BEML

Rs 937

5th October 2006

Metro opportunities

Buy

Bharat Earth Movers Limited (BEML) is a premier ISO 9001-2000 company, with a 70% market share in the domestic earthmoving industry and is the second largest manufacturer of earthmoving equipment in Asia. The Company manufactures a wide range of heavy earthmoving equipment & parts, catering to the core sectors of the Industry-Mining, Irrigation, Projects, Steel and Cement Plants, to the infrastructure segment, Defence Equipment & Aggregates for the Defence Forces and Railway Equipment, primarily for Indian Railways, and, also, has expanded its product range to cover high-quality hydraulics, heavy-duty diesel engines and Welding robots. Additionally, the Company exports its machines to over 30 countries in Africa, Europe and the Middle East.

BEML held its AGM on 28th September 2006, wherein the Company discussed its FY06 performance and the future outlook. Excerpts from the same follow:

Key Highlights of the AGM

- The Company faced an adverse business environment during FY06 since the Mining sector that BEML primarily serves showed only 1% growth, compared to 5.1% in the previous year. Coupled with this, competition from multinational companies and from the Indian players became more intense, thus making the market more demanding and intensely price competitive.
- BEML has qualified for 'Excellent' MoU rating, given by the Department of Public Enterprises as per the MoU for 2005-06, an honour restored to BEML after a period of 15 years.
- The Company has been conferred the mini Ratna/ Category-I status in view of its overall performance and profit figures. This status grants the Company enhanced financial autonomy, in terms of capital expenditure, formation of joint ventures and subsidiaries, technology tie-ups; also, the Company can be be Board-managed in the true sense, further accelerating its growth and development.
- The Company is undertaking organisational restructuring and now operates under three major business groups viz. a) Mining and Construction, b) Defence and c) Rail and Metro, with each business group headed by a functional director.
- The Company has launched two new business divisions to cash-in on the vast untapped market potential and the core competence - viz. a technology division, for providing total e-engineering solutions/ services, and a trading division, for dealing in non-company products for domestic as well as overseas customers.
- The Company has entered into Contract Mining operations through a joint venture and has roped in an overseas company to partner in the business. The first contract-mining project, at Mangalore Ore India Limited, is under execution.
- The Company is laying emphasis on exports; its exports group has been renamed the international business division and been spun-off as an independent SBU, since year beginning.
- During 2005-06, the Company committed around Rs 250 crores to capital expenditure for modernisation of all manufacturing units and for expansion of the rail unit-II at KGF, for manufacture of rail coaches and wagons.
- BEML has taken a giant leap forward, towards becoming a truly global company. The recently signed JV with CCC, Brazil, to manufacture Mining and construction equipment and rail products, with an equity participation of around 60%, would be doing a business of about Rs 500 crores in about 3 years, producing and supplying about 500 rail wagons and 200 number of construction equipment per year, to cater to the growing markets in Brazil as well as other Latin American countries.
- BEML is bullish about resolving the issues with Delhi Metro Rail Corporation (DMRC) and this would be an added trigger for the Company. The rail coach segment, currently contributing 10-15% of the turnover, is set to grow to 25% in a couple of years. BEML's estimate is that there would be a demand for 1,500 metro cars, in the next five years, from many States that are improving their urban commutation needs.
- The strong order book position, of Rs 2,500 crores at year-end and incremental orders worth more than Rs 500 crores, booked till Aug 2006, provides growth visibility.

Organisational Restructuring

The Company is undertaking organisational restructuring to get in tune with the current business demands and have better market orientation and operational effectiveness. The organisational restructuring has been implemented with effect from April1, 2006, with approval by the Ministry of Defence; the Company now operates under three major business groups viz. a) Mining and Construction, b) Defence and c) Rail and Metro and each business group is headed by a functional director. The strategic business and product heads have also been formed and organised under each business group to enhance business volume and bring about higher productivity and profitability. The Company has implemented, for the first time, the revised work norms in all divisions, with the co-operation of the employee unions, thus creating additional capacity of around 15% in manufacturing shops and 25% in assembly shops.

New business

The Company has launched two new business divisions to cash-in on the vast untapped market potential and the core competence - viz. a technology division, for providing total e-engineering solutions/ services, and a trading division, for dealing in non-company products for domestic as well as overseas customers. The Company is also well into its contract mining operations and has roped-in an overseas company to partner in the business; the first contract mining project at Mangalore Ore India Limited is under execution. These new businesses are, in fact, expected to contribute significantly to the Company's sales and profitability, in the coming years.

Brazilian Joint Venture

BEML recently entered into a joint venture with a Brazilian firm, Compagnie Comercio E Contrucoes (CCC), with 60% share in the JV and the remaining 40% held by CCC, with the objective of manufacturing the entire range of mining & construction equipments and spares, For this new venture, the Company is committed to invest Rs 100 crores, by taking over a factory on the outskirts of Rio-de-Janeiro in Brazil. BEML intends to produce 500 wagons and 200 earth-moving equipments, with spares, given the expansion of mines and offtake of wagons in the Brazilian as well as other South American markets. The JV is expected to do a business of ~Rs 500 crores in next three years. This venture is a positive step by the Company, to consolidate its leadership position in construction & mining machines and railway products in the mineral-rich territory of Brazil, which is the largest country in South America, and is poised for a big impetus in development of rail/ road logistics in the Latin American region. Also, the presence of major world steel producers in Brazil signifies availability of raw material (mainly steel) from the domestic Brazil market.

Likely resolution of the Metro rail-coaches issue

BEML, in its press release outlining its Q1FY07 performance, stated that it has bagged a Letter of Intent (LoI) from DMRC for supplying ~400 metro cars, at an estimated value of about Rs 1,700 crores. However, later, due to the decision by the Karnataka Government to impose a 12.5% sales tax, which led to a price increase of Rs 60 -70 lakhs per coach, caused DMRC to withdraw the LoI. DMRC has floated an international tender for supply of these coaches. In its AGM, the BEML Management clarified that talks are on with the Government of Karnataka to get sales tax exemption on these metro coaches and BEML is confident of resolving the issue, both with the Karnataka Government and with DMRC.

As per the MoU with DMRC, the LoI cannot be withdrawn and any issue relating to pricing shall ultimately be referred to the inter-ministerial team, for the final decision. The Management reinforced that given the situation that BEML has developed in terms of capabilities and manufacturing technology, it would be able to succeed in converting the LoI to LoA (Letter of Agreement) and start supply to DMRC. Also, BEML is looking at 50% indigenisation of the metro coaches, which would be a great boost for the Company. BEML had entered the metro rail coaches scenario nearly three years ago, on the back of signing a technology transfer pact with South Korea's Rotem and has so far supplied 180 metro coaches to DMRC, with 40 in the assembly line. The rail-coach segment, currently contributing 10-15% of the turnover, is set to grow to 25% in a couple of years. BEML's estimate is that there would be a demand for 1,500 metro cars in the next five years, from many Indian states that are improving their urban commutation needs. Negotiations are also on with Dubai, for supply of Metro coaches.

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Exports Business to grow

The Company achieved an exports turnover of Rs 61.5 crores in 2005-06, supplying equipments and spares. Having achieved market penetration in 32 countries around the world, with a view to further boost the exports, the Company has taken several strategic initiatives during the year. Its exports group has been renamed the international business division and been spun-off as an independent SBU since year beginning. It has also opened offices at overseas locations, viz. Shanghai, China and Singapore, and representative offices in Morocco and Surinam, to provide after-sales service. The Company expects to significantly improve exports in the coming years.

Healthy Order Book

BEML started the year, 2006-07, with an order book of above Rs 2,500 crores, and orders more than Rs 500 crores have been booked till Aug 2006. More orders are expected during the course of the year, in mining and construction as well as in defence and railway & metro sectors. BEML is confident of meeting the sales target of Rs 2,500 crores, and in terms of profitability, it is confidant that the profit levels would not only be maintained but also improved further, during the current year.

Modernisation and Expansion Plans

During 2005-06, the Company committed approximately Rs 250 crores to capital expenditure, towards modernisation of all manufacturing units and for expansion of rail unit-II at KGF, for manufacture of rail coaches and wagons. The Company's rail complex at Bangalore would now be concentrating only on value-added, state-of-the-art metro coaches and related technology. A heavy fabrication unit at KGF, a dedicated ancillary doing heavy structural fabrications, parts and aggregates, has also become operational and has contributed to business worth Rs 4-5 crores during the year. A similar dedicated ancillary is being created in the Company's Mysore complex, to fabricate big structures on contract-basis, to bring down cost of products and increase product profitability in tune with global business practices.

A company-wide ERP system is under implementation, which is expected to network the old operations of the Company and its offices and take the Company to higher levels of operational efficiency and cost effectiveness. In addition to this, the Company is also implementing six-sigma, to improve quality and enhance exports. Also is expected financial assistance from the Government of India, to the tune of Rs 108 crores, towards up-gradation of its metro-manufacturing facility at the Bangalore complex, and Rs 125 crores as grant towards setting up an R&D centre of excellence, for research in metro rail systems.

The Management is confident that with these business strategies and initiatives in place, the Company would be able to achieve a Rs 5000-crore turnover by 2013-14, leading to a Rs 500-crore contribution and thus move ahead, on the journey towards the Rs 10,000-crore target.

Future Outlook

BEML has taken a giant leap forward towards becoming a truly global company. The recently signed JV with CCC, Brazil, to manufacture Mining and Construction equipment and rail products, with an equity participation of around 60%, would be doing a business of about Rs 500 crores, producing and supplying about 500 rail wagons and 200 in number construction equipment per year in about 3 years, to cater to the growing markets in Brazil as well as in other Latin American countries. BEML would be investing about Rs 100 crores in this JV and the manufacturing plant would be optional in the first half of 2007-08.

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Financials

YE Mar 31 (Rs crores)	FY05	FY06	Chg (%)
Gross Sales	1,856.0	2,205.8	18.8
Net Sales	1,746.5	2,074.0	18.8
Operating Profit	259.1	248.1	-4.2
PBT	271.9	285.3	4.9
Profit after Tax	175.3	186.9	6.6
PAT adj for extra-ord	190.0	197.5	3.9%
EPS (Rs)	47.5	50.7	6.6
EPS adj for extra-ord (Rs)	51.5	53.6	3.9
OPM (%)	*14.8*	*12.0*	
Equity Paid Up	36.9	36.9	
Networth	734.7	879.7	19.7
Capital Employed	812.2	905.7	11.5
Gross Block	544.0	565.1	3.9
ROCE (%)	40.3	35.5	
RONW (%)	26.2	23.2	

(Rs crores)	Q1FY07	Q1FY06	Chg (%)
Net Sales	334.8	377.2	-11.3
Total expenditure	315.6	357.3	-11.7
Operating Profit	19.2	20.0	-3.9
OPM (%)	*5.7*	*5.3*	
PBT	23.3	20.0	16.8
Profit After Tax	15.0	12.4	21.0
Equity Share capital	36.7	36.7	
EPS (Rs)	4.1	3.4	21.0
PBT (%)	*7.0*	*5.3*	
PAT (%)	*4.5*	*3.3*	

During 2005-06, BEML registered the highest ever sales, of Rs 2,205.8 crores, which is a growth of 18.8% over the previous year. BEML posted Operating profits of Rs 248.1 crores and PBT of Rs 285.4 crores, compared to Rs 259.1 crores and Rs 271.9 crores, respectively, for the corresponding period of the previous year. For the first time, all manufacturing divisions of the Company made profits during the year and the Engine Division in particular, which broke even and earned profits as opposed to having been making losses since its inception.

The effective and optimum utilisation and management of resources, cost reduction, improvement in overall labour productivity, timely supply of goods and services, inventory control and better management of funds helped in improving the operational performance.

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Conclusion & Investment Argument

BEML has witnessed a strong turnaround in its performance in last two years, on the back of strong growth in its core business of earthmoving equipment and spares. Also, the Defence business has seen steady growth in top-line and bottom-line. However, the Railways division is yet to completely come out of the red, although it has experienced improved performance, with reduction in losses.

Due to the high growth witnessed in the economy and the increasing activity in mining and construction, the order book continues to remain strong. Also, large orders received from the Defence sector last year, are keeping the growth momentum intact. We believe that the turnover target of Rs 2,500 crores for FY07 is likely to be achieved and contribution margins likely to improve.

Going forward, over the next three to five years, the key to high growth would be based on the Brazil JV and the DMRC order for Metro coaches. In fact, if both the initiatives were successful, the Company would achieve its Rs 5,000-crore turnover target much earlier, by 2010-11 than 2013-14.

At the CMP of Rs 937, the stock is quoting at a P/E of 16.3x its FY07(E) EPS of Rs 57.6. The stock looks attractively priced, on the back of strong growth opportunities. The near-term trigger for the stock would be the successful resolution of the order from DMRC for metro coaches, for which the Management has expressed a high level of confidence. Investors can buy the stock, with a medium to long-term perspective.

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WAY2WEALTH Research

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