MIC Electronics

Initiating Coverage

Buy

CMP: Rs 54

Target Price: Rs 72

Potential Upside: 35%

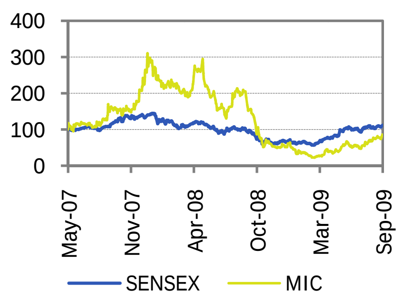
Key statistics

M cap (INR bn/USD mn)	: 5.4/111
Avg 3m daily vol.	: 1,980,389
Avg 3m daily value	: US$1.9mn
Shares O/S (mn)	: 101
Reuters	: MELC.BO
Bloomberg	: MICE IN
Sensex	: 16,454
Nifty	: 4,892
52-wk High/Low	: 125/15

Shareholding pattern (Jun '09) (%)

Indian promoter	*33.2*
FIIs	*10.2*
MFs, FIs & Banks	*2.9*
Others	*53.7*

Relative performance



Analysts:

Sameer Deshmukh
Email: sameer.deshmukh@tatacapital.com
Tel: +91 22 6745 9165

Gautam Mathur
Email: gautam.mathur@tatacapital.com

Spreading the radiance

Massive opportunities in Railways, improved traction in LED media display and the rapidly growing LED lighting segment are expected to drive MIC Electronics' growth. A first-mover advantage and established R&D capabilities are estimated to give an edge to the company compared to its competitors.

We estimate 17.6% and 20.7% CAGR in revenues and net profit through FY09-11E. We expect the company to post revenues of Rs3.6bn and Rs4.2bn in FY10E and FY11E respectively, and net profits of Rs811mn and Rs1bn in the same period. We are positive on the company's growth prospects and thus initiate our coverage with a target price of Rs 72, an upside of 35% from the current levels.

Massive opportunities in Railways: Indian Railways has taken up the task of modernising 590 large railway stations during the coming four years. This will include installing LED displays at platforms, general LED lighting and coach lighting. The annual addressable opportunity is around Rs2bn, and we expect MIC Electronics to be a major gainer due to its first-mover advantage and competitive bidding strategy.

Rapidly growing LED lighting business: The company has tied up with TERI (a non-profit research organisation) and IOCL to supply LED lanterns. The annual addressable opportunity in this segment is around Rs1.5bn. We believe that MIC will capture 25% of this opportunity as it is one of the few players shortlisted for the project, and the company has an established track record in LED business in the country.

Improved traction in LED display: With the economic recovery gaining pace globally, including India, we expect the LED display business to regain its momentum, going forward. MIC had recently bagged a contract from the Municipal Corporation of Delhi to install 50 large LED screens across the city. We also expect a revival in demand from the SLM joint venture.

Valuation

We expect the company to post an EPS of Rs 8.1 and Rs 8.6 in FY10E and FY11E, respectively. At the current market price of Rs 54, the stock is trading at a price earnings multiple of 6.7x and 6.3x based on FY10E and FY11E earnings. We initiate our coverage on the company with a '**Buy'** rating and a target price of Rs 72.

Financial summary

Year-end	Sales	YoY	EBITDA	YoY	NP	YoY	EPS	YoY	PE	EV/EBITDA	PSR	PBR	RoE	RoCE	DPS	Div yield
June	(Rs mn)	(%)	(Rs mn)	(%)	(Rs mn)	(%)	(Rs)	(%)	(x)	(x)	(x)	(x)	(%)	(%)	(Rs)	(%)
FY2008	3,608	33.2	903	108.2	701	105.1	5.9	76.5	17.5	11.7	2.9	3.8	31.8	30.4	0.4	0.7
FY2009E	3,050	-15.5	878	-2.7	681	-2.8	6.8	14.2	5.4	4.4	1.2	1.1	22.2	21.9	0.0	0.0
FY2010E	3,550	16.4	1,136	29.4	811	19.0	8.1	19.0	6.7	4.9	1.5	1.3	21.4	19.9	0.4	0.7
FY2011E	4,215	18.7	1,457	28.2	1,002	23.6	8.6	6.2	6.3	3.8	1.3	1.1	20.0	18.0	0.3	0.6

Company background

Established in the year 1988 and promoted by Dr MV Ramana Rao, a technocrat, MIC Electronics is the largest player in the Indian LED market.

The company has three divisions--LED Media, LED Lighting and Communications & Electronics. It is engaged in the design, development and production of True Color LED Video Display Systems, telecom software solutions and communication equipment (ICT). Considering the vast opportunities in the LED lighting and display business and low margins prevailing in the ICT business, MIC has been de-focusing on the latter since the past two years. It is the only company in India to have a “Design-to-Manufacture” capability for the manufacture of LED Display Systems.

MIC has a strong presence in the domains of LED Video Display (indoor/outdoor), Graphics and Text Displays, LED Lighting Solutions, Telecom Software and Communication & Electronic Products, and is supported by its headquarters at Hyderabad and three manufacturing locations. To meet the demand for its products worldwide, the company has set up establishments in Australia, Korea and the US.

MIC is working with the Indian Railways and the Municipal Corporation of Delhi to install LED video screens for the public. These projects are set to revolutionise the way information is displayed at public places. Recently, the Ministry of New and Renewable Energy (MNRE) approved MIC’s solar lantern design. These lanterns provide an eco-friendly facility to light up lakhs of Indian villages which do not have access to electricity.

TERI has undertaken the project “Lighting a Billion Lives” (LaBL) and aims to distribute solar lighting devices to people who do not have access to electricity. Similarly, Indian Oil Corp Ltd (IOCL) has a project which proposes to replace the kerosene lantern by a solar one, thus saving 500-600 liters of the fuel and avoiding 1.5 tons of CO_2 emission over its life. Being the largest player in the Indian LED market, MIC is the preferred supplier for these projects.

In 2008, MIC was selected for the “Best Under a Billion” category by Forbes Asia as one of the 22 Indian companies among 200 Asia Pacific companies.

The company successfully completed its IPO in May ’07 at the upper band of Rs 150 (face value of Rs 10), and it was oversubscribed 51 times. On NSE, MIC got listed at a 75% premium at Rs 262. Its revenues and earnings have grown at a CAGR of 43.1% and 64.4% through FY06-09.

Investment rationale

Massive opportunities in Railways

Indian Railways is in the midst of a major modernisation drive. In the first phase, the government has identified 590 large stations across the country, which will be renovated to match international standards. This process will include installation and maintenance of True Color LED display boards and General LED lighting on the platforms. We estimate that the annual addressable opportunity for MIC in LED display board and general lighting is around Rs1.1bn and Rs500mn, respectively.

The modernisation program will also include replacing the existing CFL lights in long distance trains. Currently, there are over 120,000 coaches with the railways. We estimate that even if the lights in only 5% of the coaches are replaced during the coming four years, the annual addressable opportunity for MIC stands at Rs450mn. The table below shows the annual addressable opportunity from the railways.

Table 1: Annual addressable opportunity

Category	Amount (Rs mn)
General lighting	500
LED display	1,100
Coach lighting	450
Total addressable opportunity per annum	2,050

Source: Tata Securities Research.

The company is at the forefront of securing orders from railways. It has already installed display boards at Patna and Sealdah junctions. *While competitors are still prototyping, MIC is the only player which has secured orders to install LED display boards at several stations.*

We expect MIC to continue with the momentum of securing orders from the railways, going forward. We expect it to garner revenues of Rs585mn and Rs1.2bn from the Railways in FY10E and FY11E respectively. The table below shows the estimated revenues for MIC from the Railways.

Table 2: MIC's revenue from railways

Category	FY10E	FY11E
General lighting	150	270
LED display	375	765
Coach lighting	60	150
Estimated revenues from the Railways (Rs mn)	585	1,185

Source: Tata Securities Research.

Rapidly growing LED lighting business

Several countries across the globe have taken steps to reduce their dependence on incandescent bulbs and opt for energy saving devices like the LED. The European Union has passed a resolution to phase out incandescent bulbs by 2010. Countries like Cuba and Venezuela have already phased it out.

LED has certain inherent benefits which, in our opinion, will drive the growth for the industry, going forward. These lights have a high shelf life of over 60,000 hours and generate very less heat radiation. The power consumption is a fraction of what is required for a conventional bulb, and they are maintenance free too. LED lights are environmental friendly as they lead to lesser CO_2 and mercury emissions.

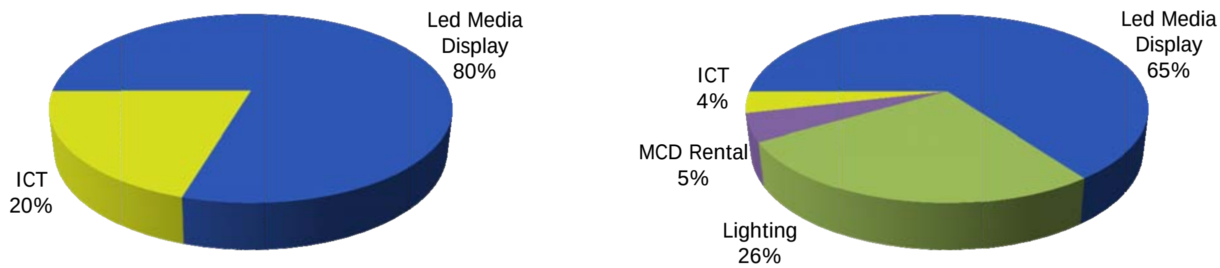
Table 3: Comparison between Incandescent, CFL & LED

Particulars		Incandescent	CFL	LED
Life span (in hours)		1,500	10,000	60,000
Watts		60	14	6
KWh of electricity used over 60k hours		3,600	840	360
Electricity costs @ Rs 5 per unit (Rs)	**a**	**18,000**	**4,200**	**1,800**
Cost per unit of bulb/CFL/LED		15	125	1,500
Bulbs needed for 60k hours of use		40	6	1
Equivalent 60k hour bulb expense (Rs)	**b**	**600**	**750**	**1,500**
Total 60,000 Hour Lighting Spend (Rs)	**a+b**	**18,600**	**4,950**	**3,300**
Savings over incandescent			**73%**	**82%**
Savings over CFL				**33%**

Source: Tata Securities Research.

The Energy and Research Institute (TERI), a non-profit research organisation, has set a target of distributing 200mn solar lanterns to rural households across the world. In India, TERI is expected to source close to 1mn solar-powered LED lamps over the next couple of years. MIC is one of the six players, whose prototype has been approved by TERI. We estimate that the company will supply around 300,000 LED lamps to TERI over the next couple of years thereby resulting in revenues of Rs600mn. Similarly, IOCL is in the process of selling LED lamps to rural households at subsidised rates through its 18,000 retail outlets. IOCL has identified MIC as a preferred supplier of LED lamps, and we estimate MIC to supply 150,000 lamps to IOCL over FY10-11E.

Chart1: Revenue break-up in FY09 and FY11E



Source: Tata Securities Research.

Improved traction in LED display business

Due to the economic slowdown, the LED display business had to witness a de-growth for the past two quarters. The division's revenues grew by 2% in FY09. With a gradual recovery taking shape in the global economy, we believe that the order flow will continue to improve, going forward.

The Commonwealth Games in 2010 and the Cricket World Cup in 2011 are expected to benefit the LED display business. MIC recently bagged a contract from the Municipal Corporation of Delhi (MCD) to install 50 display screens across the high streets and key locations. The company will install the screens in a year's time and will pay Rs60mn as yearly rent to MCD. In return, MIC will lease the screens to an advertising agency for a fixed amount. The payback for this project is five years. The table below shows the revenues and profitability for the MCD contract.

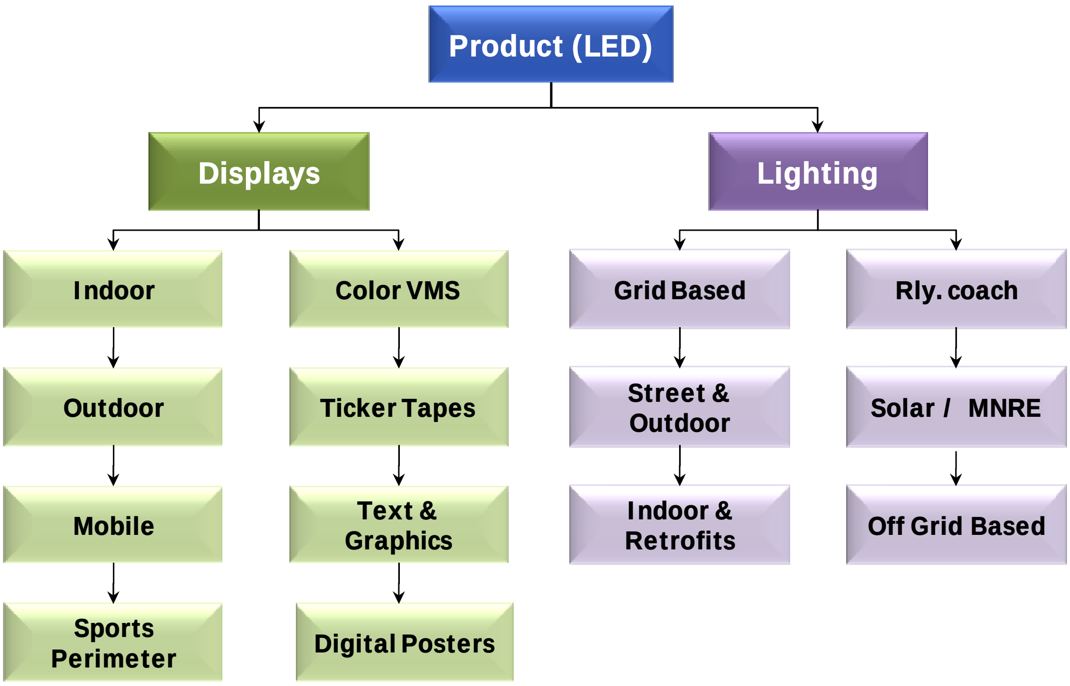
Table 4: The revenues and profitability for the MCD contract

	Amount (Rs mn)	
Particulars	**50 screens**	**1 screen**
Revenue from advt.	200	4.0
Less: MCD rent	(60)	(1.2)
Less: Overheads	(10)	(0.2)
Net receipts	130	2.6
EBITDA (%)	61.1	

Source: Tata Securities Research.

The chart below describes MIC Electronics' various business units.

Chart 2: Product portfolio



Source: Company, Tata Securities Research.

Risks and concerns

High receivables

Total debtors in MIC's books as on FY09E are estimated to be around Rs1.78bn and the debtors' days are 183, which is very high. Actual debts as on FY08 were Rs1.53bn. Major components include amounts due from a company in Hyderabad to whom LED display screens were sold. This company would in turn rent the screen for advertising purpose. Other components are receivables due from Lamar Advertizing in the US and the SLM joint venture.

Continued slowdown in the economy

The LED display business de-grew in the last half of FY09 on account of the slowdown in the economy. Going forward, if the recovery process is longer than expected, we believe that there could be some overhang in the performance of this division.

High dependence on Railways

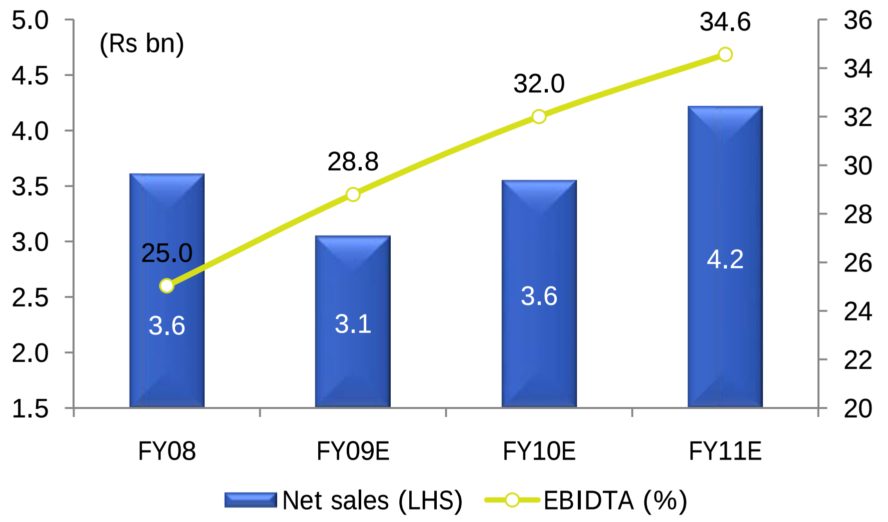
Going forward, we expect the opportunity in Railways to be a major growth driver for MIC. Any delay in allocation of new orders and execution could impact the performance of this business.

Financials and valuation

We expect MIC to post revenues of Rs 3.6bn (16.4% YoY growth) and Rs 4.2bn (18.7% YoY growth) in FY10E and FY11E respectively. The growth could have been higher, but for the planned decline in the Information and Communication (ICT) business. The margins in LED media are around 40% compared to 12-15% for the ICT business. EBITDA margins are expected to increase by 320bps in FY10E to 32% and by 260bps to 34.6% in FY11E due to an improved product mix.

Net sales and EBITDA are expected to see a CAGR of 17.6% and 28.8% through FY09-11E. We expect the company to post an EPS of Rs 8.1 and Rs 8.6 in FY10E and FY11E respectively.

Chart 3: Revenue and margin trend



Source: Tata Securities Research.

The Delhi MCD contract will involve a capital expenditure of Rs500mn. Similarly, the company is also expanding its capacities to cater to the LED lighting requirements. Over the next couple of years, we expect the company to incur a capital expenditure of Rs 1.1bn.

In Jul '08, MIC had issued 17.5mn share warrants to the promoters to be converted at a price of Rs 122 per share. Similarly, in Aug '09, 16.5mn share warrants were issued at a conversion price of Rs 44.36 per share. We do not expect the promoters to convert the first tranche of warrants as it is deep out of money. We expect the second tranche to be converted (as it is in the money) in FY11E, resulting in a dilution of 16.4%.

Valuation

At the current market price of Rs 54, the stock is trading at a price-earnings multiple of 6.7x and 6.3x based on FY10E and FY11E earnings. We believe that MIC is best-positioned to benefit from the LED (display and lighting) opportunity on account of a first-mover advantage. We are positive on the growth prospects of the company and initiate our coverage with a target price of Rs 72, an upside of 35% from the current levels. Our target price is based on a P/E multiple of 9x FY11E earnings.

MIC vs. Daktronics (The world's largest LED display manufacturer)

Daktronics Inc's stock is trading at a price earnings multiple of 20.6x and EV/EBITDA of 7.3x based on FY11E earnings. MIC, on the other hand, is trading at a P/E multiple of 6.5x and EV/EBITDA of 4x based on FY11E, respectively. Considering the growth prospects of MIC and the valuation discount compared to Daktronics, We believe that there is a sufficient scope for appreciation from the current levels.

Table 5: Financial summary of Daktronics

Particulars (YE April)	FY09	FY10E	FY11E
(Figures in $ mn)			
Net sales	582	440	486
EBITDA	67	33	41
PBT	42	8	20
Net profit	26	5	12
Earnings per share	0.6	0.1	0.4
EBITDA margin %	11.5	7.5	8.4
NPM %	4.5	1.1	2.6
Price/earnings ratio	12.4	56.8	20.6
EV/EBITDA	4.5	9.1	7.3

Source: Bloomberg

Financials

Profit & Loss (YE June)

(Rs Mn)	FY08	FY09E	FY10E	FY11E
Net sales	**3,608**	**3,050**	**3,550**	**4,215**
YoY (%)	***33***	***-15***	***16***	***19***
Total expenses				
Cost of goods sold	2024	1405	1786	2201
Staff cost	183	252	285	338
SG&A	498	515	343	220
EBIDTA	**903**	**878**	**1,136**	**1,457**
YoY (%)	***101***	***-3***	***29***	***28***
EBIDTA (%)	***25.0***	***28.8***	***32.0***	***34.6***
Depreciation	23	34	109	184
EBIT	**880**	**845**	**1,028**	**1,273**
Interest	27	71	84	104
Other income	18	8	10	10
PBT	**871**	**781**	**954**	**1,179**
Less: Taxation	152	94	143	177
Effective tax rate (%)	*17*	*12*	*15*	*15*
Recurring PAT	**719**	**688**	**811**	**1,002**
YoY (%)	***96***	***-4***	***18***	***24***
PAT (%)	***19.9***	***22.6***	***22.8***	***23.8***
Exceptional items Less: Minority Interest	18	7	0	0
Reported PAT	**701**	**681**	**811**	**1,002**

Balance Sheet

(Rs Mn)	FY08	FY09E	FY10E	FY11E
Equity capital	201	201	201	234
Share Application Money	394	394	0	0
Reserves	2,133	2,815	3,973	5,628
Net worth	**2,729**	**3,410**	**4,174**	**5,862**
Minority Interest	28	28	28	28
Total borrowings	261	400	900	1,150
Deferred tax	40	40	40	40
Total liabilities	**3,058**	**3,878**	**5,142**	**7,080**
Goodwill / Intangible	211	211	211	211
Gross block	**375**	**972**	**1,722**	**2,472**
Less: Acc. depreciation	112	146	255	438
Net block	263	826	1,467	2,034
CWIP	818	500	300	100
Investments	6	6	6	6
Current assets				
Inventories	208	306	356	423
Debtors	1,548	1,529	1,780	2,113
Cash	88	316	813	1,952
Loans and advances	712	764	890	1,056
Current liabilities & Provisio	828	612	712	845
Net current assets	**1,729**	**2,304**	**3,127**	**4,699**
Others	31	31	31	31
Total assets	**3,058**	**3,878**	**5,142**	**7,080**

Key Ratios

	FY08	FY09E	FY10E	FY11E
EPS (Rs)	5.9	6.8	8.1	8.6
CEPS (Rs)	7.4	7.1	9.1	10.1
Book value (Rs)	27	34	41	50
Dividend per share (Rs)	0.4	0.0	0.4	0.3
Debt Equity	0.1	0.1	0.2	0.2
Inventory Days	37	79	73	70
Debtor Days	157	183	183	183
ROCE (%)	30	22	20	18
ROE (%)	32	22	21	20
Dividend Yield (%)	0.7	0.0	0.7	0.6
Valuation Ratios				
PE (x)	17.5	5.4	6.7	6.3
Cash P/E (x)	14.0	5.1	5.9	5.3
Price/book value (x)	3.8	1.1	1.3	1.1
Market cap/sales (x)	2.9	1.2	1.5	1.3
EV/sales (x)	2.9	1.3	1.6	1.3
EV/EBITDA (x)	11.7	4.4	4.9	3.8

Cash Flow

(Rs Mn)	FY08	FY09E	FY10E	FY11E
Net profit	701	681	811	1,002
Depn and w/o	23	34	109	184
Deferred tax	22	0	0	0
Change in working cap	(747)	(300)	(327)	(432)
Operating cash flow	**(1)**	**415**	**592**	**754**
Goodwill / Intangible	(87)	0	0	0
Capex	(748)	(279)	(550)	(550)
Investments	1	0	0	0
Investing cash flow	**(834)**	**(279)**	**(550)**	**(550)**
Share application money	394	0	0	0
Dividend	(47)	(47)	(46)	(46)
Fresh Equity	0	0	0	732
Debt	168	139	500	250
Financing cash flow	**514**	**92**	**454**	**936**
Others	(19)	0	0	0
Net change in cash	(340)	228	496	1,139
Opening cash	429	88	316	813
Closing cash	**88**	**316**	**813**	**1,952**

Tata Securities Limited

Army & Navy Building, 2nd Floor, 148, M.G. Road, Fort, Mumbai 400 001

Tel: 91 22 6752 4000 Fax: 91 22 6637 8379 / 67524 007

Web: www.tatasecurities.com

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1. Name of the analysts:	Sameer Deshmukh / Gautam Mathur
2. Qualifications of the analysts:	B Com, CA / MBA
3. Analysts' ownership of any stock related to the information contained:	NIL
4. TSL ownership of any stock related to the information contained:	NIL
5. Broking relationship with company covered:	NO
6. Investment Banking relationship with company covered:	NO

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