

APAR INDUSTRIES

INR 247

Strong performance, revising estimates

BUY



Apar Industries' (Apar) Q2FY07 results were ahead of our expectations in terms of growth of revenue and margin. Revenue grew by 27.4% Y-o-Y, driven by strong performance in conductor business, which grew by 39% Y-o-Y. EBITDA grew by 42% Y-o-Y to INR 274 mn, while earnings grew by 59% Y-o-Y to INR 121 mn. EBITDA margin expanded by 80bps Y-o-Y to 7.8% primarily on lower operating expenses as a percentage of sales. Net margin expanded by 70bps Y-o-Y to 3.4%, due to gains on non-operating exchange rate differences. From June 2006, the company adopted a comprehensive hedging strategy to prevent forex losses. Net margins (adjusted) were at 4.1% for the quarter.

IN Q2FY07, on a business segment basis, the conductors business revenues grew by 39% Y-o-Y, polymer business declined by 11% in revenues Y-o-Y, and the transformer oil business revenues grew by 27% Y-o-Y. Conductors business formed 46% of total revenue and 41% of the operating profit (EBIT). The transformer oil business contributed 45% to the total revenue and 63% to the total EBIT in Q2FY07. The polymer division's first half has been affected on account of suspension of production during relocation of operations from Trombay to the Valia unit. Additionally, margins in the business were under pressure due to increase in cost of fuels and raw materials.

Key highlights of the quarter

- Conductor volumes were at 12,100 MT, transformer oil volumes were at 43,000 KL and polymer volumes were at 3,100 MT for Q2FY07.
- 15,000 MT capacity conductor manufacturing facility commissioned at Nalaghar, HP.
- JV formed in Australia to sell bulk transformer oil and other specialty oils.

* Encouraging outlook in the conductor business

The conductor business grew by 54% for H1FY07. More importantly the business mix changed to include ~30% high end alloy and ACSR in the total conductor revenues in H1FY07 from ~20% in FY06. Consequently EBIT margins have improved for the conductor business. We believe this trend is likely to continue as Apar is one of the few approved suppliers of conductors for Power Grid Corporation (PGCIL).

* Attractive valuations

We are revising our numbers upwards for Apar after strong Q2FY07 results and favorable macro environment in the power T&D space. With more than 60% of revenues coming from the power sector, we believe Apar will benefit from the ongoing and upcoming investments in power T&D space. On our revised EPS of INR 28.1 and INR 38.7 for FY07E and FY08E, respectively, the stock trades at attractive valuations of 8.8 FY07E and 6.4 FY08E earnings.

We continue to remain positive on the stock and reiterate our 'BUY' recommendation.

Financials

Year to March	Q2FY07	Q2FY06	% change	Q1FY07	% change	FY06	FY07E
Revenues (INR mn)	3,615	2,839	27.4	3,313	9.1	11,124	14,870
EBITDA (INR mn)	274	192	42.3	317	(13.6)	880	1,058
Net profit (INR mn)	149	80	85.9	118	26.7	549	585
EPS (INR)	5.8	3.7	58.6	5.3	9.3	26	28
PE (x)						9.3	8.8
EV/EBITDA (x)						5.8	5.0
ROAE (%)						39.7	27.9

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Priyanko Panja
+91-22-2286 4300
priyanko.panja@edelcap.com

Misal Singh
+91-22-2286 4316
misal,singh@edelcap.com

Reuters : APAR.BO
Bloomberg : APR IN

Market Data

52-week range (INR) : 294 / 152
Share in issue (mn) : 20.8
M cap (INR bn/USD mn) : 5.1 / 114.0
Avg. Daily Vol. BSE ('000) : 21.1

Share Holding Pattern (%)

Promoters : 69.9
MFs, Fls & Banks : 8.9
Fls : 4.1
Others : 17.1

* **Conductor business driving growth**

Conductor business showed robust growth in the quarter, growing by ~39% Y-o-Y, while it was up ~54% for H1FY07 Y-o-Y. The order book backlog of the conductors business was INR 5.5 bn at the end of Q2FY07. The business mix was broadly similar to Q2FY06 and Q1FY07, with the conductors business contributing 46%, polymer business contributing 9%, and the transformer oil business contributing 45%. We believe, going forward, the conductors business is going to be the major driver of growth for the company given the positive macro environment in the power sector. Apar is one of the major players in the domestic conductor market, with a market share of ~23%. Additionally, we believe the change in the product mix of conductors business in favor of high-end products like alloy conductors and ACSR conductors is likely to impact the margins from the conductors business positively. The oil business continues to show healthy growth at ~30% for H1FY07 Y-o-Y. However, we believe margins from the oil business are likely to be impacted in H2FY07 due to high volatility in crude oil prices and increase in inventory losses

* **Revising estimates: Greater contribution from conductors**

We are upgrading our estimates for Apar in the backdrop of change in the underlying business segments. Conductors business showed strong growth and improvement in margins in H1FY07, while the polymer business declined in the first half. On a consolidated basis we are revising our revenues estimates by 17% and 40% for FY07E and FY08E, respectively. We expect conductors to contribute 49%, transformer oils to contribute 41%, and polymers to contribute 10% to the total standalone revenues in FY07E. Our conductors business sales growth estimates stand revised to ~55% and ~50% from previous estimates of 29% and 8% in FY07E and FY08E, respectively, in the backdrop of increase in realizations and volumes. We are softening our growth expectations from the polymer business as production dropped in H1FY07, due to the shifting of the manufacturing unit to Valia. Decline in demand for HSR and increase in competition due to imports of NBR from Korea and Japan is likely to impact the polymer business negatively. We expect the revenues of polymers business to decline by 4% in FY07E. We are keeping the growth estimates for the revenues of transformer oil segment broadly the same at 15% for FY07E. We have summarized our key revisions in the table below.

Table 1: Revised estimates post Q2FY07 results

	Previous estimates		Revised estimates		Remarks
	FY07E	FY08E	FY07E	FY08E	
Revenues (INR mn)	12,726	13,798	14,870	19,250	Increase in growth from the conductor and transformer oil business
EBITDA (INR mn)	873	953	1,058	1,367	Increase in margins due to better mix of conductors
EBITDA margin (%)	6.9	6.9	7.1	7.1	
PAT (INR mn)	571	647	585	805	
Net margin (%)	4.5	4.7	3.9	4.2	
EPS (INR)	27.5	31.1	28.1	38.7	

Source: Edelweiss research

* **Outlook and Valuations**

We are revising our numbers upwards for Apar after strong Q2FY07 results and favorable macro environment in the power T&D space. With more than 60% of revenues coming from the power sector, we believe Apar will benefit from the ongoing investments in the power sector. On our revised EPS of INR 28.1 and INR 38.7 for FY07E and FY08E, respectively, the stock trades at attractive valuations of 8.8 FY07E and 6.4 FY08E earnings. We continue to remain positive on the stock and reiterate our **'BUY'** recommendation.

Financials snapshot								(INR mn)
Year to March	Q2FY07	Q2FY06	% change	Q1FY07	% change	FY06	FY07E	FY08E
Revenues (net)	3,615	2,839	27.4	3,313	9.1	11,124	14,870	19,250
Raw material	2,873	2,246	27.9	2,558	12.3	9,282	12,486	16,142
Staff cost	40	35	14.9	37	7.2	138	268	351
Other operating expenses	428	365	17.3	401	6.7	823	1,057	1,389
Total expenditure	3,342	2,646	26.3	2,996	11.5	10,243	13,811	17,883
EBITDA	274	192	42.3	317	(13.6)	880	1,058	1,367
Depreciation	23	18	26.3	23	1.3	86	113	117
EBIT	250	174	44.0	294	(14.8)	794	945	1,251
Interest	67	81	(17.0)	147	(54.4)	209	264	264
Other income	8	10	(18.7)	12	(26.6)	45	36	30
Extraordinary items	28	4	NM	7	-	-	-	-
PBT	164	100	64.5	152	8.1	629	718	1,017
Tax	43	23	83.8	41	4.8	80	133	212
Adjusted net profit	149	80	85.9	118	26.7	549	585	805
Reported net profit	121	76	58.6	111	9.3	549	585	805
Equity capital(FV:INR10)	208	208	0.0	208	-	208	208	208
# of shares (mn)	21	21	0.0	21	-	21	21	21
EPS (INR)	6	4	58.6	5	9.3	26	28	39
Market cap. (INR mn)						5,129	5,129	5,129
PE (x)						9.3	8.8	6.4
EV/EBITDA (x)						5.3	4.4	3.4
Market cap / Revenues (x)						0.5	0.3	0.3
as % of net revenues								
Raw material	79.5	79.1	0.4	77.2	3.0	83.4	84.0	83.9
Other operating expenses	11.8	12.9	(7.9)	12.1	(2.2)	7.4	7.1	7.2
EBITDA	7.6	6.8	11.7	9.6	(20.9)	7.9	7.1	7.1
Adjusted net profit	4.1	2.8	45.9	3.5	16.1	4.9	3.9	4.2
Tax rate	26.1	23.4	11.7	26.9	(3.0)	12.7	18.5	20.8

Financial Statements

Income statement					(INR mn)
Year to March	FY04	FY05	FY06	FY07E	FY08E
Income from operations	6,661	8,741	11,124	14,870	19,250
Direct costs	5,566	7,400	9,282	12,486	16,142
Employee costs	159	139	138	268	351
Other expenses	567	683	823	1,057	1,389
Total operating expenses	6,292	8,222	10,243	13,811	17,883
EBITDA	370	519	880	1,058	1,367
Depreciation and amortisation	84	86	86	113	117
EBIT	286	433	794	945	1,251
Interest expenses	51	146	209	264	264
Other income	48	65	45	36	30
Profit before tax	283	353	629	718	1,017
Provision for tax	21	31	80	133	212
Extraordinary items	(33)	6	101	-	-
Reported profit	295	315	448	585	805
Adjusted net profit	262	322	549	585	805
Shares outstanding	20.8	20.8	20.8	20.8	20.8
Dividend per share	2.2	3.2	3.5	4.0	4.5
Dividend payout (%)	15.9	20.8	16.2	17.0	16.9

Common size metrics- as % of net revenues

Year to March	FY04	FY05	FY06	FY07E	FY08E
Operating expenses	94.4	94.1	92.1	92.9	92.9
Depreciation	1.3	1.0	0.8	0.8	0.6
Interest expenditure	0.8	1.7	1.9	1.8	1.4
EBITDA margins	5.6	5.9	7.9	7.1	7.1
Net profit margins (adjusted)	3.9	3.7	4.9	3.9	4.2

Growth metrics (%)

Year to March	FY04	FY05	FY06	FY07E	FY08E
Revenues	22.8	31.2	27.3	33.7	29.5
EBITDA	64.1	40.2	69.7	20.2	29.2
PBT	45.6	24.7	78.5	14.1	41.6
Net profit (adjusted)	69.1	22.9	70.8	6.5	37.7
EPS	69.1	22.9	70.8	6.5	37.7

Cash flow statement

Cash flow statement					(INR mn)
Year to March	FY04	FY05	FY06	FY07E	FY08E
Net profit	262	322	549	585	805
Add: Depreciation	84	86	86	113	117
Add: E.O.adjustments	(33)	6	101	-	-
Add: Deferred tax	(20)	(11)	1	-	-
Gross cash flow	293	402	739	698	922
Less: Dividends	52	66	79	83	94
Less: Changes in W. C.	(186)	154	(492)	727	306
Operating cash flow	427	182	1,152	(113)	522
Less: Change in investments	4	7	(9)	9	-
Less: Capex	47	154	261	457	80
Free cash flow	377	21	900	(579)	442

Balance sheet					(INR mn)
As on 31st March	FY04	FY05	FY06	FY07E	FY08E
Equity capital	263	239	846	846	846
Reserves & surplus	448	689	992	1,541	2,318
Shareholders funds	711	928	1,838	2,387	3,164
Secured loans	1,204	1,146	554	1,150	1,150
Unsecured loans	321	320	502	802	802
Borrowings	1,526	1,465	1,056	1,952	1,952
Sources of funds	2,236	2,394	2,894	4,339	5,116
Gross block	1,571	1,640	1,880	2,460	2,540
Depreciation	699	781	854	967	1,084
Net block	871	858	1,026	1,493	1,456
Capital work in progress	18	103	123	0	0
Total fixed assets	889	961	1,149	1,493	1,456
Investments	5.7	12.7	3.7	12.8	12.8
Inventories	1,106	1,144	2,332	3,259	4,219
Sundry debtors	1,891	2,044	2,606	3,667	4,747
Cash and equivalents	823	717	1,514	1,878	2,385
Loans and advances	320	499	534	733	949
Other current assets	1	1	1	1	1
Total current assets	4,140	4,404	6,987	9,538	12,302
Sundry creditors and others	2,628	2,841	5,081	6,518	8,438
Provisions	40	41	79	102	132
Total CL & provisions	2,668	2,883	5,161	6,620	8,570
Net current assets	1,473	1,521	1,826	2,918	3,731
Net deferred tax	(146)	(134)	(136)	(136)	(136)
Others	15	33	52	52	52
Uses of funds	2,236	2,394	2,894	4,339	5,116
Book value per share (BV)	34	45	88	115	152

Ratios

Year to March	FY04	FY05	FY06	FY07E	FY08E
ROAE (%)	37.8	39.2	39.7	27.7	29.0
ROACE (%)	13.5	18.7	30.0	26.1	26.5
Current ratio	1.6	1.5	1.4	1.4	1.4
Debtors (days)	104	85	86	90	90
Fixed assets t/o (x)	7.4	9.4	10.5	11.3	13.1
Working capital t/o (x)	5.1	5.8	6.6	6.3	5.8
Debt/Equity	2.1	1.6	0.6	0.8	0.6

Valuations parameters

Year to March	FY04	FY05	FY06	FY07E	FY08E
EPS (INR) (adjusted)	12.6	15.5	26.4	28.1	38.7
Y-o-Y growth (%)	69.1	22.9	70.8	6.5	37.7
CEPS (INR) (adjusted)	16.6	19.6	30.6	33.5	44.3
PE (x)	19.6	15.9	9.3	8.8	6.4
Price/BV(x)	7.2	5.5	2.8	2.1	1.6
EV/Sales (x)	0.7	0.5	0.4	0.3	0.2
EV/EBITDA (x)	12.6	9.0	5.3	4.4	3.4

Edelweiss Securities

14th Floor, Express Towers,
Nariman Point, Mumbai – 400 021
Board: (91-22) 2286 4400
Email: research@edelcap.com



Naresh Kothari – 2286 4246

Head, Institutional Equities

Vikas Khemani – 2286 4206

Co-Head, Institutional Equities

INDIA RESEARCH	SECTOR	INSTITUTIONAL SALES
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Gautam Roy - 2286 4305	Airlines, Textile	Rajesh Makharia - 2286 4202
Ashutosh Goel - 2286 4287	Automobiles, Auto Components	Shabnam Kapur - 2286 4394
Vishal Goyal, CFA - 2286 4370	Banking & Finance	Ashish Maheshwari - 2286 4418
Revathi Myneni - 2286 4413	Cement	Amish Choksi - 2286 4201
Sumeet Budhraja - 2286 4430	FMCG	Deepak Rao - 2286 4204
Harish Sharma - 2286 4307	Infrastructure, Auto Components, Mid Caps	Balakumar V - (044) 4263 8283
Priyanko Panja - 2286 4300	Infrastructure, Engineering, Telecom	Monil Bhala - 2286 4363
Hitesh Zaveri - 2286 4424	Information Technology	Ashish Agrawal - 2286 4301
Pritesh Vinay - 2286 4429	Metals, Mining	Nikhil Garg - 2286 4282
Priyank Singhal - 2286 4302	Media, Retail	Neha Shakra - 2286 4276
Prakash Kapadia - 2286 4432	Mid Caps	Priya Ramchandran - 2286 4389
Niraj Mansingka - 2286 4304	Oil & Gas, Petrochemicals	Anubhav Kanodia - 2286 4361
Nimish Mehta - 2286 4295	Pharmaceuticals, Agrochemicals	Tushar Mahajan - 2286 4439
Swati Khemani - 2286 4266	Textile	Harsh Biyani - 2286 4419
Manika Prem Singh - 4019 4847	Economist	Nirmal Ajmera - 2286 4258
Sachin Arora - 2286 4512	Alternative & Quantitative	Ankit Doshi - 2286 4671
Sunil Jain - 2286 4308	Alternative & Quantitative	Ravi Pilani - 4009 4533
Yogesh Radke - 2286 4328	Alternative & Quantitative	Dipesh Shah - 2286 4434

Email addresses: firstname.lastname@edelcap.com

e.g. naresh.kothari@edelcap.com

unless otherwise specified

RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period

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