

Mid Cap
Electrical Equipment
Equity – India

Overweight (V)

Target price (INR)	1575.00		
Share price (INR)	1231.75		
Potential total return (%)	27.9		
Performance	1M	3M	12M
Absolute (%)	8.3	5.5	53.6
Relative [^] (%)	3.5	5.9	22.3
Index [^]	BOMBAY SE IDX		
RIC	KAPT.BO		
Bloomberg	KPP IN		
Market cap (USDm)	802		
Market cap (INRm)	32,641		
Enterprise value (INRm)	29651		
Free float (%)	36.31		

Note: (V) = volatile (please see disclosure appendix)

Kalpataru Power Transmission

Diversifying into logistics; Reiterate Overweight (V)

- ▶ **Q4 FY07 sales grew by 44% y-o-y, EBITDA margin expanded by 429bps to 18.1% while PAT surged by 92%; Current order back log of INR15.5bn**
- ▶ **Diversifying into logistic business with initial investment of INR65mn in FY07 and INR600-650mn in FY08e**
- ▶ **Reiterate our Overweight (V) rating with target price of INR1,575**

Strong Q4 FY07 results

Kalpataru Power Transmission Line Limited (KPTL) announced its Q4 FY07 results. Net sales grew by 44% to INR5.2bn with expansion of EBITDA margin by 429bps to 18.1% y-o-y. PAT grew by 92% y-o-y while EPS increased by 69% due to higher number of shares. The management has indicated that order back log at the end of April 2007 was INR15.5bn with potential to increase to INR23bn in near future.

Full year FY07, net sales grew by 81% y-o-y to INR15.2bn with EBITDA margin expansion of c290bps to 16%, primarily due to higher margin reported in transmission and distribution (T&D) business.

Diversifying into logistics business

In June 2006, KPTL raised INR3.5bn to diversify its business. The management has indicated that the company would diversify into logistics business. An initial investment of INR65mn has been incurred on developing warehouses in State of Rajasthan and Gujarat. KPTL would further expand the business by investing INR600-650mn in FY08.

Reiterate Overweight (V) rating

KPTL is our top pick in T&D sector primarily due to its diversified business like T&D, infrastructures and biomass power generation and now logistics. Historically, KPTL has generated higher margin in its core business of T&D than its peers like KEC International (KECI IN, Overweight (V), INR680) and Jyoti Structures (JYS IN, Neutral (V), INR220).

We have valued Kalpataru at the mid-point – INR1, 575 – of our DCF fair value INR1,345 and PE multiple based value of INR1,615 and INR95 derived from investment in its subsidiary, JMC projects. We maintain our Overweight (V) rating and target price of INR1, 575, indicating a potential return of 27.9%.

21 May 2007

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Results Summary (INRmn)

Heads	Q4 FY07	Q4 FY06	y-o-y	FY07	FY06	y-o-y
Net Sales	5,222	3,614	44%	15,249	8,404	81%
EBITDA	947	501	89%	2,489	1,144	118%
EBITDA Margin	18.1%	13.9%	429	16.3%	13.6%	271
Depreciation	54	32	68%	168	88	91%
As % of Sales	1.0%	0.9%	14	1.1%	1.0%	5
Other Income	64	22	191%	125	49	155%
As % of Sales	1.2%	0.6%	62	0.8%	0.6%	24
PBIT	958	491	95%	2,446	1,105	121%
As % of Sales	18.3%	13.6%	476	16.0%	13.1%	289
Interest	91	56	63%	280	161	74%
As % of Sales	1.7%	1.5%	20	1.8%	1.9%	(8)
PBT	867	435	99%	2,167	944	130%
Tax	222	122	82%	572	279	105%
Tax rate	26%	28%	(248)	26%	30%	(314)
PAT	645	313	106%	1,595	665	140%
Net Margins	12.3%	8.7%	369	10.5%	7.9%	254
Adj EPS	24.3	14.4	69%	60.2	30.6	96%

Source: Company

Valuation

We have used a combination of DCF approach and PE multiple approach to determine our target price.

DCF approach

We have used three-stage DCF to value Kalpataru Power. We have assumed cost of capital to be 13.5%. We have an explicit period forecast until FY10. There is a semi-explicit period of 10 years starting from FY11e. We have assumed fade period to start in FY19 and to last for 10 years. During the fade period we assume ROIC will converge with cost of capital. Our DCF based fair value is INR1,345.

PE valuation

We have arrived at target PE of 22x based on an analysis of Kalpataru Power's historical trading pattern.

Over the last three years KPTL has traded in the range of 5x-25x its one year rolling forward PE multiple. During this period the trading pattern indicates that the stock has been re-rated three times.

Until April 2005, the stock was trading in the band of 5-15x. The stock was re-rated with the improvement in industry fundamentals and company performance, and moved to the 15-20x band.

In Feb-06, there was sharp rally in the Indian mid-cap stocks and Kalpataru did not lag behind. This phase was followed by a market correction in May 2006. Kalpataru has recovered from the correction and now trades in the PE band of 20-25x.

DCF Drivers

Heads	2007e	2008e	2009e	2010e	over 20 years	2030e
Asset Turn	6.54	5.15	5.21	5.21	fading to	4.00
Pre-tax margin	14.4%	14.7%	14.9%	14.9%	fading to	4.5%
Tax effect	27.5%	26.5%	25.5%	25.5%	fading to	25.5%
ROIC	68.4%	55.6%	57.8%	57.8%	fading to	13.5%
Cost of capital	13.5%	13.5%	13.5%	13.5%	fading to	13.5%
Turnover growth	na	33.4%	33.8%	57.8%	fading to	13.5%
IC growth	69.4%	32.2%	17.9%	17.9%	fading to	5.0%
ROIC - Cost of Capital	54.9%	42.1%	44.3%	44.3%	fading to	0.0%

Source: HSBC estimates

Kalpataru Power: Rolling one-year Forward PE

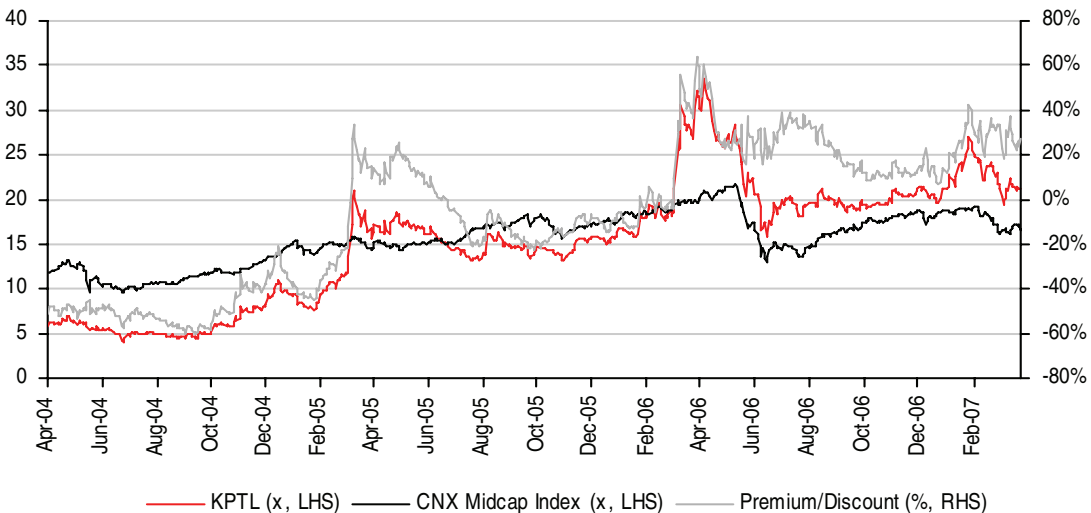


Source: Bloomberg, HSBC

We have compared the trading history of Kalpataru with the CNX Midcap Index. The stock was trading at discount to the Index until April 2005 and since then has mostly been trading at premium. Looking at the last year of trading the premium has averaged at 20%.

We believe that Kalpataru at its current stage of growth should trade at 22x. Based on our FY08e EPS estimate of INR73.3 and applying rolling one-year PE multiple of 22x we arrive at a fair value of INR1,615.

Kalpataru Power vs. CNX Midcap Index rolling one-year forward PE



— KPTL (x, LHS) — CNX Midcap Index (x, LHS) — Premium/Discount (% , RHS)

Source: Bloomberg, HSBC

Reiterate Overweight (V) rating with a target of INR1,575

We have valued Kalpataru at the mid-point – INR1,575 – of our DCF fair value INR1,345 and PE multiple based value of INR1,615 and INR95 derived from investment in its subsidiary, JMC projects.

We maintain our Overweight (V) rating and target price of INR1,575, indicating a potential return of 27.9%.

Risks

The key risks to our valuation are:

- ▶ Slowdown in the economy might affect order flow
- ▶ Slow execution of orders would have an impact on sales booking
- ▶ Higher than expected other income
- ▶ Slowdown in availability of raw materials like agricultural waste and crop residue for power generation
- ▶ Raw material price (steel) movement might affect the margin
- ▶ Slow execution of capex plans
- ▶ Higher than anticipated working capital requirement to increase interest cost burden
- ▶ Dilution of equity

Financials & valuation

Financial statements

Year to	03/2007a	03/2008e	03/2009e	03/2010e
Profit & loss summary (INRm)				
Revenue	15,373	19,967	26,710	34,723
EBITDA	2,614	3,157	4,253	5,468
Depreciation & amortisation	-168	-223	-278	-308
Operating profit/EBIT	2,446	2,934	3,976	5,161
Net interest	-280	-291	-338	-384
PBT	2,166	2,643	3,638	4,776
HSBC PBT	2,166	2,643	3,638	4,776
Taxation	-572	-700	-928	-1,170
Net profit	1,594	1,942	2,710	3,606
HSBC net profit	1,594	1,942	2,710	3,606

Cash flow summary (INRm)

Cash flow from operations	1,165	1,907	2,484	3,069
Capex	-300	-300	-300	-300
Cash flow from investment	-477	-300	-300	-300
Dividends	-124	-304	-365	-456
Change in net debt	-3,667	-1,012	-1,482	-1,929
FCF equity	585	1,316	1,847	2,385

Balance sheet summary (INRm)

Intangible fixed assets	0	0	0	0
Tangible fixed assets	1,661	1,738	1,760	1,752
Current assets	12,989	16,072	20,752	26,641
Cash & others	3,834	4,846	6,328	8,257
Total assets	15,122	18,282	22,985	28,866
Operating liabilities	5,577	6,925	9,026	11,555
Gross debt	2,328	2,328	2,328	2,328
Net debt	-1,506	-2,518	-4,000	-5,929
Shareholders funds	6,538	8,176	10,521	13,672
Invested capital	5,238	6,039	7,159	8,580

Ratio, growth and per share analysis

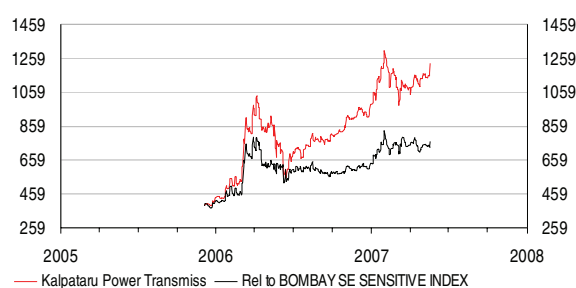
Year to	03/2007a	03/2008e	03/2009e	03/2010e
Y-o-y % change				
Revenue	81.9	29.9	33.8	30.0
EBITDA	119.1	20.8	34.7	28.6
Operating profit	121.4	19.9	35.5	29.8
PBT	129.4	22.0	37.7	31.3
HSBC EPS	96.4	21.8	39.5	33.1
Ratios (%)				
Revenue/IC (x)	3.4	3.5	4.0	4.4
ROIC	39.5	38.2	44.9	49.5
ROE	38.8	26.4	29.0	29.8
ROA	15.7	12.9	14.4	15.0
EBITDA margin	17.0	15.8	15.9	15.7
Operating profit margin	15.9	14.7	14.9	14.9
EBITDA/net interest (x)	9.3	10.8	12.6	14.2
Net debt/equity	-23.0	-30.8	-38.0	-43.4
Net debt/EBITDA (x)	-0.6	-0.8	-0.9	-1.1
CF from operations/net debt				
Per share data (INR)				
EPS reported (fully diluted)	60.15	73.30	102.28	136.09
HSBC EPS (fully diluted)	60.15	73.30	102.28	136.09
DPS	10.06	12.08	15.10	15.10
NAV	246.70	308.52	397.04	515.91

Valuation data

Year to	03/2007a	03/2008e	03/2009e	03/2010e
EV/sales	2.0	1.5	1.1	0.8
EV/EBITDA	11.7	9.4	6.6	4.8
EV/IC	5.9	4.9	3.9	3.1
PE*	20.5	16.8	12.0	9.1
P/NAV	5.0	4.0	3.1	2.4
FCF yield (%)	1.8	4.1	5.7	7.4
Dividend yield (%)	0.8	1.0	1.2	1.2

Note: * = Based on HSBC EPS (fully diluted)

Price relative



Source: HSBC

Note: price at close of 18 May 2007

Disclosure appendix

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For each stock we set a required rate of return calculated from the risk free rate for that stock's domestic, or as appropriate, regional market and the relevant equity risk premium established by our strategy team. The price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 12 months. For a stock to be classified as Overweight, the implied return must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands are classified as Neutral.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

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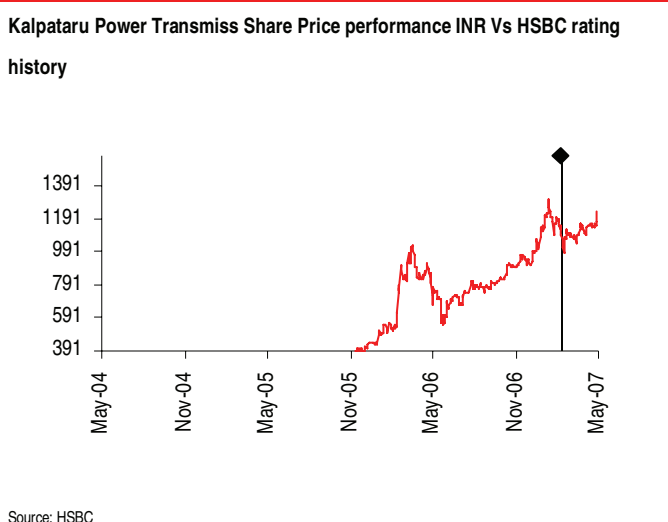
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Underweight (Sell)	21%	(13% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities



Recommendation & price target history		
From	To	Date
N/A	Overweight	26 February 2007
Target Price	Value	Date
Price 1	1575.00	26 February 2007

Source: HSBC

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