

PICK OF
THE WEEK

Easun Reyrolle Ltd.

Rs.571 | Buy

Mustering Power

Analyst

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Nifty: 3843; Sensex: 13487

Summary

Easun Reyrolle Ltd. (ERL), known for its quality manufacturing, has 20% market share in the relay panel market in the country. Last year the company made its significant foray in to the manufacturing of MV Switchgears near its control panel unit at Hosur. It has also entered into turnkey project business and has developed a comfortable order book. We expect the massive investment envisaged by the transmission and distribution sector in the country coupled with company's improved product lines and new business focus would augur well in the long run.

After the 107% jump in sales in FY06 the company's sales growth has tapered off to some extent. During H1FY07 the sales of the company increased by 26% to Rs.592m and PAT increased by 24% to Rs.73m. We expect post completion of the switchgear facility at Hosur and better revenue from the turnkey projects the sales growth of the company would take a good pace in future. The share price is trading at 11.1x to FY07E EPS of Rs.51.4 and 7.6x to FY08E EPS of Rs.75.1. Being a quality manufacturer in the high growth transmission and distribution industry the stock is a good value pick at the current levels. We expect a target price of Rs.750 in one-year's time.

Key Stock Data

Sector	Electric Equipment
Reuters	EASU.BO
Shares o/s (m)	3.3
Market cap (Rs m)	1,885
Market cap (US\$ m)	42
3-m daily average vol.	9,897

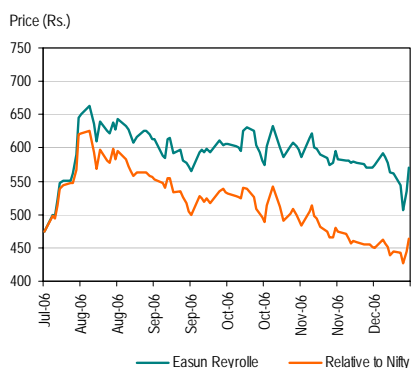
Price Performance

52-week high/low	Rs1,060/423		
	-1m	-3m	-12m
Absolute (%)	(0.6)	(7.1)	20.7
Rel to Nifty (%)	0.0	(17.8)	(16.3)

Shareholding Pattern (%)

Promoters	45.81
MFs/Banks/FIs	0.95
Non Promoter Corporate	12.96
Public & Others	40.28

Stock vs Relative to Nifty



Investment highlights

- Full effect of switchgear plant in FY08.
- 3 decades of experience in electrical equipment industry with major presence in Southern and Eastern Market of the country.
- Gradually increasing exposure in the turnkey projects in the transmission and distribution domain of the power sector. Greater scope through substation automation.
- One of the cost leaders in the electrical equipment industry with high EBITDA margin of 23%.
- Preferred vendor for utilities like APTRANSCO, KSEB, TNEB, Reliance Energy and that of industrial customers like BHEL, Sterlite, and SAIL.
- Greater opportunity through the envisaged per year investment of Rs.700bn in transmission and distribution sector in the 11th plan under APDRP scheme.

Table 1: Financial snapshot

(Rs m)

Year-end: March	FY05	FY06	FY07E	FY08E
Net sales	514	1,064	1,386	2,049
EBITDA	79	246	323	480
PAT	36	131	171	250
EPS (Rs)	10.7	39.3	51.4	75.1
P/E(x)	53.3	14.5	11.1	7.6

Source: Company reports; IDBI Capital Market Services

Investment positives

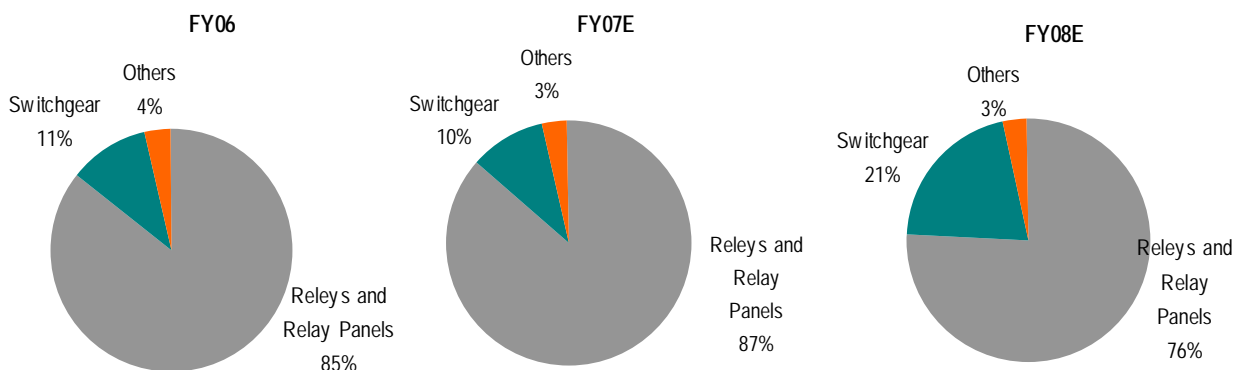
■ Growing on the value chain

The company due to its good cost leadership, enjoys 20% market share in relay panels in the country. Earlier the company was a dominant manufacture of relay device, which are used in the protection of critical power equipments. Company's relay systems uses the technology developed by Reyrolle of UK (which later acquired by Austrian firm VA Tech Hydro which in turn acquired by Siemens AG last year). The company manufactures both electromagnetic and numerical relays. The company is now putting more emphasis on the manufacturing of relay panels, which use equipments like relays and meters manufactured by the company. This has improved the margin of the company due to higher value addition. These relay systems are also sold to other major electrical equipment manufacturers. We expect a decline in growth in the relays and increased growth in relay panels going forward, which will help sustain its margin despite competition. We estimate the company will maintain its EBITDA margin of 23% going forward.

■ Full Effect of Switchgear plant in FY08

Last year the company set up a new plant at Hosur for increasing its exposure in medium voltage Switch Gears of 11KV and 33KV. With this the company will be closing its switchgear division at Chennai. This new plant will be fully operational by March 2007. The total investment in this plant will go up to Rs.130m. MV Switch Gears are widely applied in Power Transmission and Distribution systems and as compared to the LV (Low Voltage) (growth 20%) and HV (High Voltage) (growth 13%) switchgears MV Switchgears (growing more than 30%) uptake has been very fast. According to IEEMA (Indian Electrical and Electronics Manufacturing Association) despite increase in imports, the high demand for MV switchgears has led all the manufacturers to have healthy order book position of about 12 months and this surge in demand will be sustained at least for three to four years down the line. Last year the company registered gross sales of Rs.133m in switchgears. We expect a 22% rise in gross switchgears sales in FY07 and 200% rise in FY08. Although there would be competition from multinationals like Areva, Siemens, ABB and domestic players like Crompton Greaves but on the back of its cost leadership, better quality of product and service, the company withstanding such competition, would develop a good market share in the Rs.45bn domestic switchgear market.

Figure 1: Revenue breakup

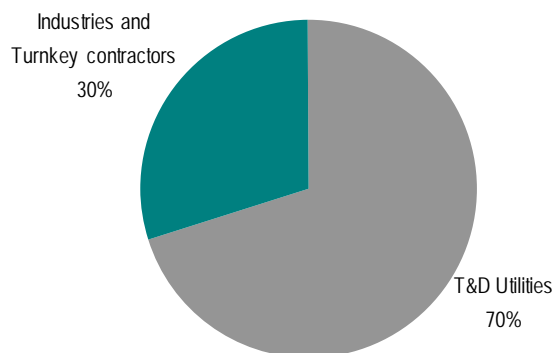


Source: Company reports; IDBI Capital Market Services

■ Increasing presence in transmission and distribution projects

The company derives its major revenue from the southern markets of the country. Company is a preferred vendor of utilities like APTRANSCO, KSEB, TNEB, and Reliance Energy who contribute around 70% of the total turnover of the company. With these utilities the company is looking at getting more transmission and distribution (T&D) automation projects going forward. Company's product range and long presence in the power sector will definitely give an edge. It has developed a comfortable order book in the project business to foster its growth in this segment. However, our estimate does not include the business from the project business.

Figure 2: Industry wise revenue



Source: Company reports; IDBI Capital Market Services

Concerns

■ Rejection of Siemens' offer

Recent rejection of Siemens offer to acquire 20% stake in the company should be looked with some concern. Although the company maintains that Siemens will remain committed to the agreement that has been entered with VATECH Hydro, but going forward it may either have to depend on some technology partner or develop its own technology. Either way the company would face tough challenge in this regard. In FY06 the company sourced around 17% of the total raw material and component from VATECH Hydro.

■ Change in technology

Presently the technology for MV and HV Switchgears has not been given much importance in the power projects in our country. Major manufacturers use the traditional technology in their equipments. Going forward if the perception for technology by the project implementers changes it may face challenge in getting and incorporating the new technology into its switchgears.

■ Fluctuation of raw material prices

Fluctuation in prices of copper, CRGO, Alluminum and other insulating materials will remain a concern. Usually the switchgears are bid on firm price basis.

Valuation

After the 107% jump in sales in FY06 the company's sales growth has tapered off to some extent. During H1FY07 the sales of the company increased by 26% to Rs.592m and PAT increased by 24% to Rs.73m. We expect post completion of the switchgear facility at Hosur and better revenue from the turnkey projects the sales growth of the company would take a good pace in future. The share price is trading at 11.1x to FY07E EPS of Rs.51.4 and 7.6x to FY08E EPS of Rs.75.1. Being a quality manufacturer in the high growth transmission and distribution industry the stock is a good value pick at the current levels. We expect a target price of Rs.750 in one-year's time.

Table 3: Q2FY07 performance

(Rs. m)

Year-end: March	Q2FY07	Q2FY06	Var. (%)	H1FY07	H1FY06	Var. (%)
Net sales	317	256	24	592	469	26
Total expenditure	249	200	24	467	378	24
Operating profit	68	55	23	124	90	38
OPM (%)	22	22	(0)	21	19	9
Other income	3	6	(56)	8	9	(16)
EBIDTA	71	61	15	132	100	33
Interest	4	2	46	6	5	28
Depreciation	6	5	23	13	11	17
Tax	22	19	19	40	25	62
Reported PAT	39	35	10	73	59	24
EPS – Annualised (Rs.)	46.8	42.4		43.5	35.3	
Equity	33	33		33	33	
Face value	10	10		10	10	

Source: Company reports; IDBI Capital Market Services

Financial summary

Profit and loss account

(Rs m)

Year-end: March	FY05	FY06	FY07E	FY08E
Sales	514	1,064	1,386	2,049
% Change	25	107	30	48
Inc/Dec in stock	(22)	13	(3)	4
Raw materials	306	587	775	1,147
Personnel expenses	65	90	120	167
Other expenses	95	145	198	293
Total expenses	445	836	1,091	1,611
Operating profit	69	228	295	439
OPM (%)	13	21	21	21
Other income	9	18	28	41
EBITDA	79	246	323	480
Interest	10	14	26	45
Depreciation	15	25	37	56
PBT	54	207	259	379
Tax	18	76	88	129
PAT	36	131	171	250
EPS (Rs.)	10.7	39.3	51.4	75.1
No. of shares (m)	3.3	3.3	3.3	3.3

Source: Company reports; IDBI Capital Market Services

Other key financials and ratios

(Rs m)

Year-end: March	FY05	FY06	FY07E	FY08E
Net block	135	139	242	287
Net current assets	227	433	679	1,045
Debt	-	11	60	100
Shareholders fund	246	378	536	763
PE (x)	53.3	14.5	11.1	7.6
P/BV	7	5	4	2
EV	1,793	1,912	1,961	2,001
EV/Sales	3	2	1	1
EV/EBITDA	23	8	6	4
EV/PAT	50	15	11	8
OPM (%)	13	21	21	21
NPM (%)	7	12	12	12
RONW (%)	15	35	32	33
ROCE (%)	21	43	35	35
Debt/Equity	0	3	11	13

Source: Company reports; IDBI Capital Market Services

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