 stands intact, the allocation across the two components would have to be worked out after obtaining the details of the de-merger from the management.

Sterlite Industries

Emerging Star

Result Update

June 16, 2004

Proves the mettle

Buy; CMP: Rs420

Sterlite's earnings after extra-ordinary items grew 124% year-on-year to Rs434 crore in Q4FY2004, sharply higher than our estimate, mainly due to a strong performance in the zinc business. This business did extraordinarily well, thanks to lower employee costs and better efficiencies from raw material usage and the power plant. Sterlite has also cleaned its balance sheet by writing off Rs447 crore for bad debts, losses in investments, and the VRS expenses of subsidiaries Balco and Hindustan Zinc. Going forward, we expect non-ferrous metal prices to remain firm over the next 12 months, driven by robust demand from China and dwindling inventories of copper and aluminium. Sterlite is currently trading at a PER of 6.4, and EV/EBITDA of 5.0 on FY2005E. Given Sterlite's attractive valuations and global-sized metal capacities that would benefit from firm prices, we maintain a Buy on the stock.

Sales increase 34%...

Net sales of Sterlite Industries grew 34% year-on-year to Rs884.4 crore in Q4FY2004, driven by a 61% year-on-year rise in copper prices (to US$2,701/tonne).

...though operating margins drop

Operating margins dropped 4.80%, mainly due to a sharp fall in treatment charges (TC)/refining charges (RC) margins to 7 cents per pound during the quarter. Spot TC/RC margins were much lower at 1.5 cents per pound during the quarter. Average TC/RC margins, however, were higher at 7 cents per pound, thanks to supply of copper concentrates from Sterlite's captive mines in Australia (which accounts for 35% of Sterlite's total requirement).

Cleaning up the balance sheet

Sterlite has written off Rs165 crore during Q4FY2004. This comprises Rs79 crore for loss in value of investments, Rs47.5 crore for advances given to fully-owned subsidiary Sterlite Paper and Rs38.5 crore for impairment of plant and machinery at the company's Lonavala and Sanaswadi units. Sterlite has taken the write-off directly to the balance sheet and adjusted them against its general reserves.

Retirement of high cost debt...

Interest cost fell 26.9% year-on-year to Rs26.7 crore in Q4FY2004, driven mainly by replacement of high-cost debt by a convertible bond issue (with a coupon rate of 1.5%). Depreciation remained flat at Rs28.3 crore in Q4FY2004, as the capacity expansion of the copper smelter was commissioned towards the end of March, 2004.

... improves overall profitability

Overall, Sterlite's stand-alone net profit grew 21% year-on-year to Rs73.3 crore in Q4FY2004 and by 18% to Rs197 crore in FY2004.

Sterlite (consolidated) results

Sterlite's consolidated revenues grew 30% year-on-year to Rs5,715 crore in FY2004, driven by strong performance of the zinc and lead businesses. The table below details volumes of each business:

Sterlite stand-alone reslults:

Year to 31 March (Rs cr)	Q4FY2003	FY2003	Q1FY2004	Q2FY2004	Q3FY2004	Q4FY2004	FY2004
Net Sales	661.4	2,207.9	594.6	769.7	821.2	884.4	3,069.8
Growth (% yoy)	-	39.0	28.0	45.0	6.0	34.0	39.0
Total expenditure	539.0	1,774.7	505.7	676.9	719.1	763.3	2,665.1
EBITDA	122.4	433.2	88.9	92.8	102.0	121.1	404.8
OPM (%)	18.5	19.6	14.9	12.1	12.4	13.7	13.2
Other income	7.3	18.0	3.0	4.5	3.3	5.7	16.5
Interest	36.5	151.0	31.8	25.7	31.8	26.7	116.0
Depreciation	28.2	105.9	26.6	26.8	26.7	28.3	108.4
PBT	65.1	194.3	33.5	44.9	46.8	71.7	196.8
Tax	1.5	11.7	1.8	2.1	2.2	4.1	10.2
Deferred tax	3.0	14.9	1.2	0.2	-6.2	-5.7	-10.5
Tax rate (%)	7.0	14.0	9.0	5.0	-8.0	-2.0	0.0
Adjusted profit after	60.6	167.7	30.5	42.5	50.8	73.3	197.1
extraordinary items Growth (% yoy)	-	84.0	2.0	3.0	42.0	21.0	18.0
EPS (Rs)	13.6	37.9	8.5	11.9	7.1	10.2	27.4
Equity	36.0	36.0	36.0	36.0	72.0	72.0	72.0

Sterlite Industries has written off Rs447 crore on account of VRS expenditure for Balco (Rs71.18 crore) and Hindustan Zinc (Rs210.1 crore), Rs79.0 crore for loss in value of investments, Rs47.5 crore for advances given to fully-owned subsidiary Sterlite Paper Limited and Rs38.5 crore for impairment of plant and machinery at the Lonavala and Sanaswadi units. Rs165 crore of these write-offs have been directly adjusted against the company's reserves, which means the net write-off in the books is about Rs280 crore.

Overall, Sterlite's consolidated net profit before extraordinary items grew 269% year-on-year to Rs717 crore. After extraordinary items, net profit is up 124% at Rs434 crore in Q4FY2004.

Sterlite Industries raising funds through a rights issue of Rs2,000 crore

Sterlite Industries has finalised the terms for its rights issue at Rs550 per share to raise Rs1,960 crore. The ratio for the rights issue is one share for every two shares held by investors. These terms are different from the earlier one-a share price band of Rs670-810, at a ratio of 3 shares for every 10 shares held by investors. The rights issue would channelise the funds raised by Vedanta Resources (the holding company of Sterlite Industries) into Sterlite Industries, which can be invested in subsidiaries like Balco and the alumina refinery project.

We raise FY2005 earnings estimate by 11%, reiterate Buy

We have upgraded our EPS estimate for Sterlite by 11% to Rs64.7 for FY2005 in view of lower costs and better efficiencies in the zinc and copper businesses. Sterlite is currently trading at a PER of 6.4, and EV/EBITDA of 5.0 on FY2005E. Given Sterlite's attractive valuations and global-sized metal capacities which would benefit from firm prices, we maintain a Buy in the stock.

Volumes (Tonnes)	FY2004	FY2003	% chg yoy	Q4FY2004	Q4FY2003	% chg yoy
Balco	97269	96095	1.2	24485	-	-
Zinc	225336	207066	8.8	56599	55687	1.6
Lead	33705	39314	-14.3	7476	10302	-27.4

Metal prices during the quarter are in the table below:

US$/tonne	Aluminium	Copper	Lead	Zinc
Q4FY2004	1667	2702	818	1087
Q4FY2003	1392	1682	466	803
yoy growth (%)	20	61	75	35
FY2004	1498	2045	606	915
FY2003	1364	1603	454	815
yoy growth (%)	10	28	33	12

Sterlite consilidated reslults:

Year to 31 March (Rs Cr)	FY2003	Q1FY2004	Q2FY2004	Q3FY2004	Q4FY2004	FY2004
Net Sales	4389.2	1192.9	1375.2	1528.0	1621.5	5714.9
Growth (% yoy)						30.0
Total Expenditure	3596.0	935.2	1105.3	1170.2	1125.3	4333.3
EBITDA	793.2	257.7	269.8	357.8	496.2	1381.6
OPM (%)	18.1	21.6	19.6	23.4	30.6	24.2
Other Income	138.3	30.2	45.9	31.9	54.9	160.0
Interest	180.6	40.3	31.4	39.6	32.8	144.5
Depreciation	301.8	66.6	71.4	72.4	68.3	278.7
PBT	449.2	180.9	212.9	277.7	450.0	1118.4
Tax	112.5	52.7	48.0	80.9	80.1	261.8
Deferred Tax	33.0	1.8	-0.3	-7.7	-69.4	-75.6
Tax Rate (%)	32.0	30.0	22.0	26.0	2.0	17.0
Reported PAT	303.7	126.4	165.2	204.5	439.3	932.2
Extraordinary items	1.2	-	-	0.0	282.1	282.1
Minority interest	108.4	54.8	68.9	58.7	33.0	215.3
Adjusted Profit After Extraordinary items	194.2	71.6	96.4	145.8	124.3	434.9
EPS (Rs)	54.1	20.0	26.8	40.6	34.6	121.1
Equity	36.0	36.0	36.0	72.0	72.0	72.0

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

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TVS Motors

Result Update

June 29, 2004

Merger gains; but pressure on growth evident

CMP: Rs70

The Q4FY04 and FY04 results of TVS Motors (TVSM) include the full year nos. for the merged engine components division of Lakshmi auto components ltd. (LACL) and are hence not comparable with previous results. For FY04, the consolidated entity has reported 4.3% growth in net sales to Rs2,820 crore, 5.4% growth in EBITDA to Rs259.4 crore and 8% growth in PAT to Rs138.4 crore. We believe that TVS, which is in the process of rebuilding its product portfolio is likely to face the heat as the competitive pressure intensify in the domestic 2-wheeler market.

Estimates for LACL engine component division

We estimate the turnover for engine components division of LACL at Rs100 crore for FY04. Considering OPM of 35% and net profit margin of 15%(last 7 quarters the avg. for LACL), the EDITDA and PAT for the division stood at Rs350 crore and 15 crore.

Sales grew by 4.3%

For FY04 TVS-M volumes grew by 2.45% driven by 24% growth in Ungeared Scooters segment. Motorcycle sales declined by 1.65% (against industry growth rate of 13.5%) whereas moped sales grew by 1%. Decline in motorcycle sales was due to sharp decline in 2-stroke entry-level bike *Max 100* and flagging sales of *Victor*. Some positives that emerged last year from TVS-M stable were success of 4-stroke ungeared scooters brand "*Scooty pep*" and growing moped sales against declining trend for the industry.

For FY04 sales for the consolidated entity grew by 4.3% to Rs2820 crore aided by contribution from engine component division.

Margins remained flat

For the full year TVS-M had OPM of 9.2%--10 bps improvement over FY03. This was primarily due to high margins in engine component business (approximately 35%) as compared to 2-wheeler business of standalone TVS-M (approximately 8-9%). For the consolidated entity EBITDA for the full year grew at slightly higher 5.3% to Rs259.4 crore. Knocking of our estimated Rs35 crore contribution of engine component division, EBITDA for the standalone entity declined by 8.8% to Rs224.3 crore.

Net profit grew by 8%

Net profit grew by 8% to Rs138.4 crore aided by sharp jump in other income (Rs36.2 crore against 20.5 crore in FY03) and 61% drop in interest expenses. We estimate that engine component division to have contributed approximately Rs15 crore to the bottom-line for the full year FY04. Ignoring this contribution PAT for standalone TVSM would have declined by3.3% to Rs123.4 crore.

New product launches

TVS-M recently launched 125cc variant of *Victor* in some of the markets. The bike has been aggressively priced and would be available across the nation by July 04. Apart from this to complete its product portfolio the company would be launching entry-level 4-stroke bike *Max 100R* by October 2004. This will help complete the product portfolio for TVS-M across the 2-wheeler segments. However the concern regarding the cannibalization of sales of 110 cc variant of *Victor* by the company's latest offering *Centra* remains.

Outlook for FY05

We believe that the company, which is still trying to rebuild its product portfolio, is likely to face the heat with increased competition in 2-wheeler industry with the eminent entry of Honda in the domestic market. The company has also postponed its proposed foray in the ASEAN market and the launch of the 3-wheelers to next year. Despite the 26.3% drop in bike sales for the company

Year to March 31(Rs cr)	Sales	yoy change	Net profit	yoy chg	EPS (Rs)	PER (x)
2001	1821.0	12.7%	62.6	-28.4%	2.6	26.5
2002	1930.2	6.0%	53.6	-14.5%	2.3	31.0
2003	2705.1	40.1%	127.6	138.2%	5.4	13.0
2004	2820.2	4.3%	138.4	8.5%	5.8	12.0
2005E	3002.3	6.5%	150.6	8.8%	6.3	11.0
2006E	3301.6	10.0%	165.7	10.0%	7.0	10.0

Note: From FY04 onwards nos. are for merged entity.

in the first two months of FY05, we have assumed 10% volume growth in motorcycles segment for the full year, allowing for fair degree of success for the company's proposed new launches. We estimate 13.8% and 3.5% volume growth in ungeared scooters and mopeds segment respectively for the full year.

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

Tata Tea

Result Update

June 25, 2004

Positive surprise in profits on strong revenue growth

CMP: Rs349

Tata Tea's FY2004 net profit (consolidated) has beaten our expectation by 6%, with growth of 81% to Rs210 crore. The growth in profits was on the back of a robust 5% growth in revenues (Rs3,085 crore), and a 19% growth in operating profits (Rs515 crore). We are impressed with the performance of Tetley, which now accounts for 74% of the company's overall revenues and 56% of its profits. Tetley's profits posted a strong growth on the back of a better cost structure as well as a 71% decline in interest costs. Consolidated EPS stood at Rs36.5, up 148%, due to lower losses in Rallis, an associate company. Note that the company's result is for 13 months, because of an extension of the accounting period.

Tata Tea continues to make its transition from a producer of tea to a marketer with global presence. We believe that this transition will continue to drive the company's re-rating, boosted by the company's entry into new geographies, and a clear focus on brands, which currently constitute 86% of its revenues.

The company's domestic business is unlikely to see any significant revival beyond the price cyclicality of teas, although productivity continues to improve. Our key concern on the domestic business is that tea has become a low-involvement category, making Tata Tea's brand more of a commodity. This is Tata Tea's biggest challenge—to continue to entice the tea-drinking consumer.

Ample growth opportunities for both Tata Tea and Tetley

Tata Tea's transformation to a marketer of tea is now complete. Even in the worst years (with steep declines in tea prices), Tata Tea has delivered steady performance. Going ahead, there are ample growth opportunities, with most of domestic brands back on the growth track and firming up of tea prices. Tetley is also focusing on increasing the business with a two-pronged strategy of exploring new geographic areas as well as introduction of new products catering to the needs of new segments—ready-to-drink beverages and fruit herbs, etc. In fact, Tetley has introduced 50 new products in the recent past, in line with its objective to increase product offerings. The company has recently extended its operations to Russia, Pakistan and Bangladesh, in addition to Western Europe (Estonia, Denmark and Greece). But even then, the company said it covers only 35% of the target tea drinkers' market.

Tetley is now a great cost side story

Tetley, which until now was a topline-growth story, is now more of a cost-side story. During FY2004, Tetley improved its operational efficiencies by closing a few factories in the USA and Australia, and financial restructuring (pre-payment of debt). Net debt in Tetley stood at £145 mn,

Tata Tea standalone numbers

Year to 31st Mar (Rs cr)	1Q FY03	1Q FY04	YoY%	2Q FY03	2Q FY04	YoY%	3Q FY03	3Q FY04	YoY%	4Q FY03	4Q FY04	YoY%
Net Sales	185.2	183.0	(1.2)	190.6	203.8	6.9	191.4	204.0	6.6	193.5	197.3	1.9
Operating profit	35.8	37.2	4.0	50.6	52.7	4.1	30.4	30.0	(1.4)	(9.0)	0.6	(106.7)
Interest	5.4	2.3	(57.2)	3.4	2.3	(31.9)	2.6	2.8	9.0	3.1	2.5	(18.0)
Depreciation	5.2	5.4	3.4	5.6	5.8	3.0	5.5	5.4	(1.6)	6.3	5.4	(14.0)
Non-op income	9.0	12.4	37.6	7.9	8.0	0.5	5.0	2.9	(41.5)	29.3	31.8	8.5
Profit before tax	25.1	29.5	17.3	41.6	44.6	7.1	22.4	21.8	(2.6)	11.0	24.5	122.3
Taxation	5.8	7.1	23.8	10.9	9.6	(11.2)	5.4	6.2	15.4	7.5	5.7	(24.2)
Tax rate (%)	23	24		26			24	2.9		68	23	
Profit after tax	19.4	22.3	15.4	30.8	35.0	13.6	17.0	15.6	(8.2)	3.5	18.8	437.1
Net margin (%)	10.4	12.2		16.2	17.2		8.9	7.6		1.8	9.5	
No. of shares (m)	5.6	5.6		5.6	5.6		5.6	5.6		5.6	5.6	
EPS (Rs)	3.4	4.0	15%	5.5	6.2	14%	3.0	2.8	-8%	0.6	3.3	437%

down £65mn yoy. Pension liability, earlier a concern, is now longer a big overhead, with the liability being capped at £18mn, against £29mn in FY2003. Cash flow from operations has increased to £42.7mn, up £5.3mn yoy.

Tetley Performance - led by increase in market share

Going ahead, we believe greater contribution will start coming from three new countries—Russia, Bangladesh and Pakistan. Our belief is based on the company's plan to increasing the penetration in these three major tea-drinking countries (Russia: 8,000 distribution network by September 2004, Bangladesh: 30,000; and Pakistan: 60,000).

India operational performance: Better than it seems

Tata Tea posted a profit of Rs91.5 crore, up 30% yoy. Interestingly, this performance was achieved despite negative contribution from plantation side, which points towards increased contribution from the branded products both in value and volume terms. Tata Tea's market share in the domestic market has started to inch up, and presently stands at 19.3%.

Our interaction with the trade: Positive direction

Our interaction with the trade continues to indicate that there is a strong turnaround happening in the sector. The macro factors all seem to be favourable—lower production, negligible stocks, higher exports, and potentially better prices. We see all pointers towards a buoyant tea market in coming periods.

Tetley Performance - led by increase in market share

Key operating nations	Market share	Comment
UK	28.4%	Has attained leadership position, taking over PG Tips (Unilever). This was achieved on account of changed promotion environment and retailer consolidation. Growth of 13% yoy.
USA	10.5%	Low brand equity but a big opportunity for growth, considering it was only the first year of operation.
Canada	21.3%	Market leadership, but an increasingly competitive market. Growth was led by increase in specialty products. Growth of 11% yoy.
Australia	20.8%	Inching towards market leadership—has become the 2nd largest brand. Sales were higher on account of better product mix, reduced cost of operation.

Key direction	Jan-April 2004	Comment
Production	Lower by 30 mn kgs	Adverse weather conditions have led to lower production. Thrust towards quality crop produce and sale.
Exports	Up by 7 mn kgs	New markets such as Iraq, Pakistan and Iran can potentially absorb 70mn kgs of Indian teas annually.
Carry forward Stocks	Negligible	Huge reversal from earlier years of huge surpluses.
Prices	Flat but reflects a rising trend	First quarter of calendar year shows a 5.4% drop in average prices; however, the new season from April has shown a firming trend. Iraq order for nearly 50mn kg is for low orthodox and broken teas, which will pull out lower-end teas from the market and will firm up domestic prices for high-grade teas.

Year to 31 March	2002	2003	2004	2005E	2006E
Shares in issue (cr)	5.6	5.6	5.6	5.6	5.6
EPS (Rs)	17.5	19.4	38.9	45.8	53.7
EPS growth (%)	0.4	10.8	99.8	17.8	17.4
PER (x)	19.4	17.5	8.8	7.4	6.3
EV/ EBITDA (x)	9.5	10.0	6.5	5.5	4.3
EV/ sales(x)	1.1	1.0	1.0	0.9	0.7
Book value (Rs/ share)	199	205	206	238	278
Price/ BV	1.7	1.7	1.6	1.4	1.2
ROCE (%)	9.1	10.6	7.4	10.5	11.4
RONW (%)	9.9	10.0	9.8	18.8	20.6
Dividend yield (%)	2.6	3.2	3.2	3.5	3.8

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

Videsh Sanchar Nigam

Result Update June 23, 2004

Weak results, further downside in Q1FY2005 **CMP: Rs136**

VSNL's Q4FY2004 result was in line with expectations. After a steady decline over the last 4-6 quarters, there was a semblance of stability in the net retentions on incoming ILD calls. This, however, was not enough to prevent a yoy decline in earnings in Q4FY2004—operating profit was down 28.7% yoy, whereas profit before tax was down 50.7% yoy (before the extraordinary charge for VRS) on account of lower other income. Net profit was down 54.1% yoy during the quarter, resulting in full-year EPS of Rs13.5 in FY2004.

Some observations on the results

The company has stopped disclosing traffic data; our estimates put VSNL's traffic at 60-65 crore minutes during the quarter. Bharti, Reliance, and Data Access continued to eat into VSNL's share during the year, especially in incoming calls.

VSNL's current net retention on incoming calls is estimated at about Rs1.0/min (gross settlement rate minus the domestic interconnect cost). The cut in the ILD termination cost in new IUC regime did not benefit the domestic ILD operators, as it had to be passed through to the foreign carriers.

We estimate the outgoing traffic to have grown at 20-25% during the quarter on account of the price elasticity effect post the ILD tariff cuts since November 2003. Our interactions with the MTNL management confirmed this. Outgoing traffic growth as well as healthy profitability on outgoing calls continues to be VSNL's saviour during FY2004.

VSNL had Rs1,500 crore of cash and bank balance as on March 31, 2004, down from Rs2,300 crore last year. The company incurred a capex of Rs800 crore in FY2004 including investment in Tata Teleservices (Rs200 crore) and expenditure on Chennai-Singapore cable and NLD. It has already incurred about 60% of the total proposed capex of US$120mn on the Chennai-Singapore undersea link. The company also acquired Dishnet for a total consideration of Rs2.7bn during the year.

Lower cash balance as well as dip in interest rates led to a sharp fall in other income-from Rs70.2 crore in Q4FY2003 to Rs35.1 crore in Q4FY2004, which was partly responsible for the sharp decline in pre-tax profits.

Transition not fully complete, earnings to decline further in FY2005

We expect VSNL's EPS to decline 21.9% to Rs10.6 in FY2005, mainly on account of the decline in outgoing ILD retentions. Though the entry of MTNL and BSNL in ILD remains unclear, the downside on outgoing retentions has already materialised after the conclusion of BSNL tender in March 2004. We believe that FY2005 may mark the bottom in VSNL's transition from monopoly profits to a business model based on commoditised minutes at wafer-thin margins. Also, the revenue growth from data (IPLC, Internet, leased lines, etc.) will not be enough in our opinion to prevent further earnings decline in FY2005.

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Oil and Natural Gas Corporation

Result Update June 22, 2004

Earnings drop 46% due to higher subsidy burden **CMP: Rs621**

ONGC's Q4FY2004 earnings came in short of our expectations as higher subsidy burden and depreciation charges led to 46.0% yoy decline in net profit. The end of year price adjustment in Q4FY03 accentuated the decline in headline profit number. Even if the present subsidy sharing mechanism continues in FY2005, we believe the impact will remain manageable after the recent decisions of the government and likely changes in the import duty structure. The current discount in ONGC's valuations (on EV/boe) will narrow with the increased political willingness to resolve the LPG/SKO shortfall as well as effect of gas-price hikes (recent coal price hike is an indicator). Besides, ONGC will be a net gainer for every rise in crude price.

Results below expectations

ONGC's Q4FY2004 result—a net profit decline of 46.0% yoy—fell short of our expectation. The main reason for the shortfall was higher subsidy burden (Rs2,690 crore against our expectation of Rs2,600 crore for the full year) and higher depreciation charges. Besides, other expenses also increased by Rs400 crore on a sequential basis during Q4FY2003. The yoy decline in the headline profit number was accentuated on account of the accounting of difference between final price (agreed with downstream oil companies) and the provisional price in Q4 of that year.

FY2005 earnings to be supported by higher crude, manageable subsidies

The government's recent decision to cut excise duty on LPG (from 16% to 8%), increase retail prices (by Rs20/cyl) and likely increase in government's contribution (from Rs3,500 crore currently to Rs6,000-7,000 crore) is likely to offset the incremental increase in subsidy burden. For example, at prevailing crude prices of US$33-34/bbl and reduced contribution from the government, the shortfall on LPG is likely to touch Rs135/cyl in FY2005. However, the recently announced decisions coupled with likely increase in government's contribution (from Rs22.5/cyl to Rs45/cyl) will offset the shortfall by Rs50/cyl, thus bringing it in line with the levels witnessed in FY2003 ie Rs90/cylinder. In effect, therefore, ONGC is likely to fetch higher realisation for its crude oil (net of discount for the cooking fuel subsidy) in FY2005 vis-à-vis FY2004. Our earnings estimate of Rs68.2 for FY2005 reflects a yoy growth of 12.2

Upstream a better bet, buy ONGC

We believe that upstream assets (ONGC, GAIL) are more immune to policy level changes in the subsidy policy as well as flexibility on auto fuels. Each dollar-per-barrel increase in crude price increases the LPG/SKO burden by an estimated Rs900 crore. Even if ONGC is made to pay 50% of the incremental subsidy shortfall, it still results in an incremental gain of US$0.46/bbl.

Key financials

Year to March 31 (Rs cr)	Net sales	yoy chg (%)	Net profit	EPS (Rs)	yoy chg (%)	PER (x)
2003	34,277.3	47.5	10,529.3	73.8	69.9	8.4
2004	32,063.9	(6.5)	8,664.4	60.8	(17.7)	10.2
2005E	34,018.9	6.1	9,718.6	68.2	12.2	9.1
2006E	35,857.7	5.4	10,290.3	72.2	5.9	8.6

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Hindustan Zinc

Result Update June 15, 2004

Beats expectations on better efficiencies

CMP: Rs80

Hindustan Zinc's Q4FY2004 result is much better than our expectation, mainly on account of better efficiencies in raw-material consumption and lower power cost. The VRS in FY2003 also led to a reduction in employee costs for FY2004. Operating margins rose sharply to 58% during the quarter, driven mainly by a rise of 35% yoy in zinc prices, and 75% yoy in lead prices. HZL had an unamortised VRS cost of Rs210.9 crore on 31 March 2003, to be written off over five years, but the company has written it off entirely in Q4FY2004. Even then, HZL's net profit before extraordinary items rose 532% yoy to Rs296 crore in Q4FY2004; after extraordinary items, the net profit is up 72% yoy to Rs85.9 crore. We have upgraded our FY2005 EPS estimate by 12% to Rs13.7, in view of the higher-than-expected process efficiencies and lower power cost. These cost efficiencies coupled with strong volume growth would drive a CAGR of 34% in HZL's earnings over FY2004-FY2006.

Zinc volumes up 2.8% yoy in Q4FY2004

HZL's zinc volumes rose by 8.8% yoy to 225,336 tonnes in FY2004, and by 2.8% yoy in Q4FY2004. Lead volumes, on the other hand, declined by 14.3% yoy in FY2004 and by 27% yoy in Q4FY2004, due to a permanent shutdown of one of its high-cost smelters.

Rise in zinc prices drives increase in tolling volumes

HZL sells its mined zinc concentrate to other producers and buys back the zinc metal produced from the concentrates. This tolling enables HZL to capture the value addition on its surplus mine output, which it cannot convert into metal for want of additional capacity. These tolled volumes have increased to 25,000 tonnes (11% of HZL's total sales volumes), driving a rise in HZL's sales in FY2004.

Net sales up 27% in FY2004, driven by higher realisations

Despite muted growth of volumes in FY2004, net sales grew by 27% to Rs1842 crore, as average realisations for zinc rose by 12%. In Q4FY2004, on the other hand, sales rose 3% yoy to Rs517 crore despite the 27.4% yoy fall in lead volumes, driven by firm prices of zinc and lead.

Operating margins rise substantially to 58.4% in Q4FY2004

HZL's operating margins increased substantially to 58.4% in Q4FY2004 and to 42% in FY2004. This margin expansion is due to two factors: better efficiencies in the process (raw material consumption) and lower power cost (due to captive power plant); and lower employee cost following a VRS, which reduced headcount by 30%. Tolling of zinc concentrates also aided the margin expansion.

Change in provisioning of employee costs

HZL had an unamortised VRS cost of Rs210.9 crore on 31 March 2003, to be written off over five years. However, the company has entirely written it off in Q4FY2004. If the company had not changed the accounting policy, Rs57.7 crore would have been charged to the P&L account for FY2004, as VRS expenditure and the balance Rs153.2 crore would remain on the balance sheet as unamortised expenditure; the net profit for Q4FY2004 would then have been higher to that extent.

In FY2004, HZL incurred an employee cost of Rs166 crore. In the first nine months of FY2004, the company had already provided for Rs171 crore, which included pro-rata VRS expenditure. HZL changed its accounting policy in Q4FY2004, and wrote off the entire VRS expense of Rs210 crore. In Q4FY2004, the company wrote back the amortised VRS expenditure in the first nine months, and hence had a negative employee cost of Rs4.3 crore.

Net profit increases by 72% yoy in Q4FY2004

Despite the changes in accounting policies and lower volume growth during Q4FY2004, HZL's net profit after extraordinary items grew by 72% yoy to Rs85.9 crore in Q4FY2004 and to Rs404.6 crore in FY2004. Net profit before extraordinary items rose 532% yoy to Rs296 crore in Q4FY2004.

HZL's volumes

Year to 31 March (tonnes)	FY2004	FY2003	% chg yoy	Q4FY2004	Q4FY2003	% chg yoy
Zinc	225,336	207,066	8.8	56,599	55,035	2.8
Lead	33,705	39,314	-14.3	7,476	10,302	-27.4
Total Volumes	222,219	246,380	-9.8	64,075	65,989	-2.9

Year to 31 March (Rs cr)	Q4FY2003	FY2003	Q1FY2004	Q2FY2004	Q3FY2004	Q4FY2004	FY2004
Net Sales	501.0	1,452.0	426.8	429.5	497.7	517.2	1,841.5
Growth yoy (%)	*23*	*2*	*31*	*22*	*41*	*3*	*27*
Total Expenditure	433.8	1,221.7	297.4	294.0	291.0	215.0	1,067.8
EBITDA	67.2	230.4	129.3	135.5	206.7	302.2	773.7
Growth yoy (%)	*10*	*59*	*213*	*182*	*179*	*350*	*236*
OPM (%)	13.4	15.9	30.3	31.5	41.5	58.4	42.0
Other Income	23.7	76.0	16.3	24.0	17.8	36.3	94.4
Interest	0.1	0.3	0.1	0.1	0.2	0.3	0.7
Depreciation	28.0	76.7	17.1	18.0	17.7	19.0	71.8
PBT	62.9	229.4	128.5	141.4	206.6	319.2	795.6
Growth yoy (%)	*5*	*120*	*261*	*150*	*177*	*408*	*247*
Tax	14.1	85.4	43.8	49.5	70.2	88.8	252.2
Deferred Tax	1.8	1.8	- 1.0	- 2.7	2.0	- 66.4	- 72.1
Tax Rate (%)	25	38	33	33	35	7	23
Reported Profit After Tax	47.0	142.2	85.7	94.6	134.4	296.8	615.5
Extra-ordinary Items	-	-	-	-		210.9	210.9
Adjusted Profit After Extra-ordinary item	47.0	142.2	85.7	94.6	134.4	85.9	404.6
Growth yoy (%)	21%	109	220	204	259	83	185

US$/ tonne	Lead	Zinc
4Q FY04	818	1087
4Q FY03	466	803
yoy growth	*75*	*35*
FY04	606	915
FY03	454	815
yoy growth	*33*	*12*

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

IVRCL Infrastructure Projects

Result Update June 11, 2004

Strong growth in order book

CMP: Rs198

IVRCL's Q4FY2004 result is in line with our expectation. Revenues grew by 76% to Rs770 crore in FY2004, driven by a strong order book. As a result, pre-exceptional earnings grew by 96% to Rs30.4 crore in the fiscal. Operating margins, however, declined by 150bps in FY2004, as the company booked losses of Rs3.2 crore for the sale of its MKDC bonds. The order book has grown to Rs1,700 crore (or 2.3x FY2004 annual revenues) as at end-FY2004.

Net sales rose by a robust 76% yoy to Rs770 crore in FY2004, driven by a strong order book. As a result, EBITDA grew by 48% yoy to Rs63.6 crore in FY2004. Margins, however, were down 150bps, as the company booked Rs3.2 crore as losses on its MKVDC (Maha Krishna Valley Development Corporation) bonds. The loss on investment is clubbed with other expenditure in the books, thus overstating the fall in operating margins.

Depreciation in FY2004 was 24% higher at Rs9.8 crore, as the company made additional provisions for impairment of certain assets. These provisions amounted to Rs2.85 crore in FY2004, of which Rs1.36 crore was in Q4FY2004.

The tax rate was lower in Q4FY2004 than in the first three quarters, in which the company had made higher tax provisions. These provisions were written back in the fourth quarter.

As a result, pre-exceptional profits grew by 96% to Rs30.4 crore in FY2004.

A write-back of earlier years' tax provisions (Rs8.8 crore) led to a rise of 153% yoy in FY2004.

We are not changing our earnings estimates for FY2005.

IVRCL raised Rs78 crore from private equity investors. IVRCL has raised Rs78 crore from private equity investors Citicorp International Finance Corporation (a unit of Citigroup Global Investments, USA) and ChrysCapital II, LLC, Mauritius. Each of these two entities bought 3.12mn shares, through a fresh issue of shares amounting to a 37% dilution in equity. The additional funds would be used by IVRCL to de-leverage its balance sheet and also to prop up its net worth to around Rs200 crore, which is the main financial criterion for pre-qualification for high-value projects. In addition to the above investment, promoters have subscribed to 0.40mn warrants at the rate of Rs125 each. The warrants are convertible any time over the next 18 months.

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Earnings Guide

Company	Price (Rs)	Sales (Rs cr) FY04	Sales (Rs cr) FY05	Net Profit (Rs cr) FY04	Net Profit (Rs cr) FY05	EPS (Rs cr) FY04E	EPS (Rs cr) FY05E	EPS (%) Growth FY05/FY04	PE (x) FY04E	PE (x) FY05E	ROCE(%) FY04E	ROCE(%) FY05E	RONW(%) FY04	RONW(%) FY05
Evergreen														
Hindustan Lever*	127.3	10,338.3	10,823.9	1,712.7	1,829.3	7.8	8.3	6.4	16.3	15.3	52.2	58.8	81.3	72.9
HDFC Bank	369.7	4,808.0	6,065.5	662.4	870.4	23.3	30.6	31.3	15.9	12.1	1.8	1.8	26.8	29.0
Infosys Tech	5,522.9	4,853.0	6,245.6	1,252.5	1,557.2	189.1	235.1	24.3	29.2	23.5	45.8	43.7	39.6	38.2
Reliance Ind	429.6	51,802.0	51,447.5	5,299.0	6,260.8	38.0	44.8	17.9	11.3	9.6	-	-	-	-
wipro	532.1	5,675.3	7,113.5	1,001.4	1,346.9	21.5	29.0	34.5	24.7	18.4	26.9	30.1	25.4	26.8
Apple Green														
ABB*	672.2	1,732.7	2,079.2	119.3	143.3	28.1	33.8	20.3	23.9	19.9	-	-	-	-
Bajaj Auto	884.6	5,085.7	5,776.4	741.6	806.4	70.6	79.7	12.9	12.5	11.1	21.1	21.5	21.1	19.9
Dr Reddy's	735.4	2,007.7	2,283.5	300.9	367.0	39.3	48.0	22.1	18.7	15.3	13.4	15.2	15.0	16.1
Gujarat Ambuja	284.5	1,902.1	2,095.6	307.4	418.2	18.8	23.8	26.6	15.1	12.0	11.1	13.3	13.9	15.6
Hero Honda	507.5	6,143.4	7,014.5	739.8	872.6	37.0	43.7	18.1	13.7	11.6	79.5	66.3	56.1	48.7
M & M	442.0	5,090.5	5,905.8	329.8	418.0	28.4	36.0	26.8	15.6	12.3	18.1	23.4	18.2	19.5
Maruti Udyog	402.6	8,975.1	10,845.0	621.2	911.5	21.5	31.5	46.5	18.7	12.8	22.5	29.5	18.0	22.7
Ranbaxy*	909.5	5,241.9	6,246.0	861.6	1,062.9	46.5	57.3	23.2	19.6	15.9	25.8	29.7	28.8	27.7
State Bank of India	430.7	10,410.8	11,671.2	3,826.0	4,525.8	72.7	86.0	18.3	5.9	5.0	1.0	1.2	20.2	19.9
Tata Motors	380.2	13,416.1	16,412.8	765.1	1,168.5	22.3	33.6	50.7	17.0	11.3	28.1	26.7	25.2	29.7
Sintex Ind	114.0	549.6	695.0	35.2	53.3	22.9	36.6	59.8	5.0	3.1	18.7	21.4	12.6	13.9
Balrampur Chini	290.2	731.5	855.5	29.5	57.3	30.2	51.7	71.2	9.6	5.6	16.9	24.2	22.7	31.0
Nichloas Piramal	775.8	1,387.2	1,653.7	223.4	256.8	58.8	67.6	15.0	13.2	11.5	27.9	31.1	54.6	51.3
Marico	121.6	889.0	1,008.2	59.0	70.0	10.0	12.1	21.0	12.2	10.0	29.2	35.2	30.0	35.2
IPCA	573.9	577.9	668.4	77.1	92.9	61.6	74.3	20.6	9.3	7.7	27.9	31.1	54.6	51.3
Corporation Bank	249.5	2,717.9	2,762.0	504.1	640.8	34.4	44.7	30.0	7.3	5.6	1.8	2.0	19.6	21.2
Oriental Bank	240.4	1,383.7	1,861.5	604.5	729.2	31.4	37.9	20.7	7.7	6.3	1.7	1.9	25.8	25.3
Emerging Star														
Welspun Gujarat	29.1	833.0	945.0	74.0	77.3	5.2	5.5	5.8	5.6	5.3	33.7	20.2	34.1	26.3
Welspun India	81.4	677.8	885.7	25.0	54.3	7.1	6.9	(2.8)	11.5	11.8	15.9	9.2	14.0	10.6
Moser Baer	179.5	1,511.8	2,010.9	353.3	443.4	31.7	39.8	25.6	5.7	4.5	15.5	16.9	23.3	24.9
Alok Industries	50.2	1,041.4	1,339.5	64.7	105.6	7.4	12.0	62.2	6.8	4.2	15.6	19.4	20.3	25.6
Aurbindo Pharma	325.2	1,629.4	1,979.5	124.7	165.9	23.4	31.1	32.9	13.9	10.5	16.6	19.3	19.9	19.2
Sterlite	441.6	6,827.9	8,439.0	621.8	776.2	51.3	59.9	16.8	8.6	7.4	15.2	12.9	23.0	17.0
Solectron Centum	60.8	44.5	92.5	6.8	17.8	4.6	12.1	163.0	13.2	5.0	4.6	32.9	4.6	40.9
Tata Metaliks	63.1	125.0	155.0	28.2	41.7	11.2	16.5	47.3	5.6	3.8	81.9	80.0	55.7	54.5
Ugly Duckling														
Satyam Comp	305.5	2,541.5	3,152.3	555.8	653.2	17.7	20.8	17.5	17.3	14.7	28.6	29.0	24.2	25.2
Tata Power	232.0	4,751.3	5,088.6	630.3	717.0	31.8	36.2	13.8	7.3	6.4	-	-	-	-
Orchid	184.6	677.8	885.7	25.0	54.3	7.7	16.8	118.2	24.0	11.0	7.5	9.2	6.2	12.5
Andhra Bank	42.6	1,588.6	1,584.3	463.5	641.8	11.6	16.0	38.1	3.7	2.7	2.0	2.2	31.9	37.6
Eveready	32.1	916.0	1,025.0	15.0	37.0	2.7	6.6	144.4	11.9	4.9	7.0	10.6	5.8	13.1
Bank of Baroda	150.1	4,057.8	4,021.3	1,017.0	1,191.1	34.6	40.5	17.1	4.3	3.7	1.3	1.5	21.3	21.3
HCL Tech	298.2	2,599.1	3,301.5	402.4	581.7	14.0	19.0	36.0	21.3	15.7	15.0	17.6	15.5	18.9
PNB	282.0	4,763.4	5,025.5	1,083.3	1,320.9	40.8	49.8	22.1	6.9	5.7	1.2	1.3	24.0	23.1
Union Bank of India	57.8	2,567.7	2,620.3	712.1	836.4	15.5	18.2	17.6	3.7	3.2	1.3	1.4	24.5	24.0
Jaiprakash Asso	102.6	3,171.1	3,695.9	234.7	313.4	13.3	17.8	33.8	7.7	5.8	12.2	14.2	21.7	23.5
Vulture's Pick														
MTNL	132.0	6,277.9	6,383.2	1,214.6	1,325.2	19.7	21.0	6.6	6.7	6.3	20.4	18.2	19.9	18.2
Indsil	19.1	58.0	64.5	1.0	11.5	1.1	12.2	1,009.1	17.3	1.6	15.1	33.6	8.0	64.1
Esab India*	52.8	1,357.6	2,041.0	7.0	110.0	0.5	7.1	1,320.0	105.6	7.4	6.1	42.1	2.6	35.3

* Year CY instead of FY
* Prices as on June 30, 2004

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