

December 18, 2009

**Not Rated**

Price	Target Price
<b>Rs209</b>	<b>NA</b>

<b>Sensex</b>	<b>16,913</b>
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**Price Performance**

(%)	1M	3M	6M	12M
Absolute	(6)	19	18	67
Rel. to Sensex	(8)	12	5	(5)

Source: Capitaline

**Stock Details**

Sector	Engg & Cap Goods
Reuters	SHRI.BO
Bloomberg	SEPC@IN
Equity Capital (Rs mn)	435
Face Value(Rs)	10
No of shares o/s (mn)	43
52 Week H/L	265/77
Market Cap (Rs bn/USD mn)	9/197
Daily Avg Volume (No of sh)	115500
Daily Avg Turnover (US\$m)	0.6

**Shareholding Pattern (%)**

	S'09	J'09	M'09
Promoters	42.4	42.5	42.6
FII/NRI	38.2	38.3	38.3
Institutions	4.9	4.9	4.9
Private Corp	3.0	2.9	2.8
Public	11.4	11.4	11.4

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**Long term growth intact**

Shriram EPC (SEPC) is an EPC and project management company in renewable energy, process and metallurgy, municipal services and wind turbine generation (WTG). We recently visited the WTG plant (in JV with Leitner) near Chennai. We believe that WTG will be a long term growth driver with expected secular demand arising from amendment in CERC regulations. However, in the short term we believe that the business is likely to be impacted by over capacity and pricing pressure in the domestic market. Improving order inflows in core EPC business (contributing over 80% of revenues) is a silver lining – order inflows have improved from Rs0.8 bn in Q4FY09 to over Rs2 bn in Q2FY10, allaying investor concerns. However, low order book cover (1.7X FY09 revenues) and low earnings visibility (next 4-5 quarters) poses risks to earning estimates in near term. Going forward, OGPL is likely to offer upsides to valuation. Presently the stock is trading at 11.5X FY10E and 8.7X FY11E consolidated consensus earnings of Rs18.5 and Rs24.3 per share respectively.

**Visit to the WTG plant near Chennai**

We visited the JV's WTG plant located at Gummidipoondi, TN (55 kms from Chennai). Key takeaways from our plant visit –

- The plant has been set up at a cost of Rs1.2 bn and has a capacity to manufacture 120 WTG sets p.a. in the +1MW range. It is the global sourcing hub for Leitner. It commenced trial productions in Jan '09.
- It has received certification for 1.35MW class WTG and expects to receive certification for 1.5 MW shortly. The JV plans to increase capacity to 250 units (350 MW) at an incremental capex of Rs1.2 bn and obtain certification for 3MW class WTG sets by 2011.
- The WTG sets are based on gearless permanent magnet technology patented by Leitner and employ modular designs. The benefits of the above are (1) high machine availability - at about 96% (2) higher energy generation (+5 to 7%) (3) lower maintenance costs - relatively 10-20% lower, (4) lower breakdown through fault resistant generators (5) low downtime and easy to maintain due to modular construction and lower number of hydraulic parts (6) suitable for class 2&3 areas (low wind areas).
- The JV presently outsources manufacture of the tower (a Trichy based company) and blades (LM Glassfibre, Bangalore). It plans to fabricate blades in-house, at a later date, by extending the existing facility in an adjoining vacant plot. The JV is also considering use of castings (outsourced from L&T) as against in-house fabrication of the mainframe (Nasal). This shall reduce lead time by 15-30 days.
- The JV presently supplies WTG sets at about Rs90 mn (EPC basis) - a 5-10% premium to peers. It expects to earn 17% gross margins on the above on sustainable basis.
- The JV has so far installed 12 WTG sets and is manufacturing another 15 sets to be supplied over next 6-12 months. The JV needs to manufacture about 50-55 (75-80 MW) units to break even. It expects to supply 40 units in FY10E (largely in the domestic market) and about 100 sets in FY11E (30% export).

**Financial Snapshot: Rs Mn**

YE-Mar	Net Sales	EBITDA (Core)	EBITDA (%)	APAT	AEPS (Rs)	EV/ EBITDA	P/BV	RoE (%)	P/E
FY05	743	68	9.2	8	0.4	8.9	19.9	4.1	511.1
FY06	1,445	133	9.2	74	3.7	1.8	2.7	8.3	57.6
FY07	2,957	244	8.2	131	6.5	2.2	2.5	8.0	32.7
FY08	6,999	794	11.3	352	8.2	1.8	2.5	13.3	25.9
FY09	10,058	928	9.2	475	11.0	1.7	2.3	12.4	19.3

### WTG Outlook – Concerns in short term, But long term remains robust

The WTG industry is witnessing strong headwinds in the aftermath of economic downturn and slowdown in investment spends, in both domestic and export markets. WTG prices have declined 10-15% over the past year as supply continues to exceed demand. Further domestic competition is likely to intensify (1) entry of new players like GE and (2) capacity expansion by existing players – e.g. Vestas is expected to double domestic capacity to 500 MW. However, SEPC has witnessed an increase in domestic enquiries. It expects to bag few orders from NTPC (100 MW), NLC (50 MW) and number of ports (5-10 MW each). SEPC also expects to benefit from captive business from its associate Orient Green Power. We believe that SEPC's targets are not very ambitious given product profile and small base facility (~175 MW presently).

We believe that, going forward, domestic market shall witness secular demand for WTG sets brought by amendment in CERC regulations (The regulations mandate independent power producers to produce about 5-10% of energy produced from non-renewable sources through renewable sources).

### EPC business – Low order book cover at 1.7X remains a concern

SEPC's order book has declined continually for the past 4-5 quarters – down 31.5% yoy to Rs14.5 bn (-8.6% qoq) as on Sep '09, on back of slowdown in private investment spends. Consequently, its order book cover has declined to 1.7X FY09 revenues (down from peak of 7.7X in FY08) – rendering low earnings visibility at 4-5 months with an average execution cycle of 18-20 months. However, improvement in order inflows during H1FY10 is the silver lining – SEPC's order inflows have improved on qoq basis from Rs0.8 bn in Q4FY09 to Rs2.2 bn in Q1FY10 to Rs2.5 bn in Q2FY10.

### MoU with NWEPI – Long term growth driver

SEPC has entered into a MoU with China based North West Electric Power Design Institute (NWEPI) to bid, in consortium, for the execution of thermal power plants in India on an EPC basis. NWEPI provides design, consultation and EPC projects in various areas related to power project and is a market leader in 1000 MW ultra-supercritical units, the air cooled condenser design technology and high voltage DC & AC power transmission engineering design. We believe that the MoU will serve as a growth driver for SEPC in the long run, enabling it to diversify into core non-renewable / thermal energy source.

### Orient Green Power - future valuation trigger

Orient Green Power (OGPL), a 40% associate of SEPC, is one of the largest Indian diversified independent renewable energy producers. Presently it operates 100 MW of wind energy assets and 40 MW in Biomass and Biogas based plants. It has raised USD 55 mn in Nov '08 (SEPC - USD 10 mn, Bessemer - USD 10 mn and Olympus Capital - USD 35 mn).

### Outlook & Valuations

We remain positively biased on SEPC's WTG venture in the long term with expected secular demand from amendments in CERC regulations. However, in the short term we believe that the business is likely to be impacted by over capacity and pricing pressure in the market. Order inflows in core EPC business (contributing over 80% of revenues) have improved on qoq basis (up from Rs0.8 bn in Q4FY09 to over Rs2 bn in Q2FY10) – allaying investor concerns. However, low order book cover (1.7X FY09 revenues) and low earnings visibility (next 4-5 quarters) poses risks to earning estimates in near term. Going forward, OGPL is likely to offer upsides to valuation. Presently the stock is trading at 11.5X FY10E and 8.7X FY11E consolidated consensus earnings of Rs18.5 and Rs24.3 per share respectively.

### About Shriram EPC

Shriram EPC (SEPC) is an engineering, design, procurement, construction and project management company. SEPC is part of the South based Shriram Group which has interests in NBFC and Finance (Shriram Auto Finance and Shriram Transport). The core business areas of the company are (1) EPC of projects with focus on turnkey solutions in renewable energy, process and metallurgy and municipal services and (2) sales and maintenance of wind turbine generation (WTG) sets. In WTG business, company provides integrated solutions including manufacture, installation and maintenance of 250 kV WTG sets. In WTG, SEPC has total installed base of 200 WTG in India and abroad.

SEPC business activities are spread into 5 different companies in addition to the parent company - (1) Hamon Shriram Cottrell - 50% holding (2) Orient Green Power - 40% holding and (3) Ennore Coke - 32% holding. SEPC has also entered into a manufacturing and marketing joint venture with Leitner for +1MW WTG sets (1) Leitner Shriram Manufacturing, a 51:49 JV with Leitwind to manufacture 1.35MW WTG (2) Shriram Letwind, a 51:49 JV to market, sell and maintain MW Class WTG sets manufactured by Leitner Shriram Mfg. SEPC has transferred its 250 kV WTG business (annual revenues – Rs1 bn) to the JV. Plans are afoot to merge the 2 JVs into a single entity with Leitner's share at 50.3% and SEPC's share at 49.7% in the merged entity.

SEPC has experienced fast track growth in FY05-09 period. Revenues have grown at 92% CAGR in FY05-09 period, from Rs743 mn in FY05 to Rs10058 mn in FY09. The operating profits have grown by 92% CAGR in FY05-09 period from Rs68 mn to Rs928 mn. The operating margins have remained stable at 9.2% in the same time period. The net profit has grown at a CAGR of 174% during FY05-09 period from Rs8 mn to Rs475 mn. In FY09, SEPC earned 94% revenues from EPC business while contribution from the WTG business was lower at 6% of revenues.

## Consolidated Key Financials

## Income Statement

Y/E, Mar (Rs. m)	FY05	FY06	FY07	FY08	FY09	CAGR
<b>Net Sales</b>	<b>743</b>	<b>1,445</b>	<b>2,957</b>	<b>6,999</b>	<b>10,058</b>	91.8%
<i>Growth (%)</i>		94.6	104.6	136.7	43.7	
<b>Expenses</b>	<b>675</b>	<b>1,312</b>	<b>2,714</b>	<b>6,205</b>	<b>9,130</b>	
<i>Growth (%)</i>		94.5	106.8	128.7	47.1	
Raw Materials	203	362	462	965	76	
<i>% Of Sales</i>	27.4	25.1	15.6	13.8	0.8	
Employee Cost	23	56	109	225	413	
<i>% Of Sales</i>	3.2	3.9	3.7	3.2	4.1	
Manufacturing Exps	368	820	1,916	4,573	7,998	
<i>% Of Sales</i>	49.6	56.8	64.8	65.3	79.5	
Admin Expenses	80	73	197	418	634	
<i>% Of Sales</i>	10.7	5.1	6.7	6.0	6.3	
Selling & Distribn Exp	0	0	30	25	9	
<i>% Of Sales</i>	0.0	0.0	1.0	0.4	0.1	
<b>EBIDTA</b>	<b>68</b>	<b>133</b>	<b>244</b>	<b>794</b>	<b>928</b>	92.2%
<i>Growth (%)</i>		95.9	82.9	225.9	16.9	
<i>EBIDTA Margin (%)</i>	9.2	9.2	8.2	11.3	9.2	
Other Income	3	10	51	18	60	
Depreciation	9	9	14	32	76	
Interest	36	38	55	197	229	
PBT	18	93	217	551	646	
Tax	9	19	85	203	233	
PAT	8	74	131	348	413	
Minority Interest	0	0	0	2	62	
<b>Adjusted PAT</b>	<b>8</b>	<b>74</b>	<b>131</b>	<b>350</b>	<b>475</b>	174.2%
<i>Growth (%)</i>		786.9	76.4	164.9	18.7	
<i>Net Margin (%)</i>	1.1	5.2	4.4	5.0	4.7	
E/O Item	0	0	0	2	0	
Reported PAT	8	74	131	352	475	

## Balance Sheet

Y/E, Mar (Rs. m)	FY05	FY06	FY07	FY08	FY09
Equity Share Capital	203	379	379	429	434
Reserves	12	1,201	1,322	2,971	3,419
Minority Interest	1	1	0	174	225
<b>Networth</b>	<b>215</b>	<b>1,580</b>	<b>1,701</b>	<b>3,573</b>	<b>4,077</b>
Secured Loans	159	441	200	1,239	2,504
Unsecured Loans	96	17	0	8	316
<b>Loan Funds</b>	<b>255</b>	<b>458</b>	<b>200</b>	<b>1,247</b>	<b>2,820</b>
<b>Capital Employed</b>	<b>470</b>	<b>2,038</b>	<b>1,901</b>	<b>4,820</b>	<b>6,897</b>
Gross Block	111	120	219	596	1,371
Less: Depreciation	20	29	43	90	179
<b>Net Block</b>	<b>91</b>	<b>91</b>	<b>176</b>	<b>506</b>	<b>1,192</b>
Capital Work In Progress	0	0	0	62	92
<b>Investments</b>	<b>27</b>	<b>27</b>	<b>171</b>	<b>806</b>	<b>1,618</b>
<b>Current Assets</b>	<b>915</b>	<b>2,287</b>	<b>2,615</b>	<b>6,915</b>	<b>9,830</b>
Inventories	217	173	275	513	1,267
Debtors	187	625	1,356	3,228	5,315
Cash & Bank	366	1,057	269	1,547	411
Loans & Advances	144	433	714	1,627	2,838
<b>Current Liabilities &amp; Prov</b>	<b>554</b>	<b>364</b>	<b>1,052</b>	<b>3,409</b>	<b>5,684</b>
<b>Net Current Assets</b>	<b>361</b>	<b>1,922</b>	<b>1,563</b>	<b>3,505</b>	<b>4,146</b>
Miscellaneous Expenditure	0	0	0	0	0
Deferred Tax	-8	-2	-9	-59	-151
<b>Capital Deployed</b>	<b>470</b>	<b>2,038</b>	<b>1,901</b>	<b>4,820</b>	<b>6,897</b>

## Key Ratios

Y/E, Mar (Rs. m)	FY05	FY06	FY07	FY08	FY09
<b>Profitability (%)</b>					
EBITDA Margin	9.2	9.2	8.2	11.3	9.2
Net Margin	1.1	5.2	4.4	5.0	4.7
ROCE	16.0	10.5	13.8	22.2	14.9
ROE	4.1	8.3	8.0	13.3	12.4
<b>Per Share Data (Rs)</b>					
EPS	0.4	3.7	6.5	8.2	11.0
CEPS	0.8	4.1	7.2	9.1	12.6
BVPS	10.6	78.0	84.0	83.3	94.0
<b>Valuation Ratios (X)</b>					
PER	511.1	57.6	32.7	25.9	19.3
CPER	254.8	51.3	29.5	23.2	16.8
P/BV	19.9	2.7	2.5	2.5	2.3
EV/Sales	5.6	2.6	1.4	1.3	1.2
EV/EBIDTA	8.9	1.8	2.2	1.8	1.7
<b>Turnover (Days)</b>					
Debtor T/o	59.0	102.5	122.3	119.5	155.0
Inventory T/o	56.8	49.3	27.6	20.5	32.3
<b>Gearing Ratio (X)</b>					
Net Debt / Equity	-0.5	-0.4	0.0	-0.1	0.6
Total Debt / Equity	1.2	0.3	0.1	0.3	0.7

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