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*Every week, the ICICIdirect research team selects a stock based on fundamental and/or technical parameters, which is likely to give a return of 20% or more over a 3-6 month perspective.*

# ABC Bearings (ANTBEA)

| | |
|---|---|
| Current Price: Rs 156 | Target Price: Rs 203 |
| Potential upside: 30% | Time Frame: 9- 12 mths |

Restructuring of its businesses, repayment of high-cost debts and capacity expansion has brought ABC Bearings back on the growth track. With a bright outlook for the automobile industry its main customer along with improvement in the agriculture and upbeat mood in the manufacturing sector, the growth prospects of the company look promising.

## Background

Established in 1960, ABC Bearings (formerly known as Antifriction Bearings) manufactures taper and cylindrical roller bearings for commercial vehicles and tractors. The company has a technical tie-up with NSK ($4 billion in revenues) of Japan, which has helped the company on superior product development and product delivery. It has capacity of 640,000 units of roller bearing used in car, commercial vehicles and tractors. The company has three plants in Bharuch (Gujarat) and its major clientele include Tata Motors and Mahindra & Mahindra, along with other tractor manufacturing companies. Its main competitors are NRB Bearings, SKF India and FAG bearings.

## Investment Rationale

### Immense growth opportunity

Annual domestic bearing demand is around Rs 3,200 crore and is divided into two segments organized and unorganized sector. In the organized sector, there are 12 major players and innumerable units in the unorganized sector. Out of the total Rs 3,200 crore demand, one-third of the demand is met by imports while the rest is indigenously produced. Around Rs 1,900 crore of sales is met by the organized sector. The company has only a 5% share in the total market, but accounts for 8% of the market share for the organized market. The industry is growing at 17-18% annually and provided immense growth opportunity.

### Restructuring the growth booster

ABC Bearing has taken major restructuring steps in past 2-3 years like repayment of high-cost debts, shutting down low-margin ball bearing unit and shifting its Lonavala unit to Bharuch. This has resulted into CAGR of 28% in net sales and 131% in net profit over FY03- FY06. Though the shifting of Lonavala unit in the initial phase of first two quarters resulted in production losses, situation was stabilized in the first quarter of the current year. The shifting of the unit at Bharuch would likely to result rationalization of production and increasing the productivity.

Subsequent to the closure of the Lonavala plant, the company has repaid sales tax loan availed from Maharashtra government which has resulted into waiver of Rs 16 crore, which would help it cut down interest cost even further in coming years.

### Expansion to drive volume growth

The company has undertaken expansion project in the current year at capital expenditure (capex) of Rs 20 crore, which would increase its capacity by around 20% to 760,000 units by FY07. It also has plans to double the capacity in next two years with additional capex. The funding would be done partly from internal accruals and partly by borrowed funds. The company is currently operating at 80% capacity utilization and the capacity expansion would further boost the volume, supporting top line growth. The company is also exploring export opportunities and has targeted 20% of the revenues from exports in coming years.

## Financials

ABC Bearings reported a 17.8% growth in net sales to Rs 152 crore in FY06. Due to higher steel prices, the major raw material, EBITDA margins declined from 19% to 17.3%. The debt restructuring lead to improvement in net profit by 32.5% to Rs 16.9 crore. For the first 9 months of the current fiscal, the company reported a 22.6% growth in net sales to Rs 136.8 crore, while EBTDA margins improved drastically from 17.6% to 21.9%. Net profit grew by 44.2% to Rs 15.4 crore.
The company has given a 40% dividend in the last fiscal and is expected to continue the same in the current year. This translates into a dividend yield of 2.6%. Going forward, we expect company to report net sales of Rs 180 crore in FY07 and Rs 213 crore in FY08 with net profit of Rs 19.8 crore and Rs23.4 crore in FY08 translating into an EPS of Rs 17.1 and Rs 20.3 respectively.

**Key Financial Ratios**

| | 2006/03 | 2005/03 | 2004/03 | 2003/03 | 2002/03 |
|---|---|---|---|---|---|
| EPS | 13.6 | 9.98 | 5.38 | 1.26 | -4.12 |
| CEPS | 19.52 | 15.43 | 11.24 | 6 | -0.57 |
| Book Value | 41.36 | 32.32 | 25.76 | 22.07 | 20.81 |
| Dividend/Share | 4 | 3 | 1.5 | 0 | 0 |
| OPM | 20.45 | 21.71 | 21.8 | 17.24 | 11.21 |
| RONW | 49.43 | 39.4 | 32.29 | 11.89 | -9.16 |
| Debt/Equity | 0.72 | 0.72 | 1.13 | 1.74 | 1.97 |
| Ratio | 2.18 | 2.14 | 1.84 | 1.86 | 2.29 |
| Interest Cover | 14.06 | 10.99 | 6.31 | 2.65 | 1.15 |

## Valuations

The potential growth in the automobile industry would give the necessary fillip to the industry. The good performance of the tractor segment is expected to further improve the condition of the industry. In the current scenario, a good export market, coupled with improvements in the agricultural sector, and upbeat mood of manufacturing sector portends a promising future. The company is well-positioned to grab a higher market share on the back of expanded capacity with higher capacity utilization. At the current price of Rs 156, the stock is attractively valued at 9.1x FY07E and 7.7x FY08E EPS. One of the reasons for the lower valuation of the stock is its smaller size as compared to peers. However, as its top line increases, it will attract better valuation. We expect the stock to touch around Rs 203 in the next 9-12 months, valuing the same at 10x its FY08E EPS.

## Technical Outlook

The stock made a bottom at Rs 90 in May 2006 and then rallied to Rs 182. It has been consolidating since then and is trying to find support at the Rs 148 level. The RSI indicator is also moving into oversold territory and currently is at 44 (30 being oversold). Traded volumes have risen to above average, which signifies accumulation. The stock has the potential to rise to Rs 196, where it could face resistance.

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