



## Indo Tech Transformers

Ugly Duckling

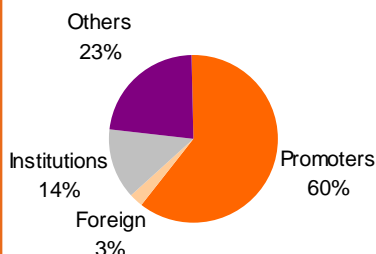
Powered by power reforms

Buy; CMP: Rs199

### Company details

Price target:	Rs280
Market cap:	Rs211 cr
52 week high/low:	Rs252/118
NSE volume: (No of shares)	75,231
BSE code:	532717
NSE code:	INDOTECH
Sharekhan code:	INDOTECH
Free float: (No of shares)	0.4 cr

### Shareholding pattern



### Price chart



### Price performance

(%)	1m	3m	6m	12m
Absolute	25.3	34.8	11.9	-
Relative to Sensex	18.3	14.7	-11.4	-

### Key points

- ◆ The fortunes of Indo Tech Transformers are all set get transformed, thanks to India's mission to achieve power for all by 2012. As part of this programme the government plans to almost double the country's installed power generation capacity from 115,000MW to 200,000MW by the end of the 11th Five-Year Plan.
- ◆ This initiative is expected result in an additional demand of around 570,000MVA of transformer capacity over FY2005-12 or of 80,000MVA per year. Another 15,000MVA of demand is expected from the replacement market every year, leading to a total annual demand of 95,000MVA. That is a huge opportunity for the transformer industry whose annual capacity stands at a mere 75,000MVA.
- ◆ Indo Tech already stands to gain from this opportunity, as it has built a strong relationship with the SEBs in the south over the years. Now to make the most of this demand explosion, it is tripling its capacity from 2,450MVA to 7,450MVA.
- ◆ Indo Tech has signed an MoU with DuPont (USA) to set up a 100MVA plant to manufacture dry-type transformers for industrial and corporate customers. These transformers are higher in realisation and installed in the basement of hotels, IT parks, malls etc. We believe this will further boost the top line of the company.
- ◆ As a result of these initiatives we expect its revenues and net profit to grow at CAGR of 52% and 49% respectively over FY2006-08E.
- ◆ At the current market price of Rs199, the stock is quoting at 8.6x its FY2008E EPS and 4.8x its FY2008E EV/EBIDTA. Considering the future growth potential of the company and the stock's attractive valuations, we recommend a Buy on the stock with a price target of Rs280.

### Company background

Indo Tech was incorporated in 1992. It started its business as a partnership firm, M/s Indo Tech Electric Company. It commenced production of small distribution transformers at Saidapet and Palakkad in 1976. Indo Tech went public in February 2006. Currently it has three plants with a total installed capacity of 2,450MVA.

### Key financials

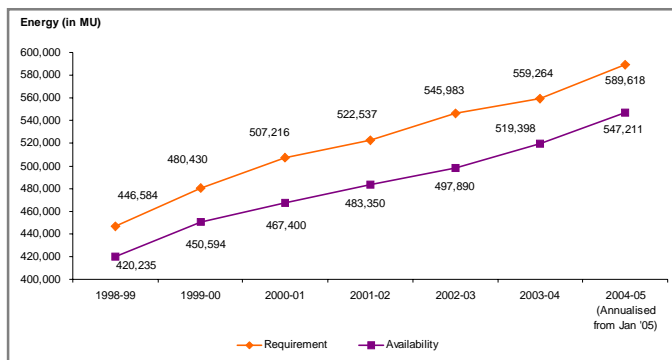
Particulars	FY2004	FY2005	FY2006	FY2007E	FY2008E
Net profit (Rs crore)	4.1	7.5	11.1	16.2	24.7
Shares in issue (crore)	0.3	0.3	1.1	1.1	1.1
EPS (Rs)	14.4	26.5	10.5	15.2	23.2
% y-o-y change		84.0	-60.6	45.6	52.6
PER (x)	13.9	7.5	19.1	13.1	8.6
Book value (Rs)	58.9	85.1	67.2	79.4	99.6
P/BV (x)	3.4	2.4	3.0	2.5	2.0
EV/EBIDTA (x)		4.1	9.2	7.2	4.8
EV/Sales (x)	1.0	0.7	1.8	1.5	1.0
Dividend yield (%)	0.0	0.0	1.0	1.5	1.5
RoCE (%)	29.2	39.2	23.0	27.6	33.8
RoNW (%)	24.5	36.8	23.3	20.8	25.9

**Investment arguments**

**Government's mission "Power for all by 2012"**

The government's emphasis on providing power for all by 2012 and the reform initiatives taken in this direction are likely to benefit all organised electrical equipment manufacturers, as there will be more thrust on quality products. This will enable organised players like Indo Tech to increase their sales by providing quality and reliable products to the state electricity boards (SEBs) and other customers. Indo Tech is already well placed to benefit from the government's "power for all" programme, as it has built a strong relationship with the various SEBs in the south over the years.

**Power supply position in India**

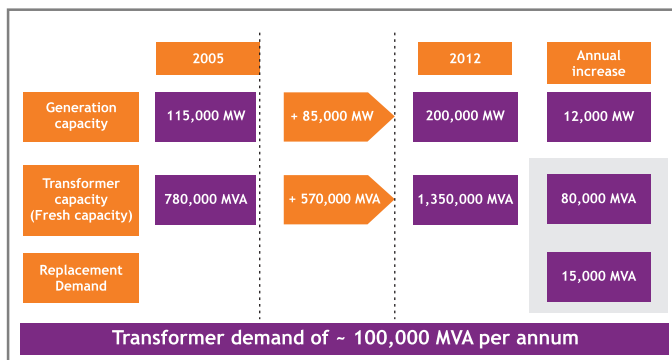


Source: Ministry of Power

**Huge demand potential**

With every megawatt (MW) of generating capacity being added, an additional 7 mega volt ampere (MVA) of transformer capacity is required. This means, if the country plans to achieve a generating capacity of 200,000MW by 2012 (115,000MW currently), then it will require an additional of 570,000MVA of transformer capacity to service this extra production. Also there is expected a replacement demand of around 15,000MVA per annum. Transformers usually have a life of 20-30 years, hence those transformers that were installed during 1970s/1980s are likely to be replaced in the next few years. This provides a huge business opportunity to organised players (like Indo Tech) in the transformer manufacturing business.

**What does this mean for transformers segment?**



Source: Ministry of Power

**Indo Tech transformer's product range**

Product	Rating	Maximum capacity
Distribution transformer	11/22/33KV	2.5MVA
Medium transformer	66/110/132/220KV	100MVA
Specialised transformer		
Wind mill application	11/22/33KV	250KVA-1,500KVA
Dry-type transformer	11/22KV	3.15MVA
Induction furnace	11/22/33KV	3.15MVA
Arc furnace	33KV	16MVA
Mobile transformer	230KV	60MVA
Unitised sub-station	33KV	5MVA

**Well-diversified robust order book**

Indo Tech had an unexecuted order book of Rs172 crore at the end of September 2006, with new orders to the tune of Rs79 crore booked during this quarter, reflecting the growing demand for transformers. We expect the order flow to remain robust as the demand for transformers is on an upswing. Indo Tech has a good mix of government and private sector projects which enables it to enjoy higher margins and protects it from any downturn in either sector.

**Strong customer base**

The company has a very strong customer base in south India, the prime customers being the state electricity boards, such as those of Tamil Nadu, Kerala, and Andhra Pradesh, as well as EPC contractors such as L&T, ABB and Reliance Energy.

**Dominant position in the south**

Over the years Indo Tech has established a strong relationship with the south-based SEBs and industrial customers. The clientele of the company includes the major SEBs from the south, ie Tamil Nadu Electricity Board, Andhra Pradesh Electricity Board, Karnataka Electricity Board and Kerala Electricity Board. These SEBs accounted for 70% of the company's total sales in FY2006. Over the years, the company has managed to get good orders from these SEBs and commands a reasonable market share in the south.

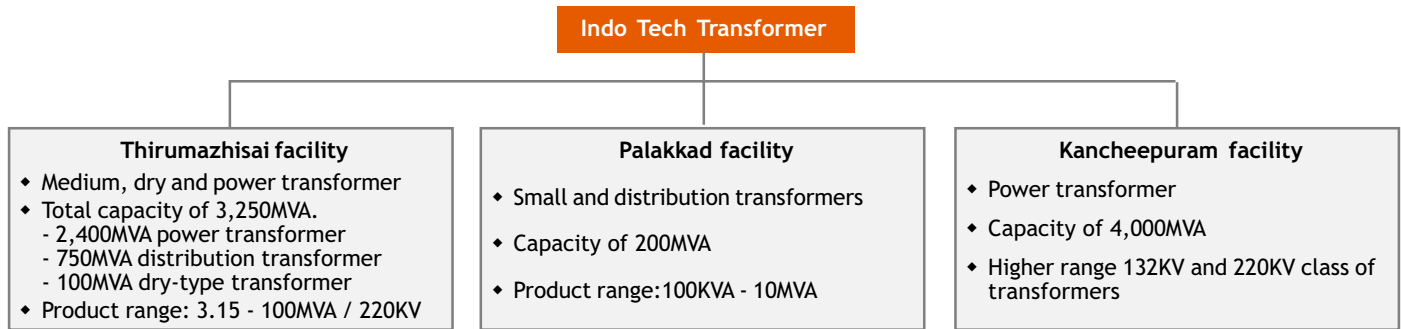
**Strong international presence**

Indo Tech is amongst the first Indian transformer manufacturers to export to North America. The company has a strategic tie-up with M/s. Mobile Source Inc Canada for marketing transformers in North/South American markets. The company has exported around 600 units to overseas markets in the past, however due to capacity constraints and a booming domestic market it did not export any in the past couple of years. Now with the enhanced capacity the company is again looking at the export market, where the margins are high.

**New products in pipeline**

Indo Tech has signed a memorandum of understanding with DuPont (USA) for setting up a 100MVA plant capable of

Expansion to cater growth



manufacturing dry-type transformers using Nomex insulating materials. The technology for the venture would be provided by the multinational. The proposed facility will be set up at its Thirumazhisai complex and will cater mainly to the requirements of industrial and corporate customers. A lot of software technology parks, hotels, hospitals and high-rise buildings are coming up in the major Indian cities where there is not sufficient space for setting up substations for oil-filled transformers. A lot of these projects require dry-type transformers, which are environment friendly and very safe, and hence can be placed indoors.

Penetrate new customer bases

Most of the customers of Indo Tech are based in the southern parts of India. In view of this, the company has a huge potential to expand its presence in the western and northern parts of the country. The company is targetting SEBs in the northern and central regions of India to widen its customer base.

Current and proposed capacity

Facility	Current (MVA)	Proposed (MVA)	Current status
Thirumazhisai— power transformer	1,800.0	2400.0	Operational from Nov 2007
Thirumazhisai— dist transformer	0.0	750.0	Operational from Nov 2007
Thirumazhisai— dry-type transformer	0.0	100.0	Will be operational by Jan 2007
Saidapet	450.0	0.0	Shifted to Trhirumazhisai
Palakkad— dist transformer	200.0	200.0	Already operational
Kancheepuram— power transformer		4,000.0	Will be operational by Sep 2007
<b>Installed capacity</b>	<b>2,450.0</b>	<b>7,450.0</b>	

Capex plans

Indo Tech has envisaged a capacity expansion plan that will increase its annual capacity from 2,450MVA currently to 7,450MVA by September 2008. The company proposes to invest Rs60 crore in this expansion exercise by

September 2008 and has already raised close to Rs38 crore from its initial public offer; the balance requirement would be met through internal accruals and debt.

Half-yearly performance

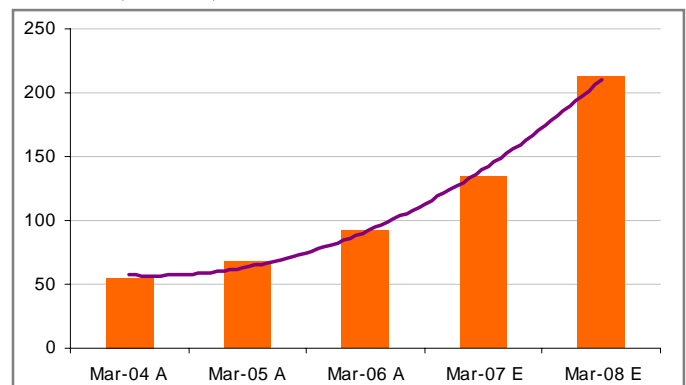
Particulars	H1FY07	H1FY06	% yoy chg
Net sales	53.9	41.6	29.4
Other income	1.8	0.3	513.8
Total income	55.7	41.9	32.8
EBIDTA	10.5	7.4	42.7
OPM (%)	19.5	17.7	
Net profit	7.8	5.0	57.0
NPM (%)	14.0	11.9	

In the first half of the current financial year, Indo Tech reported a growth of 29.4% in its net sales to Rs53.9 crore as against Rs41.6 crore in the last year. Its earnings before interest, depreciation, tax and amortisation (EBIDTA) margin stood at 19.5% as against 17.7% in the last year. The net profit of the company grew by 57% to Rs7.8 crore as against Rs4.9 crore and the net profit margin stood at 14% as against 11.9% in the same period last year.

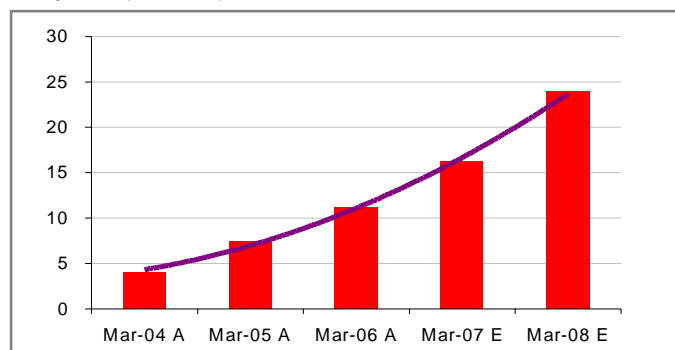
Revenue and profit growth

The company has shown consistent growth in its revenues and profits over the past three years. Considering the robust order book and expansion plans, we expect the company to show a strong revenue growth in the coming years as well.

Net sales (Rs crore)



## Net profit (Rs crore)



## Installed capacity of peer group

	Installed capacity (MVA)	Actual production (MVA)	Capacity utilisation (%)
Crompton Greaves*	19500	14074	72
BHEL	16000	14925	93
Alstom*	8500	5546	65
EMCO	8500	5964	70
ABB	8000	5383	67
Voltamp	4500	4462	99
Bharat Bijlee@	3800 to 8000	2912	77
Indo Tech#	2450 to 7450	1890	77

\*Includes reactors capacity

Source: Company Annual reports

@ Recently expanded in March 2006

# Being expanded by September 2007

## Risks and concerns

Indo Tech is in the business of manufacturing transformers which is dependent on the power sector reforms undertaken by the government. Since this is a politically sensitive issue, there could be a delay in the implementation of these reforms which could, in turn, delay the execution of the power projects.

Approximately 70% of the company's revenues come from the SEBs. Any delay in payment by them could affect our estimates for the company. However, most of these projects are funded by the World Bank and Indo Tech has not faced any such delays in the past which reduce this risk.

The company's growth is dependent on the availability of key raw materials, ie CRGO, copper and transformer oil. These constitute between 65-70% of its net sales. Any abnormal rise in the prices of these will affect the profitability of the company in case it fails to pass on the same to its customers. However, most of the company's projects have price escalation clauses and the company places back-to-back orders for the raw materials that reduce this risk as well.

## Valuation

At the current market price of Rs199, the stock is quoting at 8.6x its FY2008E earnings per share (EPS) and 4.8x its FY2008E enterprise value (EV)/EBIDTA. Considering the strong growth prospects of the company and of the industry as a whole, we believe that the stock is trading at attractive valuations. We recommend a Buy on Indo Tech with a price target of Rs280 at which level the stock would be trading at 12x its FY2008E EPS.

## Financials

## Profit and loss account

Rs (cr)

Particulars	FY04	FY05	FY06	FY07E	FY08E
Net sales	55.2	67.5	92.7	134.3	212.8
Other income	0.3	0.6	0.8	2.5	2.0
Total income	55.5	68.1	93.5	136.8	214.8
Total expenditure	48.7	56.3	75.4	109.3	172.7
Operating profit	6.8	11.8	18.1	27.4	42.1
Depreciation	0.7	0.9	0.9	1.6	3.2
PBIT	6.1	10.9	17.3	25.9	38.9
Interest	1.1	0.6	0.7	1.5	1.8
Profit before tax	5.0	10.3	16.5	24.3	37.1
Tax	0.9	2.8	5.4	8.2	12.5
Profit after tax	4.1	7.5	11.1	16.2	24.7
Reported net profit	4.1	7.5	11.1	16.2	24.7

## Balance sheet

Rs (cr)

Particulars	FY04	FY05	FY06	FY07E	FY08E
<b>Sources of funds</b>					
Share capital	2.8	2.8	10.6	10.6	10.6
Reserves total	13.8	21.1	60.7	73.7	95.2
Total shareholders funds	16.6	23.9	71.3	84.3	105.8
Total debt	2.6	2.1	2.0	7.6	7.6
Net deferred tax	1.8	1.8	1.6	1.6	1.6
Total liabilities	21.0	27.8	75.0	93.6	115.0
<b>Application of funds</b>					
Net block	9.5	10.6	13.4	47.9	68.6
Capital work in progress	0.2	0.0	0.0	0.0	0.0
Investments	0.1	0.1	11.3	11.3	11.3
Net current assets	11.2	17.2	50.2	34.4	35.1
Misc expenses not w/o	0.0	0.0	0.0	0.0	0.0
Total assets	21.0	27.8	75.0	93.6	115.0

## Valuations

Particulars	FY04	FY05	FY06	FY07E	FY08E
EPS (Rs)	14.4	26.5	10.5	15.2	23.2
PER (x)	13.9	7.5	19.1	13.1	8.6
P/BV (x)	3.4	2.4	3.0	2.5	2.0
EV/EBIDTA (x)	0.0	4.1	9.2	7.2	4.8
EV/Sales (x)	1.0	0.7	1.8	1.5	1.0

## Key ratios (%)

Particulars	FY04	FY05	FY06	FY07E	FY08E
OPM	11.8	16.6	18.7	18.6	18.9
PATM	7.3	11.0	11.9	11.8	11.5
RoCE	29.2	39.2	23.0	27.6	33.8
RoNW	24.5	36.8	23.3	20.8	25.9

The author doesn't hold any investment in any of the companies mentioned in the article.

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