Prabhudas Lilladher

Action Construction Equipment

New product launches in the pipeline

June 4, 2008

Rating	**Outperformer**
Price	Rs72
Target Price	Rs114
Implied Upside	59.4%
Sensex	15,515

(Prices as on June 4, 2008)

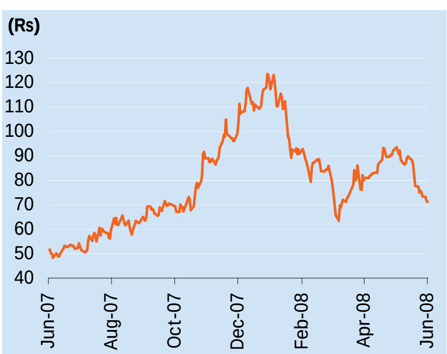
Trading Data	
Market Cap. (Rs bn)	6.4
Shares o/s (m)	89.9
Free Float	34.8%
3M Avg. Daily Vol ('000)	112.4
3M Avg. Daily Value (Rs m)	9.2

Major Shareholders	
Promoters	65.2%
Foreign	5.7%
Domestic Inst.	15.4%
Public & Others	13.7%

Stock Performance

(%)	1M	6M	12M
Absolute	(22.9)	(31.2)	38.0
Relative	(11.0)	(10.6)	30.9

Price Performance (RIC: ACEL.BO, BB: ACCE IN)



Source: Bloomberg

- **Margin pressure in Q4FY08:** Action Construction Equipment's (ACE) EBIDTA margin decreased by 124bps YoY to 7.9%. This reduction in margin was due to higher steel prices. Another reason for the decline in margin was the increase in service income, which is recorded under the other income head (65-70% of other income). If we adjust for service income, EBITDA margin would be 9.5% in Q4FY08 as compared to 10.7% in Q4FY07. Despite increase in steel prices we expect EBITDA margin to be in the range of 10 to 10.5%, because of increased share of higher margin products.
- **New products:** ACE plans to launch new products such as tandem rollers and batching plants in the second half of the year. For tandem rollers, only axles will be imported, while the remaining components will be sourced locally. The company also managed to sell one concrete pump and one piling rigs during Q4FY08. It would be initially importing these products from Zoomlion, China and then eventually will look at assembling the knocked-down kits in India.
- **Valuation:** At the ruling market price of Rs72, the stock trades at 12.7x FY09E and 8.8x FY10E earnings of Rs5.6 and Rs8.1 respectively. We expect ACE to report revenue CAGR of 40.4% and earnings CAGR of 42.0% during FY08-10E. We maintain Outperformer rating on the stock with a target price of Rs114, implying an upside of 59.4%.

Key financials (Y/e March)	FY07	FY08	FY09E	FY10E
Revenue (Rs m)	2,453	4,012	5,578	7,904
Growth (%)	*48.0*	*63.6*	*39.0*	*41.7*
EBITDA (Rs m)	260	395	556	800
PAT (Rs m)	199	363	508	732
EPS (Rs)	2.2	4.0	5.6	8.1
Growth (%)	*14.0*	*82.1*	*39.9*	*44.1*
Net DPS (Rs)	1.5	3.0	4.0	5.0

Source: Company Data; PL Research

Profitability & valuation	FY07	FY08	FY09E	FY10E
EBITDA margin (%)	*10.6*	*9.8*	*10.0*	*10.1*
RoE (%)	*18.8*	*26.6*	*31.5*	*36.9*
RoCE (%)	*25.5*	*28.5*	*32.8*	*39.4*
EV / sales (x)	0.2	0.1	0.1	0.0
EV / EBITDA (x)	2.2	1.4	0.7	0.3
PE (x)	32.2	17.7	12.7	8.8
P / BV (x)	6.1	4.7	4.0	3.2
Net dividend yield (%)	*2.1*	*4.2*	*5.6*	*7.0*

Source: Company Data; PL Research

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Management representatives:
Mr. Sorab Agarwal, Managing Director

Q: Why was there a dip in the operating margin in the final quarter?

A: This dip was primarily due to the increased cost of steel. Steel prices have gone off the roof, increasing more than 40% from mid-February. But we have seen some cooling-off in prices in the last three weeks. Going ahead, we expect steel prices to further cool-off may be by another 5%. Another point to be noted on the margin front is that 50% of our other income for the quarter was from operating service income, so when you add that back we have taken a hit of 1 to 1.5%.

Q: What is the percentage of steel in our raw materials requirement and will you be able to pass on the increase in cost to your customers?

A: Raw materials is 75% of our sales, of which 15-20% of steel is bought by us for fabrication, another 25-30% of the raw material consist of fabricated products bought by us and the remaining consists of gears, transmission, axles and engines bought. Increase in steel prices would have affected us by 10%, but if you incorporate the 7-8% increase in our prices and slight cooling-off steel prices, we should comfortably maintain PBT margin of 11.5 to 12% as we have in the past.

We can definitely pass on a part of the increase in costs to our customers; in fact, we have gradually started increasing our prices from March and have currently increased it by 7-8% from last year. We do not want to increase the prices by say 10-12% because this will not go down well with our customers.

Q: Sir what is your guidance for FY09 and FY10?

A: I am very comfortable with us growing at 40% to 45% over the next two years, both in terms of topline and bottomline.

Q: What are the new products we are looking to launch in this year?

A: We are getting into road equipments. We will start manufacturing single- and double-tandem rollers to start with, and maybe next year we will bring in pavers as well. These products will be manufactured in India with more than 75% of the components being sourced locally.

Q: And what about excavators?

A: We intend to enter this market in the next two to three years. We have sold 250 Backhoe loaders this year, once we pass the 1,000-unit mark in a year we will get into excavators. This could result in a capital expenditure of Rs8-10bn.

Q: Is ACE still facing trouble selling Backhoe loaders?

A: Not at all. In fact, due to the recent announcements of most financing companies refusing to finance more than 80%, has put us on a level playing field as earlier the likes of JCB were getting 90% financing. Actually this would work in our favour because our prices are much lower than JCB's, so the customer will be paying a much lower margin on our products.

Q: What are your capex plans for the next year?

A: Our overall capex for this year would be Rs15-20bn. We plan to set-up a new facility in Chopanki by the end of this year. We will be manufacturing Backhoe loaders and mobile cranes in this facility.

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PL's Recommendation Nomenclature

BUY	:	> 15% Outperformance to BSE Sensex	**Outperformer** (OP)	:	5 to 15% Outperformance to Sensex
Market Performer (MP)	:	-5 to 5% of Sensex Movement	**Underperformer** (UP)	:	-5 to -15% of Underperformace to Sensex
Sell	:	<-15% Relative to Sensex			
Not Rated (NR)	:	No specific call on the stock	**Under Review** (UR)	:	Rating likely to change shortly