Prabhudas Lilladher

FAG Bearings India

Improved margins

April 21, 2008

Rating	BUY
Price	Rs522
Target Price	Rs676
Implied Upside	29.6%
Sensex	16,481

(Prices as on April 17, 2008)

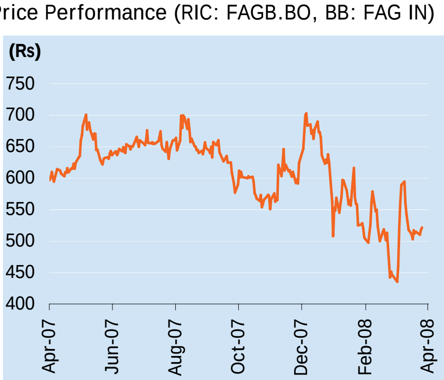
Trading Data	
Market Cap. (Rs bn)	8.7
Shares o/s (m)	16.6
Free Float	48.7%
Avg. Daily Vol ('000)	11.3
Avg. Daily Value (Rs m)	5.9

Major Shareholders	
Promoters	51.3%
Foreign	8.6%
Domestic Inst.	15.8%
Public & Others	24.3%

Stock Performance

(%)	1M	6M	12M
Absolute	16.8	(9.6)	(13.3)
Relative	3.8	(2.8)	(36.0)

Price Performance (RIC: FAGB.BO, BB: FAG IN)



Source: Bloomberg

Q1CY08 Result Update

- **Results:** Fag Bearings' (FBIL) Q1CY08 results were better than our expectations. Net sales grew by 9.4% YoY from Rs1.57bn to Rs1.72bn (we expected Rs1.75bn), mainly due to slowdown in the auto and industrial sectors. There was a sharp drop in two-wheeler and commercial vehicle sales during the quarter, which has affected overall sales growth. The company's EBIDTA margin declined by 30bps from 22.2% to 21.9% YoY (we expected 16.0%), due to increase in personnel cost. Personnel cost increased by 200bps from Rs115m to Rs159m due to rise in salaries and lower sales growth. Material cost declined by 80bps from 53.9% to 53.1% despite rise in prices of steel and components, as the company was able to pass the same to its customers. FBIL's net profit improved by 15.5% YoY from Rs220m to Rs254m due to lower tax rate (we expected Rs178m).
- **Capex update:** FBIL has undertaken a €60m (Rs3.8bn) expansion plan for needle bearings. The same is likely to go on-stream in the current year and would contribute substantially from CY09 onwards.
- **Valuation:** We expect the company to report 21% CAGR in net sales and 19% CAGR in net profit over CY07-09. We also expect its EBIDTA margin to decline from 20.4% in CY07 to 19.3% in CY09 due to expected increase in material cost.

  At the CMP of Rs520, the stock trades at 9.8x CY08E EPS of Rs53.0 and 7.7x CY09E EPS of Rs67.6. We maintain Outperformer rating on the scrip with a price target of Rs676 (10x CY09 earnings) over the next 12 months, which is an upside of 30% over the CMP.

Key financials (Y/e Dec)	CY06	CY07A/E	CY08E	CY09E
Revenue (Rs m)	5,420	6,413	7,645	9,321
Growth (%)	*32.7*	*18.3*	*19.2*	*21.9*
EBITDA (Rs m)	1,181	1,309	1,452	1,800
PAT (Rs m)	748	792	881	1,123
EPS (Rs)	47.6	5.9	11.3	27.4
Growth (%)	*45.0*	*47.6*	*53.0*	*67.6*
Net DPS (Rs)	4.0	4.0	4.5	5.0

Source: Company Data; PL Research

Profitability & valuation	CY06	CY07A/E	CY08E	CY09E
EBITDA margin (%)	*21.8*	*20.4*	*19.0*	*19.3*
RoE (%)	*34.4*	*28.1*	*24.6*	*25.0*
RoCE (%)	*33.5*	*27.0*	*23.6*	*24.0*
EV / sales (x)	1.6	1.4	1.1	0.9
EV / EBITDA (x)	7.3	6.6	6.0	4.8
PE (x)	11.6	10.9	9.8	7.7
P / BV (x)	3.5	2.7	2.2	1.7
Net dividend yield (%)	*0.8*	*0.8*	*0.9*	*1.0*

Source: Company Data; PL Research

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Highlights

Lower sales growth

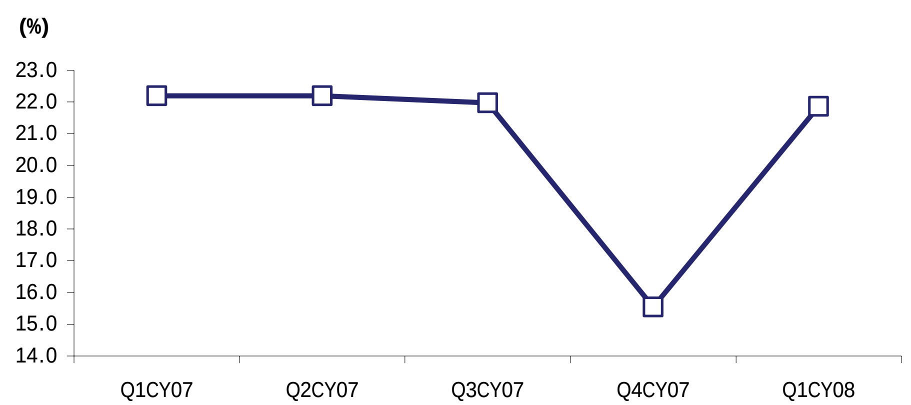
For Q1CY08, FBIL posted growth of 9.4% YoY in net revenue from Rs1.57bn to Rs1.72bn. The lower growth can be attributed to the slowdown in commercial vehicles and two-wheeler segments during the quarter. High interest regime and rise in fuel prices have resulted in negative growth in these segments. Moreover, industrial production during April 2007-February 2008 declined to 5.6% as compared to 8.7% during the same period of the previous year. This has also led to lower demand for the company's products.

FBIL derives 30% of its revenue from auto segment (only cars) and 50% revenue from industrial segment (commercial vehicles, two- and three-wheelers, and industrial applications) and balance 15% from the replacement market and trading. The negative growth of two-wheeler and commercial vehicles have affected the company's results, as these form around 50% of its sales. For CY08, the sharp rise in steel prices would result in increase in prices of vehicles. With higher interest rates, this may affect the auto segment severely.

Margin declines by 30bps

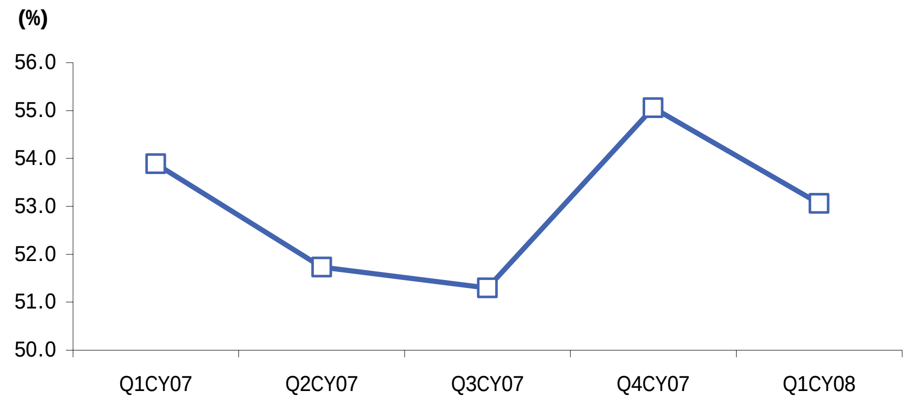
Due to the sharp increase in personnel expenses, FBIL's EBIDTA margin declined by 30bps from 22.2% to 21.9% YoY. The company's personnel cost increased by 200bps from 7.3% to 9.3% of net sales due to lower sales growth and rise in salaries. FBIL's material cost declined by 80bps from 53.9% to 53.1% despite rise in prices of steel and components, as the company was able to pass the increase to its customers. Other expenses declined by 80bps from 16.6% to 15.8% of net sales. The company's material cost and EBIDTA margin, over the last five quarters, are shown in the following graphs:

EBITDA margin



Source: Company Data, PL Research

Material cost as % of sales



Source: Company Data, PL Research

As seen from the above graphs, the company's EBIDTA margin declined from 22.0% in Q3CY07 to 15.5% in Q4CY07 (650bps decline QoQ) mainly due to increase in the material cost and other expenses. Material cost has increased from 51.3% in Q3CY07 to 55.1% in Q4CY07 (380bps rise QoQ), thereby reducing its EBIDTA margin. However, the company has exhibited better performance in Q1CY08 with its material cost falling by 200bps from 55.1% to 53.1% QoQ, as the company was able to pass the increase in material cost to its customers. This has resulted in 640bps improvement in EBIDTA margin from 15.5% to 21.9% QoQ.

PAT grew 16%YoY

FBIL's other income from services declined by 12% from Rs26m to Rs23m. Its interest income improved from Rs3m to Rs17m. Its PBT for the quarter grew by 10% from Rs331m to Rs363m. Effective tax rate came down from 33.5% to 30.0% during the quarter. This has resulted in 16% growth in PAT before EO items from Rs220m to Rs254m. Net profit after EO items (prior period expenses) declined by 8% from Rs220m to Rs202m.

Outlook

FBIL's future performance is likely to be affected by the continued slowdown in the auto and industrial sectors, from which it derives 85% of its revenue. The auto segment is likely to witness lower growth due to rise in material cost, fuel prices and high interest rates. The industrial segment has also indicated a slowdown in the Q1CY08, and the same is likely to continue in future. However, the replacement segment is likely to grow well due to rise in the number of vehicles in recent years.

Concerns

The slowdown in auto and industrial segment is likely to affect the overall performance of the company. Moreover, given a high interest rate scenario and the recent price hike in petrol and diesel, it is likely to affect demand for the auto segment. We expect a slowdown in the auto sector, due to the sharp rise in steel prices, which has resulted in an increase in prices of vehicles.

Overall industrial growth for April 2007-February 2008 has declined from 8.7% to 5.6% YoY. This is likely to affect demand for industrial bearings, and in turn will affect performance of the company.

Valuation

We expect the company to report 21% CAGR in net sales and 19% CAGR in net profit over the next two years (CY07 through CY09). We also expect the company's EBIDTA margin to decline from 20.4% in CY07 to 19.3% in CY09 due to the expected rise in material cost. We expect material cost to increase from 53.0% in CY07 to 54.5% in CY08 and then decline to 54.3% in CY09. FBIL is a debt-free company and hence will be able to sustain itself in bad times. We expect the company's RoE to decline from 28.1% in CY07 to 25% in CY09. FBIL's RoCE is also likely to decline from 27.0% in CY07 to 24.0% in CY09.

At the CMP of Rs520, the stock trades at 9.7x CY08E EPS of Rs53.0 and 7.6x CY09E EPS of Rs67.6. We maintain Outperformer rating on the scrip with a price target of Rs676 (10x CY09 earnings) over the next 12 months, which is an upside of 30% over the CMP.

Q1CY08 result overview *(Rs m)*

Y/e Dec	Q1CY08	Q1CY07	YoY gr. (%)	Q4CY07	QoQ gr. (%)
Net sales	**1,715**	**1,568**	*9.4*	**1,675**	*2.4*
Expenditure					
Raw materials	910	845	*7.7*	922	*(1.3)*
as % of net sales	*53.1*	*53.9*		*55.1*	
Personnel expenses	159	115	*38.3*	137	*16.1*
as % of net sales	*9.3*	*7.3*		*8.2*	
Other expenses	271	260	*4.2*	355	*(23.7)*
as % of net sales	*15.8*	*16.6*		*21.2*	
Total expenditure	1,340	1,220	*9.8*	1,414	*(5.2)*
OPBDIT	**375**	**348**	*7.8*	**260**	*44.1*
OP margin (%)	*21.9*	*22.2*		*15.5*	
Other income	23	26	*(11.5)*	30	*(24.1)*
PBDIT	**398**	**374**	*6.4*	**291**	*37.0*
Depreciation	52	46	*13.0*	52	*0.4*
Interest	(17)	(3)	*NA*	(11)	*61.9*
PBT	**363**	**331**	*9.7*	**249**	*45.6*
Prov. for tax	109	111	*(1.8)*	108	*1.2*
% of PBT	*30.0*	*33.5*		*43.2*	
PAT	**254**	**220**	*15.5*	**142**	*79.4*
Extra-ordinary item	52	-	*NA*	(3)	*NA*
Reported PAT	**202**	**220**	*(8.2)*	**145**	*39.5*

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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