

BUY – Target Rs.477
CMP Rs.350

Key Data	
BSE Code	517271
NSE Code	HBLPOWER
Reuters Code	HBLN.BO
Bloomberg Code	HBPS.IN
Sensex	18526
CMP, Rs	350
No.of Shares,cr	2.4
Face Value	10.0
Mcap,Rs cr	850
Mcap,USD cr @ 40	21.2
52 week H/L	493 / 195
15 day Avg. Daily Vol. BSE	5766
Share holding	% Holding
Promoters	70.2%
Banks/MFs/Fin. Inst.	1.8%
FIIS	7.8%
Body Corporate	12.0%
Public	8.2%
Total	100%
Share Holding >1% , Dec'07	
Sonata Investments	7.1%
Goldman Sachs	4.5%
UTI	2.9%
India Fund Inc	2.7%
UTI Master Value	1.8%

We had initiated coverage on HBL Power System Limited dated 23rd Nov'07. We had recommended 'Buy' at price of Rs.363 with target of Rs.477. The stock has seen a sharp run since then and achieved the target given. We maintain our Buy recommendation on account of impressive growth in topline as well as better operating and net margins achieved on back of lower raw material (lead) prices.

Key Raw Material prices dip by 30%-35%, Margins shoot up

In our report, we had raised concerns over volatile price of raw materials and shown that Raw Material as % to Sales is increasing constantly due to higher base metal prices. In last 3-4 months, price of 2 key **raw materials have fallen by more than 30-35% from its peak in October**, which has resulted in improved situation on raw material as a percentage to sales. This is positive for battery manufacturers like HBL Power, and had a positive impact on EBIDTA margins.

Excellent topline growth, margins improved

For Q3FY08, it has reported **Revenues of Rs.288.6 crore compared to Rs.121.9 crore in the same period last year, a 137% growth** on YoY basis and 11% growth on QoQ basis. It has reported EBIDTA of Rs.51.9 crore compared to Rs.18.3 crore last year, **a growth of 183%. Growth in PAT is even more impressive at 279%** as its PAT stood at Rs.27.7 crore in Q3FY08 from Rs.7.3 crore in Q3FY07. EBIDTA Margin improved to 18% in Q3FY08 from 11.2% in Q2FY08 and 15.1% in Q3FY07. On QoQ basis, EBIDTA margin expanded by 680 basis points, mainly due to lower raw material (lead) prices

[Website: www.hbl.in](http://www.hbl.in)

Analyst: Tarun Surana

tarun.surana@spasecurities.com

Mobile: +91- 9987063467

Phone: +91- 22- 40439000

Valuation

At CMP of Rs.350, HBL Power is trading at P/Ex of 13.9 on its FY08 estimated EPS of Rs.25.2, and at P/Ex of 11.1 on its FY09 estimated EPS of Rs.31.6 which looks very attractive. We maintain our 'Buy' recommendation on the stock with **price target of Rs.477**, at which it will trade at P/E x of 15 on its FY09 EPS of Rs.31.6.

Brief Financials	Revenues	Growth	EBITDA	Net Profit	Growth	EPS	EV / EBIDTA	P / BV	P/E
Rs, crore		%			%	Rs.	x	x	x
FY05	282.2		38.8	18.5		9.2	24.0	6.0	38.1
FY06	366.1	30%	54.7	26.3	42%	11.9	16.8	4.1	29.4
FY07	509.5	39%	72.2	32.1	22%	13.2	13.0	3.5	26.5
FY08F	968.1	90%	136.6	67.8	111%	25.2	7.0	2.3	13.9
FY09F	1355.3	40%	193.7	85.1	26%	31.6	5.6	1.9	11.1

Results Analysis

Income Statement								
Rsm	Q3FY07	Q2FY08	Q3FY08	QOQ	YOY	9mFY08	9mFY07	Growth over 9m
Net Sales	121.57	260.83	288.63	11%	137%	688.42	344.68	99.7%
Expenditure								
Inc/Dec in stock	-10.17	-35.47	-23.29			-85.88	-26.14	228.5%
Raw Materials	87.61	223.54	209.50	-6%	139%	553.00	242.02	128.5%
<i>% to sales</i>	<i>63.7%</i>	<i>72.1%</i>	<i>64.5%</i>			<i>67.9%</i>	<i>62.6%</i>	
Staff Cost	8.56	14.35	13.74	-4%	61%	39.51	25.86	52.8%
<i>% to sales</i>	<i>7.0%</i>	<i>5.5%</i>	<i>4.8%</i>			<i>5.7%</i>	<i>7.5%</i>	
Other expenditure	17.22	29.15	36.79	26%	114%	82.81	50.47	64.1%
<i>% to sales</i>	<i>14.2%</i>	<i>11.2%</i>	<i>12.7%</i>			<i>12.0%</i>	<i>14.6%</i>	
Total Expenditure	103.22	231.57	236.74	2%	129%	589.44	292.21	101.7%
EBITDA	18.35	29.26	51.89	77%	183%	98.98	52.47	88.6%
Other Income	0.44	0.56	0.64	14%		1.69	1.62	4.3%
Gross Profit	18.79	29.82	52.53	76%	180%	100.67	54.09	86.1%
Interest	4.41	5.51	6.71	22%	52%	17.28	12.43	39.0%
Depreciation	2.40	2.75	2.75	0%	15%	8.25	7.20	14.6%
PBT	11.98	21.56	43.07	100%	260%	75.14	34.46	118.0%
Tax	4.68	7.85	15.40	96%	229%	27.20	12.98	109.6%
PAT	7.30	13.71	27.67	102%	279%	47.94	21.48	123.2%
EPS Rs	3.01	5.12	10.32	102%	243%	17.89	8.01	123.2%
Margin, %								
OPM	15.1%	11.2%	18.0%			14.4%	15.2%	
NPM	5.6%	5.0%	9.4%			6.7%	5.8%	
TAX	39%	36%	36%			36%	38%	

HBL has shown very robust growth on all accounts be it topline, EBIDTA or PAT. Revenues grew by 137% YoY and 11% QoQ whereas EBIDTA growth was even higher at 183% YoY and 77% QoQ. The growth was robust on 9 month results as well. Its revenues for 9mFY08 increased by 99.7% compared to same period previous year. EBIDTA grew by 88.6% and PAT grew by 123% for the same period. Its 9 month EPS has gone up from 8.01 to 17.89 in 9mFY08.

Investment Rationale

Power and Telecom (tower) infrastructure growth to be key driver for its products

HBL's products find application in telecom infrastructure segment (telecom towers). As we know, Telecom infrastructure segment is going for huge capex plans with aggressive plants to build tower infrastructure from players like Reliance Communication, Bharti Airtel, GTL, Idea etc. Company's products find its application at the base station of the tower. Company's market leader position, focused strategy to tap more of this market which is also supported by recent capacity addition so that on supply side does not put constrain on growth and company can meet the growing orders.

Capacity Expansion

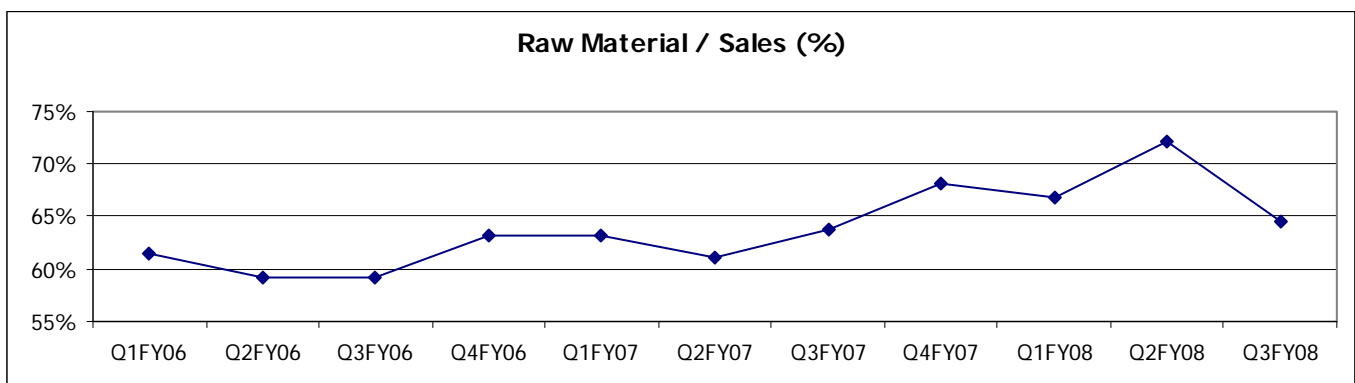
At the time when HBL power is expected to grow its top line significantly, due to its timely capex, it will not be hit due to lack of capacity. **Capital expenditure of Rs.150 crore** was taken up in Apr'06 which has been completed recently and has started **production from Dec'07**. With this, HBL has established 70-million amperes per month batteries manufacturing capacity at Vizianagaram in Andhra Pradesh. It plans to take the capex up further by approx. same amount in next year.

As the production from new plant starts from Dec'07, its full effect will be seen in increased production and top line from 4th quarter FY2008.

Leader in niche telecom segment

Company has carved its **niche in telecom segment batteries (with approx 70% of its revenue coming from the segment)** and continues to enjoy huge market share (over 50%) in Batteries for telecom segment which is also growing very rapidly.

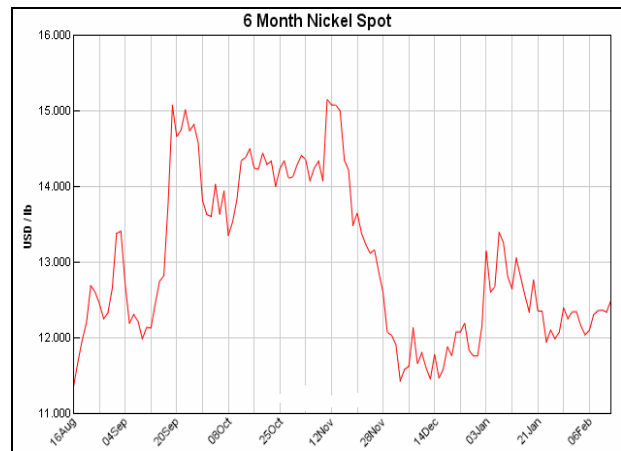
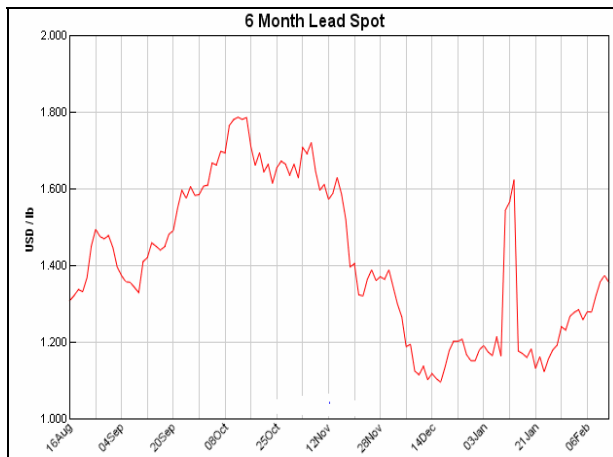
Worst seems over: Ability to transfer increase raw material (Lead) prices now



Till recently, increasing raw material prices was big problem for the company as can be seen in chart where Raw material expenses as % to revenues has gone up from below 60% to above 70%. But now, Company is in constant process of transferring the raw material price risks to its customers as per new contract terms. Accordingly, any price rise in raw material will be now transferred. It will **take care of margins**, which were reduced because raw material price hike was not transferable in contracts negotiated earlier.

Raw Material prices take a down turn, margins improved

In our report, we had raised concerns over volatile price of raw materials and shown that Raw Material as % to Sales is increasing constantly due to higher base metal prices. In last 4 month, prices of 2 key **raw materials have fallen by more than 30%**, which resulted in improved situation on Raw Material expenses out of total expenditures. This is positive for battery manufacturers like HBL Power, and lead to positive impact on EBIDTA margins as margins in last quarter stood at 11.2% whereas in Dec'07 quarter margins was at 18% on the back of lower Raw material as a percentage of sales which stood at 64.5% in Dec'07 compared to 72.1% in Sep'07 quarter..



Source: www.kitco.com

Peer Comparison

Company (Rs.Cr)	Revenue 9mFY08	EBIDTA 9mFY08	EBIDTA Margin	PAT 9mFY08	PAT Margin	EPS TTM	P/Ex at TTM EPS
HBL Power	688.4	100.7	14.6%	48.0	7.0%	24.2	14.5
Exide Industries	2,053.6	357.5	17.4%	187.5	9.1%	2.9	25.8
Amararaja Batteries	778.7	145.5	18.7%	68.2	8.8%	14.7	14.3

HBL Power is dominant player in telecom segment. Other players in batteries segment mainly focus on automotive batteries. HBL Power is trading at par with Amararaja batteries in terms of P/E multiples based on TTM EPS. Exide commands premium based on its investments in insurance business where in it holds substantial stake in ING Vaisya Life Insurance. Amararaja batteries and Exide are also witnessing high growth rates of above 90% YoY. HBL Power had lower EBIDTA and PAT margins compared to its peers due to lack of price escalation clause in earlier quarters of the year when raw material price were on its way up. Now, having the price escalation clause in place and softening raw material prices from peak augurs well for the company in maintaining margins going ahead. We are positive on HBL Power and the sector due to high demand from user industries and expect higher valuation for the sector given the robust growth.

Valuation & Ratios

Valuations	FY05	FY06	FY07	FY08F	FY09F
Revenues, Rscr	282.18	366.1	509.5	968.1	1355.3
growth, %		30%	39%	90%	40%
EBITDA, Rscr	38.8	54.7	72.2	136.6	193.7
Net profit, Rscr	18.5	26.3	32.1	67.8	85.1
growth, %		42%	22%	111%	26%
EPS, Rs	9.2	11.9	13.2	25.2	31.6
CEPS, Rs	12.0	14.9	16.7	29.3	39.7
P/E, x	38.1	29.4	26.5	13.9	11.1
P/Bv, x	6.0	4.1	3.5	2.3	1.9
EV/EBITDA, x	24.0	16.8	13.0	7.0	5.6
Mcap/Sales, x	3.0	2.3	1.7	0.9	0.6
Dividend Payout, %	19%	14%	13%	7%	6%

Growth Ratios	FY05	FY06	FY07	FY08F	FY09F
Income growth	68%	30%	39%	90%	40%
Operating Profit growth	0%	41%	32%	89%	42%
Earnings growth	113%	42%	22%	111%	26%

Key Ratios	FY05	FY06	FY07	FY08F	FY09F
OPM %	13.8%	14.9%	14.2%	14.1%	14.3%
NPM %	6.5%	7.2%	6.3%	7.0%	6.3%
ROE %	16%	14%	13%	16%	17%
ROA %	8%	8%	8%	10%	9%
D/E x	1.0	0.7	0.7	0.7	0.9
Asset Turnover Ratio x	2.2	2.3	2.3	2.8	2.3

Company's OPM remained in the range of 14% consistently which we expected to be lower in FY08 due to increased raw material prices which company couldn't pass on to the clients on older contracts. However, due to 18% OPM in Q3FY08, we have increased our margin expectation from 12.4% to 14.1% for FY08. We expect OPM to increase to 14.3% in FY09, as management is in constant process of passing on any rise in raw material price to the clients. We expect a lower PAT margin in FY09 on higher depreciation and interest cost due to capacity expansion.

Income Statement					
Rs, crore	FY05	FY06	FY07	FY08F	FY09F
Revenues	282.2	366.1	509.5	968.1	1355.3
Raw Materials Consumed	162.6	215.9	322.0	658.3	921.6
Manufacturing Expenses	41.4	48.0	55.1	88.2	114.6
Employment Costs	26.1	29.3	37.7	53.5	81.3
Administrative expenses	13.3	18.2	22.6	31.5	44.0
Operating Expenditure	243.4	311.4	437.4	831.5	1161.7
Operating Income	38.8	54.7	72.2	136.6	193.7
Other Income	2.2	2.9	3.7	4.5	5.5
Gross Profits	41.0	57.7	75.9	141.1	199.2
Finance and Interest Costs	9.7	13.3	16.6	23.9	44.3
Depreciation	5.7	6.7	8.5	11.3	21.9
Profit Before Tax	25.6	37.7	50.8	106.0	133.0
Tax	7.2	11.5	18.8	38.1	47.9
Profit after Tax	18.5	26.3	32.1	67.8	85.1
Extraordinary items	0.0	0.0	0.0	0.0	0.0
Net Profit	18.5	26.3	32.1	67.8	85.1

Cash flow statement					
Rs crore	FY05	FY06	FY07	FY08E	FY09E
Cash flow from operations	24.1	32.9	40.6	79.1	107.0
Cash for working capital	(51.7)	(34.5)	(24.7)	(99.4)	(108.7)
Net operating cash flow- A	(27.6)	(1.6)	15.8	(20.4)	(1.7)
Net purchase of fixed assets	(19.7)	(45.2)	(87.4)	(174.4)	(164.4)
Net Purchase of investments	(0.1)	(17.0)	15.9	-	-
Net cash flow from investing- B	(19.8)	(62.1)	(71.5)	(174.4)	(164.4)
Proceeds from equity	(0.0)	51.0	22.1	112.1	-
Proceeds/Repayments from borrowings	51.2	28.8	38.3	110.4	161.0
Dividend payments	(3.4)	(3.8)	(4.3)	(4.7)	(4.7)
Net cash flow from financing- C	47.8	76.1	56.1	217.8	156.3
Net cash flow (A+B+C)	0.3	12.4	0.4	23.0	(9.9)
Opening Cash	12.1	12.4	24.8	25.2	48.2
Closing Cash	12.4	24.8	25.2	48.2	38.3

Balance Sheet					
Rs, crore	FY05	FY06	FY07	FY08F	FY09F
Sources of Funds					
Equity Share Capital	20.1	22.1	24.3	27.0	27.0
Reserves & Surplus	96.8	168.2	215.5	388.5	468.8
Net Worth	116.8	190.3	239.8	415.4	495.8
Secured	92.8	118.6	153.7	253.7	403.7
Unsecured	19.4	21.5	22.6	24.6	26.6
Loan Funds	112.2	140.1	176.3	278.3	430.3
Deffered Tax Liability	6.71	7.66	10.34	18.34	27.34
Total Liability	235.7	338.1	426.4	712.0	953.4
Application of Funds					
Gross Block	126.93	161.58	222.69	347.12	581.55
Less: Depreciation	31.4	38.0	46.3	57.6	79.5
Net Block	95.6	123.5	176.4	289.5	502.0
WIP	7.6	18.1	44.4	94.4	24.4
Net Fixed Assets	103.2	141.7	220.8	383.9	526.4
Investments	1.44	18.43	2.53	2.53	2.53
Current Assets					
Inventories	53.2	67.7	75.3	159.1	204.2
Debtors	115.6	138.3	174.2	318.3	445.6
Cash and Bank	12.4	24.7	25.1	48.2	38.3
Loans and Advances	17.6	29.4	57.4	119.4	148.5
Other Current Assets	0.0	0.0	0.0	0.0	0.0
Current Liabilities	56.2	64.9	94.5	185.7	278.5
Provisions	12.1	17.7	35.7	133.7	133.7
Net Current Assets	130.6	177.5	202.0	325.6	424.5
Misc Expnses	0.6	0.4	1.1	0.0	0.0
Total Assets	235.7	338.1	426.4	712.0	953.4



HBL Power System Limited

Equity Research Desk

Result Update

14th February, 2007

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1. Analyst ownership of the stock - No
2. Group/Directors ownership of the stock – No
3. Broking relationship with company covered - No

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Hitendra Gupta	Research Analyst	hitendra.gupta@spasecurities.com
Tarun Surana	Research Analyst	tarun.surana@spasecurities.com
Abhishek Kothari	Research Associate	abhishek.kothari@spasecurities.com
For more information Visit us at www.spacapital.com		
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101, 10th Floor, Mittal Court A-Wing, Nariman Point, Mumbai 400021. Tel: (022) 22801240-49; 40439000 Fax: (022) 22846318		
NEW DELHI		
25, C-Block Community Centre, Janak Puri, New Delhi - 110 058 Tel: (011) 25517371, 25515086, Fax: (011) 25532644 B- 1A- 132, Sector-51, Noida - 201301 Ph: 0120 - 4241222-26 Fax: 0120 - 4241227 409, Qutab Plaza, DLF City, Phase- I, Gurgaon Ph: 0124 - 4380090-94 Fax: 0124 - 4380089		
KOLKATA		
Diamond Chambers, Room no. 8-O, 8th Floor, 4 Chowringhee Lane, Kolkata - 700016 Tel: (033) - 22521537 Fax: (033) - 22521540		
BANGALORE		
703 & 704, 7th Floor, Brigade Tower, 135, Brigade Road, Corporation Division no. 61, Bangalore - 560025 Ph: 080 - 41148395		
JAIPUR		
UL-15, Amber Tower, Sansar Chand Road, Jaipur - 302001. Tel: (0141) 5107044/5107144 Fax: 5107144		
CHENNAI		
3H, 3rd floor, East Coast Chambers, 92/34, G.N.Chetty, T. Nagar, Chennai - 600014 Tel: (044) 52071380-82 Fax: 52071379		
AHMEDABAD		
407, Anand Mangal Complex - I, Behind Omkar House, C.G.Road, Navrangpura, Ahmedabad Tel: (079) 32998056		
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