

Atlas Copco

BSE SENSEX 9545.06	BLOOMBERG ATCP IN
S&P CNX 2798.80	REUTERS CODE ATLA.BO

15 June 2006

Buy

Rs1,050 (Ex Bonus - Rs525)

Equity Shares (m)	11.3
52-Week H/L (Rs)	2270/755
1,6,12 Rel. Perf. (%)	-23/-16/-9
M.Cap. (Rs b)	11.8
Avg. Daily Vol. ('000)	11.7

YEAR END	NET SALES (Rs m)	PAT (Rs m)	EPS (Rs)	EPS GROWTH (%)	P/E (x)	P/BV (x)	ROE (%)	ROCE (%)	EV/ SALES (x)	EV/ EBITDA (x)
12/05A	5,699	511	22.7	29.2	23.4	5.7	27.4	30.5	2.0	12.3
12/06E	6,838	666	29.5	30.3	17.8	4.5	28.4	36.8	1.7	9.4
12/07E	8,206	818	36.2	22.8	14.5	3.6	27.5	36.2	1.4	8.0

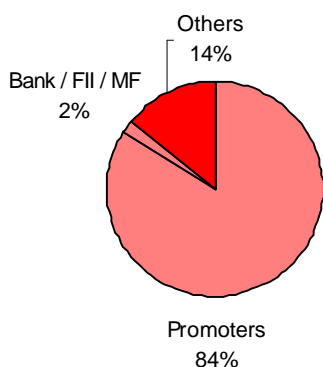


Investment Ideas for Private Clients

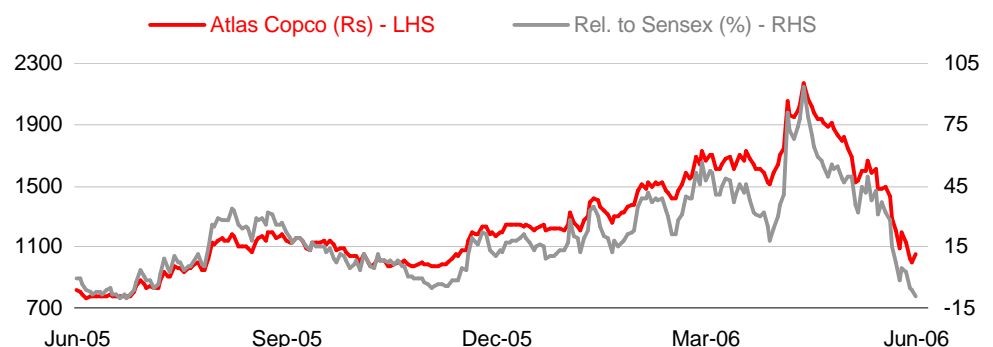
Atlas Copco India (ACIL) is an excellent play on India's construction and mining sectors. We expect new opportunities such as CBM (coal-bed methane) prospecting and CNG compressors to drive 30% EPS CAGR through CY07. We recommend **BUY**.

- **Major beneficiary of rising industrial capex :** ACIL has products like air & gas compressors and pneumatic tools which are required in most industries. We expect these products to register >20% CARG over the next 2 years on the back of huge expansion activity in sectors like power, automobiles, cement and steel.
- **Construction and mining boom to boost sales :** In 2004, ACIL acquired Ingersoll-Rand's drilling solutions business, further strengthening its mining equipment portfolio. Thrust on CBM (coal-bed methane) will also push demand for ACIL's high-end compressors.
- **Intermech acquisition will open up CNG compressor segment :** Atlas Copco has globally acquired Intermech Ltd of New Zealand, a leader in CNG compressors. ACIL is a potential beneficiary of India's CNG drive - a Rs8-16b opportunity over the next 5 years.
- **30% CAGR in EPS through CY07; reasonable valuation :** Robust topline growth and steady margins should lead to a 30% CAGR in EPS through CY07 for ACIL. The stock trades at the lower end of EV/EBITDA band relative to peers. We recommend **BUY** with a 15-18m price target of Rs725 (ex 1:1 bonus, 20x CY07E EPS of Rs36.2).

SHAREHOLDING PATTERN (%)



ATLAS COPCO VS SENSEX - LAST 1 YEAR



Investment Argument

Even when India's capital goods sector was in a recession during 1999 to 2003, Atlas Copco India (ACIL) registered a PAT CAGR of 27% CY98 through CY05.

We expect the company to sustain a similar performance going forward. Here are the key positives which could make this happen.

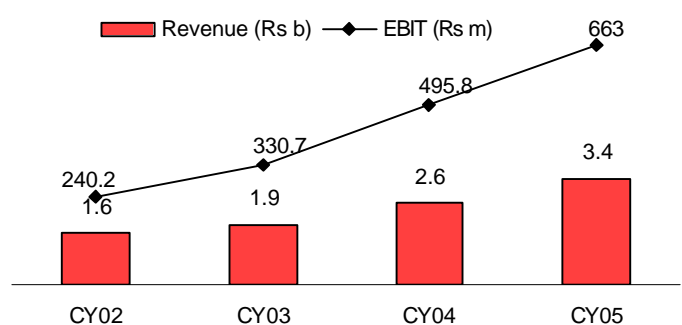
Major beneficiary of rising industrial construction activity

ACIL's industrial segment has the following products -

Products	Key markets
Air & gas compressors	General industry, power, textiles, cement, pharma
Pneumatic & electric tools	Automotive manufacturing & aftermarket

We expect this segment to register >20% CARG over the next 2 years on the back of huge expansion activity in sectors like power, automobiles, cement and steel.

GROWTH IN THE INDUSTRIAL SEGMENT



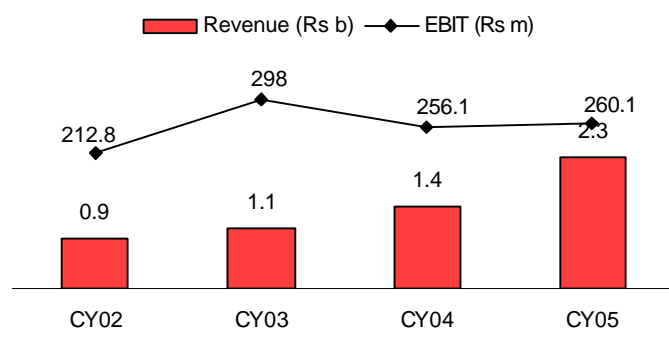
Source: Company / Motilal Oswal Securities

Background

Atlas Copco (India) Ltd is an 84% subsidiary of Atlas Copco AB, Sweden and is a leading maker of compressors and construction & mining equipment in India. ACIL makes the reciprocating, screw and centrifugal ranges of compressors. In the construction and mining segment, it manufactures underground, surface and geo-technical equipment and also rock and construction tools.

It amalgamated Chicago Pneumatic India Ltd with itself effective April 1, 2000. In 2004, it acquired the drilling solution business of Ingersoll-Rand (India) Ltd for Rs.1.38b. In 2005, ACIL bought Intermech Ltd, a New Zealand company which designs, makes and markets CNG compressors.

GROWTH IN THE CONSTRUCTION & MINING SEGMENT



Source: Company / Motilal Oswal Securities

Mining boom to boost sales : In September 2004, ACIL acquired the drilling solutions business from Ingersoll-Rand India for Rs1.38b. This has significantly strengthened its product range, to cater to the mining sector. We expect the Centre to deregulate mining for the private sector by end-2008, which should lead to significant investment activity.

Thrust on CBM will push demand for high-end compressors: Apart from general mining activity, several companies like Reliance, ONGC and Essar Oil have lined up massive prospecting plans for coal-bed methane gas (CBM).

CBM prospecting has huge business implications for both divisions of ACIL - drilling equipment (to get to the coal-bed) and high-end compressors (to compress and pipe up the gas).

CBM PROSPECTING - CURRENT STATUS

Particulars	Gas volume (tcf)*	Investments needed
Gas already discovered		
RIL	3.65	\$547.5m
ONGC	1.3	\$195m
Great Eastern Energy Corporation	1.0	\$150m
Gas being explored		
RIL	8.7	\$1.3b
ONGC	5.0	\$750m

* - trillion cubic feet

Source: Motilal Oswal Securities

Intermech acquisition opens up CNG compressor segment

India and China are strongly pushing for CNG (compressed natural gas) as an alternative fuel to petrol and diesel. As is evident from the name itself, compressors are vital components in CNG filling stations; their function is to compress the natural gas thus easing the process of transfer to the vehicle (see box for market potential).

In CY05, Atlas Copco global has acquired Intermech Ltd of New Zealand, a leading manufacturer of CNG compressors. We estimate the Indian market at Rs8b-16b over the next 5 years. We expect ACIL to get a sizeable share of the Indian CNG compressors market via trading in Intermech compressors initially, and possible technology transfer later.

China is in the midst of a massive CNG drive before the Olympics in 2008. ACIL may benefit from outsourcing if there are production constraints in Atlas Copco China's capacity.

India's CNG compressors potential

Consequent to the Supreme Court order, CNG is expected to be implemented in 16 cities over the next 5 years. Some projects like Pune are already taking off, while others like Lucknow are yet to be finalised.

A very conservative estimate of the Indian market for CNG compressors is Rs500m to Rs1.5b per city as under-

50-100 filling stations per city

→

2 CNG compressors per filling station

→

Each compressor cost about Rs5m-7.5m

→

Rs500m to Rs1.5b

Thus, the total CNG compressors market in India works out to Rs8-16b over the next 5 years.

High spares business will help sustain topline and margins

ACIL's spares and consumables sales are rising in the last few years. They now form 20% of the company's revenues. During bad years it was this segment that cushioned ACIL's performance. Going forward, we expect the high margin spares segment to contribute to profits even more in view of the booming economy.

Plant rejig likely to improve efficiency : Currently, ACIL has three facilities - Pune, Nasik and Bangalore (drilling business acquired from Ingersoll). It is now realigning production at these units to improve operational efficiency.

Pune - This unit will be dedicated to compressors. The company plans to expand its Pune plant and also set up another unit nearby soon.

Nasik - Construction & mining equipment and tools will now be made here. Also, products made at Bangalore will be shifted here in CY06. Expansion at Nasik is likely to be completed by September 2006.

Financials & Projections

Even when India's capital goods sector was in a recession CY98 through CY05, ACIL registered revenue CAGR of 23% and PAT CAGR of 27%.

In CY05, it recorded revenue of Rs5.74b (up 42% YoY) and PAT of Rs510m (up 29% YoY). RoE stood at 27.7% and RoCE at 32.4%.

Recently, the company declared a 1:1 bonus.

Going forward, our key assumptions are -

- Revenue CAGR of 20% (CY05 - CY07)
- EBITDA margins improving by 150 bps from 18.0% in CY05 to 19.5% in CY07
- Capex of Rs400m in Nasik and Rs750m in Pune.

Based on the above, we expect ACIL's sales to be Rs6.8b for CY06 and Rs8.2b for CY07. Expected PAT is Rs666m in CY06 and Rs818m in CY07.

Valuation & Recommendation

ACIL's EPS CAGR through CY07 works out to 27%. This is the same level as its CAGR CY98 through CY05, and indicates the company's inherent strength to tide over business cycles.

At CMP, the stock trades at the lower band of EV/EBITDA relative to peers in the capital goods sector. Our 15-18 month price target for ACIL is Rs725 (ex bonus, 20x CY07E EPS of Rs36.2), giving an annualized return of 25% from current levels. We advise **BUY**.

Companies	CMP (Rs)	EPS (Rs)		PE (x)		EV/Sales (x)		EV/EBITDA (x)		Rev CAGR (%)		PAT CAGR (%)	
		(07)	(08)	(07)	(08)	(07)	(08)	(07)	(08)	(98-05)	(06-08)	(98-05)	(06-08)
Cummins India	164	12	15	13.7	10.9	1.3	1.1	8.9	7.2	7.0	20.5	7.4	23.3
Atlas Copco	1050	58.4	71.4	18.0	14.7	1.7	1.4	9.4	8.0	23.6	24.0	26.9	29.7
Crompton Greaves	790	50.5	59.7	15.6	13.2	1.4	1.3	13.2	11.0	4.9	14.9	26.5	25.5
Thermax	228	13.5	17.3	16.9	13.2	1.7	1.3	14.3	10.9	10.0	25.9	3.2	24.6
BHEL	1837	90.9	118.5	20.2	15.5	2.2	1.8	11.0	8.7	6.8	24.8	4.0	32.9
Larsen & Toubro	2041	106.9	132.4	19.1	15.4	1.6	1.2	16.8	13.1	13.8	25.7	6.9	36.2
Alstom Projects	209	11	15.5	19.0	13.5	1.0	0.8	18.0	14.5	*43.2	26.9	*18.5	50.7
Siemens	840	35	45.9	24.0	18.3	2.0	1.6	14.4	11.1	#17.4	29.6	#46.4	34.1
ABB	2069	68.9	92	30.0	22.5	2.0	1.5	18.0	12.7	19.2	31.3	29.0	33.5
Sector Aggregate				20.7	15.9								

(07) - CY06 / FY07 (08) - CY07 / FY08

Source: Company / Motilal Oswal Securities

* From 200012 to 200503 # From 199909 to 200509

Investment concerns

- Depreciation of rupee vis-à-vis the dollar could lower our estimates as imported raw material and components form 18% of revenues.

Mitigant: ACIL had exports of Rs940m in CY05, 25% higher than previous year. Going forward too, we expect exports to act as a natural hedge against currency fluctuation.

- The compressor and pneumatic tool industry is cyclical, and linked with capital investment in the economy.

Mitigant: Our core argument is that capital spending in the economy is unlikely to slowdown for the next 5 years at least.

- Low liquidity in the stock due to a high 84% holding of Atlas Copco, Sweden.

Mitigant: ACIL recently declared a 1:1 bonus which partly addresses this issue.

Financials and Projections

INCOME STATEMENT		(Rs m)				
Y/E DECEMBER	FY03	FY04	FY05	FY06E	FY07E	
Net sales	2,941	3,993	5,699	6,838	8,206	
<i>Change (%)</i>		35.8	42.7	20.0	20.0	
Stock adjustment	78	230	-269	270	225	
Net sales (Stock adj.)	3,019	4,223	5,430	7,108	8,430	
Raw material	1,710	2,620	3,328	4,336	5,143	
<i>% of Net sales</i>	57	62	61	61	61	
Staff cost	280	327	436	569	674	
<i>% of Net sales</i>	9	8	8	8	8	
Admin and other expenses	554	798	642	881	1,012	
<i>% of Net sales</i>	18	19	12	12	12	
EBITDA	476	478	1,024	1,322	1,602	
<i>Change (%)</i>		0.5	114.2	29.1	21.2	
Depreciation	59	106	196	217	237	
EBIT	416	372	827	1,105	1,364	
Interest	2	23	50	53	64	
Other income	98	64	51	40	40	
PBT	512	413	828	1,092	1,341	
Tax	174	182	323	426	523	
<i>Rate (%)</i>	34.1	44.1	39.0	39.0	39.0	
Reported PAT	338	231	506	666	818	
Extra - ordinary gain / (loss)	(61)	(165)	(6)	0	0	
Adjusted PAT	399	396	511	666	818	
<i>Change (%)</i>		-1	29	30	23	
<i>EBITDA margin (%)</i>	16	12	18	19	20	
<i>PAT margin (%)</i>	14	10	9	10	10	

Financials and Projections (contd...)

BALANCE SHEET

Y/E DECEMBER	FY03	FY04	FY05	FY06E	FY07E	
Equity share capital	113	113	113	226	226	Bonus of 1:1
Reserves	1,353	1,520	1,949	2,401	3,092	
Networth	1,466	1,633	2,062	2,627	3,318	
Loans	61	989	740	584	1,013	
Net deferred tax liability	-46	-31	-14	-14	-14	
Capital employed	1,481	2,591	2,788	3,197	4,318	
Gross fixed assets	749	1,892	1,975	2,325	2,375	Expansion at Nasik
Less: Depreciation	412	475	642	859	1,097	
Net fixed assets	337	1,417	1,332	1,465	1,278	
Capital WIP	2	7	15	0	750	Proposed expansion at Pune
Investments	482	0	0	0	0	
Curr. assets	1,345	2,387	2,697	3,254	4,004	
Inventory	397	789	823	1,016	1,329	
Debtors	714	1,279	1,526	1,838	2,205	
Cash & bank balance	122	150	87	100	120	
Loans & advances	112	170	262	300	350	
Current liab. & prov.	744	1,220	1,257	1,522	1,714	
Creditors	591	1,031	1,018	1,236	1,393	
Other liabilities	0	0	0	0	0	
Provisions	153	190	239	286	321	
Net current assets	601	1,167	1,440	1,732	2,290	
Misc. exp. (not w/o)	60	0	0	0	0	
Application of funds	1,481	2,591	2,788	3,197	4,318	

E: Estimates

Financials and Projections (contd...)

RATIOS					
Y/E DECEMBER	FY03	FY04	FY05	FY06E	FY07E
Basic (Rs)					
EPS *	17.7	17.5	22.7	29.5	36.2
<i>Growth (%)</i>		-0.8	29.2	30.3	22.8
Cash EPS	20.3	22.2	31.4	39.2	46.8
Book value	62.3	72.4	91.4	116.4	147.1
DPS	2.5	2.5	3.0	4.0	5.0
Payout (incl. div. tax) (%)	16	16	15	15	16
Valuation (x)					
P/E			23.4	17.8	14.5
Cash P/E			16.9	13.4	11.2
Price/Book value			5.7	4.5	3.6
Dividend yield (%)			0.6	0.7	0.8
EV / Sales			2.0	1.7	1.4
EV / EBITDA			12.3	9.4	8.0
Profitability ratios (%)					
RoE	25.4	14.9	27.4	28.4	27.5
RoCE	29.6	17.9	30.5	36.8	36.2
Turnover ratios					
Debtors (days of sales)	81	107	90	90	90
Inventory (days of sales)	45	66	49	50	54
Creditors (days of total exp.)	42	65	55	55	55
Asset turnover (x)	2.0	1.6	1.9	2.2	1.9
Leverage ratio					
Debt/Equity (x)	0.0	0.6	0.4	0.2	0.3

Financials and Projections (contd...)

CASH FLOW STATEMENT

Y/E DECEMBER	FY03	FY04	FY05	FY06E	FY07E
PBT before EO items	451	248	823	1,092	1,341
Add : Depreciation	59	106	196	217	237
Interest	2	23	50	53	64
Less : Direct taxes paid	174	182	323	426	523
(Inc)/Dec in WC	-416	-539	-337	-279	-538
CF from operations	-79	-343	410	658	581
EO, misc. & other items	-61	-165	-6	0	0
CF from oper. incl. EO items	-18	-179	416	658	581
(Inc)/Dec in FA	-122	-1,191	-120	-335	-800
(Pur)/Sale of investments	93	482	0	0	0
CF from investments	-28	-710	-120	-335	-800
Inc/(Dec) in netw orth	26	20	-35	-60	-71
Inc/(Dec) in debt	-38	927	-249	-156	430
Less : Interest paid	-2	-23	-50	-53	-64
Dividend paid	-8	-8	-24	-41	-55
CF from fin. activity	-22	916	-359	-310	239
Inc/Dec in cash	-67	28	-64	13	20
Add: Beginning balance	190	122	150	87	100
Closing balance	122	150	86	100	120



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1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
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