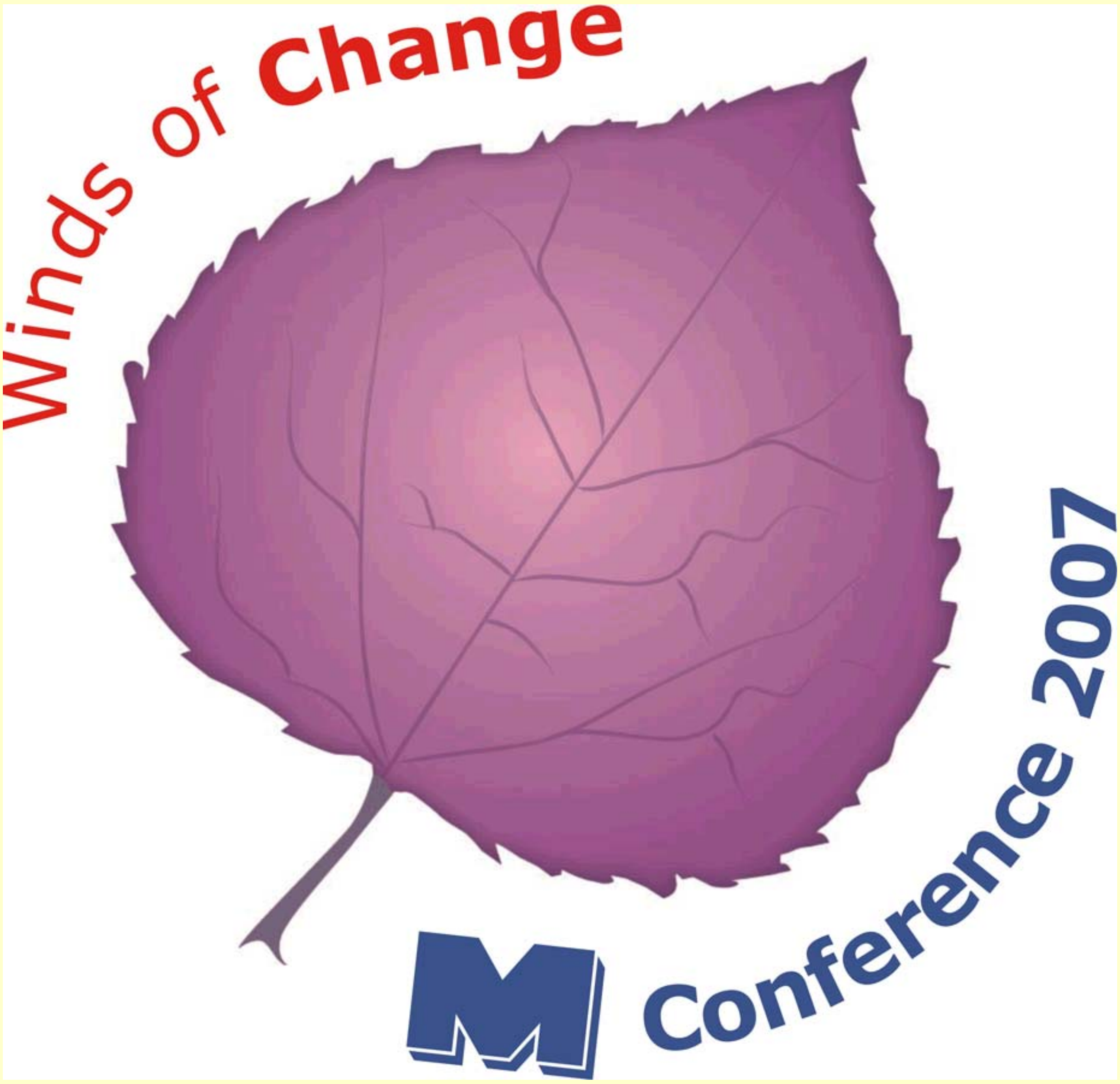
Man Financial



Tuesday, March 13, 2007

The Taj Mahal Hotel – Business Centre, Mumbai

Winds of Change Conference 2007

Power Finance Corporation (Mkt Cap USD 2.7bn)
Satnam Singh
CFO

Yes Bank (Mkt Cap USD 785mn)
Rajat Monga / Debasis Ghosh
CFO / VP

Voltas (Mkt Cap USD 605mn)
B N Garudacha
Investor Relation

Everest Kanto Cylinders (Mkt Cap USD 318mn)
Prem Khurana
Chairman & MD

J K Cement (Mkt Cap USD 219mn)
Mr Prashant Seth / Mr K M Jain
GM Finance / GM - A/cs

Ess Dee Aluminium (Mkt Cap USD 134mn)
Ajay Doshi / Darshan Majmudar / Prasenjit Datta / Debdeep Bhatacharya
President Fin & Business / VP Finance & Co. Sec / Tech Dir / President Sales & Mktg

Ramkrishna Forgings (Mkt Cap USD 42mn)
Rajendra Mundra
Finance Mgr/Co. Sec

Man Financial

Power Finance Corporation

Not Rated / Rs 104

Parthapratim Gupta *(parthapratim.gupta@manfinancial.in) +91 22 6667 9962*

- **Business overview:** PFC is a specialised institution in power sector financing with a market share of 23% in total disbursements (as per Planning Commission's 10th Plan mid-term appraisal). The clientele of PFC spans across the entire value chain (generation, transmission and distribution), pertaining to the domestic power sector.
- **Strong investment demand:** As per the 11th plan, a tentative 67,677MW (source: CEA) capacity is expected to be added over the next five years.
- **Ultra Mega Power Projects (UMPPs) – a potential goldmine:** PFC has been designated as the nodal agency by the GOI for the development of 8 UMPPs (each having a capacity of 4,000 MW). PFC has incorporated 8 wholly owned subsidiaries to act as SPVs for these projects. The subsidiary companies will work in conjunction with MOP & CEA to obtain the necessary clearances for the generation projects and later on these projects will be transferred to successful bidders through a tariff based international competitive bidding process. Apart from the UMPPs, PFC has incorporated subsidiaries as SPVs for two transmission projects and one hydroelectric project. The management also intend to venture into power trading through the SPV route. PFC derives twin benefits from the UMPPs in the form of loan disbursements to the developers and augmentation of fee-based revenue stream in the form of consulting and advisory services.
- **Valuations:** PFC is trading at 10.5x FY08E earnings and 1.3x FY08E adjusted book value. We have a positive outlook on the stock keeping in mind the huge investment demand in the power sector, PFC's proven expertise in the field with dominant market share, augmentation of fee-based revenue streams through advisory and consultancy services and private equity venture and above all, impeccable asset quality with net NPAs at 0.16% as on H1FY07.Further, we believe ROE to improve in the future from the levels of 12.5% (post dilution) on the back of increase in leverage (5.5 times as against the permissible limit of 10 times).

This note should be read for

- A peek into the company's affairs

Bloomberg code :	POWF IN
Reuters code :	PWFC.BO
www.pfcindia.com	
BSE Sensex :	13049
NSE Nifty :	3755

Company data	
O/S shares :	1,148mn
Market cap (Rs) :	120bn
Market cap (USD) :	2722mn
52 - wk Hi/Lo (Rs) :	121 / 85
Face Value (Rs) :	10

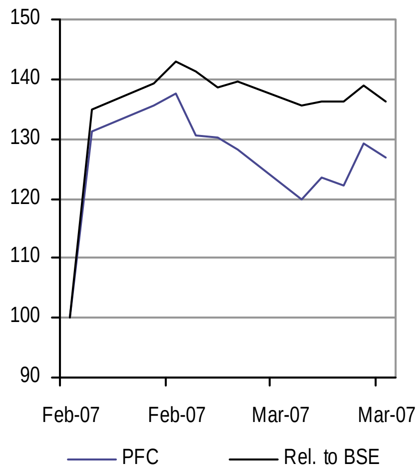
Share holding pattern, %	
Promoters :	89.8
FII / NRI :	3.4
FI / MF :	1.5
Non Promoter Corp. Holdings :	1.0
Public & Others :	4.2

Valuation summary

Y/E Mar, Rs mn	FY04	FY05	FY06E	FY07E	FY08E
Pre-prov ROE (%)		19.3	16.4	16.8	17.0
Pre-prov ROA (%)		4.1	3.2	3.1	2.8
Net Profit (adjusted)	9,001	7,761	8,496	9,760	11,422
% growth		-13.8%	9.5%	14.9%	17.0%
EPS (Rs)	8.7	7.5	8.2	8.5	10.0
Adj BVPS (Rs)	56.0	60.7	67.0	74.6	81.6
ROE (%)		15.8	14.6	12.5	12.6
P/E (x)	11.9	13.9	12.7	12.3	10.5
Adj. P/BV (x)	1.9	1.7	1.6	1.4	1.3

Source: Company, Man Financial Research Estimate

Price vs. Sensex



Source: Bloomberg, Man Financial Research

Risks

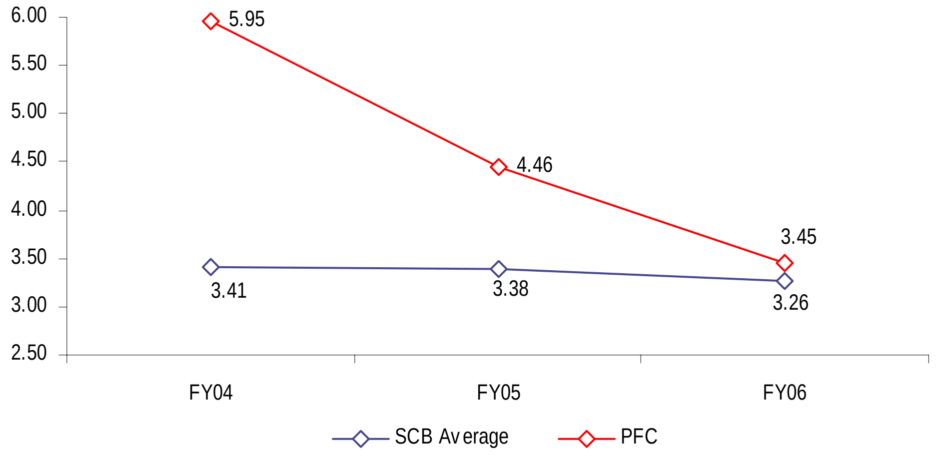
PFC is faced with growing competition from the domestic public and private sector commercial banks and other financial institutions providing power sector finance products and services. The key differentiator between PFC and commercial banks is the latter's cost of funding, which is much lower compared to PFC. We believe that PFC's net interest margins might come down in the future from the current 3.37% (at the end of H1FY07) to ~ 3.1% in FY08E, owing to rise in funding costs.

We expect commercial bank's lending to NBFC's might witness higher rates in order to accommodate the rise in the provisioning requirements (from 0.4% to 2%) and increase in risk weights from 100% to 125% in the third quarter review of monetary policy. Incidentally, 51% of PFC's borrowings are from domestic banks and financial institutions (as on H1FY07).

However, we believe that PFC is likely to maintain its dominance in power sector financing on the back of proven expertise in this domain and more importantly, the huge addressable market. In addition to this, the sheer size of the investments in the power sector require certain minimum eligibility in terms of net worth, limiting the competition to a large extent. Also, we believe banks are unlikely to overexpose them to power sector financing because that might lead to ALM mismatches, keeping in mind their funding pattern.

Further, in addition to that, the high volume growth (keeping in mind the investment demand from the power sector), leading to strong growth in the advances portfolio and the rise in the fee-based income are likely to play a major role in the future earnings progression.

Movement in net interest margins (%) vis-à-vis scheduled commercial banks over the last three years

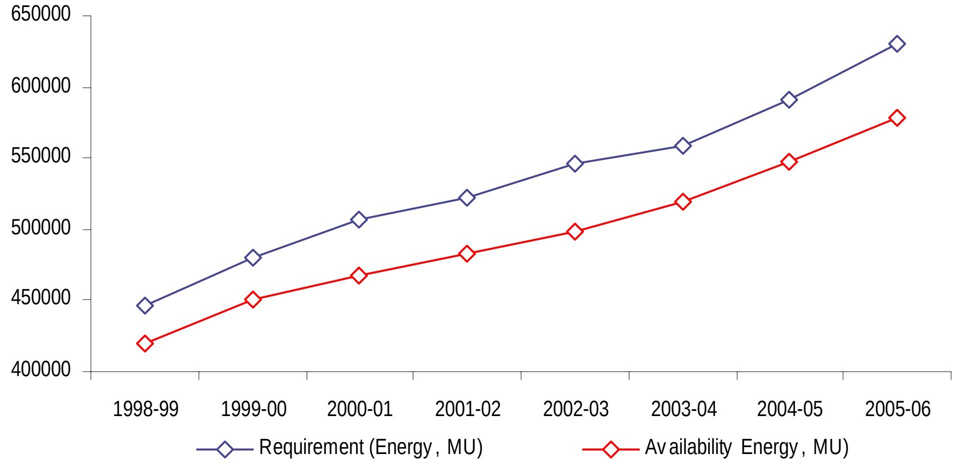


Source: Company RHP, Man Financial Research

Man Financial

Power Sector Overview

Demand Supply Gap leading to…



Source: Company RHP

According to CEA, energy shortage in Fiscal 2006 amounted to 8.3% of total requirements, with the peak shortage estimated at 12.3%

In H1FY06, energy shortage amounted to 8% of total requirements, with the peak shortage estimated at 12.2% of peak demand requirements

Strong investment demand and in turn PFC's disbursements

	FY08E	FY09E	FY10E	FY11E	FY12E	Total
Annual Addition (MW)	10,622	14,634	12,768	18,527	11,126	67,677
At 80% capacity addition of target	8,498	11,707	10,214	14,822	8,901	54,142
Potential inv. (Rs bn)	680	937	817	1186	712	4331
Potential disbursements for PFC (Rs bn)	143	194	168	240	142	887
Market share (%)	21%	21%	21%	20%	20%	20%

Source: CEA, Man Financial Research Estimates

As per the 11th plan, a tentative 67,677MW capacity is expected to be added over the next five years.

Key Assumptions

- We have taken the capacity addition @ 80% of the target (54%, 47% and 75% in VIII, IX and X five year plans respectively)
- We have taken an overall 20% market share in disbursements for PFC (down from the current 23%, which we believe is a conservative estimate), in view of increased competition from the scheduled commercial banks

Business Overview

PFC is a specialised institution in power sector financing with a market share of 23% in total disbursements (as per Planning Commission's 10th Plan mid-term appraisal). The clientele of PFC spans across the entire value chain (generation, transmission and distribution), pertaining to the domestic power sector.

Ultra Mega Power Projects (UMPPs) – a potential goldmine

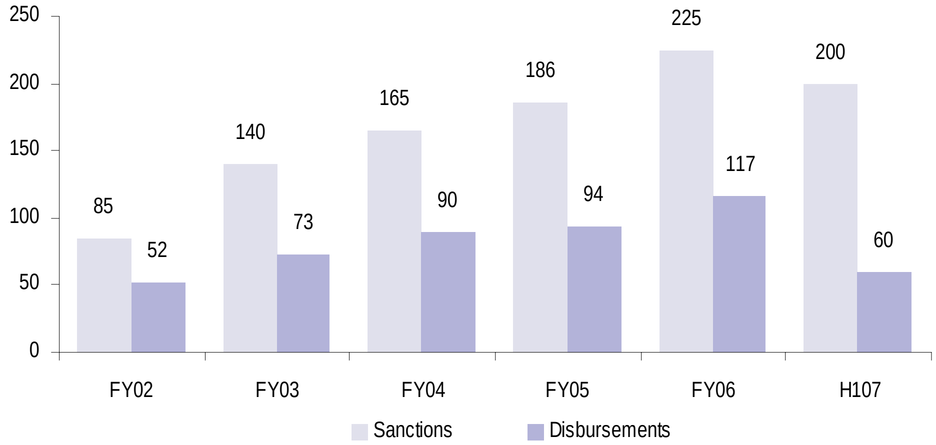
PFC has been designated as the nodal agency by the GOI for the development of 8 UMPPs (each having a capacity of 4,000 MW). PFC has incorporated 8 wholly owned subsidiaries to act as SPVs for these projects. The subsidiary companies will work in conjunction with MOP & CEA to obtain the necessary clearances for the generation projects and later on these projects will be transferred to successful bidders through a tariff based international competitive bidding process. Apart from the UMPPs, PFC has incorporated subsidiaries as SPVs for two transmission projects and one hydroelectric project. The management also intend to venture into power trading through the SPV route.

PFC derives twin benefits from the UMPPs in the form of loan disbursements to the developers and augmentation of fee-based revenue stream in the form of consulting and advisory services.

Venture into Private Equity – supportive of future earnings

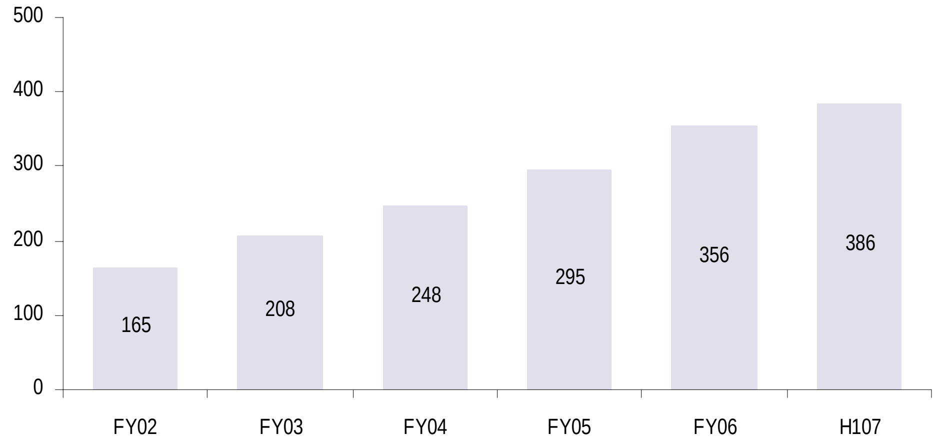
PFC is in the process of setting up a venture capital fund, 'India Power Fund' in collaboration with OBC & LIC, whereby its commitment is Rs 2bn. We believe this venture will prove to be earnings accretive to the company in form of fees (typically, 1.5% - 2% of AUM) and also in the form of capital gains at the time of exit.

Sanctions and disbursements (Rs bn)



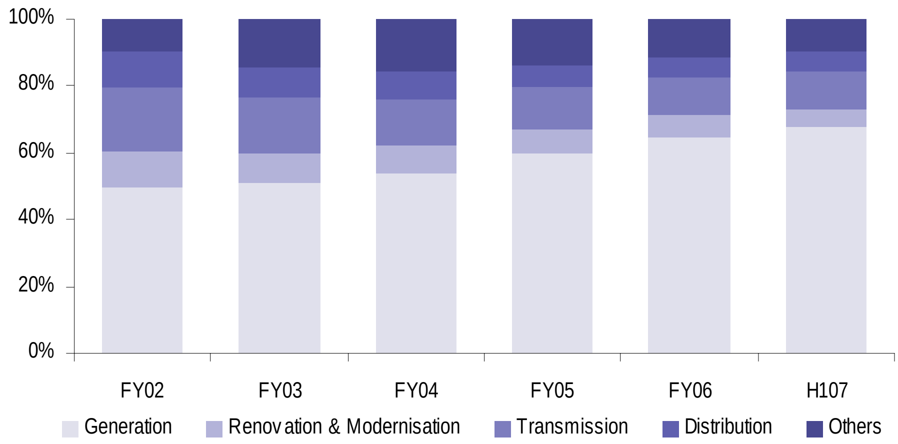
Source: Company RHP

Advances Portfolio (Rs bn)



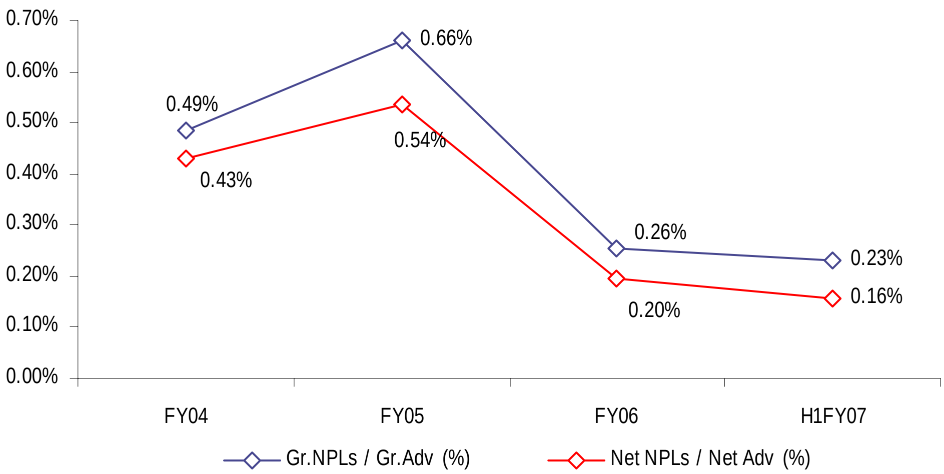
Source: Company RHP, Man Financial Research

Break-up of Advances portfolio



Source: Company RHP, Man Financial Research

Impeccable asset quality



Source: Company RHP, Man Financial Research

FINANCIALS

Income Statement

Y/E Mar (Rs mn)	FY04	FY05	FY06	FY07E	FY08E
Interest on Loans	26,942	27,132	29,176	38,075	50,450
% growth	*0.0%*	*0.7%*	*7.5%*	*30.5%*	*32.5%*
% yield on Avg Loans	*0.0%*	*10.0%*	*9.0%*	*9.5%*	*9.9%*
Interest on Borrowings	13,465	15,026	17,936	24,662	34,650
% growth	*0.0%*	*11.6%*	*19.4%*	*132.1%*	*40.5%*
% cost of Avg borrowings	*0.0%*	*7.6%*	*7.4%*	*8.1%*	*8.8%*
Net Interest Income	13,477	12,107	11,241	13,413	15,800
% growth	*0.0%*	*-10.2%*	*-7.2%*	*19.3%*	*17.8%*
% of Avg IBA / AWF	*6.0%*	*4.5%*	*3.5%*	*3.3%*	*3.1%*
Fee Income	0	5	11	24	48
% of Avg IBA / AWF	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Gain/Loss on sale of assets	0	0	0	0	0
Gain/Loss on sale of investments	0	0	0	2	2
Dividend income on investments	0	10	10	13	13
Other income	1,288	1,255	1,028	925	832
Non-recurring income	30	45	0	0	0
Total non interest income	1,318	1,315	1,048	964	896
% Non+Int Inc (excld port gains) / NII	*9.6%*	*10.5%*	*9.3%*	*7.2%*	*5.7%*
Total Income	14,794	13,422	12,288	14,378	16,696
% growth	*0.0%*	*-9.3%*	*-8.4%*	*17.0%*	*16.1%*
Personnel Expenses	373	446	485	500	510
% of Total expenses	*24.0%*	*29.0%*	*37.6%*	*40.2%*	*39.0%*
Other Expenses	1,178	1,092	804	745	798
Total Op expenses	1,551	1,538	1,288	1,245	1,308
% growth	*0.0%*	*-0.8%*	*-16.3%*	*-3.4%*	*5.0%*
% of Total Income	*10.5%*	*11.5%*	*10.5%*	*8.7%*	*7.8%*
% of AWF	*0.0%*	*0.6%*	*0.4%*	*0.3%*	*0.3%*
Net Inc (Loss) before prov	13,243	11,883	11,000	13,133	15,388
% growth	*0.0%*	*-10.3%*	*-7.4%*	*19.4%*	*17.2%*
Provision for NPAs	6	228	-144	120	160
% of average advances	*0.00%*	*0.08%*	*-0.04%*	*0.03%*	*0.03%*
% of Total Income	*0.04%*	*1.70%*	*-1.17%*	*0.83%*	*0.96%*
Provision for Invst deprn	0	3	2	-1	-1
Net Inc (Loss) before tax	13,238	11,652	11,142	13,014	15,229
% growth	*0.0%*	*-12.0%*	*-4.4%*	*16.8%*	*17.0%*
Provision for Income Tax	4,237	3,891	2,646	3,253	3,807
% effective tax rate	*32.0%*	*33.4%*	*23.7%*	*25.0%*	*25.0%*
Net Profit	9,001	7,761	8,496	9,760	11,422
% growth	*0.0%*	*-13.8%*	*9.5%*	*14.9%*	*17.0%*
% of Avg IBA / AWF	*0.0%*	*2.9%*	*2.6%*	*2.4%*	*2.2%*
Adj.Net Profit	10,185	9,705	9,754	9,760	11,422
% growth	*0.0%*	*-4.7%*	*0.5%*	*0.1%*	*17.0%*
% of Avg IBA / AWF	*0.0%*	*3.6%*	*3.0%*	*2.4%*	*2.2%*

Source: Company, Man Financial Research Estimates

We expect the yields to improve with the return of the pricing power (as banks are also hiking lending rates)

NIM likely to come down due to rise in funding costs

We expect the fee income to rise significantly in the future; however, we have not incorporated in our estimates

Operating cost to AWF is amongst the lowest in the industry

Adjusted net profit higher in earlier years due to extra-ordinary income in the form of interest restructuring premium and exchange gains

Balance Sheet

As at 31st Mar (Rs mn)	FY04	FY05	FY06	FY07E	FY08E
Assets					
Cash and bank balances	3,530	3,384	3,648	10,660	7,507
% growth	0.0%	-4.1%	7.8%	192.2%	-29.6%
% of current assets	20.2%	22.1%	20.4%	39.5%	26.9%
Other current Assets	7,914	6,220	6,936	7,977	9,971
% growth	0.0%	-21.4%	11.5%	15.0%	25.0%
% of current assets	45.3%	40.7%	38.8%	29.5%	35.7%
Loans and Advances	6,044	5,696	7,282	8,375	10,468
% growth	0.0%	-5.8%	27.8%	15.0%	25.0%
% of current assets	34.6%	37.2%	40.8%	31.0%	37.5%
Current Assets, Loans & Advances	17,488	15,301	17,867	27,011	27,946
% growth	0.0%	-12.5%	16.8%	90.5%	3.5%
% of total assets	6.6%	4.9%	4.8%	5.7%	4.6%
Advances	248,273	295,201	356,025	445,032	578,541
% growth	0.0%	18.9%	20.6%	25.0%	30.0%
% of total assets	93.1%	94.8%	95.0%	94.0%	95.1%
Investments	120	141	165	158	158
% growth	0.0%	17.5%	17.1%	0.0%	0.0%
% of total assets	0.1%	0.1%	0.1%	0.0%	0.0%
Net Fixed Assets	853	813	847	1,349	1,705
% growth	0.0%	-4.6%	4.2%	52.8%	26.4%
% of total assets	0.3%	0.3%	0.2%	0.3%	0.3%
Total Assets	266,735	311,456	374,904	473,550	608,350
% growth	0.0%	16.8%	20.4%	26.3%	28.5%
Assets to Equity ratio	4.5	4.9	5.4	5.5	6.4
Liabilities					
Share capital	10,305	10,305	10,305	11,478	11,478
Reserves & Surplus	48,500	53,848	59,473	74,864	83,029
Borrowings	177,480	216,482	269,248	338,304	449,868
% growth	0.0%	22.0%	24.4%	25.6%	33.0%
% of total liabilities	66.5%	69.5%	71.8%	71.4%	73.9%
Current Liabilities & Provisions	12,231	10,271	14,170	20,222	25,227
% growth		-16.0%	38.0%	42.7%	24.8%
% of total liabilities	4.6%	3.3%	3.8%	4.3%	4.1%
Deferred Tax Liability	7,191	8,990	9,705	10,675	11,743
Interest subsidy fund from GOI	11,028	11,559	12,003	18,005	27,007
Total Liabilities	266,735	311,455	374,904	473,547	608,352
% growth	0.0%	16.8%	20.4%	26.3%	28.5%
Gross Non performing loans	1,207	1,947	910	1,046	1,152
Gr.NPLs / Gr.Adv (%)	0.5%	0.7%	0.3%	0.2%	0.2%
Net Non performing Loans	1,073	1,585	698	733	843
% Net NPLs / Net Adv	0.4%	0.5%	0.2%	0.2%	0.1%
% Net NPLs to Equity	1.8%	2.5%	1.0%	0.8%	0.9%

Source: Company, Man Financial Research Estimates

Investments include 8% stake in PTC and 'Small is Beautiful Trust Fund'

Unrealized gains stand at Rs 530mn as on H1FY07

Leverage ratio at 5.5 times as against the permissible 10 times for NBFCs

We expect the leverage to improve in the future leading to better ROE

Deferred tax liability is on account of deduction in respect of special reserve created and maintained (not exceeding 40%of profits) derived from the business of providing long-term finance

We believe that the deferred tax liability should be added to the net worth (as other players like HDFC & IDFC are not required to provide for the same) which works out to an addition of Rs 9 to the book value

Asset quality is impeccable

Profitability, Productivity, Liquidity and Valuation Ratios

	FY04	FY05	FY06	FY07E	FY08E
Earnings and Valuation Ratios:					
Pre-provision Operating RoAE (%)		19.3	16.4	16.8	17.0
RoAE (%)		15.8	14.6	12.5	12.6
Pre-provision Operating ROA (%)		4.1	3.2	3.1	2.8
RoAA (%)		3.4	2.8	2.3	2.1
EPS (Rs.)	8.7	7.5	8.2	8.5	10.0
Book Value (Rs.)	57.1	62.3	67.7	75.2	82.3
Adj BV (Rs.)	56.0	60.7	67.0	74.6	81.6
Dividend per share (Rs.)	3.1	3.7	3.5	3.3	3.5
Revenue Analysis :					
Interest income on IBA (%)		10.0	9.0	9.5	9.9
Interest cost on IBL (%)		7.6	7.4	8.1	8.8
NIM on IBA / AWF (%)		4.5	3.5	3.3	3.1
Core fee Inc / AWF (%)		0.0	0.0	0.0	0.0
Op.Exp / TI (%)	10.5	11.5	10.5	8.7	7.8
Op.Exp / AWF (%)		0.6	0.4	0.3	0.3
Employee exps / Op exps (%)	24.0	29.0	37.6	40.2	39.0
Tax / Pre-tax earnings (%)	32.0	33.4	23.7	25.0	25.0
Asset Quality :					
GNPAs / Gr Adv (%)	0.5	0.7	0.3	0.2	0.2
NNPAs / Net Adv (%)	0.4	0.5	0.2	0.2	0.1
Growth Ratio:					
Advances (%)		18.9	20.6	25.0	30.0
Borrowings (%)		22.0	24.4	25.6	33.0
Net worth (%)		9.1	8.8	23.7	9.5
Net Int Income (%)		(10.2)	(7.2)	19.3	17.8
Non-fund based income (%)		(9.3)	(8.4)	17.0	16.1
Non-Int Exp (%)		(0.8)	(16.3)	(3.4)	5.0
Profit Before Tax (%)		(12.0)	(4.4)	16.8	17.0
Net profit before extra ordinaries (%)		(13.8)	9.5	14.9	17.0
Net profit after extra ordinaries (%)		(4.7)	0.5	0.1	17.0
Capital Adequacy Ratio:					
Tier I (%)	22.3	20.8	18.7	18.5	15.6
Internal Capital Generation rate (%)		10.0	9.6	8.5	8.6
NNPAs to Equity (%)	1.8	2.5	1.0	0.8	0.9

Source: Company, Man Financial Research Estimates

ROE to come down post issue; we expect ROE to improve on the back of improved leverage

Core fee income is negligible compared to industry; however we expect it to improve on the back of rise in the project advisory services and venture in to private equity

77% of advances of PFC are to state sector entities; however the maintenance of escrow accounts provides cushion against any major default

We expect the advances portfolio to grow at 25% & 30% in FY07E & FY08E respectively

CAR remains comfortable; much above the stipulated level of 12%

March 9, 2007

INDIA / BANKING / COMPANY UPDATE

Man Financial

Yes Bank

Not Rated / Rs 123

Parthapratim Gupta (parthapratim.gupta@manfinancial.in) +91 22 6667 9962

- Yes Bank is a 2-year young, technology driven private sector bank with 29 fully operational branches and an asset base of Rs 82bn (growth of 6x in 2 years). Advances and deposits stand at Rs 48bn and Rs 55bn respectively as of 3QFY07. Yes Bank has carved out a niche for itself by adopting an integrated strategy of providing banking as well as advisory services (through a very experienced and active investment banking team) with a primary focus on mid-sized corporate and SME segments in India.
- The management has plans to take the number of branches to ~45 by FY07E, ~100 by FY08E and finally to ~250 by FY10E. The existing employee strength stood at 2,161. The bank hires almost 150-175 new employees every month.
- Currently, Yes Bank's major forte lies in corporate banking constituting 63% of total advances portfolio, followed by business banking (emerging corporates and SME) @ 36% and the balance from retail segment. However, the management has set a target (likely by FY10E) of rebalancing the portfolio towards business banking @ ~40% and the rest coming from corporate and retail segments (~30% each).
- Net interest margins stood @ 3% at the end of Q3FY07, witnessing sequential improvement in each of the last three quarters. CASA ratio for the bank stood at 7.3% and the management intends to take it to 20-25% by FY10E (as the benefits from the new branches start accruing). We believe that net interest margins might witness some pressure in the short-to-medium term (as the bank might have to resort to costlier wholesale deposits in its endeavor to maintain the growth momentum). However, in the long term, net interest margin is likely to improve on account of change in the advances portfolio mix towards SMEs and retail segments (resulting in higher yields) and the improvement in the CASA ratio (keeping the rise in cost of deposits under check due to proposed branch expansion).
- Fee income remains a key component of the overall profitability. Non-interest income/Total Income ratio at 50%+ is one of the best among the private banking space (second to ICICI Bank only). The key differentiator is the superior quality (leading to sustainability also) being reflected in the form of low proportion of trading income (~1% in Q3FY07).
- Operating expenses /Total income ratio (50-52%) might continue to remain high in sync with the investments in branch expansion (both in physical and human assets). However, the ratio is likely to improve going forward as the high cost investments have been mostly completed upfront and as the revenue from the new branches start pouring in.
- Asset quality remains impeccable with zero net NPAs till date.
- CAR (%) stood at 14.3%, with Tier-I @ 10.2%. However, we expect an equity dilution of ~10% in FY08E, in perspective of the current balance sheet growth.
- Key concerns remain (i) disappointment on execution front hurting asset growth and margins simultaneously (ii) deterioration in asset quality (not a seasoned portfolio) and (iii) churn in the top management.
- **Valuation:** Yes Bank is trading at 25.6x FY08E earnings and 2.6x FY08E adjusted book value (taking into account an equity dilution of 10%@ Rs 180/share). We have a positive view on the stock (as it could very well qualify as a potential acquisition candidate with the opening of the sector in FY09E on back of its superior management, array of financial products encompassing the entire value chain and strong technology platform).

This note should be read for
- *A peek into the company's affairs*

Bloomberg code :	YES IN
Reuters code :	YESB.BO
www.yesbank.com	

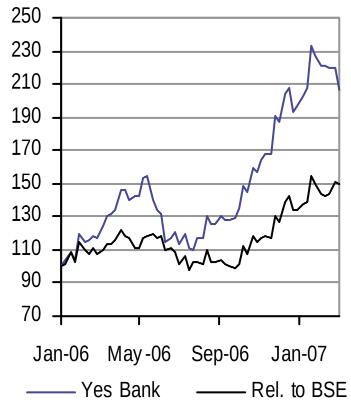
BSE Sensex :	13049
NSE Nifty :	3762

Company data	
O/S shares :	270mn
Market cap (Rs) :	35bn
Market cap (US$) :	785mn
52 - wk Hi/Lo (Rs) :	170 / 67
Avg. daily vol. (3mth) :	847,709
Face Value (Rs) :	10

Share holding pattern, %	
Promoters :	35.9
FII / NRI :	54.0
FI / MF :	2.0
Non Promoter Corp. Holdings :	1.2
Public & Others :	7.0

Price performance, %	1mth	3mth	1yr
Abs	-15.0	-8.2	43.5
Rel to BSE	-4.6	-2.5	20.3

Price vs Sensex



Source: Bloomberg, Man Financial Research

Valuation summary

Y/E Mar, Rs mn	FY06	FY07E	FY08E	FY09E
Pre-prov ROE (%)	25.1	26.5	28.1	34.8
Pre-prov ROA (%)	3.8	2.8	2.4	2.3
Net Profit	553	934	1,481	2,374
% growth	*1571.9*	*68.9*	*58.5*	*60.3*
EPS (Rs)	2.0	3.3	4.8	7.7
Adj BVPS (Rs)	21.2	28.1	46.7	54.4
ROE (%)	14.0	13.8	13.3	15.2
P/E (x)	60.0	36.9	25.6	16.0
Adj. P/BV (x)	5.8	4.4	2.6	2.3

Source: Company, Man Financial Preliminary Research Estimates

Yes Bank vis-à-vis its peers

Y/E Mar	FY06	FY07E	FY08E	FY09E
YES BANK				
NIM / AWF (%)	3.3	3.0	2.9	3.0
Core fee income /AWF (%)	3.4	2.4	1.9	1.7
Operating exp. / AWF (%)	3.3	2.8	2.6	2.5
ROAA (%)	2.1	1.5	1.2	1.0
ROAE (%)	14.0	13.8	13.3	15.2
HDFC BANK				
NIM / AWF (%)	4.2	4.1	4.2	4.3
Core fee income /AWF (%)	1.9	2.0	2.2	2.3
Operating exp. / AWF (%)	2.8	2.9	3.0	3.0
ROAA (%)	1.4	1.4	1.5	1.6
ROAE (%)	17.7	19.9	21.7	23.2
ICICI BANK				
NIM / AWF (%)	2.1	2.3	2.4	2.5
Core fee income /AWF (%)	1.8	1.9	2.1	2.1
Operating exp. / AWF (%)	2.3	2.3	2.3	2.2
ROAA (%)	1.3	1.1	1.1	1.1
ROAE (%)	14.3	12.7	15.4	17.4
UTI BANK				
NIM / AWF (%)	2.6	2.8	3.0	3.0
Core fee income /AWF (%)	1.4	1.4	1.5	1.5
Operating exp. / AWF (%)	2.0	2.1	2.1	2.1
ROAA (%)	1.2	1.2	1.1	1.1
ROAE (%) *	18.3	20.8	17.3	15.7

Source: Company, Man Financial Preliminary Research Estimates

* Taking into account equity dilution of 15% (no guidance from management)

Company background

Yes Bank is the only new age private sector bank to be awarded greenfield banking license by RBI in the last 12 years. Yes Bank boasts of a superior management team led by Mr. Rana Kapoor at the helm.

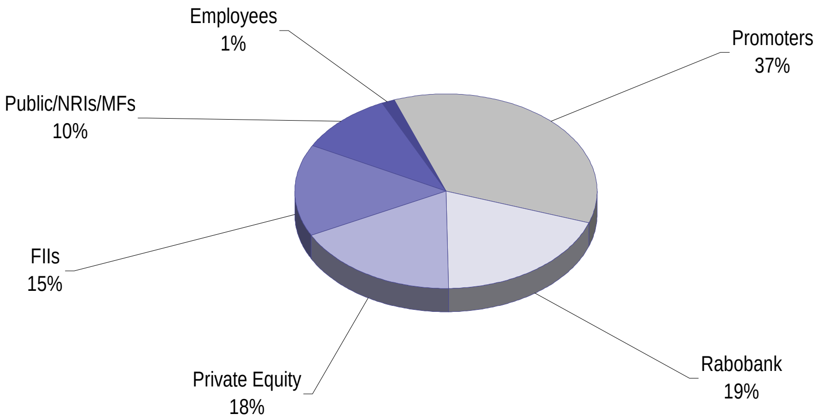
Retention of quality top management is a key to success….

Key Management Personnel

Name	Designation	Previous Assignment
Rana Kapoor	Managing Director & CEO	Managing Partner/CEO & Managing Director - Rabo India
H. Srikrishnan	Executive Director	Country Head - Transaction Banking & Operations - HDFC Bank
Ajay Mahajan	Group President - Financial Markets, Institutions and Investment Management	Managing Director, Global Markets Group & Country Treasurer - Bank of America
Sunil Gulati	Group President - Corporate & Insitutional/Emerging Corporates Banking, Risk Management & CDS	Managing Director - GE Commercial Finance
Somak Ghosh	President - Corporate Finance & Development Banking	Director - Project Advisory & Infrastructure Mgmt - Rabo India
Suresh Sethi	President - Branch Operations & Transaction Banking	Global Transaction Services Head - Carribean, Central & Latin America, Citibank N.A.
Aditya Sanghi	Country Head - Investment Banking	Executive Director, Head of Mergers & Acquisitions - Rabo India
Suhail Kazmi	President - Retail Banking & Wealth Management	Retail Head, West & South India - ABN Amro Bank
Varun Tuli	President - Business Banking	Executive Director and Country Head - Avigo Capital Partners
Sumit Gupta	Country Head - Emerging Corporates Banking	Associate Director & Head (North) - Rabo India
Rajnish Datta	Country Head - Retail Assets	Business Head & Director - AMEX
Sandeep Sarkar	Country Head - Financial Markets	Vice President - Bank of America
Rajat Monga	Chief Financial Officer	Head of Treasury - Rabo India

Source: Company, Man Financial Research

Shareholding Pattern as at Jan 26,2007(%)



Source: Company, Man Financial Research

Private equity investors include Citicorp Venture Capital, Chrys Capital & AIF capital; 3-yr lock-in expiring in May'07

Other key investors are Fidelity (4.8%), Swiss Re (3.6%), HSBC (2.4%) & TIA Crest (1.8%)

Rabobank's 14.8% holding has a lock-in of period of five years expiring in 2010E

Business Overview

Key business segments

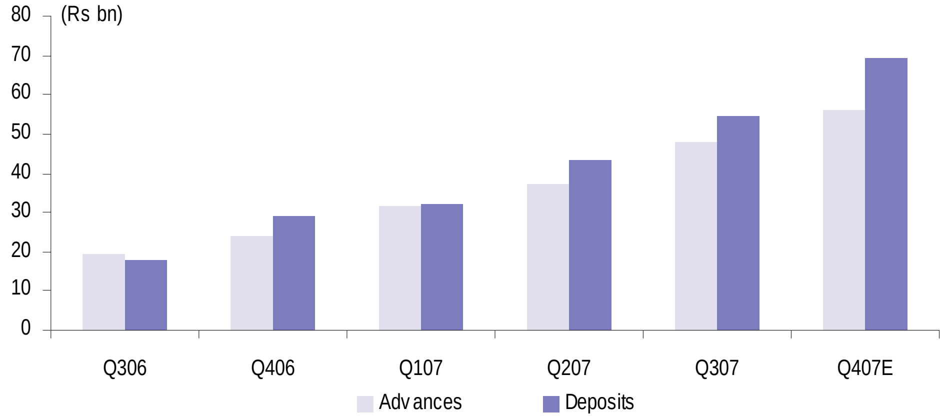
Corporate & Institutional Banking	Business Banking	Retail Banking
Customer focus Corporates having turnover exceeding Rs 7.5bn *Products* Array of financial products including corporate finance, transaction banking, treasury products and financial advisory *Client base* 379 customers Target – 800 corporate customers & 360 government owned institutions	*Customer focus* Emerging Corporates having turnover between Rs 1 bn – Rs 7.5 bn SMEs having turnover between Rs 0.05bn and Rs 1 bn *Objective* Partnering tomorrow's large corporates providing host of products; even including wealth management products to business owners *Client base* 444 customers	*Initial Customer focus* Mass Affluent segment having income between Rs 0.5mn – Rs 2.5mn *Objective* Targeting the affluent segment via primary differentiation in service quality Planning to open new branches in regions with high CASA potential (50%-60% in northern region, followed by 30% in the western region)

Source: Company, Man Financial Research

Business banking and retail banking to be the key drivers going forward

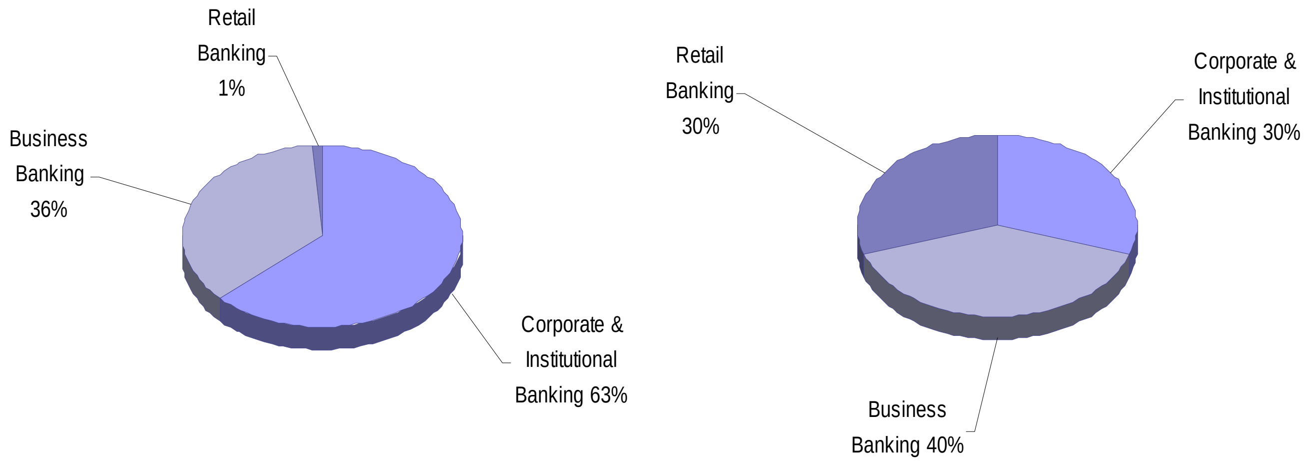
We believe that NIM is likely to improve on account of shift in the portfolio mix towards SMEs and retail (leading to higher yields) and improvement in CASA ratio (once the benefits of branch expansion start flowing in)

Advances & Deposits



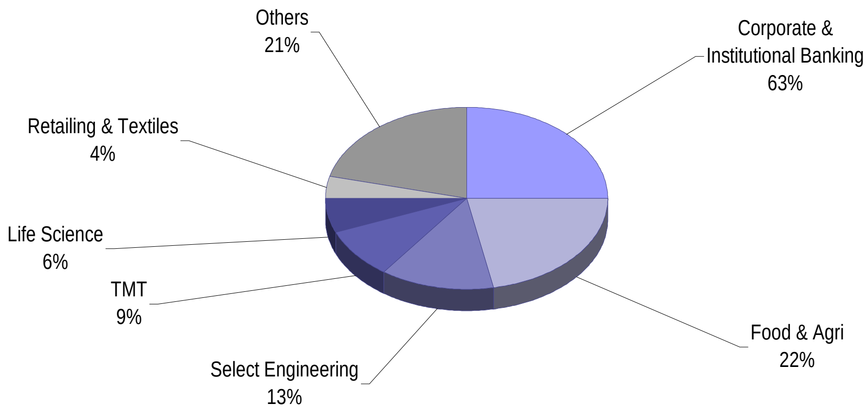
Source: Company, Man Financial Preliminary Research Estimates

Existing & Target (FY10E) segment wise contribution to advances portfolio (%)



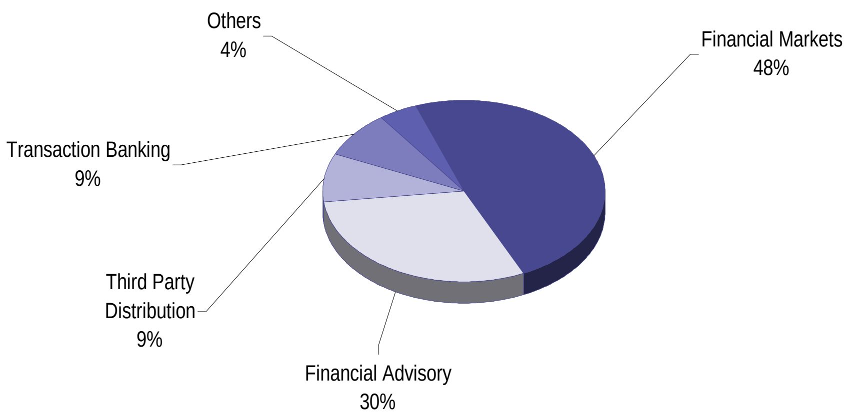
Source: Company, Man Financial Research

Sector wise break-up of advances portfolio (%)



Source: Company, Man Financial Research

Break-up of non-interest income (%)



Source: Company, Man Financial Research

FINANCIALS

Income Statement

Y/E Mar (Rs mn)	FY05	FY06	FY07E	FY08E	FY09E
Interest on Loans	231	1,361	3,879	8,531	16,848
% yield on Avg Loans	6.1%	8.6%	9.7%	10.2%	10.7%
Interest on Investments	62	475	1,188	2,198	3,627
% yield on Avg Investments	3.1%	5.4%	5.8%	5.7%	5.6%
Others	6	65	98	147	221
% yield on Avg Cash and Cash Equivalents	2.3%	4.9%	3.2%	2.6%	2.1%
Total Interest Earned	300	1,902	5,166	10,876	20,696
% of Avg IBA / AWF	4.9%	7.3%	8.1%	8.5%	8.9%
Interest on Deposits	89	851	2,872	6,461	12,793
% cost of Avg deposits	2.7%	4.7%	5.8%	6.3%	6.6%
Interest on Borrowings	29	189	340	476	666
% cost of Avg borrowings	1.6%	4.5%	6.5%	5.6%	5.3%
Interest on Debt	0	7	60	164	271
% cost of Avg Debt	NA	1.5%	1.8%	2.3%	2.6%
Total Interest Expended	118	1,047	3,271	7,101	13,730
% Cost of Avg IBL	2.3%	4.6%	5.7%	6.0%	6.3%
Net Interest Income	181	855	1,894	3,775	6,966
% growth	NA	371.4%	121.7%	99.3%	84.5%
% of Avg IBA / AWF	3.0%	3.3%	3.0%	2.9%	3.0%
Comm, Exch & Brok	78	419	692	1,038	1,505
Gain on Foreign exch	70	477	835	1,462	2,558
Gain on securities trading	26	40	30	40	50
Other Income	8	61	120	180	270
Total non interest income	182	997	1,677	2,719	4,383
% Non+Int Inc (excld port gains) / NII	86.1%	112.1%	86.9%	71.0%	62.2%
Total Income	363	1,852	3,571	6,494	11,348
% growth	NA	410.2%	92.8%	81.8%	74.7%
Personnel Expenses	213	501	1,178	2,356	4,123
% of Total expenses	53.3%	58.2%	66.5%	69.8%	69.5%
Other Expenses	187	360	594	1,018	1,807
Total Op expenses	399	861	1,772	3,374	5,929
% growth	NA	115.6%	105.7%	90.4%	75.8%
% of Total Income	118.5%	47.5%	50.0%	52.3%	52.5%
% of AWF	6.6%	3.3%	2.8%	2.6%	2.5%
Net Inc (Loss) before prov	-36	991	1,800	3,120	5,419
% growth	NA	-2818.6%	81.6%	73.4%	73.7%
Provision for NPAs	19	73	215	549	1,180
% of average advances	0.5%	0.5%	0.5%	0.7%	0.8%
% of Total Income	5.2%	3.9%	6.0%	8.5%	10.4%
Provision for Invst deprn	0	73	147	294	587
Net Inc (Loss) before tax	-55	844	1,437	2,278	3,652
% growth	NA	-1622.2%	70.2%	58.5%	60.3%
Provision for Income Tax	-18	291	503	797	1,278
% effective tax rate	32.2%	34.5%	35.0%	35.0%	35.0%
Net Profit	-38	553	934	1,481	2,374
% growth	NA	1571.9%	68.9%	58.5%	60.3%
% of Avg IBA / AWF	-0.6%	2.1%	1.5%	1.2%	1.0%

Source: Company, Man Financial Preliminary Research Estimates

Net interest margins to improve with rising yields and improving CASA ratio

Fee-based income - a key driver of profitability

Operating-cost-to income ratio to remain high in sync with branch expansion

We expect the provisions to rise in line with the industry standards

We expect the earnings to grow at a CAGR of 59% over FY07E-FY09E

Balance Sheet

As at 31st Mar (Rs mn)	FY05	FY06	FY07E	FY08E	FY09E
Assets					
Cash & Bal with RBI	530	2,156	4,037	7,427	13,525
% growth	NA	306.5%	87.3%	84.0%	82.1%
% of deposit	8.0%	7.4%	5.8%	5.5%	5.4%
Loans and Adv	7,610	24,071	56,000	112,000	201,600
% growth	NA	216.3%	132.6%	100.0%	80.0%
% of deposit	114.3%	82.3%	80.9%	82.7%	79.9%
Investments	4,028	13,700	27,384	49,819	80,782
% growth	NA	240.1%	99.9%	81.9%	62.2%
% of deposit	60.5%	46.8%	39.6%	36.8%	32.0%
- of which G-Secs	2,687	8,119	18,269	36,537	63,940
% of deposit	40.4%	27.7%	26.4%	27.0%	25.3%
Fixed Assets (Net)	196	347	521	781	1,172
% of total assets	1.5%	0.8%	0.6%	0.4%	0.4%
Other assets	417	1,351	2,500	3,749	5,624
Total Assets	12,782	41,626	90,442	173,777	302,703
% growth	NA	225.7%	117.3%	92.1%	74.2%
Liabilities					
Share capital	2,000	2,700	2,800	3,080	3,080
Reserves and Surplus	170	3,027	5,061	11,302	13,675
Debt	0	1,000	5,550	8,560	12,060
Borrowing	3,697	4,648	5,810	11,222	14,027
% growth	NA	52.7%	101.1%	74.1%	31.9%
% of total liabilities	28.9%	13.6%	12.6%	11.4%	8.6%
Total Deposits	6,659	29,263	69,200	135,410	252,390
% growth	NA	339.5%	136.5%	95.7%	86.4%
% of total liabilities	52.1%	70.3%	76.5%	77.9%	83.4%
- of which Demand Dep	72	3,009	72	3,009	5,536
% of total deposits	1.1%	10.3%	8.0%	10.0%	13.0%
- of which Savings Dep	20	108	1,384	6,771	17,667
% of total deposits	0.3%	0.4%	2.0%	5.0%	7.0%
Other liab incld prov	256	988	2,017	4,204	7,468
Total Liabilities	12,782	41,626	90,438	173,778	302,700
% growth	NA	225.7%	117.3%	92.2%	74.2%
Gross Non performing loans	0	0	0	0	0
Gr.NPLs / Gr.Adv (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Net Non performing Loans	0	0	0	0	0
% Net NPLs / Net Adv	0.0%	0.0%	0.0%	0.0%	0.0%
% Net NPLs to Equity	0.0%	0.0%	0.0%	0.0%	0.0%

Source: Company, Man Financial Preliminary Research Estimates

36% of investment portfolio in HTM

Duration of AFS portfolio < 1yr (mostly in T-Bills)

Asset quality impeccable with zero NPAs till date

Profitability, Productivity, Liquidity and Valuation Ratios

	FY05	FY06	FY07E	FY08E	FY09E
Earnings and Valuation Ratios:					
Pre-provision Operating RoAE (%)	-3.4	25.1	26.5	28.1	34.8
RoAE (%)	(3.5)	14.0	13.8	13.3	15.2
Pre-provision Operating ROA (%)	(0.6)	3.6	2.7	2.4	2.3
RoAA (%)	(0.6)	2.1	1.5	1.2	1.0
EPS (Rs.)	(0.2)	2.0	3.3	4.8	7.7
Book Value (Rs.)	10.9	21.2	28.1	46.7	54.4
Adj BV (Rs.)	10.9	21.2	28.1	46.7	54.4
Dividend per share (Rs.)	0.0	0.0	0.0	0.0	0.0
Revenue Analysis :					
Interest income on IBA (%)	4.9	7.3	8.1	8.5	8.9
Interest cost on IBL (%)	2.3	4.6	5.7	6.0	6.3
NIM on IBA / AWF (%)	3.0	3.3	3.0	2.9	3.0
Core fee Inc / AWF (%)	2.4	3.4	2.4	1.9	1.7
Portfolio gains / Total Inc (%)	7.7	2.2	0.8	0.6	0.4
Op.Exp / TI (%)	118.5	47.5	50.0	52.3	52.5
Op.Exp / AWF (%)	6.6	3.3	2.8	2.6	2.5
Employee exps / Op exps (%)	53.3	58.2	66.5	69.8	69.5
Tax / Pre-tax earnings (%)	32.2	34.5	35.0	35.0	35.0
Asset Quality :					
GNPAs / Gr Adv (%)	0.0	0.0	0.0	0.0	0.0
NNPAs / Net Adv (%)	0.0	0.0	0.0	0.0	0.0
Growth Ratio :					
Loans (%)	NA	216.3	132.6	100.0	80.0
Investments (%)	NA	240.1	99.9	81.9	62.2
Deposits (%)	NA	339.5	136.5	95.7	86.4
Networth (%)	NA	163.9	37.3	82.9	16.5
Net Int Income (%)	NA	371.4	121.7	99.3	84.5
Non-fund based income (%)	NA	514.7	72.0	62.7	61.7
Non-Int Exp (%)	NA	115.6	105.7	90.4	75.8
Profit Before Tax (%)	NA	(1,622.2)	70.2	58.5	60.3
Net profit (%)	NA	1,571.9	68.9	58.5	60.3
Asset / Liability Profile					
Avg CASA/ Deposits (%)	1.4	8.9	10.2	13.3	18.3
Avg Adv / Avg Dep (%)	114.3	88.2	81.3	82.1	80.9
Avg Invst / Avg Dep (%)	60.5	49.4	41.7	37.7	33.7
Incr Adv / Deposits (%)	114.3	72.8	79.9	84.6	76.6
Avg Cash / Avg Dep (%)	8.0	7.5	6.3	5.6	5.4
Capital Adequacy Ratio:					
Tier I (%)	15.0	13.4	9.6	9.2	7.1
Internal Capital Generation rate (%)	NA	25.5	16.3	18.8	16.5
NNPAs to Equity (%)	0.0	0.0	0.0	0.0	0.0

Source: Company, Man Financial Preliminary Research Estimates

RoE to come down in FY08E on account of equity dilution

Core fee income to average working funds ratio is among the best among the private sector banks

Loan growth to continue on account of low base

CASA ratio to improve as more and more retail branches get operationalised

Equity dilution of 10% factored in at a price of Rs 180/share

Voltas Ltd

***Abhijeet Dakshikar** (abhijeet.dakshikar@manfinancial.in) +91 22 6667 9963*
***Shridatta Bhandwaldar** (Research Associate)*

Diverse growth

- Currently the order book stands at Rs 24bn (~1.1x trailing 4-quarter sales), which is 71% higher compared to that at FY06 end. The domestic and international book stands at Rs 18bn and Rs 6bn respectively. During the quarter the order flow was at Rs ~5bn.
- Revenues for Q3FY07 at Rs 5.69bn (+31% YoY). Q3FY07 revenues are in line with our expectations. Nine-month growth has been sluggish at 24% YoY as compared to last years 49%.
- Operating margin stood at 4.8% (-100bps YoY). This is mainly due to increase in other operating costs and staff costs by ~100bps. Margin decline is on account of change in the product mix in EA&S business and lower margins in the international business. Management expects in line/slight decline in the margins for the entire year FY07.
- EBITDA margin at 6.2% (-60bps YoY) as against our expectation. Lower than expected other income widened the YoY gap in margins.
- Net profit is down by 14.4% YoY to Rs 194mn as against Rs 227mn(adjusted) last year. This is below our expectation due to higher tax rate 41%.
- Provision of Rs 20mn under AS-15, exchange loss of Rs 20mn and other consultancy fees charges explains the micro details of the higher staff and other costs during the quarter.
- MAT (Minimum Alternate Tax) is no more applicable to the company and thus the full tax rate will be applicable during the FY07E. This has impacted the quarter net margins. The tax rate during the quarter is at 41%.

Valuation

- We have reduced our FY08 earnings estimates by 11% due full tax rate impact and delay in the margin improvement as against our expectations and have introduced FY09 estimates. We have raised 1-year target price to Rs 117 from Rs 113 based on DCF.
- Stock trades at PER of 17.3xFY08E and EV/EBITDA of 10.4xFY08E

Risks

- Operating margin pressure in 1) the international business due to delays and exchange rate fluctuations 2) Decline in margins in EA&S businesses due to change in the product sales mix.

Valuation summary

Y/E Mar, Rs mn	FY04	FY05	FY06	FY07E	FY08E
Net Sales	13,867	18,531	23,812	31,120	38,894
Growth, %	8.9%	33.6%	28.5%	30.7%	25.0%
Core EBIDTA	447	1,007	1,184	1,975	2,651
EBIDTA margins, %	3.22	5.44	4.97	6.35	6.81
Net profit	506	705	997	1,550	2,035
Net profit margin %	*3.6*	*3.8*	*4.2*	*5.0*	*5.2*
EPS, Rs	1.4	2.9	3.1	4.7	6.2
EPS Growth, %	65.21	112.30	5.84	51.46	31.25
PER, x	58.8	27.7	26.9	17.3	13.2
EV/EBIDTA, x	37.2	19.3	16.0	10.4	8.1
EV/Net Sales, x	1.87	1.39	1.10	0.83	0.66
Price/Book Value, x	13.8	11.1	8.8	6.8	5.2
ROIC, %	27.76	65.66	35.88	44.98	50.29
ROE, %	26.48	45.02	36.10	42.01	41.43
Dividend Yield, %	0.12	0.85	1.53	2.32	3.04

Source: Company, Man Financial Research Estimates

Maintain BUY / Rs 81
Target Rs 117 (+44%)

Sector (Relative to market)

OW	N	UW
■		

Stock (Relative to market)

B	OP	N	UP	S
■				
> 10%	5% to 10%	5% to –5%	-5% to -10%	< -10%

This note should be read for
- Recent result details
- Investment argument for Voltas
- Detail Financial

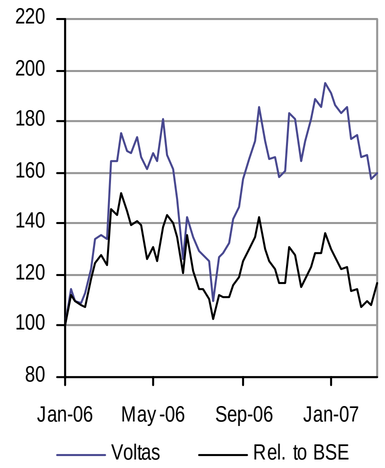
Bloomberg code:	VOLT IN
Reuters code:	VOLT.BO
www.voltas.com	
BSE Sensex:	13049
NSE Nifty:	3762

Company data	
O/S shares:	331mn
Market cap (Rs):	27bn
Market cap (US$):	605mn
52 - wk Hi/Lo (Rs):	121 / 64
Avg. daily vol. (3mth):	1.6mn
Face Value (Rs):	10

Share holding pattern, %	
Promoters:	27.4
FII / NRI / OCBs :	25.1
FI / MF / Banks:	23.6
Non Promoter Corp. Holdings:	5.3
Public & Others:	18.5

Price performance, %	**1mth**	**3mth**	**1yr**
Abs	-18.8	-27.0	-15.5
Rel to BSE	-4.6	-16.0	-31.6

Voltas vs. Sensex



Source: Bloomberg, Man Financial Research

INVESTMENT OVERVIEW

Sustainable competitive advantage	Diversified revenue streams, overall leadership position in the Indian HVAC&R market, and its leverage to the Middle East real estate market has seen Voltas outgrow the overall market in India. Its relationship with LMW for distribution of spinning machines is likely to add ~25% of EBIT for the next three years with TUF scheme now getting extended beyond 2007. In addition, the products business which was so far loss making is likely to generate value going ahead through restructuring of manufacturing activities, i.e., shifting the manufacturing base from the loss-making Hyderabad unit to the tax-haven Uttaranchal
Financial structure	As of now, the company has a favourable D/E at 0.3. The free cash flow is healthy and capex requirements are much lower as compared to expected cash flows in next two years
Shareholder value creation	From zero in FY04 Voltas is expected to generate a shareholder value of Rs 2.5 per share in FY08E.
Earnings visibility	Earning visibility is high owing to leverage to investments in a combination of industries including service such as IT/ITES and retail and manufacturing industries such as textile, mining, construction, etc. The petrodollar-driven spurt in infrastructure investments in Middle East market provides further diversification and hence de-risking. The order book at the end of first quarter stands at Rs 24bn (~1.1x projects sales for trailing four quarters). LMW (~25% of EBIT) has an order book of Rs 32bn (2.5x FY06 sales), which in effect gives clarity to Voltas' engineering agency business' sustainability for the next two years
Man vs. consensus	In line with market expectations.
Future event triggers	Complex water treatment projects and new airport infrastructure
Expected price momentum	Expected to move upwards

Source: Man Financial Research

Key risks

- The very nature of international service business gives rise to two risks, i.e., delay in execution of the project and credit risk
- The opportunity in the domestic market is too attractive to be missed by the international players, which could make the domestic market more competitive
- Overall change in macroeconomic parameters can slowdown the domestic growth in both household as well as industrial/services segments
- Raw material price volatility

Business update (Inputs from company Q3FY07 concall)

Order book details

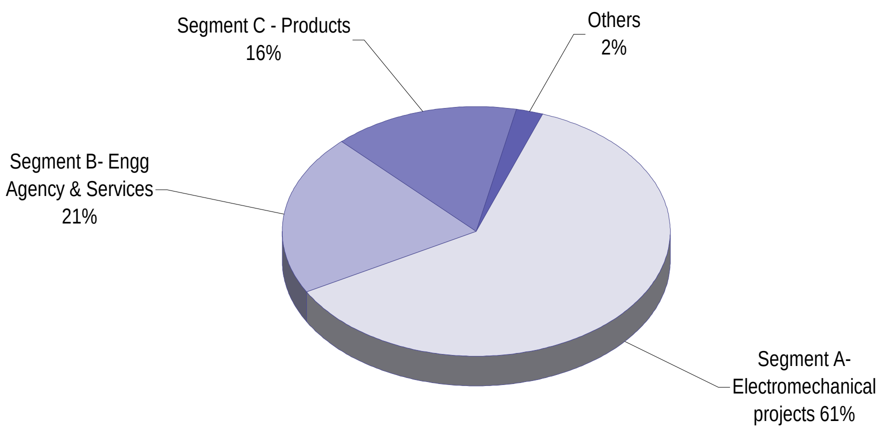
The current order book stands at Rs 24bn(~1.1x trailing 4-quarters). During the first nine month of the FY07, the order book has grown by 71%. At the end of last financial year the order book was Rs 13bn. Out of current order backlog of Rs 24bn, 18bn is from international market (mainly from Middle East) and Rs 6bn from domestic market. The order flow is expected to remain strong in both the geographies.

Revenue outlook

Revenue outlook remains strong from long-term perspective. We have estimated revenue CAGR of 25% for FY07-09. During the first three quarters the revenues have grown by 25% YoY, lower than our earlier full year estimates of 32%YoY. Thus we have reduced our full year estimates to 28%YoY. Given the last three quarter results we have maintained some caution while introducing FY09 estimates at 22%.

During the quarter the domestic projects business showed a higher growth rate than the international business, primarily due to lower revenue booking in the international projects. According to management the international projects are in the engineering and design phase whereas the major revenue booking takes place in the third stage i.e. construction phase. In the EA&S (Engineering agency and Services) business also the segments related to infrastructure like construction equipment, mining equipments and MHE (Material Handling Equipments) showed stronger growth than the Textile and other sub-segments.

Revenue breakup for Q3FY07



Source: Man Financial Research

Margin outlook

Margin pressure continued to haunt the business. The operating margins during the quarter declined to 4.8%(-100bps YoY). Out of four-business segments three-showed decline in the margins. Along with this the staff costs and other manufacturing expenses also showed a sharp YoY growth of 90bps.

The staff and other costs according to management have increased on accounts of

- As-15 provisions (approx. 70mn for first three quarters)
- Higher consultancy and contract staff costs in international business
- Extra IT infrastructure costs due to the restructuring of the entire IT services
- Business consultant fees

On the segments front the margins continued to remain under pressure. During the quarter the international business PBIT margins declined by 200bs where as the EA&S also showed a decline in margin by about 400bps. The change in the product mix sales in EA&S according to management resulted in the decline. The EA&S business constitutes traded goods like textile and manufactured like forklifts, mining equipments, MHE etc. The change in mix towards the manufactured product sell has resulted in margin decline. The mix is expected to continue to remain skewed towards manufactured products and thus the margins in this segment are also expected to remain at the current levels. The unitary product segment made losses at PBIT level. The others business segment unlike others showed a mark improvement due to rental income from the leased space at Mumbai.

The operating margin according to management will remain stable/slightly low for FY07, whereas the net margins can decline due to impact of full tax rate as compared 22% tax rate of the corresponding period last year. At operating level we have assumed a margin improvement of 100bps over FY07-09, due to factors like,

- International business margins will improve over next few quarters as more projects will start booking revenues
- Manufacturing facility at low cost Pantnager in Himachal Pradesh
- Lower other expenses due to reduced IT spending post IT restructuring and the business consulting cost is non-recurring in nature
- Better management of exchange fluctuations
- Lower provisioning under As-15 is expectation from management

Other major highlights

- Segmental growth – The Mechanical electrical and plumbing division registered a 23% growth during the quarter. Out of these the domestic business registered a strong growth of 50% YoY as compared to lower growth in the international business. The lower growth is due to more projects in the initial phases whereby the major revenue has yet to start.
- In the EA&S segment (~76%YoY), the sub segments like MHE, Forklifts, mining equipments grew at a rate of ~100% YoY during the quarter. The textile sub segment has shown a growth of ~25% YoY.
- Growth in unitary products is at 26%YoY. In the products business, the higher growth came from split air conditioners at ~50%..

Below expectation

YE March (Rs mn)	Q3FY06	Q3FY07	YoY	FY06	FY07E	YoY
Income from Operations	4,352.50	5,689.20	*30.7%*	18,531.40	23,811.90	*28.5%*
Total Expenditure	4,098.90	5,414.30		17,524.10	22,627.4	
(Inc)/Dec in stock in trade	-130.30	-4.40		-334.30	-	
Consumption of Raw Materials	3,352.60	4,223.80		14,340.10	17,455.8	
Staff Cost	461.20	638.40		1,762.30	2,478.3	
Other Operating Expenses	415.40	556.50		1,756.00	2,010.7	
Operating Profits	253.60	274.90	*8.4%*	1,007.30	1,184.48	*17.6%*
Operating Profit Margin	5.7%	4.8%		5.4%	5.0%	
Other Income	47.50	84.90		296.40	460.30	
EBIDT	301.10	359.80	*19.5%*	1,303.70	1,644.8	*26.2%*
EBIDTA Margin	*6.8%*	*6.2%*		*6.9%*	*6.8%*	
Interest (net)	15.40	13.70		14.00	70.3	
EBDT	285.70	346.10		1,289.70	1,574.4	
Depreciation	21.80	29.00		110.90	123.2	
PBT	263.90	317.10		1,178.80	1,451.2	
PBT after Extraordinary	150.40	330.10		916.50	1,451.2	
Tax	30.00	92.40		263.50	454.7	
Provision for deferred tax	6.80	43.40		-51.50	-	
- Effective tax rate	*24%*	*41%*		*23.1%*	*25.0%*	
PAT	227.10	194.30	*-14.4%*	704.50	996.57	*41.5%*
Net Profit Margin	*5.3%*	*3.4%*		*3.8%*	*4.22%*	
EPS	0.7	0.6		2.9	3.1	

Source: Company, Man Financial Research

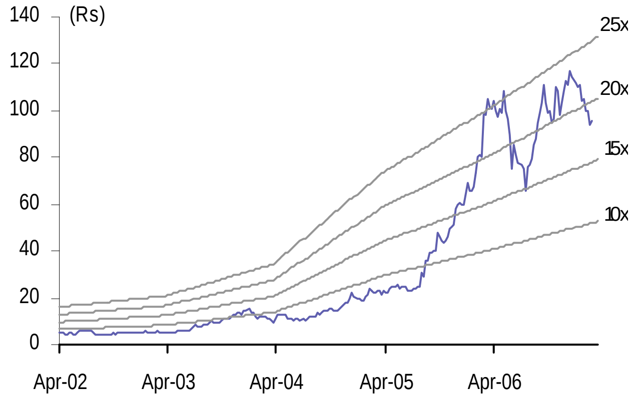
Segmental details

Particulars	Q3FY06	Q3FY07	
% of Total Revenue			
Segment A- Electromechanical projects	64.9%	61.5%	
Segment B- Engg Agency & Services	15.4%	20.8%	
Segment C - Products	16.1%	15.6%	
Others	3.7%	2.1%	
% of Total PBIT			
Segment A- Electromechanical projects	50.6%	41.0%	
Segment B- Engg Agency & Services	42.5%	55.9%	
Segment C - Products	-1.0%	-6.4%	
Others	7.9%	9.5%	
Growth			
Segment A- Electromechanical projects	61.0%	23.0%	
Segment B- Engg Agency & Services	209.0%	76.0%	
Segment C - Products	10.0%	26.0%	
Others	-48.0%	-25.0%	
PBIT margin			*bps*
Segment A- Electromechanical projects	7.0%	5.1%	-190
Segment B- Engg Agency & Services	24.7%	20.6%	-410
Segment C - Products	-0.6%	-3.1%	-250
Others	19.3%	34.5%	1,520

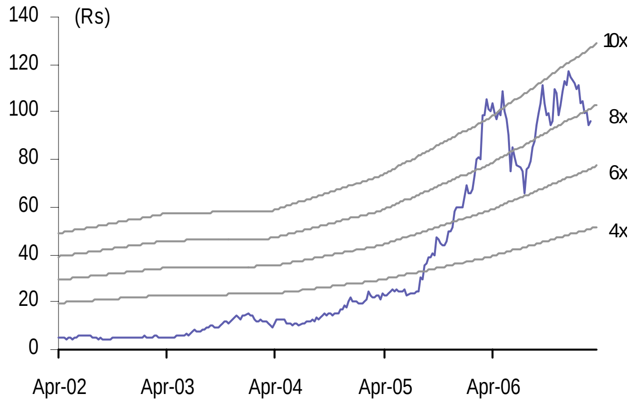
Source: Company, Man Financial Research

RELATIVE AND ROLLING ABSOLUTE VALUATION

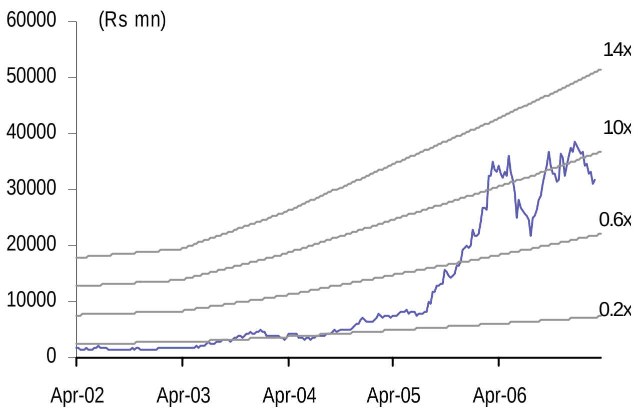
PE band



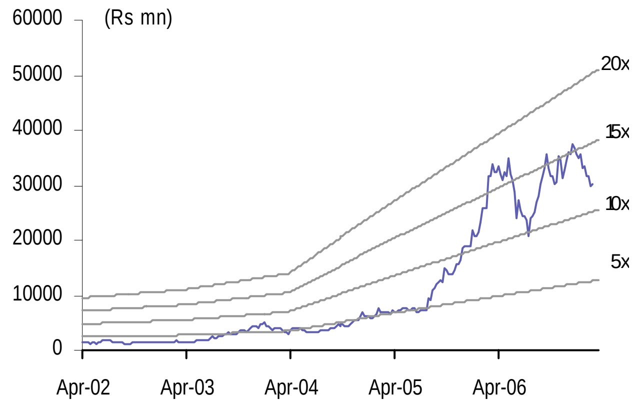
PBV band



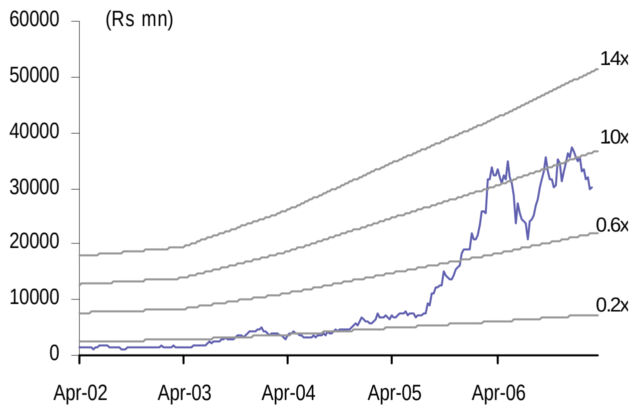
Market cap to sales band



EV/EBIDTA band



EV/Sales band



INVESTMENT THESIS

Margins to improve 125bps by FY09E

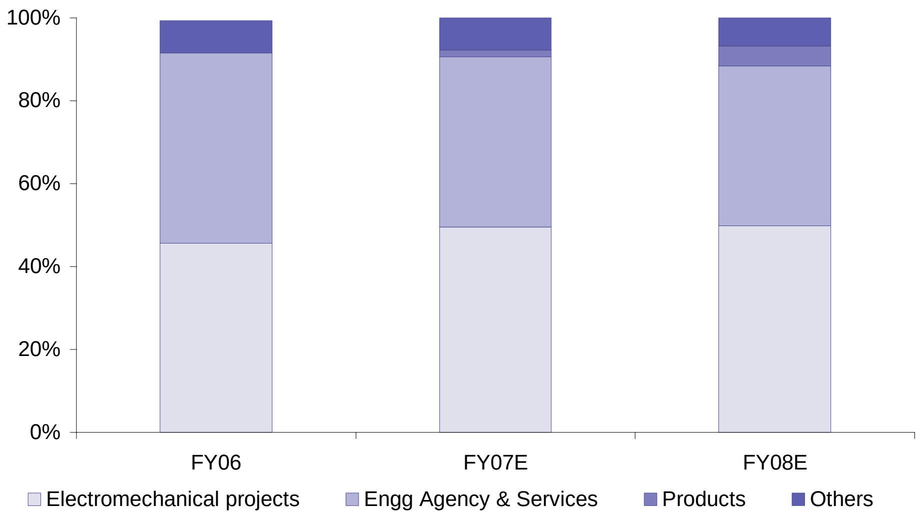
Voltas' EBITDA margins are expected to improve 125bps by FY09E from the current 6.8% driven by a turnaround in its products division and expected increase in contribution from the MEP business.

Positive operating contribution from product division

Up until recently, Voltas' products division was loss making due to: (1) higher fixed costs because of excessive workforce, (2) lesser pricing power due to competition, and (3) rising material costs. However, over the last few years it took the following measures to reduce these pressures.

- Employee rationalisation: Voltas has reduced its employee strength to 2,855 in FY06 from more than 8,000 in FY99. This has made the organisation much leaner, reducing fixed costs. The current excessive capacity of around 900 employees will be eliminated by the VRS scheme that Voltas has implemented at its Hydrabad facility.
- Shifting of manufacturing operations to tax-benefit locations: In early FY06, Voltas began shifting its manufacturing operations to Pantnagar in Uttaranchal, which offers tax benefits. This is a 50:50 joint venture with Fedders, USA. The plant has a capacity of 300,000 units (flexible). It has discontinued its Hyderabad manufacturing unit. It has also almost discontinued its refrigeration manufacturing, which was making losses. The overall costs of this factory were as high as around Rs 250 mn per year at low capacity utilization.

Improving positive contribution by products segment to PBIT



Source: Man estimates

From a negative contribution in FY07, products will start contributing around 2% to PBIT by FY08E

Middle East to drive MEP projects

Voltas has aggressively entered into new geographies, a strategy that will pay off well over the medium term. In FY06, it got around 35% of its revenue from ME and other markets, where it is fairly established as an MEP contractor. While the margins from this business are lower than domestic margins, they are expected to improve marginally as the company becomes more established in this business. We believe this business is also more scalable since capex is low and Voltas is an established player in the ME market now.

High volume growth is expected

The following factors are expected to drive Voltas' volume growth.

Huge potential in Middle East for MEP projects

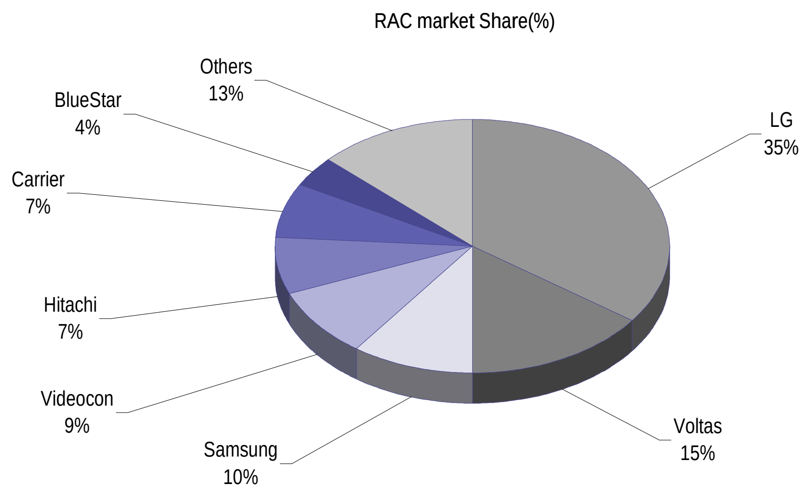
Since Voltas is an established player in the ME for MEP projects, it stands to gain from the increasing investments in realty in that country. Currently, Voltas gets around 35% of its revenues from projects in the Middle East and other markets.

Growth in the central air-conditioning market due to the retail and IT/ITES boom

The central air conditioning market has been growing at a healthy rate of around 20%-25% for last three years and the momentum is expected to continue. Investments in the IT/ITES space over FY06-08 are pegged at Rs 148bn in IT/ITES industry and Rs 60bn in the retail segment. In terms of space addition, 118 mn sq. ft. will be added in the IT/ITES space while 40 mn sq. ft. will be added in retail.

Voltas has a significant market share at around 15%

Room air-conditioning market share



Source: CrisInfac (FY06E)

India has one of the lowest AC penetrations among other developing countries at around 1-2%. This signifies a huge growth potential for air-conditioning in India. The room air-conditioning market grew at ~20% for last three years and we expect the momentum to continue for the next 3-5 years. Low penetration of room ACs and growing disposable incomes create an ideal situation for growth in room AC demand. Voltas has gained a ~15% market from low of 11% in FY04. Also, the organized segment of RAC has grown from 88% of total in FY02 to 98% in FY06E, showing a clear trend of consolidation in the industry.

Local infrastructure story — huge investments in domestic infrastructure

Infrastructure development in India on a roll

The Indian infrastructure segment is expected to see an investment of Rs 2,229bn over FY06-08E. This is more relevant to Voltas because it gets 13% of its revenue from engineering agency and services businesses, which is a function of infrastructure activities.

Infrastructure investments in India over FY06-08E

Particulars	Percentage	Expected Investment (Rs. bn)	Growth percentage (%)
Road	34	757.86	37.53
Urban Infrastructure	20	445.8	43.83
Irrigation	19	423.51	44.67
Railways	8	178.32	15.06
Power-Hydel	6	133.74	-29.39
Power-Thermal	6	133.74	10.95
Others	7	156.03	51.02
Total		2,229	

Source: CrisInfac and Man Estimates

Voltas' EA&SB segment includes trading of textile, mining, construction, and material-handling equipment, and this segment contributes almost 46% at the PBIT level. This business is expected to get a big boost from higher investments in domestic infrastructure.

Engineering agency and services businesses details

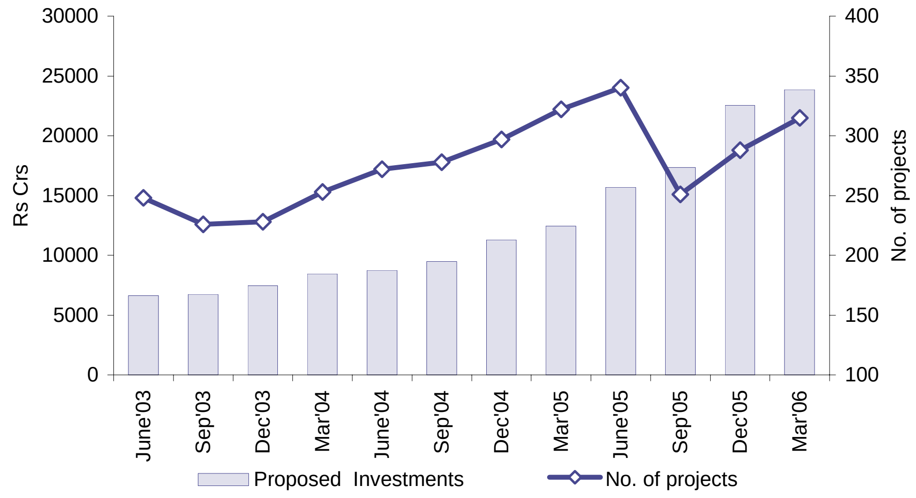
Segment	Products procured	Manufacturers*
Textile Machinery	Spinning, Weaving and Knitting etc.	LMW (75%), Terrot
Mining and Construction equipments	Hydraulic and Electrical shovels, Excavators, Crushing equipments, Dump trucks etc	Terex, Toyo
Machine Tools	Cutting tools etc.	LMW, SRP

Source: Man Research (* Non comprehensive list)

Textile machinery

Voltas' textile (EA&SB) business registered a 45% growth in FY06. This growth is expected to continue because the government is gunning for its target of pushing the industry's size to US$ 85bn by FY10 from the current US$ 37bn. According to industry sources, even a 10% replacement of existing machinery in the spinning segment will bring in huge growth for the company.

Textile investments



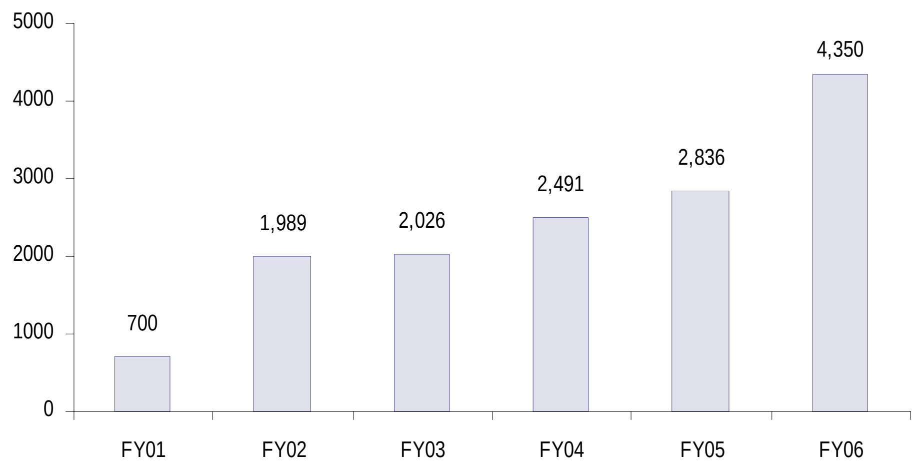
Source: CMIE and Man Estimates

Technology Upgradation Fund Scheme (TUFS)

The Government of India introduced the Technology Upgradation Fund Scheme (TUFS) for Textile and Jute Industries, initially for a period of five years from April 1999 to March 2004. The Scheme has now been extended by three years to cover sanctions up to 31 March 2007. The scheme is intended to facilitate induction of state-of-the-art or near state-of-the-art technology in the textiles Industry with loans at subsidised rates. This incentive is routed through the nodal agencies (financial institutes like banks) by reimbursing 5% p.a. on the projects sanctioned under this scheme. This scheme is even likely to be extended beyond March 2007 to continue promoting investments for technology upgradation, although the incentive is likely to lower than the current 5%. This will further boost the business for the textile machinery division of Voltas. For FY07, the government is planning to provide an additional Rs 10bn, as the budgeted Rs 5.35bn got exhausted during the first quarter itself.

The graph below shows the total amount released by the textile ministry to nodal agencies – FIs and banks under TUFS.

Overall amount released to nodal agencies under TUFS (Rs mn)



Source: Textile Ministry, GoI

Over FY02-06 the textile ministry has released around Rs 14bn to nodal agencies under TUFS

Top-five states under TUFS

State, Rs bn	No. of applications	Project costs	Sanctioned amount
Tamilnadu	1,175	75.15	43.47
Gujarat	1,295	62.74	22.5
Maharashtra	302	39.56	18.23
Punjab	510	43.19	16.61
Rajastan	360	28.69	12.15
Others	741	86.33	40.85
Total	4,383	335.66	153.81

Source: Textile Ministry, GoI

Brief about Laxmi Machine Works (LMW) details

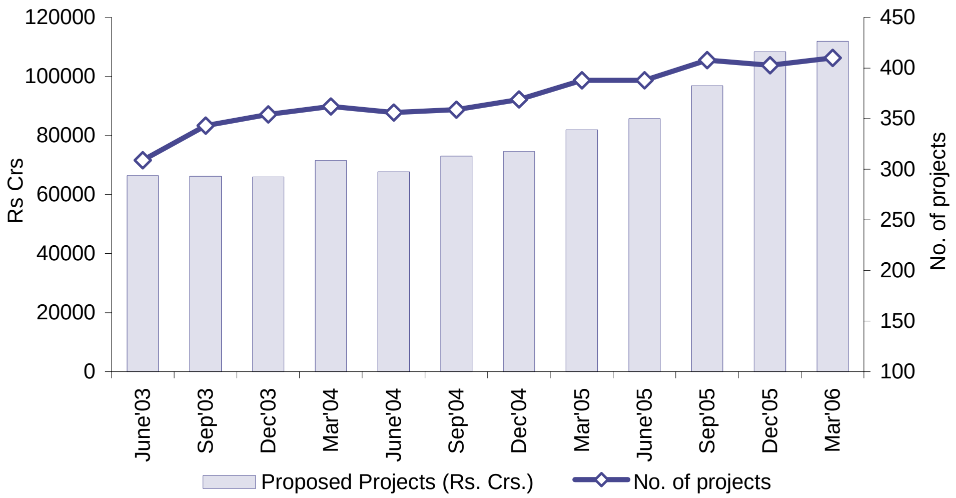
The Coimbatore based company is one of the biggest suppliers of the textile machinery. The order book of the company has almost doubled to Rs 32 bn in FY06. This company enjoys a market share of about 60% in the domestic market and distributes around 75% of its textile machinery through Voltas.

LMW financials, Rs mn	FY05	FY06
Sales	9,908	13,021
EBITDA	1,553	2,472
Net Profit	734	1,482
Order book	16,000	32,000

Construction and mining

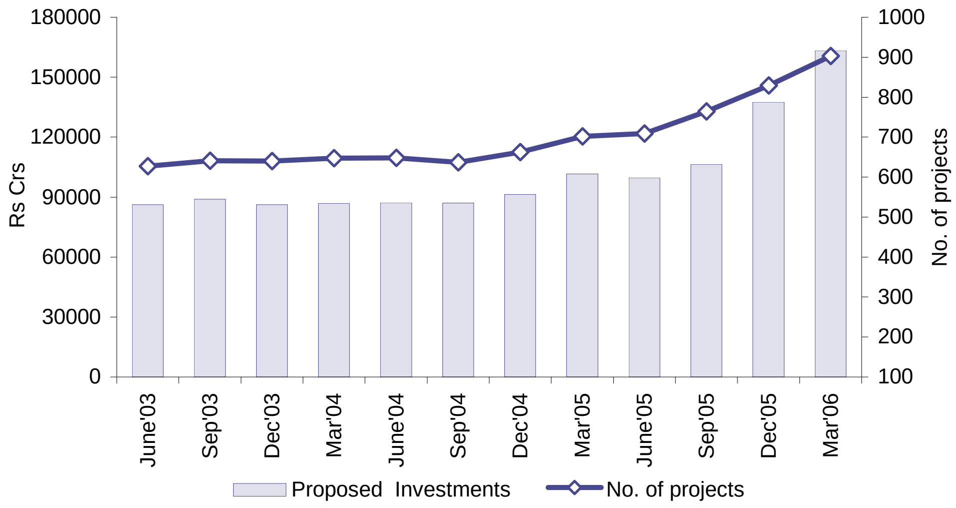
The construction segment has also observed the same trend over the last 12 quarters.

Mining investments



Source: CMIE and Man Estimates

Construction investments



Source: CMIE and Man Estimates

BUSINESS OVERVIEW

Background:

Voltas is a Tata group engineering company (28% shareholding), started in 1954 has interests in diversified businesses like HVAC&R, trading and servicing of textile, mining, construction equipments, machine tools, chemical products, water treatment equipments and forklifts. Voltas caters mainly to India (65% of revenues) and Middle East market (27% of the revenues). The company is one of the leading players in MEP (mechanical-electrical-plumbing) in the Middle East and second largest player in domestic central air-conditioning market with ~30% share.

The chart below depicts a detailed structure of Voltas business model -

Business structure

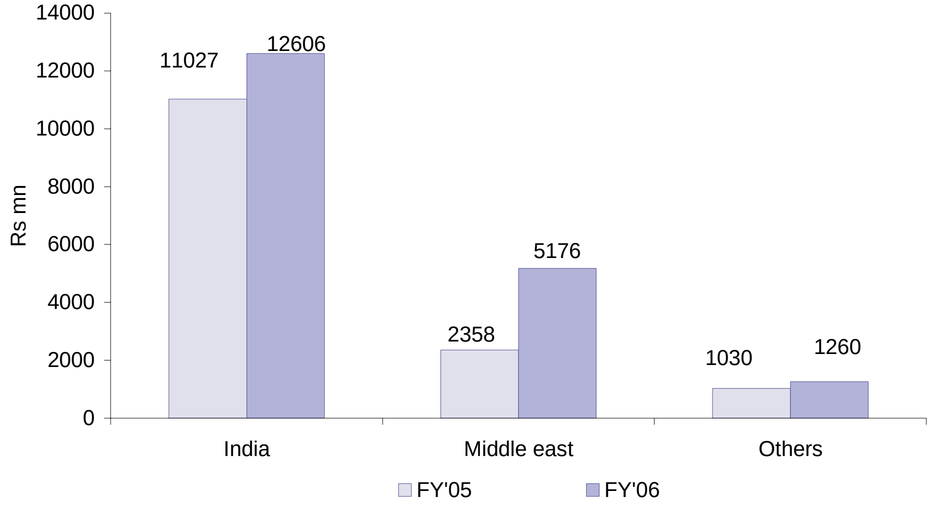
Voltas

Electromechanical Projects and services*	Engineering Agency & Services	Unitary Products	Others
Products and Services			
• Mechanical • Electrical • Plumbing	• Textile M/C • Mining/Construction equipments • Machine tools	• RAC & SAC • Refrigerator • Water coolers & dispensers etc.	• Forklifts • Chemical trading • Water treatment products
Revenue and Margin Contribution			
Revenue = 59% PBIT = 46% PBIT margin = 6%	Revenue = 13% PBIT= 46% Margin= 27.60%	Revenue = 25% PBIT = -1% Margin= - 0.22%	Revenue = 3% PBIT = 8% Margin= 23%

* Includes domestic HVAC projects and international MEP projects

As shown below, the exports contributed to ~35% to the topline.

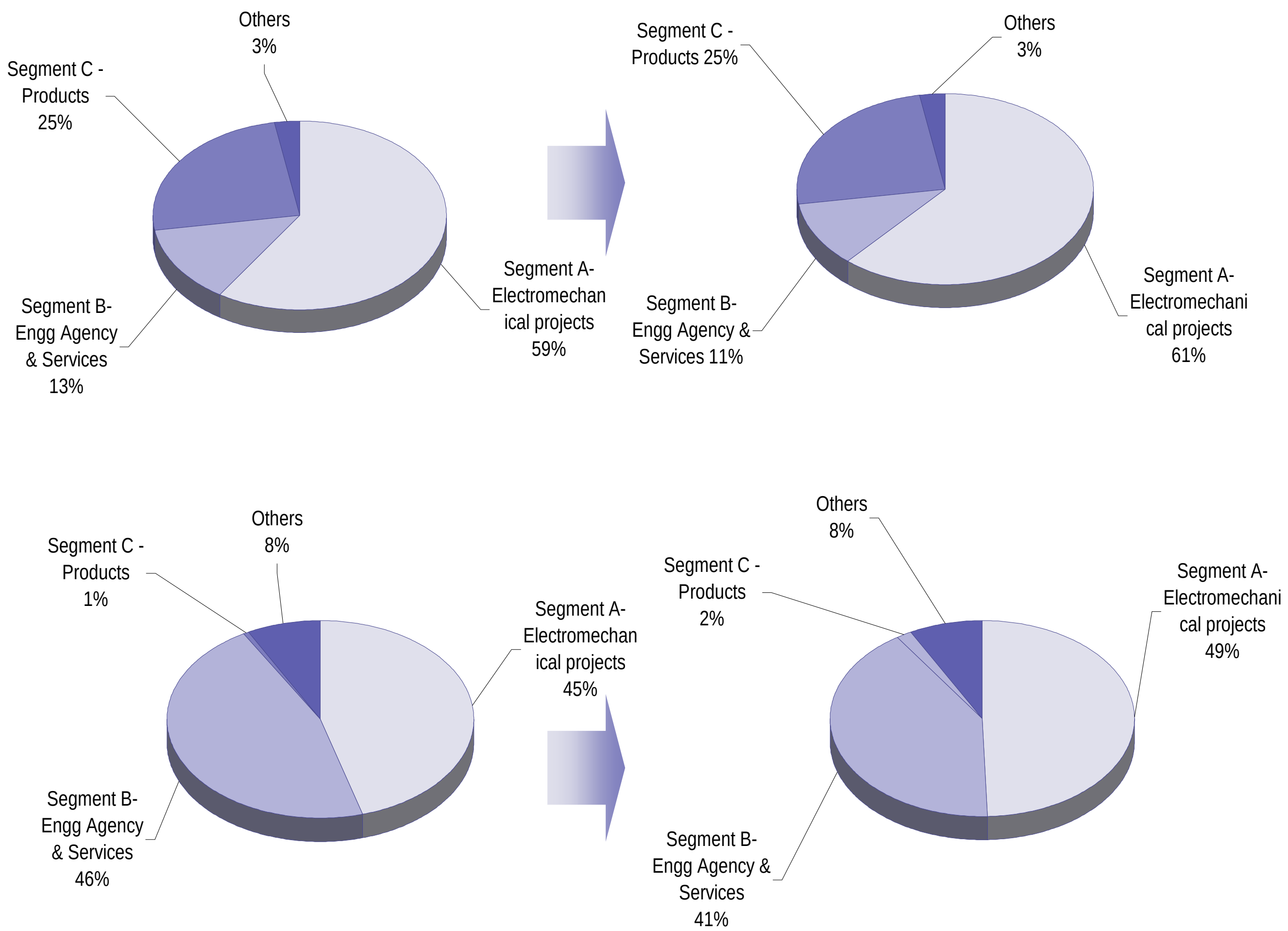
Revenue contribution (geographical)



Source: Annual Report

Revenue and PBIT contribution

FY06 **FY08E**



Source: Man Financial research estimates

FINANCIALS

Income Statement

Y/E Mar, Rs mn	FY05	FY06	FY07E	FY08E	FY09E
Net sales	13,867	18,531	23,812	31,120	38,894
Growth, %	*8.9*	*33.6*	*28.5*	*30.7*	*25.0*
Other income	251	328	460	506	506
Total income	14,118	18,860	24,272	31,626	39,401
Operating expenses	13,420	17,524	22,627	29,145	36,244
EBITDA	698	1,335	1,645	2,481	3,157
Growth, %	*26.8*	*91.3*	*23.2*	*50.8*	*27.2*
Margin, %	*4.95*	*7.08*	*6.78*	*7.84*	*8.01*
Depreciation	105	111	123	187	178
EBIT	593	1,225	1,522	2,294	2,979
Growth, %	*42.0*	*106.3*	*24.3*	*50.8*	*29.9*
Margin, %	*4.20*	*6.49*	*6.27*	*7.25*	*7.56*
Interest paid	68	46	70	80	72
Pre-tax profit	526	1,179	1,451	2,215	2,907
Tax provided	70	212	455	664	872
Profit after tax	456	967	997	1,550	2,035
Net profit	506	705	997	1,550	2,035
Man net profit	456	967	997	1,550	2,035
Growth, %	*65.2*	*112.2*	*3.1*	*55.6*	*31.3*
Extraordinary items: Gains/(Losses)	50	-261	-	-	-
Unadj. shares (m)	331	331	331	331	331

Cash Flow

Y/E Mar, Rs mn	FY05	FY06	FY07E	FY08E	FY09E
Pre-tax profit	576	917	1,478	2,215	2,907
Depreciation	105	111	123	187	178
Chg in working capital	-17	218	-895	-647	-874
Total tax paid	72	177	455	664	872
Interest income(Less)	59	85	70	70	70
Profit loss on sale of assets(Less)	142	161	-	-	-
Cash flow from operating activities (a)	392	824	182	1,020	1,269
Capital expenditure	402	-524	-145	72	78
Chg in investments	134	-137	-53	-107	-108
Interest received	59	85	70	70	70
Cash flow from investing activities (b)	595	-575	-128	35	40
Free cash flow (a+b)	987	248	54	1,055	1,309
Equity raised/(repaid)	-	-	-	-	-
Debt raised/(repaid)	232	-344	318	-55	-105
Dividend (incl. tax)	-188	-226	-409	-620	-814
Interest paid	-68	-46	-70	-80	-72
Other financing activities	-	-	-	-	-
Cash flow from financing activities (c)	-25	-616	-161	-754	-991
Net chg in cash (a+b+c)	962	-368	-108	301	317

Balance Sheet

As at 31st Mar, Rs mn	FY05	FY06	FY07E	FY08E	FY09E
Cash & bank	1,457	1,086	979	1,279	1,598
Debtors	3,613	3,977	5,219	6,821	8,525
Inventory	2,400	2,995	4,240	5,968	7,992
Loans & advances	1,174	1,282	1,957	2,558	3,197
Total current assets	8,644	9,339	12,395	16,626	21,312
Investments	462	610	610	610	610
Net fixed assets	825	1,348	1,493	1,421	1,344
Non-current assets	1,287	1,958	2,103	2,031	1,954
Total assets	9,931	11,298	14,498	18,657	23,266
Current liabilities	6,175	7,297	9,394	12,277	15,345
Provisions	971	1,133	1,305	1,705	2,131
Total current liabilities	7,147	8,431	10,699	13,983	17,476
Non-current liabilities	1,064	720	1,038	984	879
Total liabilities	8,211	9,151	11,738	14,967	18,355
Paid-up capital	331	331	331	331	331
Reserves & surplus	1,605	2,083	2,697	3,627	4,847
Shareholders' equity	1,720	2,147	2,761	3,690	4,911
Total equity & liabilities	9,931	11,298	14,498	18,657	23,266

Per-share data

	FY05	FY06	FY07E	FY08E	FY09E
MAN EPS (INR)	1.4	2.9	3.1	4.7	6.2
Growth, %	*65.2%*	*112.3%*	*5.8%*	*51.5%*	*31.3%*
Book NAV/share (INR)	5.9	7.3	9.2	12.0	15.7
FDEPS (INR)	1.4	2.9	3.1	4.7	6.2
CEPS (INR)	1.7	3.3	3.4	5.3	6.7
CFPS (INR)	29.1	-11.1	-3.3	9.1	9.6
DPS (INR)	0.6	0.7	1.2	1.9	2.5

Financial structure

	FY05	FY06	FY07E	FY08E	FY09E
Operating cash flow/Total debt (x)	0.4	1.1	0.2	1.0	1.4
Total debt/Equity (x)	0.6	0.3	0.4	0.3	0.2
Net debt/Equity (x)	(0.2)	(0.2)	0.0	(0.1)	(0.1)

Profitability, productivity, liquidity and valuation ratios

	FY05	FY06	FY07E	FY08E	FY09E
Return on assets (%)	4.6	8.6	6.9	8.3	8.7
Return on equity (%)	26.5	45.0	36.1	42.0	41.4
Return on Invested capital (%)	27.8	65.7	35.9	45.0	50.3
RoIC/Cost of capital (x)	2.3	5.4	2.9	3.7	4.1
RoIC - Cost of capital (%)	15.6	53.5	23.7	32.8	38.1
Return on capital employed (%)	18.8	35.3	28.1	34.9	36.4
Cost of capital (%)	12.2	12.2	12.2	12.2	12.2
RoCE - Cost of capital (%)	6.6	23.1	15.9	22.7	24.2
Asset turnover (x)	13.1	18.2	14.1	12.5	12.2
Sales/Total assets (x)	1.4	1.6	1.6	1.7	1.7
Sales/Net FA (x)	16.8	13.7	15.9	21.9	28.9
Working capital/Sales (x)	0.2	0.1	0.1	0.1	0.2
Fixed capital/Sales (x)	0.1	0.1	0.1	0.0	0.0
Receivable days	95.1	78.3	80.0	80.0	80.0
Inventory days	63.2	59.0	65.0	70.0	75.0
Payable days	162.5	143.7	144.0	144.0	144.0
Current ratio (x)	1.2	1.1	1.2	1.2	1.2
Quick ratio (x)	0.9	0.8	0.8	0.8	0.8
Interest cover (x)	8.8	26.6	21.6	28.8	41.1
PSR(X)	1.9	1.4	1.1	0.9	0.7
PER (x)	58.8	27.7	26.9	17.3	13.2
PEG (x) - y-o-y growth	0.5	4.7	0.5	0.6	NA
PCE (x)	47.8	24.8	23.9	15.4	12.1
PCF (x)	2.8	-7.3	-24.9	8.9	8.4
Price/Book (x)	13.8	11.1	8.8	6.8	5.2
Yield (%)	0.1	0.8	1.5	2.3	3.0
EV/Net sales (x)	1.9	1.4	1.1	0.8	0.7
EV/EBITDA (x)	37.2	19.3	16.0	10.4	8.1
EV/EBIT (x)	43.7	21.1	17.3	11.3	8.6
EV/NOPLAT (x)	88.4	38.7	43.3	23.1	15.9
EV/CE	9.3	9.0	6.9	5.5	4.4
EV/IC (x)	24.5	25.4	15.5	10.4	8.0

Source: Company, Man Financial Research Estimates

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Man Financial

Everest Kanto Cylinders Ltd

Mandar Pawar *(mandar.pawar@manfinancial.in) +91 22 6667 9987*

Outperformer / Rs 800
Target Rs 925 (+16%)

Stock (Relative to market)

B	OP	N	UP	S
> 10%	5% to 10%	5% to –5%	-5% to -10%	< -10%

This note should be read for
- Details of business & its outlook
- Analysis of financials & risk factors
- Valuation & target price

Firing on all cylinders

- **EKC is well-positioned to capitalize on the growth opportunities derived from the increasing preference for CNG**
- **Capacity expansion by 42% through FY06-FY09 and steady operating margins would drive revenue and profit growth for the company**
- **Strong profit margins and capital efficiency ratios support high valuations for the stock. We believe that there is further room for valuation upside**
- **We rate the stock as an Outperformer with a target price of Rs 925, 19% upside from CMP**

Investment Rationale

- Between FY06-09, revenues are expected to grow at a CAGR of 49.5%, aided by higher production, post its capacity expansion. We expect revenues to be at Rs 7.9bn by FY09E
- EBIDTA will likely grow at 48% CAGR, supported by robust volume growth and sustained operating margins at ~25%
- Robust growth expected in earnings, over the next 2 to 3 years, with reasonable visibility, and this would drive valuations for the stock higher

Risks

- Dependent on a single supplier of raw material
- Sharp increase in steel prices and the inability to pass on the hike to the customers
- Competition from other cylinder manufacturers
- Preference for alternative fuels, which may curb CNG conversion

Valuation

- The stock is currently quoting at a P/E of 16.0x and EV/EBIDTA of 9.8x based on our FY08E estimates
- Our target price of Rs 925 is based on PEG of 0.75x considering EPS CAGR growth of 40.2% between FY07E and FY09E
- At our target price, the stock would quote at a P/E and EV/EBIDTA of 19.0x and 11.6x, respectively, based on our FY08E estimates

Bloomberg code :	EKCL IN
Reuters code :	EKCL.BO
www.everestkanto.com	
BSE Sensex :	13049
NSE Nifty :	3762

Company data

O/S shares :	18mn
Market cap (Rs) :	14bn
Market cap (USD) :	318mn
52 - wk Hi/Lo (Rs) :	907 / 269
Avg. daily vol. (3mth) :	474,727
Face Value (Rs) :	10

Share holding pattern, %

Promoters :	61.8
FII / NRI :	19.5
FI / MF :	7.8
Non Promoter Corp. Holdings :	2.9
Public & Others :	7.9

Price performance, %

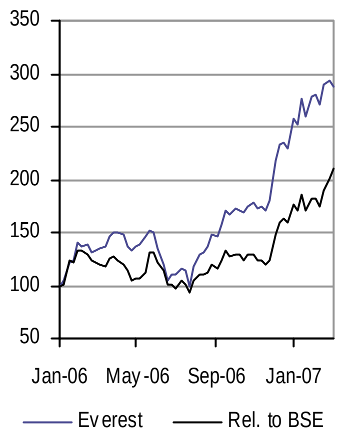
	1mth	3mth	1yr
Abs	5.7	22.4	113.4
Rel to BSE	16.1	28.0	90.2

Valuation summary

Y/E Mar, Rs mn	FY2005	FY2006	FY2007E	FY2008E	FY2009E
Net sales	1,324	2,355	4,159	6,184	7,861
Growth, %	79.4	77.9	76.6	48.7	27.1
Core EBIDTA	287	594	1,085	1,576	1,928
EBIDTA margins, %	21.7	25.2	26.1	25.5	24.5
Net profit	143	324	596	951	1,171
Net profit margin, %	10.8	13.8	14.3	15.4	14.9
EPS, Rs	15.8	21.9	32.1	48.7	60.0
EPS growth, %	334.4	38.0	46.6	51.9	23.2
PER, x	50.5	36.6	24.9	16.4	13.3
EV/EBIDTA, x	56.0	27.0	14.7	10.1	8.2
EV/Net sales, x	12.2	6.8	3.8	2.6	2.0
Price/Book value, x	17.3	7.9	5.2	4.3	3.5
ROIC, %	18.4	28.5	29.8	31.8	31.7
ROE, %	40.0	33.6	27.1	29.2	28.9
Dividend yield, %	0.2	0.5	0.9	1.1	1.8

Source: Company, Man Financial Research Estimates

Price vs. Sensex



Source: Bloomberg, Man Financial Research

COMPANY BACKGROUND

Everest Kanto Cylinders Ltd. (EKC) is engaged in the business of manufacturing cylinders for industrial gases and CNG, since 1978. EKC manufactures a wide range of cylinders for industrial gases, medical gases, fire-fighting equipment, the beverage industry, and CNG cylinders for vehicles.

EKC's first manufacturing facility was set up at Aurangabad which manufactures small-sized cylinders (water capacity of 1 to 21 litres), the capacity of which is currently at 0.11 million cylinders per annum. The company's second facility at Tarapur has an annual production capacity of 0.16 million cylinders per annum and manufactures large-sized and high-pressure gas cylinders (water capacity of more than 21 litres). It has also set up a facility at Gandhidham and Dubai, with a production capacity of 0.34 million and 0.096 million cylinders per annum, respectively.

EKC's current manufacturing facilities

	Cylinder type	Current capacity, nos.
Aurangabad	Industrial	110,000
Tarapur	CNG, Industrial	160,000
Gandhidham	CNG, Industrial	340,000
Dubai	CNG	96,000
Total		706,000

Source: Company

Rating and price target

At a CMP of Rs 778, the stock trades at a P/E and EV/EBIDTA of 16.0x and 9.8x, respectively, based on its FY08E financials.

Our target price of Rs 925 is based on a PEG of 0.75x (2-year EPS CAGR growth of 40.2% between FY07E-09E) and leaves an upside of 19% from the CMP. Based on FY08E earnings, our target price implies a P/E of 19.0x, EV/EBIDTA of 11.6x and P/BV of 5.0x.

We rate the stock as an Outperformer

Price Performance

Rs, %	CMP close	1M	3M	6M	1Year	YTD
BSE Sensex	13049	-10.4	-5.6	9.3	23.2	-5.5
Nifty	3762	-10.3	-5.2	8.2	20.0	-5.3
Everest Kanto	800	5.7	22.4	81.5	113.4	11.2
Indraprastha Gas	101	-14.4	-13.9	-16.6	-23.3	-12.7
Gujarat Gas	1305	-1.9	8.3	22.9	-2.1	7.1

Source: Bloomberg

INVESTMENT RATIONALE

Aggressive capacity expansion plan

In order to cater to the huge demand potential, EKC has chalked out its major expansion plan whereby its total production capacity would increase by 42% from FY06 through FY09.

EKC's capacity build up

(No. of cylinders)	2003	2004	2005	2006	2007E	2008E	2009E
Aurangabad	110,000	110,000	110,000	110,000	110,000	110,000	110,000
Tarapur	160,000	160,000	160,000	160,000	160,000	160,000	160,000
Gandhidham	-	-	-	340,000	340,000	340,000	340,000
Dubai	-	96,000	96,000	96,000	192,000	192,000	192,000
China	-	-	-	-	-	200,000	200,000
Total	270,000	366,000	366,000	706,000	802,000	1,002,000	1,002,000

Source: Company

EKC would set up a new facility in China for production of CNG cylinders with an initial capacity of 200,000 cylinders and plans to further expand the capacity up to 400,000 in FY09 depending upon the demand. But, we have assumed that the capacity of this plant is at 200,000 cylinders. Capacity at the Dubai plant would be doubled to 192,000 cylinders. The Dubai and China plants would cater to the international markets.

Total capex at the China and Dubai plant is expected at US$ 75 mn. The company recently raised US$ 20 mn through private placement of equity shares for financing its expansion plans. Of these, US$ 16.5 mn would be utilized for setting up of the new plant at China while the remaining US$ 3.5 mn would be utilized for expanding the capacity at its Dubai plant. The balance of the capital requirement would be met through a mix of debt and internal accruals and further dilution of equity is unlikely.

CNG and cylinder market provides excellent growth opportunities

The domestic market for CNG cylinders comprises of more than 50% of the total gas cylinders market and is expected to grow at a CAGR of 26% till FY09. Overall growth for the market is expected at 19%.

Segment growth rate in the domestic market

('000 cylinders)	2003-04	2008-09E	CAGR
Auto	137	437	26%
Medical	55	89	10%
Industrial	55	89	10%
Defence	27	44	10%
Total	274	659	19%

Source: Company Prospectus

We expect preference for CNG to grow due to the cost advantage over conventional auto fuels i.e. petrol and diesel. However, auto LPG is also likely to emerge as a popular alternative. At present, oil marketing companies are dispensing auto LPG at very few of their gas stations because of which this fuel is not yet popular. If the number of outlets selling auto LPG increase, then the conversions and volume growth expected in CNG would not be deliverable.

Cost economics works in favour of CNG when compared against other fuels. The operating cost for vehicles running on CNG is significantly lower as compared to those running on petrol (lower by 69% for cars) and diesel (lower by 39% for buses and 56% for cars). The payback period for recovery of capital cost for conversion is about ten months for a petrol car and 18 months for a diesel car, although it is much longer for buses due to the higher cost of conversion.

The following table shows the cost competitiveness of CNG against other auto fuels

CNG's competitiveness vis-à-vis alternative fuels

Fuel type	Petrol	Diesel	LPG	CNG
Fuel cost per unit, Rs	44.9	31.3	25.0	19.2
Mileage	Km/Ltr	Km/Ltr	Km/Kg	Km/Kg
-Car	15	15	15	21
-Auto	25	20	23	35
-Buses	0	4	0	4
Operating cost per km	Rs./km	Rs./km	Rs./km	Rs./km
-Car	2.99	2.08	1.67	0.91
-Auto	1.79	1.56	1.09	0.55
-Buses	0	7.81	0	4.80
Cost differential against CNG				
-Car	*69%*	*56%*	*45%*	
-Auto	*69%*	*65%*	*50%*	
-Buses	-	*39%*	-	
Avg. km per day				
-Car	50	50	50	50
-Auto	100	100	100	100
-Buses	0	100	0	100
Annual savings, Rs				
-Car	37,882	21,335	13,731	-
-Auto	45,458	37,008	19,651	-
-Buses	-	109,956	-	-
Conversion cost, Rs				
-Car				32,000
-Auto				23,000
-Buses				350,000
Pay back period, months				
-Car	10	18		
-Auto	6	7		
-Buses	-	38		

Source: Cris Infac, Man Financial Research

The growth would be driven by retrofit conversions in the existing as well as new city gas distribution (CGD) circles and also by the OEM segment.

The city gas distribution (CGD) business has gained momentum in the past few years due to a regulatory push, guided by the Auto Fuel Policy, which stresses on clean fuel options. In 2002, the Supreme Court directed the government to give priority to the transportation sector in polluted cities in India while allocating natural gas to these areas. In response, GAIL initiated Project Blue Sky under which it will form JVs for CGD in various small cities in India. Markets for CNG vehicles and CNG cylinders are set to expand and EKC is well positioned to capitalize on this opportunity.

Major cities where CGD projects are/to be implemented

GAIL & JV	GAIL & OMCs	GSPC	IGL	MGL	GGCL	GAEL
Bangalore	Pune	Vapi	Delhi	Mumbai	Surat	Ahmedabad
Bhopal	Kanpur	Valsad	Greater Noida		Bharuch	Vadodara
Chennai	Lucknow	Rajkot	Ghaziabad		Ankaleshwar	
Cochin	Agra					
Coimbatore	Hyderabad					
Indore	Secunderabad					
Kolkatta						

Source: Cris Infac

For EKC's CNG cylinders market, the retrofit segment is a major one comprising of nearly 65% of the total demand. OEM forms 25% of the demand while the balance 10% is by city gas companies distribution for the cascades. Although OEM is not a major segment, it is expected to expand significantly as the passengers and commercial automobile manufacturers, such as Tata Motors, Ashok Leyland, Eicher Motors, General Motors and Hindustan Motors are launching CNG variants of some of their models.

Competitive environment is not challenging

EKC currently commands 80% share in the domestic market for cylinders and does not face a serious threat from any of its competitors. Major competitors in the market are Bharat Pumps and Compressors Ltd., Maruti Koatsu Cylinders and a new entrant, Rama Cylinders Ltd. On a global level, major manufacturers of gas cylinders are Luxfer (UK, US, Australia), Faber (Italy), Dynetek (Canada), Beijing Tianhai Company (China), Inflex (Argentina) and Worthington (UK). Imported cylinders, too, are uncompetitive due to the high manufacturing and freight cost.

The industry has to comply with strict safety standards and lengthy approval procedures, which act as entry barriers for new players, domestic and foreign. Cylinders manufactured in India need to be tested in accordance with Indian standards set by the Bureau of Indian Standards and also the approval of the regulator i.e. Chief Controller of Explosives is required.

Sourcing of raw material is critical

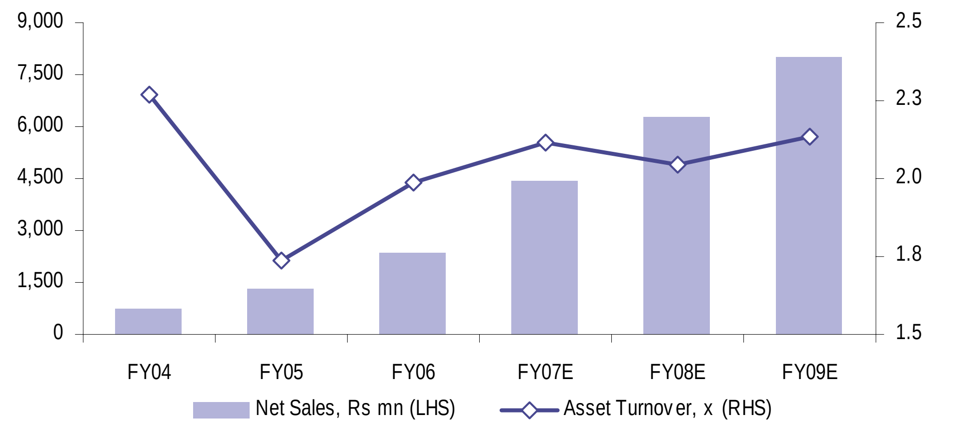
EKC is largely dependent on the Tenaris Group, Italy, for sourcing of seamless steel tubes required as raw material for both industrial as well as CNG cylinders. Carbon manganese steel is used for industrial cylinders manufacturing while chrome molybdenum steel is used for CNG-based gas cylinders. To diversify its resource base, the company is also looking at other supply sources although there are very few options, which can deliver the required quality of raw material. The import of seamless tubes from China has not yielded any significant cost saving as the inferior quality of material requires an additional cost of processing.

FINANCIAL ANALYSIS

Robust volume leads growth in revenues

We expect EKC's aggressive capacity expansion plan to yield strong revenue growth at a CAGR of 49.5% between FY06-FY09 on the back of a 38% CAGR growth in volumes. We expect net sales to reach close to Rs 7.9 bn by FY09E. Volume growth would be boosted by an increase in utilization rates at the Gandhidham and Dubai plant and commissioning of the China plant. Due to capacity expansion and corresponding capex, we expect only a minor improvement in asset-turnover ratio from 1.99x to 2.11x.

Volumes to drive revenue growth

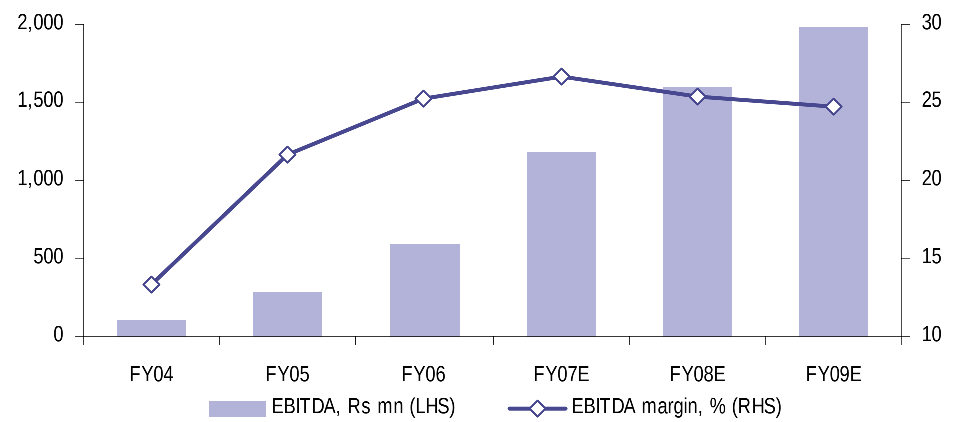


Source: Company, Man Financial Research Estimates

EBIDTA, too, to grow strongly with steady margins

Going forward, due to its strong market position, we do not expect pressure on EKC's operating margins, which has improved significantly from 13.3% in FY04 to 25.2% in FY06. We expect its EBIDTA margin to remain steady at around 24-25%, as we believe that the company has the flexibility to pass on any increase in the input prices to the consumer. We expect EBIDTA to grow at a CAGR of 48% between FY06-09E.

Strong EBIDTA growth and steady margins

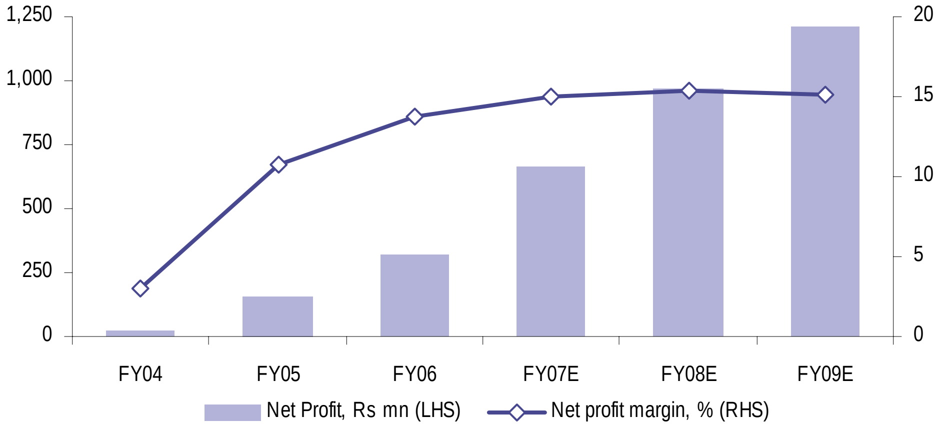


Source: Company, Man Financial Research Estimates

Lower tax rate to push net profit growth higher

We estimate a net profit of Rs 1.2 bn by FY09E, i.e. a CAGR growth of 53.5% over FY06 and expect the net profit margin to stabilize at around 15%. Net profit will be boosted by a lower effective tax rate of 25% by FY09E against 32% currently as a result of higher contribution from the Dubai plant, which enjoys tax incentives as it is set up in the Jebel Ali Free Zone. We do not expect and have not factored in any further equity dilution.

Strong growth in net profit to be seen

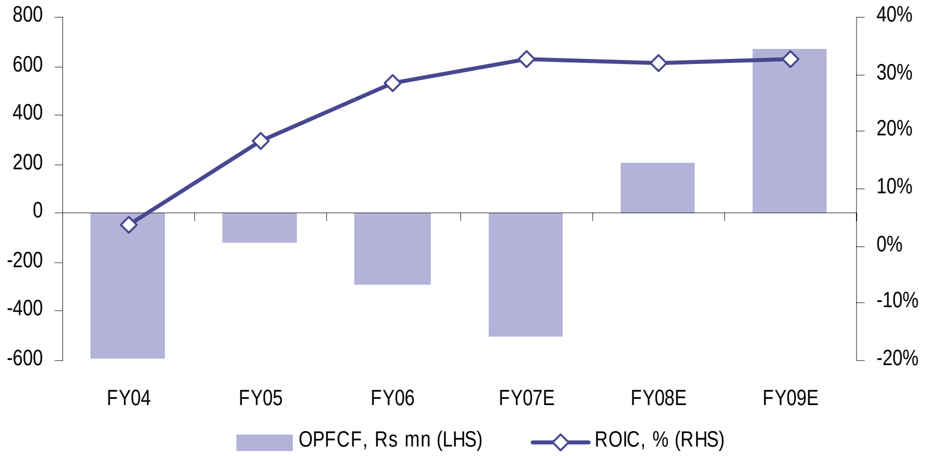


Source: Company, Man Financial Research Estimates

Operating free cash flow to turn positive

With investments in capacity expansion yielding results and substantial growth in operating profit, we expect the company to generate positive free cash flow from FY08E onwards. We expect improvement in ROIC up to 31.7% by FY09E from 28.5% in FY06. We also expect a higher dividend payout from the company on the back of an increase in free cash flow.

Operating free cash flow to turn positive in FY08E



Source: Company, Man Financial Research Estimates

KEY RISKS

Increase in competition

The existing players are working at low utilization rates of below 50%. However, Rama Cylinders, with its manufacturing capacity of up to 300,000 cylinders, can increase the level of competition in the domestic market. Aggressive marketing strategies by the competitors to increase the market share can compel EKC to reduce its prices for cylinders and margins. Any other new entrant in the market or increase in imports could also threaten EKC's existing market share.

Preference for alternative fuels

CNG has gained wide acceptance mainly on account of its cost advantage over alternative fuels. However, the retail prices of petrol and diesel have been reduced due to a fall in crude oil prices, which has reduced CNG's attractiveness over petrol and diesel. A further reduction in retail prices due to the sustained softness in crude oil prices and government policies backing a cut in retail prices of auto fuels, would stem CNG demand growth and put EKC's growth prospects at risk. Auto LPG could also emerge as a viable and cheaper fuel option, also limiting the CNG market growth.

Dependency on a single raw material supplier

EKC is dependent solely on Tenaris for the supply of raw material and also does not have long-term contracts with them. Substantial changes in the terms and conditions by the supplier can cause a shortage of raw material for EKC. However, the two parties have a long and established relationship and serious disruptions in supply is not expected.

Increase in input cost

Raw material cost constitutes close to 75% of the total operating cost and any sharp increase in the steel prices would have a significant impact on earnings growth and valuations.

OUTLOOK AND VALUATION

EKC is well poised to capitalize on the high growth expected in the CNG cylinder business. With a gradual increase in capacity over the next three years and no severe threat of competition, we believe that EKC will be on a strong growth path. Our positive outlook is also supported by the high capital efficiency ratios that it has achieved and which we believe would be sustained in the coming years.

At a CMP of Rs 778, EKC is valued at a P/E of 16.0x, EV/EBIDTA of 9.8x and P/BV of 4.2x, based on our estimates for FY08E. We believe that strong profit margins and capital efficiency ratios, along with huge earning potential with a good amount of visibility, support the high valuations for the stock.

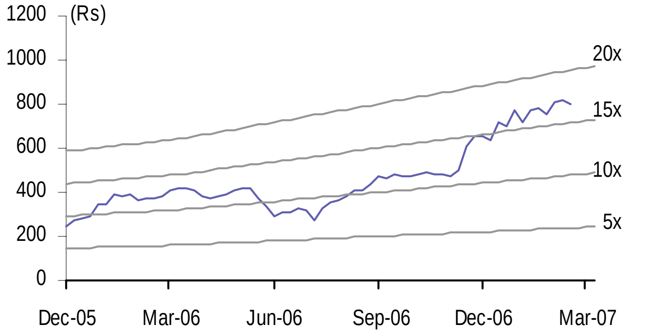
There is no other listed company with a business model similar to EKC against which its valuations can be compared. EKC is currently in a high growth phase and has reasonably good visibility of earnings growth for the next three to four years. We set our target price using a PEG of 0.75x based on a 2-year CAGR growth rate of 40.2% between FY07E and FY09E. Our price target for the stock is Rs 925.

Based on FY08E earnings, our target price implies P/E of 19.0x, EV/EBIDTA of 11.6x and P/BV of 5.0x and gives upside of 19% from the current market price.

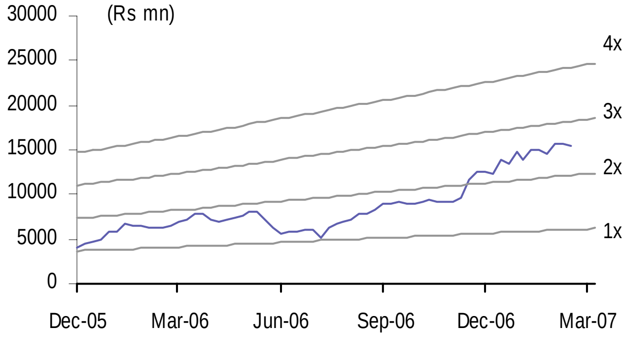
We rate the stock as an Outperformer.

VALUATION BAND AND PREMIUM DISCOUNT CHARTS

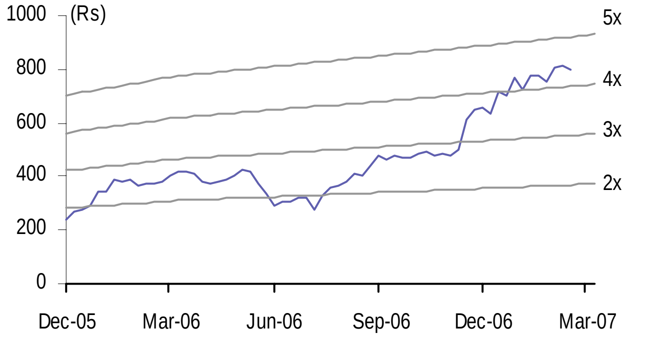
P/E band



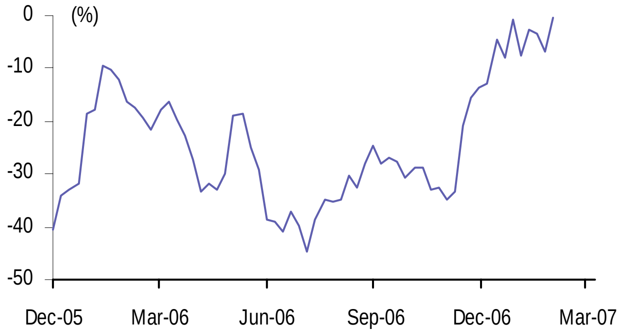
EV/Sales band



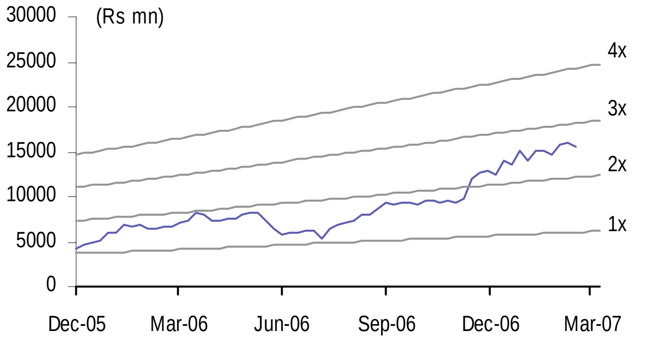
P/BV band



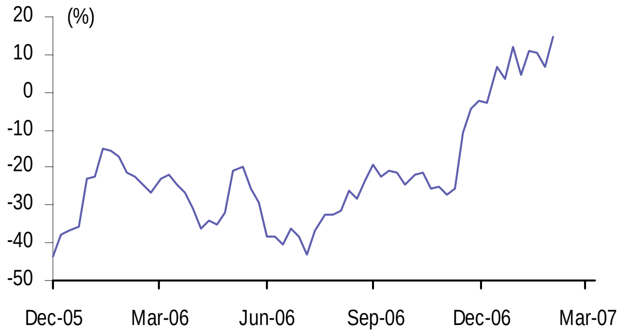
PE premium discount to BSE 30 Index



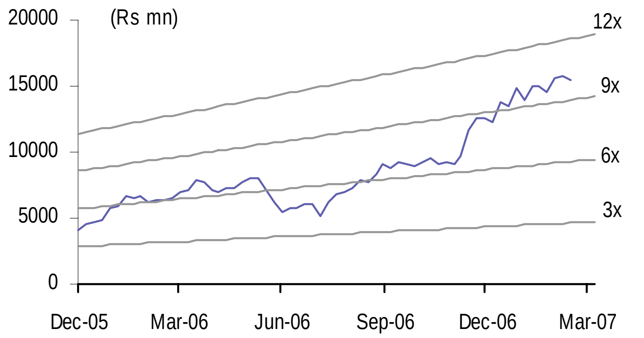
Mcap/Sales band



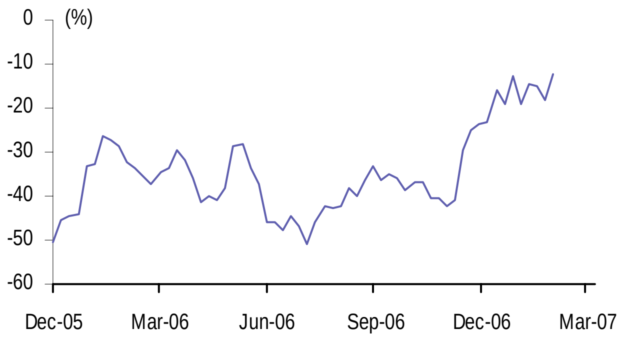
PBV premium discount to BSE 30 Index



EV/EBIDTA band



Mcap/Sales premium discount to BSE 30 Index



Source: Man Financial Research

FINANCIALS

Income Statement

(Rs mn)	FY05	FY06	FY07E	FY08E	FY09E
Net sales	1,324	2,355	4,159	6,184	7,861
Growth, %	79.4	77.9	76.6	48.7	27.1
Other income	48	15	20	20	20
Total income	1,372	2,370	4,178	6,204	7,881
Operating expenses	-1,037	-1,761	-3,074	-4,608	-5,933
EBITDA	287	594	1,085	1,576	1,928
Growth, %	192.5	106.6	82.7	45.3	22.3
Margin, %	21.7	25.2	26.1	25.5	24.5
Depreciation	-78	-98	-203	-281	-345
EBIT	209	496	882	1,295	1,583
Growth, %	933.3	137.2	77.7	46.9	22.2
Margin, %	15.8	21.1	21.2	20.9	20.1
Interest paid	(26.6)	(37.1)	(46.1)	(43.1)	(36.6)
Pre-tax profit	231	475	855	1,271	1,566
Tax provided	-76	-152	-260	-321	-394
Profit after tax	155	323	596	951	1,171
Net Profit	155	323	596	951	1,171
MAN Net profit	143	324	596	951	1,171
Growth, %	551.6	127.1	83.9	59.6	23.2
Extraordinary items: Gains/(Losses)	0	0	0	0	0
Unadj. shares (m)	12	18	20	20	20
Wtd avg shares (m)	9	15	19	20	20

Balance Sheet

(Rs mn)	FY05	FY06	FY07E	FY08E	FY09E
Cash & bank	36	290	409	238	479
Marketable securities at cost	0	104	200	225	250
Debtors	168	234	513	847	1,077
Inventory	400	423	731	1,080	1,370
Loans & advances	171	495	512	613	726
Total current assets	776	1,546	2,364	3,003	3,903
Investments	21	28	28	28	28
Gross fixed assets	979	1,571	2,521	3,211	3,901
Less: Depreciation	-546	-636	-835	-1,111	-1,451
Add: Capital WIP	6	5	5	5	5
Net fixed assets	439	939	1,691	2,105	2,455
Total assets	1,237	2,514	4,084	5,136	6,386
Current liabilities	563	679	908	1,270	1,712
Total current liabilities	563	679	908	1,270	1,712
Non-current liabilities	256	325	295	235	184
Total liabilities	820	1,004	1,203	1,506	1,896
Paid-up capital	120	176	195	195	195
Reserves & surplus	297	1,333	2,685	3,435	4,295
Shareholders' equity	417	1,509	2,880	3,630	4,490
Total equity & liabilities	1,237	2,514	4,084	5,136	6,386

Cash Flow

(Rs mn)	FY05	FY06	FY07E	FY08E	FY09E
Pre-tax profit	231	475	855	1,271	1,566
Depreciation	78	98	203	281	345
Chg in working capital	-63	-297	-373	-423	-192
Total tax paid	-102	-165	-260	-321	-394
Other operating activities	0	0	0	0	0
Cash flow from operating activities	145	110	426	809	1,325
Capital expenditure	-80	-603	-955	-695	-695
Chg in investments	4	-7	0	0	0
Chg in marketable securities	2	-104	-96	-25	-25
Other investing activities	0	0	0	0	0
Cash flow from investing activities	-74	-714	-1,052	-720	-720
Free cash flow	70	-604	-626	89	605
Equity raised/(repaid)	60	844	920	0	0
Debt raised/(repaid)	-26	83	-30	-60	-51
Dividend (incl. tax)	-17	-70	-145	-200	-312
Other financing activities	0	0	0	0	0
Cash flow from financing activities	17	856	745	-260	-363
Net chg in cash	87	253	119	-171	242

Source: Company, Man Financial Research Estimates

Ratios Fundamentals

	FY05	FY06	FY07E	FY08E	FY09E
Operational & Financial Ratios					
MAN EPS (INR)	15.8	21.9	32.1	48.7	60.0
Growth	334.4	38.0	46.6	51.9	23.2
Book NAV/share (INR)	46.3	101.9	155.1	186.0	230.0
FDEPS (INR)	12.9	18.3	30.5	48.7	60.0
CEPS (INR)	24.5	28.5	43.0	63.1	77.7
CFPS (INR)	(6.2)	18.2	21.9	40.5	66.9
DPS (INR)	1.7	4.2	6.8	9.0	14.0
Performance Ratios					
Return on assets (%)	16.9	18.5	18.9	21.2	20.7
Return on equity (%)	40.0	33.6	27.1	29.2	28.9
Return on Invested capital (%)	18.4	28.5	29.8	31.8	31.7
RoIC/Cost of capital (x)	1.8	2.8	2.9	3.1	3.1
RoIC - Cost of capital (%)	8.0	18.2	19.5	21.6	21.5
Return on capital employed (%)	26.9	27.7	25.0	27.8	28.0
Cost of capital (%)	10.4	10.3	10.3	10.3	10.3
RoCE - Cost of capital (%)	16.5	17.3	14.7	17.5	17.7
Efficiency Ratios					
Asset turnover (x)	1.7	2.0	2.0	2.0	2.1
Sales/Total assets (x)	1.3	1.3	1.3	1.3	1.4
Sales/Net FA (x)	3.0	3.4	3.2	3.3	3.4
Working capital/Sales (x)	0.1	0.2	0.2	0.2	0.2
Fixed capital/Sales (x)	-	-	-	-	-
Receivable days	46.3	36.3	45.0	50.0	50.0
Inventory days	110.4	65.6	64.1	63.8	63.6
Payable days	60.2	51.7	48.1	51.5	55.8
Current ratio (x)	1.4	2.3	2.6	2.4	2.3
Quick ratio (x)	0.7	1.7	1.8	1.5	1.5
Interest cover (x)	7.9	13.8	19.8	31.1	45.2
Dividend cover (x)	9.5	5.3	4.7	5.4	4.3
Financial Stability Ratios					
Total debt/Equity (%)	117.0	26.2	12.7	8.4	5.7
Net debt/Equity (%)	108.3	0.1	(8.4)	(4.3)	(10.6)
Ratios: Valuations					
PER (x)	50.5	36.6	24.9	16.4	13.3
PEG (x) - y-o-y growth	0.2	1.0	0.5	0.3	0.6
Price/Book (x)	17.3	7.9	5.2	4.3	3.5
Yield (%)	0.2	0.5	0.9	1.1	1.8
EV/Net sales (x)	12.2	6.8	3.8	2.6	2.0
EV/EBITDA (x)	56.0	27.0	14.7	10.1	8.2
EV/EBIT (x)	77.0	32.3	18.1	12.3	10.0
EV/NOPLAT (x)	76.2	36.2	19.4	12.7	10.4
EV/CE	23.9	8.7	5.0	4.1	3.4

Source: Company, Man Financial Research Estimates

Man Financial

APPENDIX

Gas Cylinder Manufacturing Process

Globally, three basic technologies or process routes are followed for the manufacture of high-pressure seamless steel gas cylinders, which are described below:

1) **Billet Piercing Process**

The cylinder shells are produced by piercing heated steel billet and subsequently drawing it through a ring and roller dies.

2) **Deep Draw Process**

The deep draw process is a cold forming method in which flat circular steel blanks are loaded into a hydraulic press. A cylindrical draw punch contacts the blank and pushes it through an intake ring. The blank is drawn into a cup of dimensions suitable to the steel type. The steel gets work hardened during this cold draw process. The cup is heat-treated, lubrication is done and the cup is again subjected to next draw to reduce the diameter, reduce the wall thickness and to increase the length. This process is repeated two to three times to ensure that the final bottom formed cylinder blank is available. Even though the cold draw process forms the blanks, they need a large amount of energy, equipment and manpower, to accommodate intermediate annealing and soaping operations.

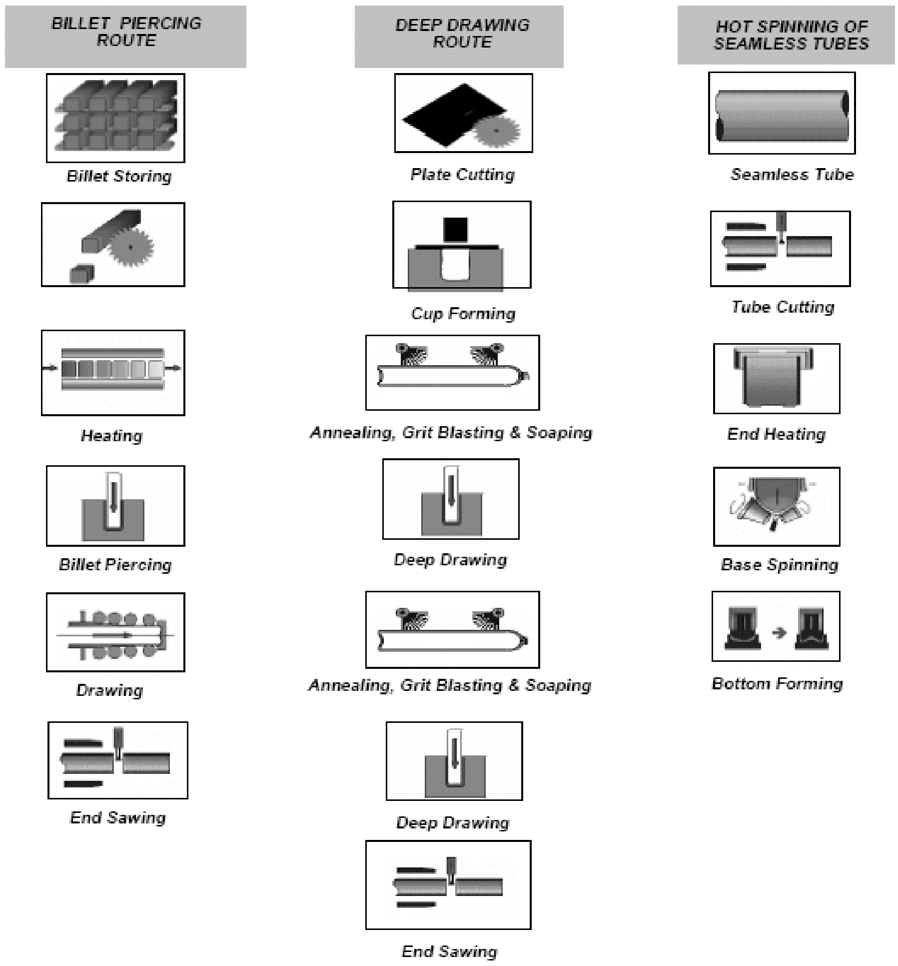
3) **Hot Spinning Process**

Seamless steel tubes are cut into the required length and by hot forming on spinning machines, the bottom is formed. This process does not call for the huge setup as for billet piercing and end sawing, neither does it call for the repeated cycles of deep drawing, annealing heat treatment, soaping and the end sawing, as necessary in the deep drawing process. The remaining steps i.e. neck forming, heat treatment, hardness testing, neck machining and threading, hydraulic testing, pneumatic testing, drying, etc are more or less common in all the three process.

EKC adopts the Hot Spinning process at all of its manufacturing plants. This process has the advantages of: (1) low initial investment cost, (2) flexibility in manufacture of a wide range of cylinders, and (3) low operating costs.

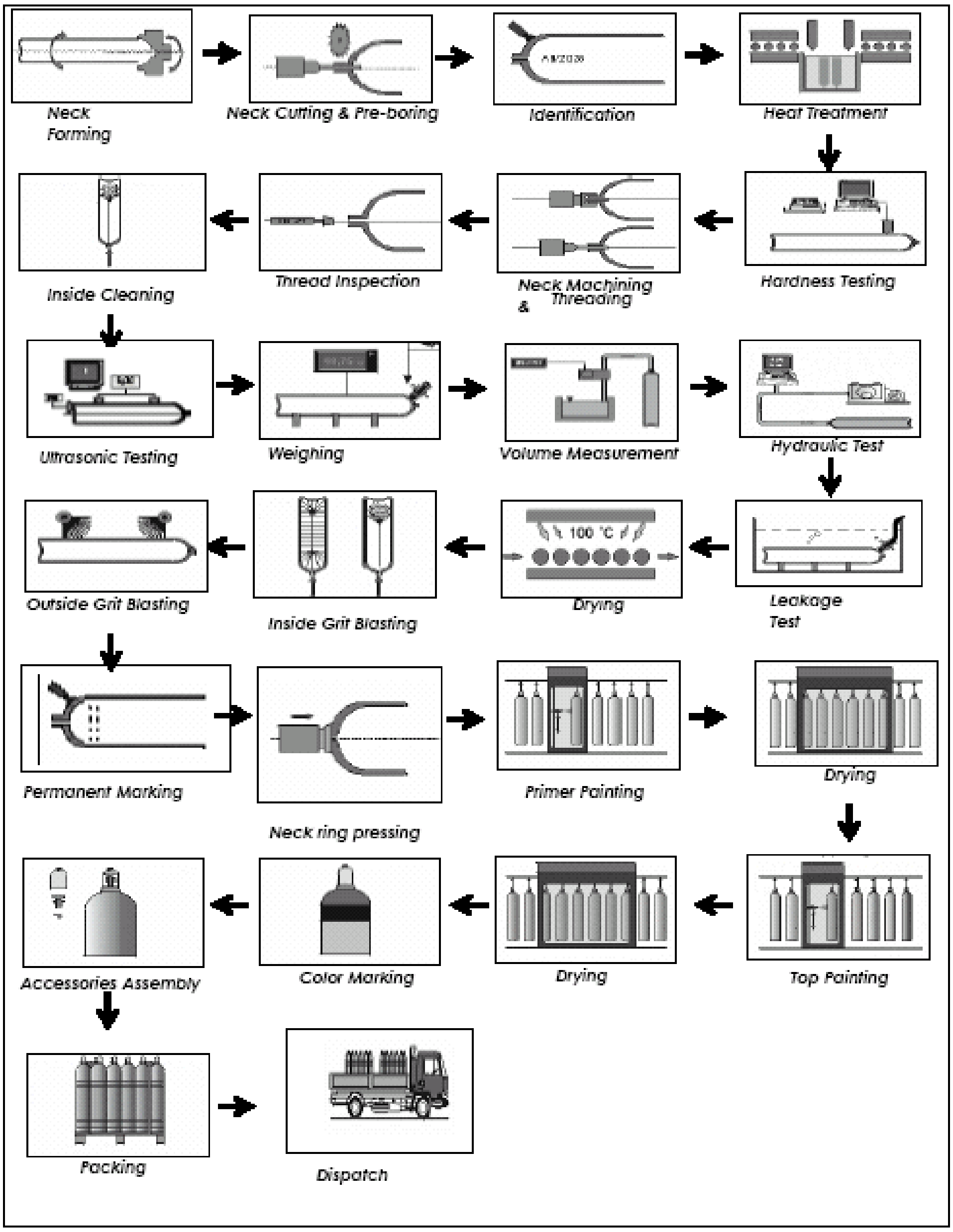
Following diagrams show the process differentials for different technologies and some common processing steps:

Different Techniques



Source: Company Prospectus

Common Process Steps



Source: Company Prospectus

Man Financial

JK Cement

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Vaibhav Agarwal *(Research Associate)*

BUY / Rs 139

Sector (Relative to market)

OW	N	UW
■		

Stock (Relative to market)

B	OP	N	UP	S
■				
> 10%	5% to 10%	5% to –5%	-5% to -10%	< -10%

This note should be read for
- Details of business & its outlook
- Analysis of financials & risk factors
- Valuation & target price

Heavy lifting is over

JK Cement Limited is a North India based company with an integrated cement capacity of 4mtpa of grey cement and 0.35mtpa of white cement. JK also has a coal-fired captive power plant close to its existing grey cement plants. All its existing manufacturing facilities are located in Rajasthan. The stock offers multiple earnings triggers over FY06-09E and is a potential re-rating candidate driven by streamlined operating cost structure, reduced financial leverage, future regional diversification, and volume growth.

- Capacity-addition-led volume growth (+5% yoy) and margin expansion (1125bps) led by strong realisations in FY07E to facilitate blanket improvement in profitability (yoy net profit +439%, EBITDA +141%)
- Most of the cost benefits (~Rs200/tonne) from additional captive power to flow through in FY08E.
- Capacity expansion from greenfield project in Karnataka (3mtpa, +75%) to kick-in by FY09E; to facilitate regional diversification of cement capacity. JK has also acquired assets of Nihon Nirmaan ltd at Gotan, Rajasthan. Expected production of ~0.3-0.35mn tonnes to commence by Q3FY08.
- Attractively valued. SOTP indicates that JK's current grey cement capacity is available at US$ 44/tonne (FY08E)
- We expect the stock to re-rate on re-vitalised balance sheet, improved cost structure, and regional diversification

Risks

- Higher-than-expected imbalance in industry demand-supply
- More-than-anticipated impact on cement realisations in North India in FY09E due to oversupply
- Pushback in JK's captive power and capacity addition projects

Valuation

- P/E of 5.5x FY07E and 4.4x FY08E; EV/EBITDA of 4.0x FY07E, 3.7x FY08E. EV/tonne of US$67/tonne FY07E and US$65/tonne FY08E.

Bloomberg code :	JKCE IN
Reuters code :	JKCE.BO
www.jkcement.com	
BSE Sensex :	13049
NSE Nifty :	3762

Company data

O/S shares :	70mn
Market cap (Rs) :	10bn
Market cap (USD) :	219mn
52 - wk Hi/Lo (Rs) :	231 / 109
Avg. daily vol. (3mth) :	129,569
Face Value (Rs) :	10

Share holding pattern, %

Promoters :	61.6
FII / NRI / OCBs :	11.5
FI / MF / Banks :	10.9
Non Promoter Corp. Holdings :	4.9
Public & Others :	11.1

Price performance, %

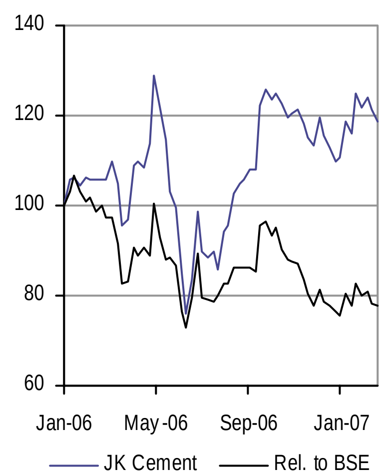
	1mth	3mth	1yr
Abs	-26.6	-22.9	-14.1
Rel to BSE	-16.1	-17.2	-37.3

Valuation summary

Y/E Mar, Rs mn	FY2006	FY2007E	FY2008E	FY2009E
Net Sales	8,737	12,091	12,674	13,935
Core EBIDTA	1,320	3,188	3,747	3,356
EBIDTA margin, %	15.1	26.4	29.6	24.1
Net profit	326	1757	2186	1786
PAT margin, %	3.7	14.5	17.2	12.8
EPS, Rs	4.7	25.1	31.3	25.5
EPS Growth, %		439.3	24.4	-18.3
PER, x	29.8	5.5	4.4	5.4
EV/EBITDA, x	9.6	4.0	3.7	4.7
EV/Net Sales, x	1.5	1.0	1.1	1.1
Price/Book Value, x	1.4	1.2	1.0	0.8
ROIC, %	6.5	18.1	18.2	12.5
ROE, %	6.1	23.4	23.7	16.3
Dividend Yield, %	1.1	1.1	1.1	1.1

Source: Company, Man Financial Research Estimates

JK Cement vs. Sensex



Source: Bloomberg, Man Financial Research

ABOUT JK CEMENT

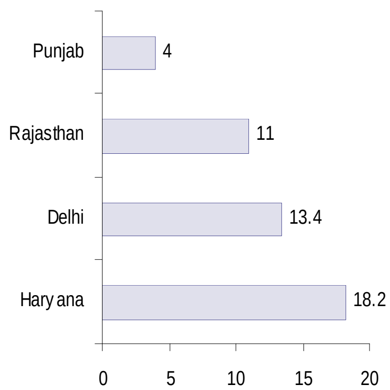
- JK Cement Limited currently has an integrated cement capacity of ~4mtpa of grey cement and ~0.4mtpa of white cement. JK also has a coal-fired captive power plant close to its existing grey cement plants. All its existing manufacturing facilities are located in Rajasthan.
- In its current form, JK Cement was formed in November 2004 as a result of slump sale of cement division of JK Synthetics Limited (JKSL), a BIFR-registered sick company.
- JK issued 20mn fresh equity shares (~29% of shares outstanding post issue) in Q4FY06 to primarily undertake captive power projects (~43MW) for its grey cement division and limited capacity expansion at its existing grey cement (+0.5mtpa) and white cement (+0.1mtpa) plants.
- It primarily competes with other North Indian cement producers like ACC, Grasim, Gujarat Ambuja, Shree Cement, and JK Lakshmi Cement in the grey cement segment and with Grasim in white cement segment.
- The company recently announced a 3mtpa greenfield project in South India (Karnataka). The plant will have 2.25mtpa clinker capacity accompanied by a 40MW captive power unit and will primarily produce blended (PPC) cement. The capacity is expected to come on-stream by Q3FY09 and the project cost is pegged at ~Rs 9bn. The project will be funded by debt and internal accruals.

Financial snapshot

Rs mn	FY03*	FY04*	FY05**	FY06	FY07E	FY08E
Net Revenue	5,985	6,272	7,744	8,737	12,091	12,674
YoY, %		*5*	*23*	*13*	*38*	*5*
EBITDA	495	538	884	1,320	3,188	3,747
YoY, %		*9*	*64*	*49*	*141*	*18*
EBITDA Margin, %	*8*	*9*	*11*	*15*	*26*	*30*
Net Profit	NA	NA	NA	326	1,757	2,186
YoY, %					*439.4*	*24.4*

*Figures for FY03 and FY04 are for JKSL cement division and are only available up to EBITDA level.
**Financials for FY05 are based on proforma consolidation of JKSL cement division before slump sale in Nov'04and JK cement's audited financials for Nov'04-Mar'05
Source: Company, Man Financial Research Estimates

Market share in primary mkts (%)



Manufacturing facilities

Location	Cement Type	Capacity
Existing		
Nimbahera, Rajasthan	Grey Cement	2.8 mtpa
Mangrol, Rajasthan	Grey Cement	0.75 mtpa
Gotan, Rajasthan	White Cement	0.4 mtpa
New		
Mudgal Karnataka (Dec '08)	Grey Cement	3mtpa
Nihon Nirmaan Gotan (Dec'07)	Grey Cement	0.3mtpa

Source: Company

Captive power facilities

Location	Details	Capacity (MW)	Commissioning Details
Bamania, Rajasthan	Coal based	15	Existing Capacity
Bamania, Rajasthan	Coal based	10	March 2007
Nimbahera, Rajasthan	Pet coke, coal mix based	20	April 2007
Nimbahera, Rajasthan	Waste heat recovery based	13.2	June 2007
Mudgal, Karnataka	Coal Based	40	December 2008

Source: Company

Revenue drivers

	FY03	FY04	FY05	FY06	FY07E	FY08E
Average Cement Capacity (mtpa)	3.3	3.9	3.9	3.9	4.3	4.8
Grey Cement	3.0	3.6	3.6	3.6	3.9	4.4
White Cement	0.3	0.3	0.3	0.3	0.4	0.4
Cement Produced (mn tonnes)	3.1	3.2	3.6	3.7	3.9	3.9
Grey Cement	2.9	3.0	3.3	3.5	3.7	3.6
-OPC	2.5	2.1	2.5	2.1	1.2	0.9
-PPC	0.4	0.9	0.8	1.4	2.5	2.7
White Cement	0.2	0.2	0.2	0.2	0.2	0.3
Capacity Utilisation, %	94	83	92	97	92	81
Grey Cement, %	96	84	94	99	94	83
White Cement, %	67	72	75	76	67	64
Clinker Produced-Grey Cement (mn tonnes)	NA	NA	3.1	3.2	3.0	3.0
Aggregate Cement: Clinker-Grey Cement	NA	NA	1.09	1.11	1.21	1.23
Realisation-Grey Cement (Rs/tonne)						
Gross Realisation	2,175	2,195	2,449	2,627	3,457	3,617
Net Realisation	1,707	1,714	1,933	2,080	2,855	3,016
YoY, %		0	13	8	37	6
Realisation-White Cement (Rs/tonne)						
Gross Realisation	6,696	6,770	7,456	8,226	8,473	8,600
Net Realisation	5,288	5,322	5,804	6,336	6,487	6,624
YoY, %		1	9	9	2	2

Source: Company, Man Financial Research Estimates

Cost Analysis - Grey Cement

Rs/ton	FY03	FY04	FY05	FY06	FY07E	FY08E
Net Realisation	1,707	1,714	1,933	2,080	2,855	3,016
Operating Cost	1,644	1,626	1,752	1,802	2,082	2,085
Raw Material	176	182	193	217	287	321
Power	361	326	353	378	404	212
Fuel	337	307	376	352	338	365
Freight	406	421	424	483	579	637
Others	363	389	405	372	473	551
EBITDA	62	89	182	278	773	931

Cost Analysis - White Cement

Rs/ton	FY03	FY04	FY05	FY06	FY07E	FY08E
Net Realisation	5,288	5,322	5,804	6,336	6,487	6,624
Operating Cost	3,703	4,066	4,553	4,835	5,091	5,223
Raw Material	434	491	579	625	648	670
Power	487	499	474	557	607	607
Fuel	516	542	664	739	760	783
Freight	412	529	714	807	904	994
Others	1,854	2,004	2,122	2,107	2,173	2,170
EBITDA	1,586	1,257	1,250	1,501	1,396	1,401

Source: Company, Man Financial Research Estimates

Q3FY07 Results: Stellar performance

- **JK Cement's Q3FY07 results were significantly better than estimates. Net profit increased 48% qoq despite lower other income, led by rebound in volumes (+15% qoq) and ~4% qoq improvement in net realizations. We are upgrading FY07E and FY08E earnings by ~14-15% and upgrading target price by ~7% to Rs256 (31% upside). We are introducing FY09 estimates.**
- Net profit at Rs 502mn, up 544% yoy and 48% QoQ
- EBITDA margin at 27.7%, up 1,266 bps yoy and 400 bps QoQ
- Consolidated EBITDA/tonne at Rs 876, up Rs 155/tonne vs. Q2FY07
- Strong QoQ realisations growth (+Rs 120/tonne), volumes up ~15% QoQ

Net realisations up ~4% QoQ

- Net realisations were up by ~4% QoQ. QoQ improvement was primarily led by grey cement; white cement realizations were largely flat.
- Ebitda/tonne up ~22% QoQ on higher realizations, operating leverage
- EBITDA/tonne improved to Rs 876 (+Rs 155 QoQ) lead by higher realisations and volumes rebound. Except for stock adjustments, operating costs declined QoQ on higher capacity utilization.

Other Highlights

- **Acquisition of assets of Nihon Nirmaan, capacity up by** ~ 6% Earlier this month, JK announced acquisition of assets of Nihon Nirmaan ltd from IDBI for Rs 420mn. The plant is situated in proximity of JK's white cement facility at Gotan. The plant was originally designed for white cement but the company intends to produce grey cement in this unit and expects an annual production of ~0.3-0.35 mn tonnes. Capacity is likely to come on-stream in Q3FY08 & capex on the upgrade is ~Rs250 mn (total outlay Rs 670mn or US$47/tonne).
- **Entitlement for interest subsidy, total saving Rs13/sh (NPV ~Rs10/sh)** JK announced that it received an entitlement of ~5% interest subsidy from Rajasthan government. The benefit will not impact earnings as it is to be accounted under capital receipts but will result in cash benefits in the form of lower sales tax outlay. JK will get 50% waiver on sales tax on cement sold in the state of Rajasthan. JK estimates total benefit at Rs890mn and is confident of availing the exemption within the benefit period expiring Nov '2011.
- **Other projects largely on-track JK expects all power projects (total 43MW)** to come on-stream in H1FY08. Installation of 10MW turbine at Bamania has been slightly delayed and is likely to be completed by Feb '07 (original target Dec '06).
- **Revise price target to Rs 256 (+7% vs. earlier); upgrading earnings by** ~15%
- **We are upgrading earnings for FY07E and FY08E by** ~14-15% on higher realizations despite a ~3% downgrade on grey cement volume forecasts.

Q3FY07 Results Analysis

(Rs mn)	Q3FY07	Q2FY07	QoQ, %	Q3FY06	YoY, %	FY07E	FY08E
Net Sales	3190	2682	*19*	2217	*44*	12091	12674
Operating Expenses	2307	2047	*13*	1884	*22*	8904	8927
EBITDA	883	635	*39*	333	*165*	3188	3747
Margin, %	27.7	23.7	*400bps*	15.0	*1266bps*	26.4	29.6
Depreciation	82	81	*1*	76	*8*	327	401
EBIT	801	554	*45*	257	*212*	2861	3346
Margin, %	25.1	20.7	*445bps*	11.6	*1352bps*	23.7	26.4
Interest paid	81	92	*-12*	154	*-47*	342	297
Other Income	15	51	*-71*	18	*-17*	103	74
Pre-tax profit	735	513	*43*	121	*507*	2622	3123
Tax provided	233	173	*35*	43	*442*	865	937
MAN Net profit	502	340	*48*	78	*544*	1757	2186
EPS, Rs	7.2	4.9	*48*	1.6	*360*	25.1	31.3
Annualised EPS, Rs	28.7	19.4		6.2	*360*		
Unadj. shares (mn)	69.9	69.9		69.9		69.9	69.9
Wtd avg shares (mn)	69.9	69.9		69.9		69.9	69.9

Source: Company, Man Financial Research Estimates

Operating Revenue & Cost Analysis

Per Tonne Analysis	Q3FY07	Q2FY07	QoQ, %	Q3FY06	YoY, %	FY07E	FY08E
Grey Cement Volumes (mn tonnes)	0.94	0.81	*16.4*	0.90	*5.0*	3.68	3.64
White Cement Volumes (mn tonnes)	0.06	0.06	*-0.3*	0.06	*1.7*	0.24	0.25
Total Volumes (mn tonnes)	1.00	0.87	*15.2*	0.96	*4.8*	3.93	3.90
Net Realization	3166	3046	*3.9*	2312	*36.9*	3079	3252
Operating Cost	2290	2325	*-1.5*	1965	*16.5*	2268	2290
Raw Material	351	308	*14.1*	142	*147.7*	310	344
Power and Fuel	766	834	*-8.1*	811	*-5.6*	780	630
Employee	124	134	*-7.4*	105	*17.8*	125	142
Freight & Handling	588	599	*-1.8*	498	*17.9*	599	660
Other Expenses	460	451	*2.1*	408	*12.9*	453	515
EBITDA	876	721	*21.5*	347	*152.4*	812	961

Source: Company, Man Financial Research Estimates

Change in Estimates

	FY07E	FY08E
Cement Sales Volumes (Mn Tonnes)-Grey Cement		
Old	3.80	3.75
New	3.68	3.64
%change	*-2.97*	*-2.91*
Cement Sales Volumes (Mn Tonnes)-White Cement		
Old	0.24	0.25
New	0.24	0.25
%change	*1.90*	*1.90*
Net Cement Realization-Grey Cement (Rs/Tonne)		
Old	2770	2931
New	2855	3016
%change	*3.06*	*2.90*
Net Cement Realization-White Cement (Rs/Tonne)		
Old	6550	6853
New	6487	6624
%change	*-1.0*	*-3.3*
Net Sales (Rs mn)		
Old	12076	12710
New	12091	12674
%change	*0.1*	*-0.3*
EBITDA (Rs Mn)		
Old	3079	3546
New	3188	3747
%change	3.5	5.7
PAT		
Old	1540	1901
New	1757	2186
%change	*14.0*	*15.0*

Source: Man Financial Research Estimates

Valuation Summary

Current Capacity - Grey Cement	
FY08E Grey Cement EBITDA (Rsmn)	3,390
FY08E Grey Cement EBITDA margin, %	30
FY08E Grey Cement EBITDA/Share (Rs)	48
Target EV/EBITDA (x)	4.8
EV/Share - Grey Cement (Rs)	233
FY08E Implied Target EV/tonne (US$)	80
Current Capacity - White Cement	
FY08E White Cement EBITDA (Rsmn)	357
FY08E White Cement EBITDA margin, %	21
FY08E White Cement EBITDA/Share (Rs)	5
Target EV/EBITDA (x)	6.0
EV/Share - White Cement (Rs)	31
Implied Target EV/tonne (US$)	116
New Capacity - Grey Cement (to be commissioned by Sep-Dec'08)	
FY08E Investment in Karnataka Grey Cement Project (Rsmn)	3,500
FY08E Investment/Share	50
Target Price / Book (x)	1
EV/Share - Karnataka Grey Cement Project	50
Total EV/Share	313
Net Debt/Share	58
Equity Fair Value/Share (Rs)	256
% upside	*84%*
FY08E Implied Target P/E (x)	8.2
FY08E EV based on CMP (Rsmn)	13,759
FY08E Grey Cement Capacity (EOP, mtpa)	4.1
EV of White Cement and Karnataka Project	5,641
EV-Grey Cement Capacity at CMP	8,118
FY08E EV/tonne at CMP (US$)	44
FY08E EV/EBITDA- Grey Cement (x)	2.4

Source: Company, Man Financial Research

FINANCIALS

Income Statement

Y/E Mar, Rs mn	FY2006	FY2007E	FY2008E	FY2009E
Net sales	8,737	12,091	12,674	13,935
Growth, %		*38*	*5*	*10*
Operating expenses	-7,417	-8,904	-8,927	-10,579
EBITDA	1,320	3,188	3,747	3,356
Growth, %		*141*	*18*	*-10*
Margin, %	*15*	*26*	*30*	*24*
Depreciation	-310	-327	-401	-476
EBIT	1,010	2,861	3,346	2,880
Growth, %		*183*	*17*	*-14*
Margin, %	*12*	*24*	*26*	*21*
Net Interest and others	-488	-239	-223	-328
Pre-tax profit	522	2,622	3,123	2,552
Tax provided	-196	-865	-937	-766
Profit after tax	326	1,757	2,186	1,786
MAN Net profit	326	1,757	2,186	1,786
Growth, %		*439*	*24*	*-18*
Extraordinary items: Gains/(Losses)	0	0	0	0
Unadj. shares (m)	70	70	70	70
Wtd avg shares (m)	70	70	70	70

Cash Flow

Y/E Mar, Rs mn	FY2006	FY2007E	FY2008E	FY2009E
Pre-tax profit	522	2,622	3,123	2,552
Depreciation	310	327	401	476
Chg in working capital	173	724	638	533
Total tax paid	-196	-865	-937	-766
Cash flow from operating activities	808	2,807	3,225	2,796
Capital expenditure	-835	-2,669	-4,195	-4,593
Cash flow from investing activities	-835	-2,669	-4,195	-4,593
Free cash flow	-27	138	-970	-1,797
Equity raised/(repaid)	2,790	0	0	0
Debt raised/(repaid)	-591	-1,873	590	1,917
Dividend (incl. tax)	0	-120	-120	-120
Cash flow from financing activities	2,199	-1,992	470	1,798
Net chg in cash	2,172	-1,854	-500	1

Man Financial

Balance Sheet

As at 31st Mar, Rs mn	FY2006	FY2007E	FY2008E	FY2009E
Cash & bank	2,854	1,000	500	501
Debtors	461	638	669	736
Inventory	840	1,120	1,164	1,282
Loans & advances	927	1,060	1,083	1,133
Other current assets	12	17	17	19
Total current assets	5,094	3,835	3,433	3,671
Gross fixed assets	9,592	11,372	12,357	21,418
Less: Depreciation	-612	-1,063	-1,588	-2,188
Add: Capital WIP	569	1,458	4,668	200
Net fixed assets	9,549	11,767	15,437	19,430
Other non-current assets	19	26	28	30
Total assets	14,662	15,629	18,899	23,132
Current liabilities	1,923	2,662	2,790	3,068
Non-current liabilities	5,996	4,711	5,910	8,323
Total liabilities	7,919	7,373	8,700	11,391
Paid-up capital	699	699	699	699
Reserves & surplus	6,043	7,556	9,499	11,042
Shareholders' equity	6,743	8,256	10,198	11,741
Total equity & liabilities	14,662	15,629	18,899	23,132

Per-share data

	FY2006	FY2007E	FY2008E	FY2009E
MAN EPS (INR)	4.7	25.1	31.3	25.5
Growth, %		*439.3*	*24.4*	*-18.3*
Book NAV/share (INR)	96.4	118.1	145.8	167.9
FDEPS (INR)	4.7	25.1	31.3	25.5
CEPS (INR)	9.1	29.8	37.0	32.4
CFPS (INR)	10.9	40.5	45.8	39.6
DPS (INR)	1.5	1.5	1.5	1.5

Financial structure

	FY2006	FY2007E	FY2008E	FY2009E
Total debt/Equity (%)	86.3	47.8	44.5	55.0
Net debt/Equity (%)	44.0	35.7	39.6	50.7

Profitability, Productivity, Liquidity and Valuation Ratios

	FY2006	FY2007E	FY2008E	FY2009E
Return on assets (%)	5.3	13.0	13.8	9.7
Return on equity (%)	6.1	23.4	23.7	16.3
Return on Invested capital (%)	6.5	18.1	18.2	12.5
RoIC/Cost of capital (x)	0.5	1.4	1.4	1.0
RoIC - Cost of capital (%)	-6.2	4.9	4.9	-0.6
Return on capital employed (%)	6.0	15.4	16.3	11.2
Cost of capital (%)	12.7	13.3	13.3	13.1
RoCE - Cost of capital (%)	-6.7	2.1	3.0	-1.9
Asset turnover (x)	0.9	1.1	1.0	0.9
Sales/Total assets (x)	0.7	0.8	0.7	0.7
Sales/Net FA (x)	0.9	1.1	0.9	0.8
Working capital/Sales (x)	0.0	0.0	0.0	0.0
Fixed capital/Sales (x)	0.0	0.0	0.0	0.0
Receivable days	19.3	19.3	19.3	19.3
Inventory days	35.1	33.8	33.5	33.6
Payable days	0.0	0.0	0.0	0.0
Current ratio (x)	2.6	1.4	1.2	1.2
Quick ratio (x)	2.2	1.0	0.8	0.8
Interest cover (x)	1.9	13.4	13.5	8.2
Dividend cover (x)	3.1	16.7	20.8	17.0
PER (x)	29.8	5.5	4.4	5.4
PEG (x) - y-o-y growth	n/a	0.0	0.2	-0.3
Price/Book (x)	1.4	1.2	1.0	0.8
Yield (%)	1.1	1.1	1.1	1.1
EV/Net sales (x)	1.5	1.0	1.1	1.1
EV/EBITDA (x)	9.6	4.0	3.7	4.7
EV/EBIT (x)	12.6	4.4	4.1	5.4
EV/NOPLAT (x)	20.1	6.6	5.9	7.8
EV/CE	1.0	1.0	0.9	0.8
EV/IC (x)	1.3	1.2	1.1	1.0

Source: Company, Man Financial Research Estimates

March 9, 2007

INDIA / PACKAGING / VISIT NOTE

Man Financial

Ess Dee Aluminium

Not Rated / Rs 225

Vinod Nair *(vinod.nair@manfinancial.in) +91 22 6667 9766*

Growth-packed

- We recently met the management of Ess Dee Aluminium (EDAL) to discuss the company's new initiatives and capacity expansion programs for which it undertook an IPO of Rs 1566mn.

Key takeaways

- The company is present in a niche segment (pharma packaging) within the overall packaging industry, which is witnessing a 14-15% growth.
- Ess Dee has three main sources of operations, namely manufacturing of aluminium foil, PVC, and printing. Major value addition takes place during the process of reducing aluminium sheets to lesser microns.
- It has an ambitious expansion plan to increase its capacity from 3,600 tons to 18,000 tons in FY06-08E.
- The company plans to enter the FMCG aluminium packaging segment, towards which the initial groundwork has been completed, and business is expected to commence from 1QFY08.

Our take

- Ess Dee's healthy relationship with Indian pharma companies makes it well poised to achieve its goal of becoming a Rs 3000mn company by FY08E from Rs 588mn in FY06. Clients include Cipla, Wockhardt, Cadila and Torrent.

Valuation

- EDAL's stock is trading at a P/E of 15.5x FY07E and 9.6x FY08E, which is attractive for a company which is expected to grow its sales at 108% FY06-08E and EPS at 157% FY06-08E. The PEG is attractive at 0.3x FY07E. The risk is high net working capital days of 302 days. The D/E is comfortable at 0.3x.

This note should be read for
- Business Profile
- Management Guidance

Bloomberg code :	EDS IN
Reuters code :	ESDA.BO
www.duttagroup.in	
BSE Sensex :	13049
NSE Nifty :	3762

Company data	
O/S shares :	26mn
Market cap (Rs) :	5943mn
Market cap (USD) :	134mn
52 - wk Hi/Lo (Rs) :	344 / 210
Avg. daily vol. (monthly) :	609,699
Face Value (Rs) :	10

Share holding pattern, %	
Promoters :	64.6
FII / NRI :	7.9
FI / MF :	10.2
Non Promoter Corp. Holdings :	3.0
Public & Others :	14.3

Price performance, %

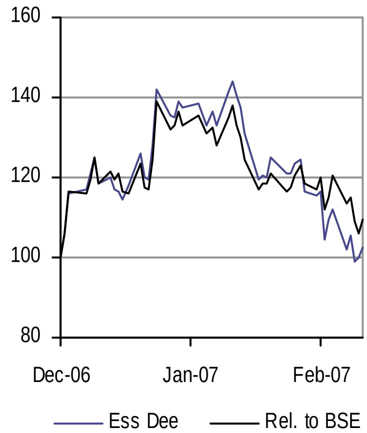
	1mth	3mth	1yr
Abs	-21.5	–	–
Rel to BSE	-11.1	–	–

Valuation summary

Y/E Mar, Rs mn	FY2006	FY2007 (6m)	FY2007E	FY2008E
Net Sales	625	588	1,500	2,700
Growth, %		88.3	155.0	80.0
Core EBIDTA	150	166	443	807
EBIDTA margins, %	24.1	28.3	29.5	29.9
Net profit	94	120	334	620
Net profit margin %	15.0	20.4%	22.2	22.9
EPS, Rs	3.6	4.5	12.6	23.5
EPS Growth, %		27.5	178.4	85.7
PER, x (Adj)	63.2	49.6	17.8	9.6
EV/EBIDTA, x (Adj)	45.4	41.1	15.4	8.5
EV/Net Sales, x	10.9	11.6	4.6	2.5
Price/Book Value, x (Adj)	34.2	37.5	12.0	9.6
ROIC, %	34.5	16.0	16.7	18.0
ROE, %	38.1	20.5	13.4	20.0
Dividend Yield, %		0.0	0.0	0.0

Source: Company, Man Financial Research Estimates

Price vs. Sensex

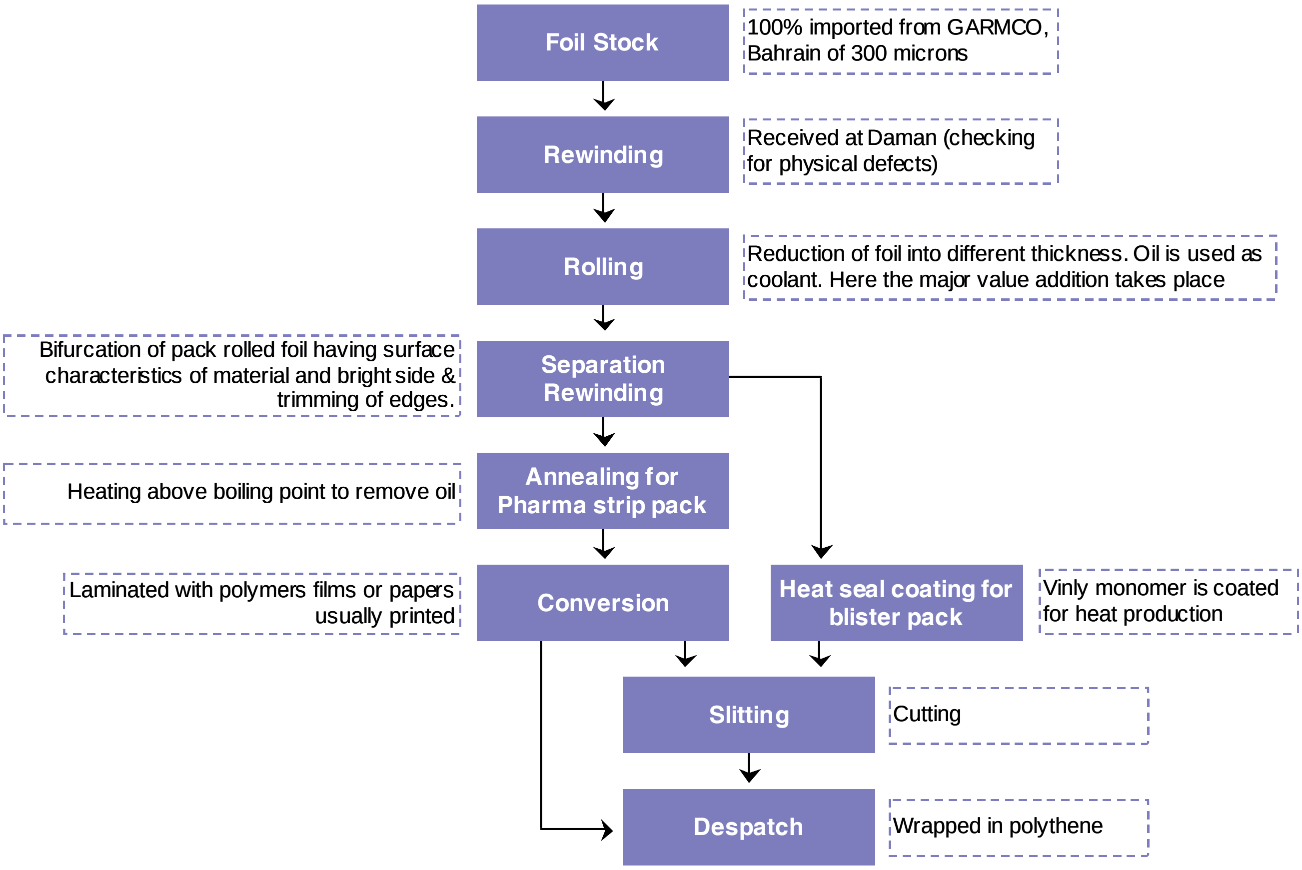


Source: Bloomberg, Man Financial Research

COMPANY BACKGROUND

ESS DEE Aluminium Limited (EDAL) is a pharmaceutical packaging solution provider. The company's business involves three aspects, namely, manufacturing aluminium foils, PVC foil, and printing of foil.

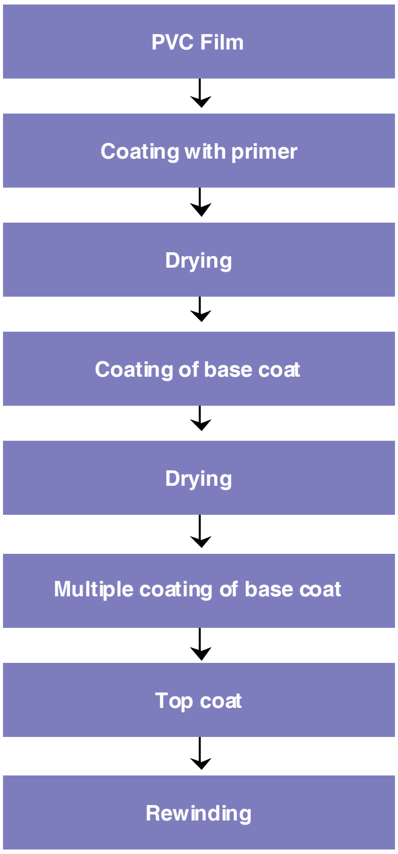
In the case of manufacturing aluminium foil, EDAL undertakes cold rolling of aluminium sheets into thinner gauge according to the requirements of its clients. The process has been outlined below.



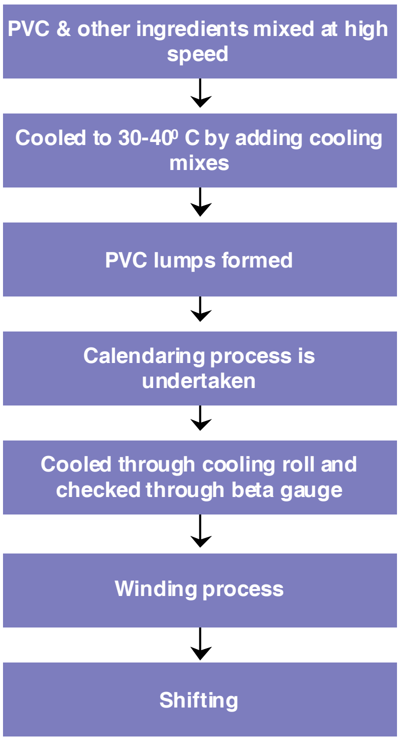
Source: Company

EDAL also manufactures PVC films and PVdC-coated PVC barrier thermoforming films for blister packaging, which forms one side of the packaging material, while the other side is aluminium foil.

PVdC coating process



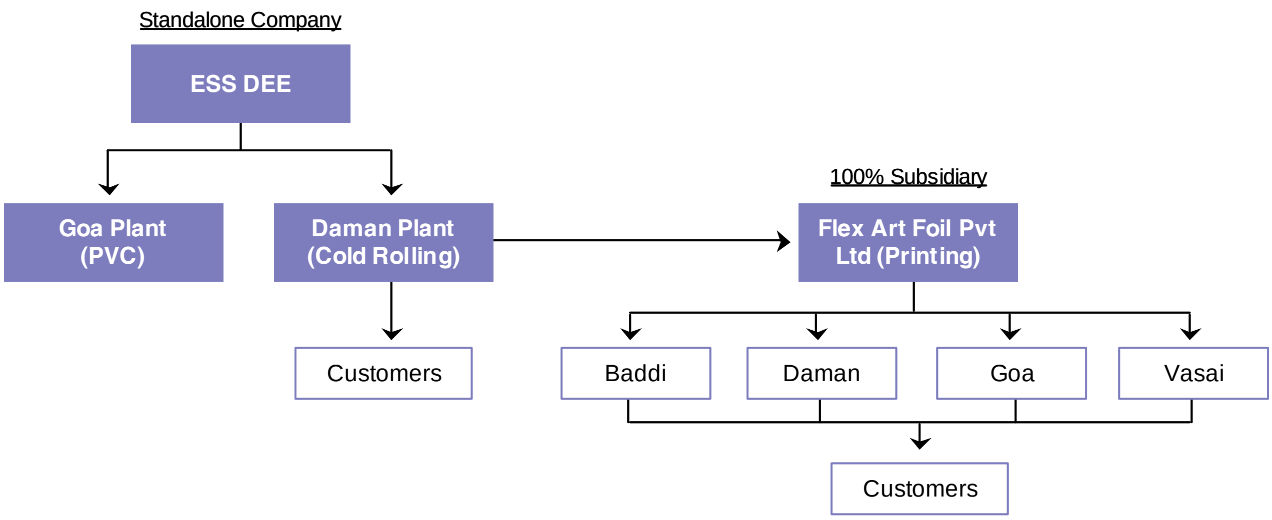
PVC calendaring process



Source: Company

The100% subsidiary, Flex Art Foil Private Ltd., converts the rolled aluminium foil (printer's stock) into customized printing and design.

Company Structure



Source: Company

Management

EDAL is promoted by Mr. Sudip Dutta, aged 34 years, the chairman and managing director of the company. He is a first-generation entrepreneur and has 15 years of experience in the packaging industry. Mr. Prasenjit Dutta, aged 42 years, functions as a director (Technical) at EDAL. Mr. Prasenjit Dutta is a B. Tech (Metallurgy) from IIT (Kharagpur) with 21 years of experience in the steel and aluminium industry.

The Product

The product is called blister packaging where there are two basic variants: the first is where one side of the package has PVC, where the cavity is constructed, while the other side is aluminium foil, also called blister foil. The second variant has aluminium foil on both the sides.

If the drug is light sensitive, instead of blister foil strip foil is used, which has a different coated material on both sides of the foil against the blister foil. In both strip foil and blister foil, aluminium foil forms the essential material in the center.

In blister packing, PVdC coating could also be applied on the outer side, which increases the volume potential and reduces the moisture and gas permeability of the packet.

ARGUMENTS

The Business

We understand from the management that the business involves three basic operations, first, production of aluminium foil into different microns, second, manufacturing of PVC or PVdC material and third, printing. The maximum value addition takes places during the process of down-gauging aluminium sheets into foils. The lower the gauge, the higher the value addition. The aluminium sheets of 300 microns are 100% imported from GRAMCO (Bahrain). The cost of a 300-micron sheet is Rs 135 per kg. , while a rolled 25 micron sheet fetches about Rs 250 per kg.

Capacity Addition Program

The standalone company has two units: one each at Daman and Goa, while the subsidiary has four printing units at Baddi, Daman, Goa and Vasai.

Capacity Expansion

Daman Plant (MTPA)	FY05	FY06	FY07E	FY08E
Installed capacity	3,600	3,600	9,100	18,000
Utilisation (%)	31.9	67.8	58.1	65.0
Production	479	2,441	5,286	11,693
Goa plant (MTPA)				
Installed capacity	4,200	4,200	4,200	5,800
Utilisation (%)	51.95	52.5	85.7	81.0
Production	2,182	2,204	3,600	4,700

All the plants are US DMF-approved. EDAL, going forward, could take the opportunity to increase its exposure in the export market. The nature of the business requires having a manufacturing unit closer to its clients and hence, EDAL has adopted a multi-location manufacturing plant structure, especially in the case of printing units.

A total capex of Rs 1140mn is required for the capacity addition program. About Rs 600mn has already been invested and the project is proceeding according to schedule. EDAL is currently working at 85% capacity utilization.

New Products

EDAL is plans to introduce Alu-Alu packaging for the pharma industry, which is ahead of the blister packaging product. Alu-Alu has total barrier properties and is useful for low-dose, high-potency, new generation drugs. The current bulk of the domestic requirement is imported.

Entry in FMCG

Today, EDAL wholly caters to the requirement of the pharma industry. As a diversification strategy, the company is entering the FMCG space. It plans to enter only the aluminium-based packaging within the FMCG sector, which is similar to what the company currently undertakes and hence, the management does not expect the margin to be maintained. EDAL has started testing the waters by making samples for FMCG players, which still need to be approved. The FMCG business is expected to start from 1QFY08E.

High Working Capital Requirement

The business requires high working capital and as on September FY07, the receivable period stands at 298 days, inventories are 172 days and creditors payable are 168 days. The net working capital period is 302 days, which puts pressure on the working capital requirement. The scenario, in terms of WC requirement, is expected to be maintained, going forward, and could put additional pressure on a company which plans to increase its business by more than 4x by FY08E. Risk of non-payment of dues is less as it has a strong client base in the pharma sector. EDAL, currently, has WC loans to the tune of about Rs 500mn. The debt/equity is expected to be 0.4x in FY07E. The interest coverage is 6x for the nine months ended Dec'07.

Industry

Pharmaceutical packaging includes glass, PET bottles, strips, blister packaging, injectibles, ampoules and bulk. The packaging cost is expected to be 5% - 6% of the pharma sector. Hence, the market is small and fragmented. The total packaging for the pharmaceutical/biotechnology industry is expected to be about Rs 250bn in size and is growing at 14-15%. Two important players in the blister packaging segment are EDAL and Bilcare. The unorganized sector caters to more than 50% of the requirement. Due to the high fragmentation of the sector, industrial data are not available.

Funds Raised

During Dec'06, EDAL had an IPO for 6.96 million shares at a price of Rs 225, raising a total sum of Rs 1566mn. The equity has increased to Rs 264.1mn from Rs 19.4mn. The money has been raised to augment its capex of Rs 1140mn for increasing its capacity.

Financials

For the 9MFY07E, EDAL has reported net revenues of Rs 966.3mn, EBITDA margins of 29.6% and PAT of Rs 211.5mn i.e. PAT margin of 21.9%. There are no corresponding consolidated figures, since the consolidation happened in FY07.

The management has given a guidance of Rs 1600mn-Rs 1700mn sales for FY07 and +Rs 3000mn by FY08. Management expects the margins to be maintained, going ahead, as the margins would not be impacted by its entry in the FMCG packaging space. The company does not disclose its volume figures and hence, we have relied on the management's inputs to provide a basis of valuation parameters, going ahead.

FINANCIALS

Income Statement

Y/E Mar, Rs mn	FY2006	FY2007 (6m)	FY2007E	FY2008E
Net sales	625	588	1,500	2,700
Growth, %		*88.3*	*155.0*	*80.0*
Other income	11	4	24	25
Total income	635	592	1,524	2,725
Operating expenses	474	422	1,058	1,893
EBITDA	150	166	443	807
Growth, %		*121.4*	*165.8*	*82.4*
Margin, %	*24.1*	*28.3*	*29.5*	*29.9*
Depreciation	7	5	12	15
EBIT	144	161	430	793
Growth, %	*-279.4*	*124.4*	*166.3*	*84.3*
Margin, %	*22.6*	*27.3*	*28.2*	*29.1*
Interest paid	36	27	66	80
Pre-tax profit	118	138	388	738
Tax provided	24	19	55	118
Profit after tax	94	120	334	620
Man net profit	94	120	334	620
Net profit	94	120	334	620
Growth, %	*-131.6*	*155.0*	*178.4*	*85.7*
Unadj. shares (m)	26	26	26	26
Wtd avg shares (m)	26	26	26	26

Cash Flow

Y/E Mar, Rs mn	FY2006	FY2007 (6m)	FY2007E	FY2008E
Pre-tax profit	118	138	388	738
Depreciation	7	5	12	15
Chg in working capital	(387)	(168)	(568)	(906)
Total tax paid	(24)	(19)	(55)	(118)
Cash flow from operating activities (a)	(287)	(43)	(222)	(271)
Capital expenditure	(263)	(132)	(900)	(650)
Chg in investments	(1)	0	-	-
Cash flow from investing activities (b)	(264)	(131)	(900)	(650)
Free cash flow (a+b)	(551)	(174)	(1,122)	(921)
Equity raised/(repaid)	1,529	7,334	1,522	-
Debt raised/(repaid)	431	62	400	50
Cash flow from financing activities (c)	1,960	7,396	1,922	50
Net chg in cash (a+b+c)	1,409	7,222	800	(871)

Balance Sheet

As at 31st Mar, Rs mn	FY2006	FY2007 (6m)	FY2007E	FY2008E
Cash & bank	42	146	990	119
Debtors	275	487	1,042	1,875
Inventory	217	281	667	1,200
Loans & advances	56	69	167	300
Total current assets	590	984	2,865	3,494
Investments	1	0	0	0
Net fixed assets	249	375	1,263	1,898
Non-current assets	0	9	-	-
Total assets	839	1,359	4,128	5,392
Current liabilities	146	275	729	1,313
Provisions + Deffered Tax	15	17	23	34
Total current liabilities	162	292	752	1,346
Non-current liabilities	431	493	893	943
Total liabilities	592	784	1,645	2,289
Paid-up capital	75	194	264	264
Reserves & surplus	172	389	2,219	2,839
Shareholders' equity	247	584	2,484	3,103
Total equity & liabilities	839	1,368	4,128	5,392

Per-share data

	FY2006	FY2007 (6m)	FY2007E	FY2008E
MAN EPS (INR)	3.6	4.5	12.6	23.5
Growth, %	#DIV/0!	27.5%	178.4%	85.7%
Book NAV/share (INR)	9.4	22.1	94.0	117.5
FDEPS (INR)	3.6	4.5	12.6	23.5
CEPS (INR)	3.8	4.7	13.1	24.0
CFPS (INR)	53.4	273.5	30.3	-33.0

Financial structure

	FY2006	FY2007 (6m)	FY2007E	FY2008E
Operating cash flow/Total debt (x)	(0.7)	(0.1)	(0.2)	(0.3)
Total debt/Equity (x)	1.7	0.8	0.4	0.3
Net debt/Equity (x)	1.6	0.6	(0.0)	0.3

Profitability, Productivity, Liquidity and Valuation Ratios

	FY2006	FY2007 (6m)	FY2007E	FY2008E
Return on assets (%)	11.2	8.8	8.1	11.5
Return on equity (%)	38.1	20.5	13.4	20.0
Return on Invested capital (%)	34.5	16.0	16.7	18.0
RoIC/Cost of capital (x)	3.8	1.8	1.8	2.0
RoIC - Cost of capital (%)	25.4	6.9	7.6	8.9
Return on capital employed (%)	38.4	16.8	17.9	18.9
Cost of capital (%)	9.1	9.1	9.1	9.1
RoCE - Cost of capital (%)	29.3	7.6	8.8	9.7
Asset turnover (x)	0.9	0.5	0.4	0.7
Sales/Total assets (x)	0.7	0.4	0.4	0.5
Sales/Net FA (x)	2.5	1.6	1.2	1.4
Working capital/Sales (x)	0.7	1.2	1.4	0.8
Fixed capital/Sales (x)	0.4	0.6	0.8	0.7
Receivable days	161	302	253	253
Inventory days	127	174	162	162
Payable days	86	171	177	177
Current ratio (x)	3.7	3.4	3.8	2.6
Quick ratio (x)	2.3	2.4	2.9	1.7
Interest cover (x)	4.0	6.0	6.5	9.9
PSR(x)	9.5	10.1	4.0	2.2
PER (x)	63.2	49.6	17.8	9.6
PEG (x) - y-o-y growth	2.3	0.3	0.2	0.4
PCE (x)	59.1	47.6	17.2	9.4
PCF (x)	4.2	0.8	7.4	(6.8)
Price/Book (x)	34.2	37.5	12.0	9.6
Yield (%)		-	-	-
EV/Net sales (x)	10.9	5.8	4.6	2.5
EV/EBITDA (x)	45.4	20.5	15.4	8.5
EV/EBIT (x)	47.5	21.2	15.9	8.6
EV/NOPLAT (x)	43.6	19.9	15.0	8.3
EV/CE	10.5	7.3	2.8	1.7
EV/IC (x)	6.3	2.0	1.7	1.0

Source: Company, Man Financial Research Estimates

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Man Financial

Ramkrishna Forgings Limited

***Ambrish Mishra** (ambrish.mishra@manfinancial.in) +91 22 6667 9996*
***Prachi Kulkarni** (Research Associate)*

Moving up the Value Chain

- **Doubling of capacity and high margin new product introduction (crown wheel, ring gears and bearing races) through ring rolling line to drive volumes and margins**
- **Rising asset turnover once the capacity utilisation rises and higher margins to drive profitability and economic profits and hence a re-rating**
- **Valuations are attractive at 8x FY08E earnings**

Investment Rationale

- R K Forgings has a focused business model—It has consistently tried to diversify into wider sectors and geographies.
- Capacity to be doubled to 51,000 tpa by May'07 through ring rolling line with introduction of high margin new products like crown wheel, ring gears and bearing races
- Ring rolling will give the company an edge over competition in the domestic crown-wheels market.
- Derisking business model with new customer additions and starting supplies to domestic bearings industry. Received orders from Timken and SKF.
- Profitability to improve on account of higher capacity utilisation and increasing contribution of machined components
- Exports grow at a brisk pace and will continue to receive greater thrust. We estimate exports to constitute 19% of sales by FY09E.

Risks

- Higher client concentration
- Delay in installation and stabilization of the new ring rolling line
- Input costs in the medium to long term

Valuation

- At the current price of Rs 123, R K Forgings trades at 8.1x and 6.7x its FY08E and FY09E EPS, respectively.
- Valuations are attractive as the company is on a high-growth trajectory and enjoys a fairly strong revenue and earnings growth visibility. Is a strong re-rating candidate.
- We recommend Buy with a target price of Rs 197, at which it will trade at 13x FY08E earnings.

BUY / Rs 123
Target Rs 197 (+60%)

Sector (Relative to market)

OW	N	UW
■		

Stock (Relative to market)

B	OP	N	UP	S
■				
> 10%	5% to 10%	5% to –5%	-5% to -10%	< -10%

This note should be read for
- Business Details
- Analysis of financials and risk factors
- Valuation and Target price

Bloomberg code :	RMKF IN
Reuters code :	RKFO.BO
www.ramkrishnaforgings.com	
BSE Sensex :	13049
NSE Nifty :	3762

Company data	
O/S shares :	15mn
Market cap (Rs) :	2bn
Market cap (USD) :	42mn
52 - wk Hi/Lo (Rs) :	173 / 65
Avg. daily vol. (3mth) :	89,905
Face Value (Rs) :	10

Share holding pattern, %	
Promoters:	43.9
FII / NRI :	4.6
FI / MF :	28.7
Non Promoter Corp. Holdings :	9.5
Public & Others :	13.4

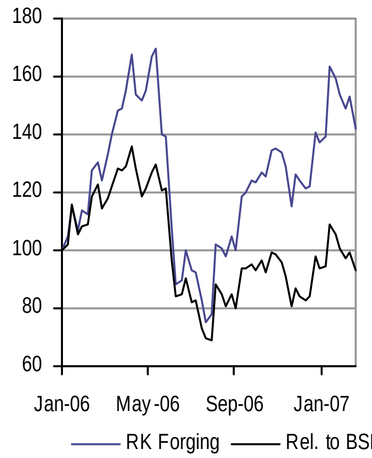
Price performance, %	1mth	3mth	1yr
Abs	-15.6	6.8	-4.5
Rel to BSE	-5.2	12.5	-27.7

Valuation summary

Y/E Mar, Rs mn	FY2005	FY2006	FY2007E	FY2008E	FY2009E
Net Sales	753	946	1,482	2,276	2,596
Growth, %	142.1	25.7	56.6	53.6	14.1
Core EBIDTA	95	182	277	469	553
EBIDTA margins, %	12.7	19.2	18.7	20.6	21.3
Net profit	45	85	142	231	278
Net profit margin, %	6.0	9.0	9.6	10.1	10.7
EPS, Rs	3.5	5.6	9.3	15.2	18.3
EPS Growth, %	97.3	58.7	66.8	62.4	20.6
PER, x	34.9	22.0	13.2	8.1	6.7
EV/EBIDTA, x	23.2	12.8	9.4	6.0	4.7
EV/Net Sales, x	2.9	2.5	1.8	1.2	1.0
Price/Book Value, x	5.8	3.1	2.6	2.0	1.6
ROIC, %	10.4	13.0	14.6	15.4	14.7
ROE, %	23.0	19.5	21.5	28.1	26.7
Dividend Yield, %	0.8	-	1.1	1.6	2.0

Source: Company, Man Financial Research Estimates

Price vs. Sensex



Source: Bloomberg, Man Financial Research

INVESTMENT OVERVIEW

Sustainable competitive advantage	Moving up the value chain by investing in product machining and die-making technology. Ring rolling line to give it an edge over competition
Financial structure	Capex funded through a mix of debt and equity. Net D/E below 1x
Shareholder value creation	Improving profitability and growing size would lead to a re-rating of the stock
Earnings visibility	Is strong with growing demand from existing customers, new customer additions and improving margins
Valuation	Is attractive at 8.1x FY08E EPS, with an EPS CAGR of 48% during FY06-FY09E
Man vs. consensus	N.A.
Future event triggers	Successful acquisition of a forging unit
Expected price momentum	Expect 60% upside from current levels in 12 months' time

Source: Man Financial Research

Rating and price target

At the current price of Rs 123, R.K. Forgings is trading at 8.1x and 6.7x its FY08E and FY09E EPS, respectively. On an EV/EBIDTA basis, the stock is available at 6x and 4.7x FY08E and FY09E EBIDTA, respectively. The valuations are attractive as the company is on a high-growth trajectory and enjoys a fairly strong revenue and earnings growth visibility. We recommend Buy with a target price of Rs 197, at which it will trade at 13x FY08E earnings. An upside of 60%.

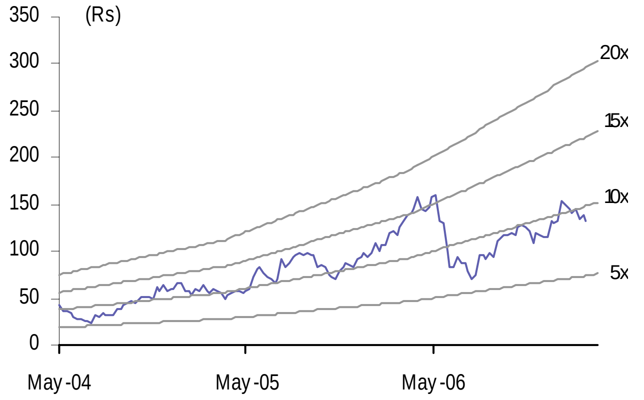
Price Performance

Rs, %	CMP Close	1M	3M	6M	1Year	YTD
BSE Sensex	13049	-10.4	-5.6	9.3	23.2	-5.5
Nifty	3762	-10.3	-5.2	8.2	20.0	-5.3
RK Forging	123	-15.6	6.8	9.0	-4.5	-5.6
Bharat Forge	314	-10.8	-9.8	-9.2	-31.6	-13.4
Amtek Auto	357	-8.2	1.4	10.8	10.6	-0.1
Clutch Auto	113	-24.5	-13.2	-5.1	-30.9	-19.9

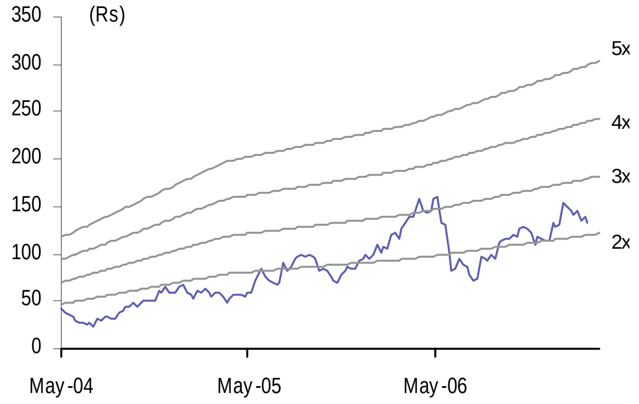
Source: Bloomberg

ABSOLUTE ROLLING VALUATION BAND CHARTS

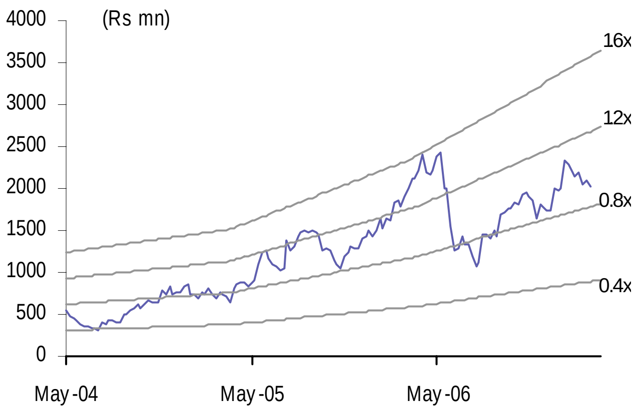
PE band



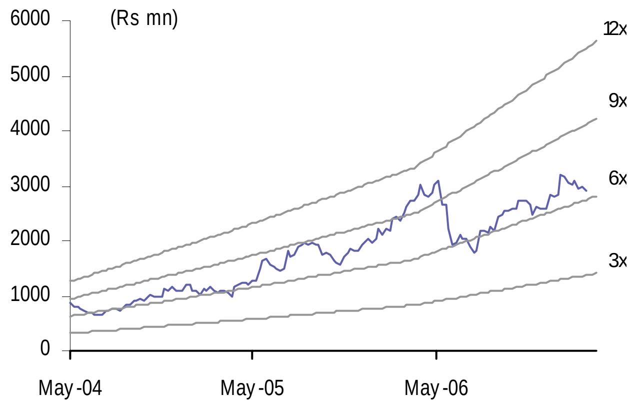
PBV band



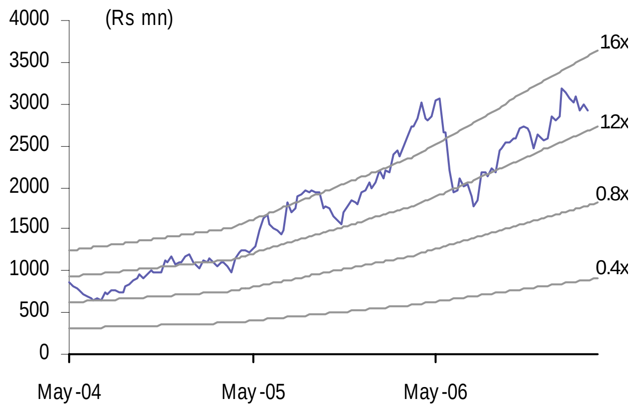
MCap/Sales band



EV/EBIDTA band



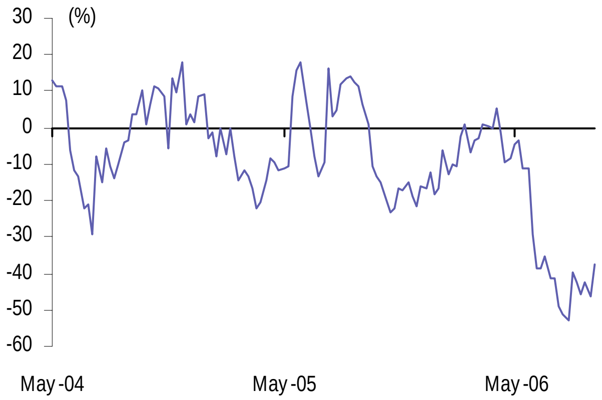
EV/Sales band



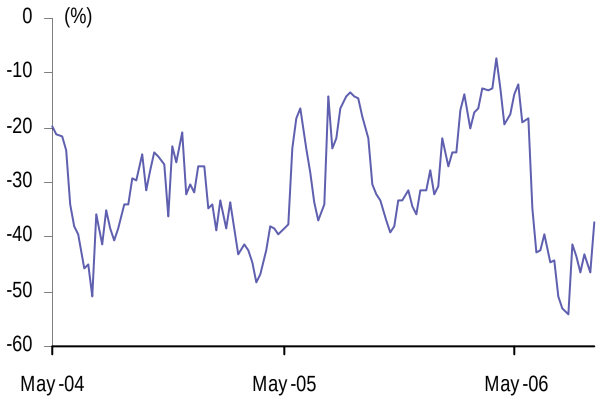
Source: Man Financial Research

PREMIUM / DISCOUNT TO SENSEX

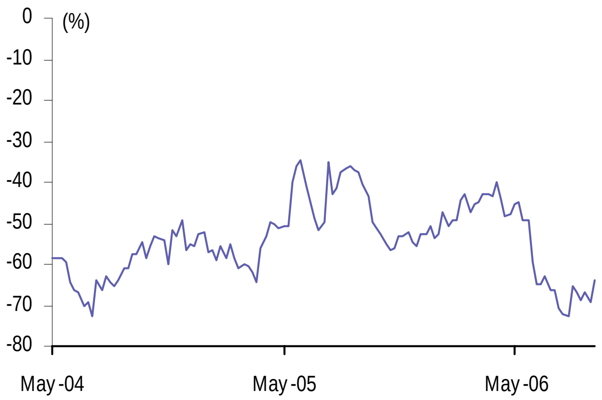
PE



PBV



MCap/Sales



Source: Man Financial Research

Historic and prospective peer valuation comparison

	Year	Equity multiples				Enterprise multiples				
		PER	PEG	PBR	PCF	EV/EBITDA	EV/EBIT	EV/NOPLAT	EV/Sales	EV/IC
Amtek Auto	FY2005	24.8		4.3	n/a	22.8	29.4	37.6	4.1	7.2
	FY2006	17.1		2.5	504.3	15.6	19.7	25.3	3.0	4.3
	FY2007E	15.4	0.5	1.8	14.6	8.9	10.9	14.3	1.7	2.6
	FY2008E	11.7		1.5	10.8	6.8	8.2	11.0	1.4	2.3
Bharat Forge	FY2005	57.2		12.6	151.9	24.5	31.9	64.5	4.3	7.6
	FY2006	27.8		5.5	23.4	16.6	22.0	34.5	2.9	5.0
	FY2007E	22.8	0.7	3.2	6.1	11.9	15.9	22.7	2.0	4.9
	FY2008E	17.3		2.8	8.9	9.4	12.2	17.4	1.7	6.8
Clutch Auto	FY2005	16.5		2.1	102.8	15.2	21.3	23.4	2.4	2.2
	FY2006	11.8		2.6	3.5	10.2	12.8	13.2	1.6	2.6
	FY2007E	10.2	0.3	2.4	20.2	7.1	8.4	11.9	1.2	2.7
	FY2008E	7.5		1.9	25.0	6.0	7.1	10.3	1.0	2.2
RK Forging	FY2005	34.9		5.8	n/a	23.2	28.4	45.4	2.9	4.7
	FY2006	22.0		3.1	90.2	12.8	15.4	23.6	2.5	3.1
	FY2007E	13.2	0.2	2.6	261.5	9.4	11.0	16.2	1.8	2.4
	FY2008E	8.1		2.0	8.2	6.0	7.1	10.5	1.2	1.6

Source: Company, Man Financial Research Estimates

PEER Comparison on key business parameters

Company	Forging Capacity in India (tpa)	Forging Capacity outside India (tpa)	Est. Machining Capacity (Pcs)	Key Components	Est. Customer Concentration	EBIDTA Margin (%)*	PAT Margin (%)*	PAT (Rs Mn)*	Remarks
Amtek Auto	85,000	NA	25,000,000	Connecting rods, Camshafts	Maruti Udyog	30.0%	19.3%	2,716	Operating margins are high as it generates close to 50% of revenue from machining. Cons OPMs are at 19%.
Ahmednagar Forgings	74,000	NA	16,000**	Steering knuckle, Connecting rods, Spiders & Gear shifter forks, Rear-axle shafts	Commercial Vehicle players like Tata Motors, Force Motors	23.0%	14.1%	1,160	Is largely into large forged components. Growing machining business has helped in improving margins.
Bharat Forge	240,000	360,000	650,000	Crankshafts, Front Axle assemblies	Commercial Vehicle players like Tata Motors, Ashok Leyland	25.6%	14.0%	3,071	Undisputed leader in Crankshafts for CVs in the domestic market. Margins strong due to higher machining business. Cons OPMs are at 18%. Global forging capacity at about 6 lacs tonnes
Ramkrishna Forgings	26,900***	Nil	NA	Railways: Screw couplings, Draw gear assembly, Snubber assembly. Automotive: Gears, Main shafts, Flanges, Spindle axle beam, Pinion drives, Rear axle shafts	Tata Motors	21.3%	10.7%	231	Growing at a brisk pace by expanding forging as well as machining capacities. OPMs to further expand after start of the ring rolling line. Venturing into new high margin products like crown-wheels, ring gears and bearing races.

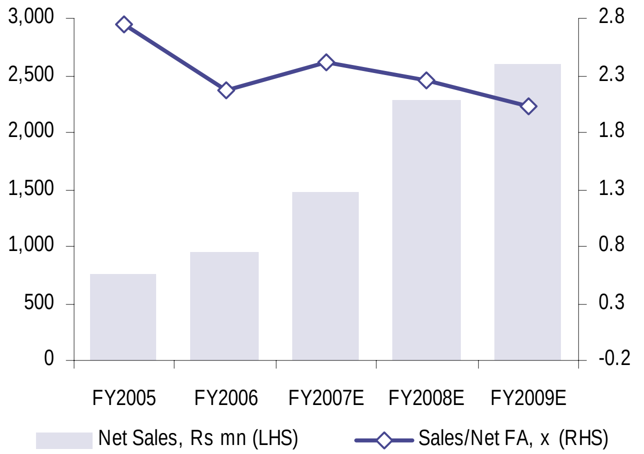
* estimated standalone figures for FY2008E
**Machining capacity
***New ring rolling line will take the capacity to 50,900 tpa
Source: Company, Man Financial Research

KEY RISKS

- Higher client concentration in its automobile business, as Tata Motors accounts for close to 45% of its annual revenue. However, the company is addressing the same by diversifying its client-base with the addition of Ashok Leyland and Automotive Axles. It also focuses on exports aggressively. Supply of components for the bearings industry would be another step towards de-risking the revenue stream.
- Delay in the installation and stabilization of the new ring rolling line could impact our revenue estimates, thereby affecting the estimated earnings growth.
- Input cost in the medium to long term would be an area of concern, in line with the other component manufacturers.
- Cyclical nature of the automobile industry.
- Exchange rate fluctuation, since exports growth is expected to be exponential over the next couple of years.

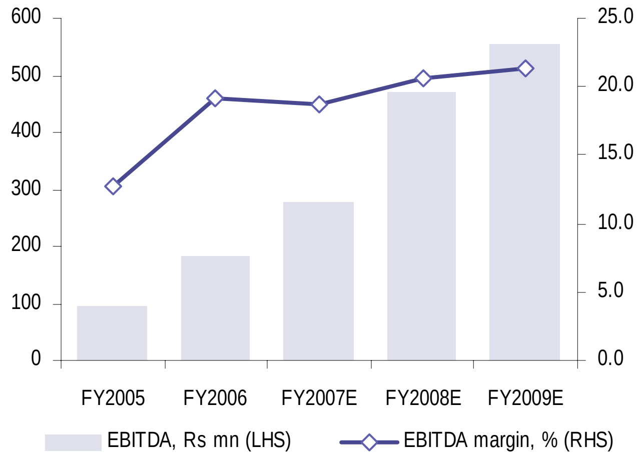
VALUE CREATION

Sales and Sales/Net fixed assets



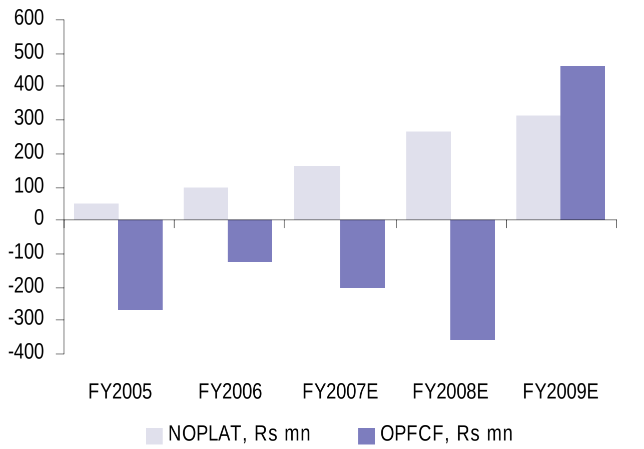
Growing volumes to drive sales

EBITDA and EBITDA margin



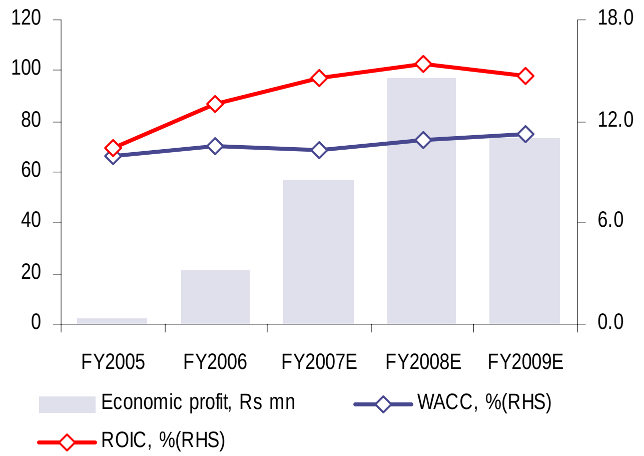
EBIDTA improving due to value added products

Noplat and OPFCF



OPFCF turning +ve from FY09 due to higher Capex

Economic profit



Economic profit to grow with improving profitability

Source: Man Financial Research

COMPANY BACKGROUND

Promoters

Promoted by Mr. M.P. Jalan in 1981, R.K. Forgings operates one of the largest forging and CNC plants in Eastern India. Mr. Jalan is a mechanical engineer from BITS Pilani, with an experience of more than a decade in the forgings industry.

Plants, Products and Customers

Currently, the company has three plants: two in Jamshedpur, while one is located in Howrah. Total capacity currently stands at 26,900 MTPA. The company is accredited with ISO 9001:2000 & QS: 9000 from BVQI and received accreditation for TS-16949 in December 2005. R.K. Forgings is approved by the core defence sector industrial organizations like DGQA (vehicles), DCQA (armaments) and DGQA (engineering equipment).

The company started business primarily by supplying critical forged components to the Indian railways for their wagons and coaches and is in the approved panel of the Railway Design and Safety Organization (RDSO). It diversified into automobiles over the last five to six years and became a leading supplier for Tata Motors' CV plant in Jamshedpur. It is also on the approved panel of Ashok Leyland, Automotive Axles, Hindustan Motors, BEML and other engineering units in the country. It also supplies to Tata group companies like Telcon and HV Axles. The non-railway segment currently contributes over 75% of R.K. Forging's revenue vis-à-vis about 55% in FY03. The key products manufactured by R.K. Forging include:

- Railways: Screw couplings, draw gear assembly, snubber assembly, hanger, block hanger side frame key
- Automobiles: Gears, main shafts, flanges, spindle axle beam, spindle housing, brackets, pinion drives, rear axle shafts, Crown wheels

Exports have started gaining significance in the last couple of years. The company currently supplies after-market products for automotive, rails and roads, in markets like US and Mexico. For the export market, it manufactures products like valve bonnets, rotors, ring gears, end caps, pulleys, etc.

JAMSHEDPUR	LILUAH	JAMSHEDPUR	JAMSHEDPUR
Plant - I	Plant - II	Plant - III	Plant – IV (Proposed)
▪ Forging ▪ Die-Making ▪ Heat Treatment ▪ Testing ▪ Upset Forging	▪ Machining ▪ Fabrication ▪ Assembly ▪ Functional Testing	▪ CNC Machining ▪ VMX Die-Making ▪ HMC Machining ▪ Hobbing ▪ Broaching ▪ Shaping ▪ Shaving ▪ Induction Hardening ▪ Seal Quenching ▪ Hardening & Tempering	▪ Ring Rolling

INVESTMENT RATIONALE

Moving up the value chain in old products by upgrading technical standards

To move up the value chain and enhance growth opportunities, R.K. Forgings installed 13 CNC & 3 VMC machines during FY05 at an investment of Rs 216 million. The VMC machines have helped the company immensely to move away from the conventional way of die making to the more sophisticated VMC route. This has led to a reduction in the time cycle of die making from about seven days to just a day or two. The microprocessor-controlled VMCs deliver dies with utmost precision, thereby improving the quality of the final forged product. The company has also invested towards an entire line of gear hobbing, shaping and shaving, broaching and gear testing machines to add value to the components delivered to customers. The company has invested Rs 160 million towards a heat treatment facility during FY07, which would earn much higher realizations for the company, going ahead.

These focused investments have helped the company to garner more business from the existing players through new products and by way of demand for value-added services (like machining) for existing raw forged components. On the other hand, the company has also been able to reduce the rejection rates from 1.01% in FY05 to 0.85% in FY06.

Doubling capacity through the ring rolling line

After achieving strong business growth in the automobile space, over the last couple of years, R.K. Forgings plans to gear up for the next growth phase. The company is in the process of installing a completely new ring rolling line as part of its next expansion phase. The new line will add about 24,000 tpa to the existing forging capacity of 26,900 tpa, taking the total forging capacity of the company to 50,900 tpa. The new line is believed to be a high-end forging technology, delivering higher value with a significant saving in material costs through higher raw material yield. The ring rolling line, imported from a reputed German manufacturer, is a fully automated robotic line, with a lower manpower requirement.

Currently, the only other manufacturing facility in the country, which has a ring rolling line is at ‘Echjay Industries’ in Rajkot. The company will invest a total amount of close to Rs 600 million towards the new ring rolling line, financing for which has already been tied up through a mix of debt and equity.

Expanding value added product range – Crown wheels, ring gears and bearing races

The ring rolling line would be utilised for the manufacture of medium- and large-sized auto components, for both the domestic and export markets. In fact, with the start of the new line, R.K. Forgings will initiate supply to the domestic tractor players as well, along with cementing the existing ties with the commercial vehicle makers. The company currently plans to manufacture two key auto components through the ring rolling line, namely crown-wheels and ring gears. These components are currently manufactured and supplied to domestic auto players with the use of conventional hammer/press forging technology. As a result, it is expected that the demand for crown-wheels and ring gears, manufactured using the ring rolling technology, would draw strong demand. About 70% (~17,000 tpa) of the installed ring rolling capacity would be devoted towards the production of auto components of different sizes, ranging from 25 kg to 40 kg.

The products—crown-wheels and ring gears—would be supplied to the customers in finished form, after machining and heat treatment. The conventional hammer/press forging route costs more due to low raw material yield. The ring rolling technology would not only ensure higher yield (and hence, a lower cost), but will also deliver superior finished components to the automobile OEMs.

Further, the company would make use of the ring rolling technology to manufacture bearing races (both inner and outer) for the domestic bearing industry. For this, the company would devote about 30% (~7,000 tpa) of the installed ring rolling capacity and will manufacture bearing races used for ball bearings. The proposed size of the bearing races to be manufactured would range from 20 kg to 35 kg for large-scale applications in various industries.

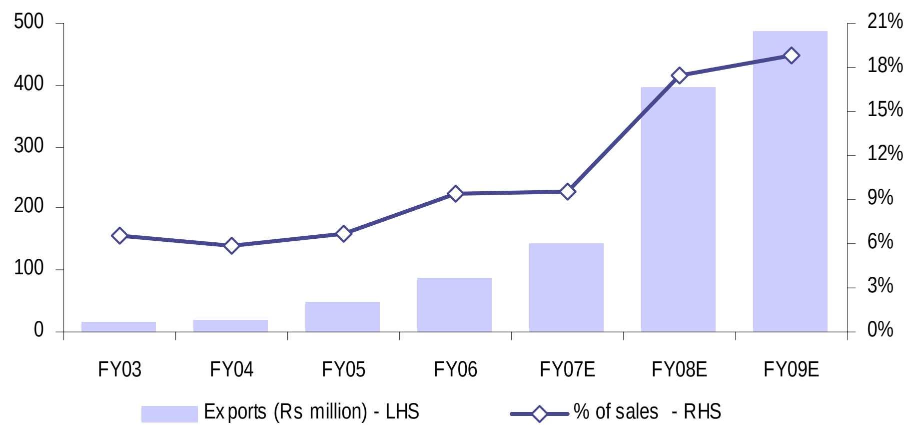
Customer diversification happening

Apart from Tata Motors, the other key target customers include Ashok Leyland, Mahindra and Mahindra, TAFE, Automotive Axles and Arvin Meritor. We believe that this will ensure the much-required customer diversification for R.K. Forgings, which so far had been dependent on Tata Motors for its auto component business growth. R.K. Forgings has also received orders for bearing races from industry giants like Timken and SKF. The company has been able to seize this opportunity as the players currently import their requirements from Italy, China and a few other European countries.

Exports to witness robust growth, to reach 19% of sales by FY09E

One of the key de-risking strategies of the company has been to grow its export business. Exports of the company have grown from just Rs 17 million in FY03 to Rs 89 million in FY07E and is expected to end FY07 with exports of Rs 142 million (Rs 96 million in 9MFY07). Exports constituted 6.6% of the company's sales in FY03, 9.4% in FY06 and would reach about 9.6% by the end of FY07. It currently exports to players like IPI and CAB in US and Mexico; largely catering to the replacement markets. However, with the start of the ring rolling line, exports are expected to grow significantly, mainly on account of initiating supply of crown-wheels to global auto component giant, 'Arvin Meritor'. R.K. Forgings is also in talks with other potential customers like Fairfield, Caterpillar and others for growth opportunities.

Export Trend



Source: Company, Man Financial Research Estimates

Closely looking at inorganic growth opportunities

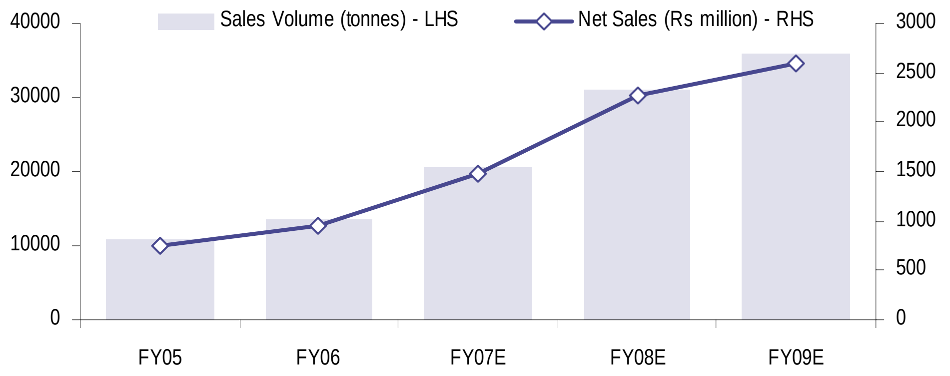
Apart from the undertaken organic growth initiatives through capacity addition in raw forging and machining facilities, R.K. Forgings is also looking closely at inorganic growth opportunities in the domestic forging market. The company has been scouting around for acquisitions for a while now, with its focus mainly on access to the passenger vehicles segment and geographical diversification. We believe that any significant development on this front would help the company to enter into a different league altogether.

FINANCIAL ANALYSIS

Revenue CAGR estimated at 40% during FY06-FY09E

We expect the company to end FY07 with a total production of about 20,600 tonnes and capacity utilization of 77% against utilization in FY06. With the installation of its ring rolling line and higher capacity utilization of existing capacity, we expect the company to report strong volume growth during FY08 and FY09. Demand would be driven by repeat orders from existing clients, increasing share with large customers like Tata Motors and Ashok Leyland, new customer additions, ramp up in existing products and the introduction of new products. We estimate volume CAGR during FY06-FY09E at 38.8% from 13,410 tonnes to 35,880 tonnes. Contribution from the ring rolling line is expected to be substantial by FY09E at 40% of total volume. Net sales are estimated to grow at a CAGR of 40% during FY06-FY09E, largely driven by domestic automotive business and exports. We estimate net sales at Rs 1.5 billion, Rs 2.3 billion and Rs 2.6 billion for FY07E, FY08E and FY09E, respectively.

Revenue growth trend

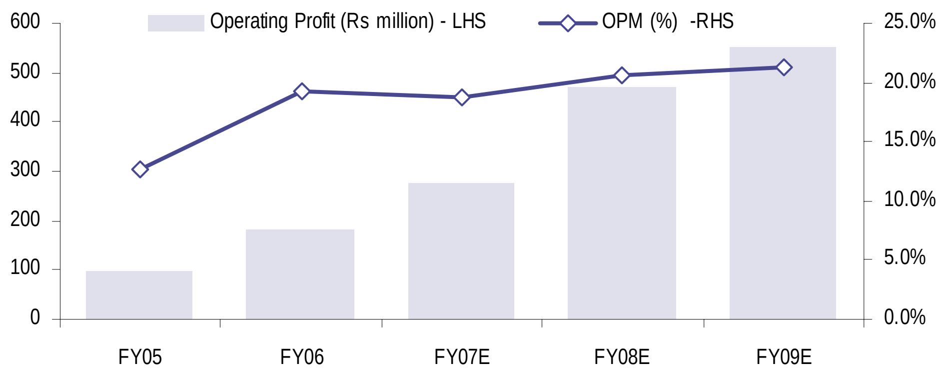


Source: Company, Man Financial Research Estimates

OPM to be strong, ensures a 45% CAGR in operating profit

Operating margins of the company are expected to be strong in view of savings on raw material from the ring rolling line. Also, higher capacity utilization would help to deliver benefits of economies of scale as the capacity utilization improves. We expect OPM to improve from 18.7% in FY07E to 21.3% in FY09E and operating profit to grow from Rs 277 million in FY07E to Rs 553 million in FY09E, a CAGR of 48% during FY06-FY09E.

Operating profit and OPM trend

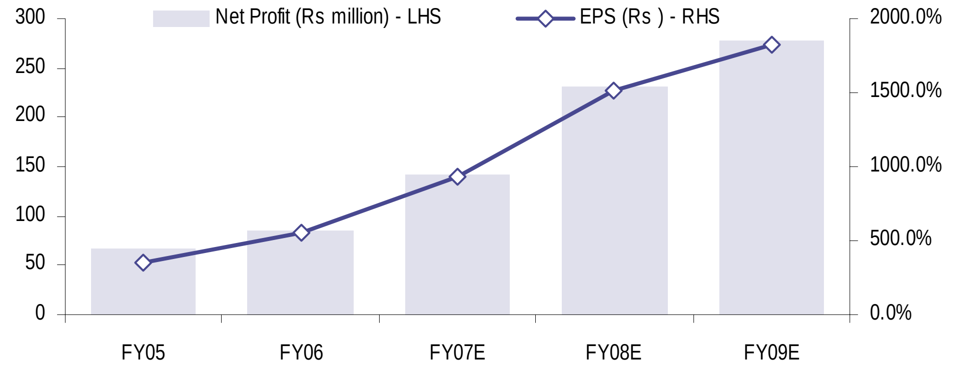


Source: Company, Man Financial Research Estimates

Earnings CAGR at 48% during FY06-FY09E

We expect R.K. Forgings' earnings CAGR at 48.4% during FY06-FY09E. We estimate EPS for FY07E, FY08E and FY09E at Rs 9.3, Rs 15.2 and Rs 18.3, respectively. We have assumed a peak tax rate of about 32%.

Earnings trend

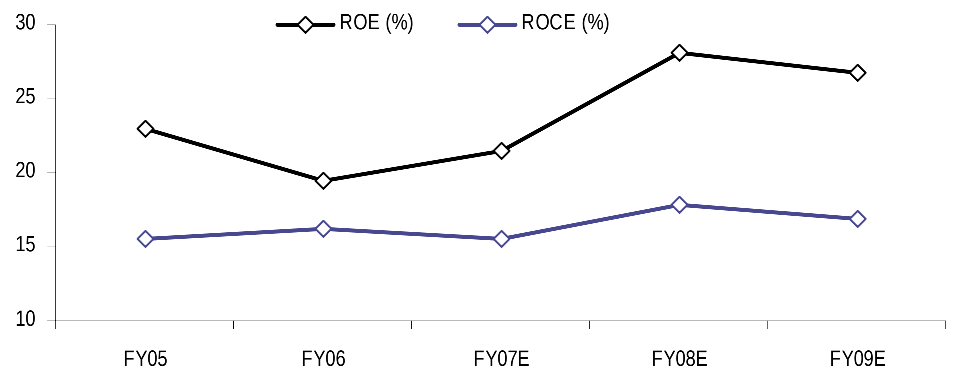


Source: Company, Man Financial Research Estimates

RoE to improve, post-tax ROCE to remain strong

We estimate return ratios of the company to remain healthy, going ahead. While RoE would improve from 19.5% in FY06 to 26.7% in FY09E, we expect the post-tax ROCE to remain healthy at around 17%. We have assumed a lower capacity utilization for the ring rolling line, which, to an extent, has impacted the return ratios.

Return ratios



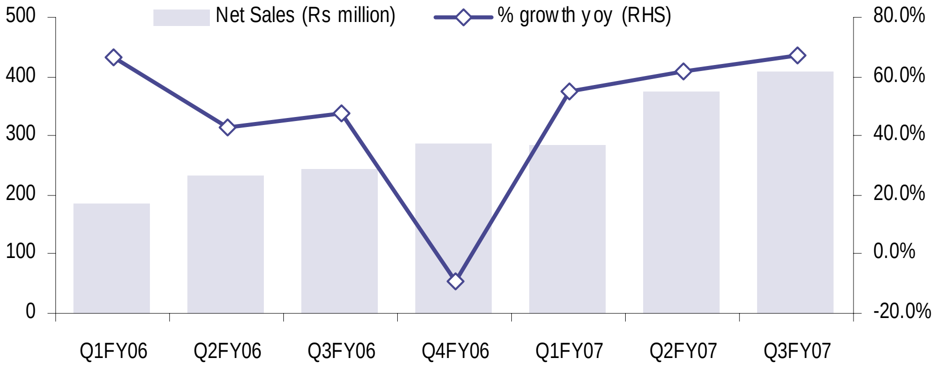
Source: Company, Man Financial Research Estimates

QUARTERLY RESULTS ANALYSIS

Revenue growth momentum continues

R.K. Forgings has been delivering consistent growth for the last several quarters, which indicates increasing business in the domestic and export markets. The growth in revenue for 3QFY07 at 67.1% YoY was driven by strong demand in the automotive business, mainly from its largest customer, Tata Motors. Revenue for 9MFY07 was up by 61.7% YoY at Rs 1.07 billion.

Quarterly revenue movement

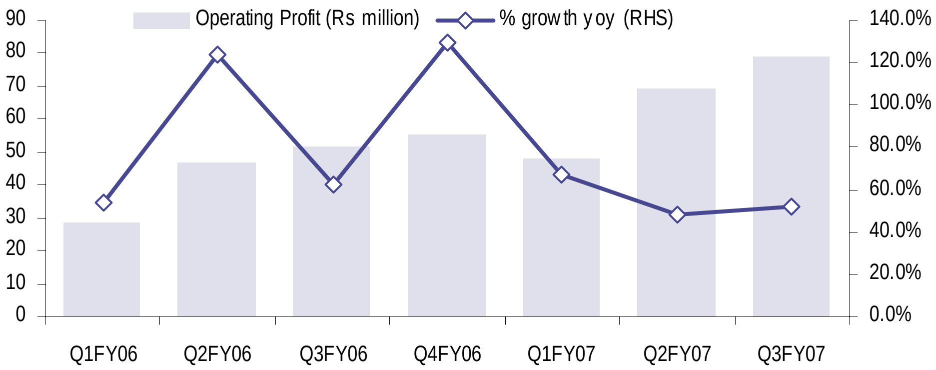


Source: Company, Man Financial Research Estimates

Higher value addition drives operating profit

Value addition through machining has helped the company to report strong OPMs; even if the pressure on account of higher input cost continues to remain. Operating margin for 3QFY07 and 9MFY07 stood at 19.4% and 18.4%, respectively, while the operating profit for the respective periods grew by 52.4% and 54.3%.

Quarterly Operating Profit movement



Source: Company, Man Financial Research Estimates

Earnings growth is strong

Higher top-line and strong margins have helped the company to record healthy bottom-line growth. Net profit for 3QFY07 and 9MFY07 grew by 60.5% and 68.7%, respectively. EPS for 3QFY07 and 9MFY07 was at Rs 2.6 and Rs 6.7, respectively.

FINANCIALS

Income Statement

Y/E Mar, Rs mn	FY2005	FY2006	FY2007E	FY2008E	FY2009E
Net sales	753	946	1,482	2,276	2,596
Growth (%)	*142.1*	*25.7*	*56.6*	*53.6*	*14.1*
Total income	753	946	1,482	2,276	2,596
Operating expenses	657	764	1,205	1,807	2,043
EBITDA	95	182	277	469	553
Growth (%)	*149.1*	*90.4*	*52.5*	*69.2*	*18.1*
Margin (%)	*12.7*	*19.2*	*18.7*	*20.6*	*21.3*
Depreciation	17	30	39	70	90
EBIT	78	152	238	398	463
Growth (%)	*211.1*	*94.3*	*56.8*	*67.5*	*16.4*
Margin	*10.4*	*16.0*	*16.0*	*17.5*	*17.9*
Interest paid	13	31	39	65	67
Net interest	13	31	39	65	67
Non-recurring items	7	10	10	11	12
Pre-tax profit	72	130	209	344	409
Tax provided	27	45	67	114	131
Profit after tax	45	85	142	231	278
Net profit	45	85	142	231	278
Man net profit	45	85	142	231	278
Growth (%)	*278.9*	*88.9*	*66.8*	*62.4*	*20.6*
Unadj. shares (m)	13	15	15	15	15
Wtd avg shares (m)	13	15	15	15	15

Cash Flow

Y/E Mar, Rs mn	FY2005	FY2006	FY2007E	FY2008E	FY2009E
PBT	72	130	209	344	409
Depreciation, amortisation	17	30	39	70	90
Chg in working capital	-17	-48	-141	-13	-13
Total taxes paid	-15	-32	-50	-83	-110
Other operating activities	3	0	0	0	0
Cash flow from operating activities (a)	61	81	57	319	375
Capital expenditure	-197	-173	-248	-650	-50
Chg in investments	0	-130	0	130	0
Chg in marketable securities	0	0	0	0	0
Other investing activities	3	0	0	0	0
Cash flow from investing activities (b)	-194	-303	-248	-520	-50
Free cash flow	-133	-223	-191	-201	325
Equity raised/(repaid)	113	242	-1	0	0
Debt raised/(repaid)	34	67	241	120	-120
Dividend (incl tax)	-13	0	-20	-30	-38
Other financial activities	3	0	0	0	0
Cash flow from financing activities (c)	137	309	220	90	-158
Net chg in cash (a)+(b)+c	4	86	29	-111	167

Balance Sheet

As at 31st Mar, Rs mn	FY2005	FY2006	FY2007E	FY2008E	FY2009E
Cash & bank	18	104	132	21	188
Debtors	209	204	365	508	559
Inventory	180	287	414	500	500
Loans & advances	44	60	126	230	335
Total current assets	450	654	1,037	1,259	1,583
Investments	0	130	130	0	0
Gross fixed assets	354	487	800	1,470	1,520
Less: Depreciation	36	65	104	174	264
Add: Capital WIP	47	85	20	0	0
Net fixed assets	364	508	716	1,296	1,256
Non-current assets	364	638	846	1,296	1,256
Total assets	815	1,292	1,883	2,555	2,839
Current liabilities	348	424	498	592	438
Provisions	14	11	81	194	343
Total current liabilities	362	435	579	786	781
Non-current liabilities	179	256	583	847	896
Total liabilities	541	691	1,162	1,633	1,677
Paid-up capital	128	153	152	152	152
Reserves & surplus	145	447	569	770	1,010
Shareholders' equity	273	601	721	922	1,162
Total equity & liabilities	815	1,292	1,883	2,555	2,839

Per-share data

	FY2005	FY2006	FY2007E	FY2008E	FY2009E
MAN EPS (INR)	3.5	5.6	9.3	15.2	18.3
Growth (%)	*97.3*	*58.7*	*66.8*	*62.4*	*20.6*
Book NAV/share (INR)	21.4	39.5	47.5	60.6	76.4
FDEPS (INR)	3.5	5.6	9.3	15.2	18.3
CEPS (INR)	4.9	7.6	11.9	19.8	24.2
CFPS (INR)	-6.8	1.4	0.5	15.0	29.1
DPS (INR)	1.0	0.0	1.3	2.0	2.5

Financial structure

	FY2005	FY2006	FY2007E	FY2008E	FY2009E
Operating cash flow/Total debt (x)	0.2	0.2	0.1	0.3	0.5
Total debt/Equity (x)	1.3	0.8	1.0	1.0	0.6
Net debt/Equity (x)	1.2	0.6	0.8	1.0	0.5

Profitability, Productivity, Liquidity and Valuation Ratios

	FY2005	FY2006	FY2007E	FY2008E	FY2009E
Return on assets (%)	9.0	10.1	10.6	12.4	12.0
Return on equity (%)	23.0	19.5	21.5	28.1	26.7
Return on Invested capital (%)	10.4	13.0	14.6	15.4	14.7
RoIC/Cost of capital (x)	1.0	1.2	1.4	1.4	1.3
RoIC - Cost of capital (%)	0.4	2.5	4.2	4.6	3.4
Return on capital employed (%)	15.5	16.2	15.6	17.9	16.9
Cost of capital (%)	10.0	10.5	10.3	10.9	11.3
RoCE - Cost of capital (%)	5.5	5.7	5.2	7.0	5.6
Asset turnover (x)	1.6	1.2	1.3	1.3	1.2
Sales/Total assets (x)	1.3	0.9	0.9	1.0	1.0
Sales/Net FA (x)	2.7	2.2	2.4	2.3	2.0
Working capital/Sales (x)	0.1	0.1	0.2	0.2	0.2
Fixed capital/Sales (x)	0.0	0.0	0.0	0.0	0.0
Receivable days	101.5	78.5	89.9	81.5	78.6
Inventory days	87.3	110.7	102.0	80.2	70.4
Payable days	86.7	85.5	85.8	82.8	86.7
Current ratio (x)	1.2	1.5	1.8	1.6	2.0
Quick ratio (x)	0.7	0.8	1.1	1.0	1.4
Interest cover (x)	6.2	4.9	6.1	6.1	6.9
Dividend cover (x)	3.5		7.2	7.6	7.3
PER (x)	34.9	22.0	13.2	8.1	6.7
PEG (x) - y-o-y growth			0.3		
PCE (x)	25.2	16.3	10.3	6.2	5.1
PCF (x)	n/a	90	261.5	8.2	4.2
Price/Book (x)	5.8	3.1	2.6	2.0	1.6
Yield (%)	0.8	0.0	1.1	1.6	2.0
EV/Net sales (x)	2.9	2.5	1.8	1.2	1.0
EV/EBITDA (x)	23.2	12.8	9.4	6.0	4.7
EV/EBIT (x)	28.4	15.4	11.0	7.1	5.6
EV/NOPLAT (x)	45.4	23.6	16.2	10.5	8.3
EV/CE	4.9	2.7	2.0	1.6	1.3
EV/IC (x)	4.7	3.1	2.4	1.6	1.2

Source: Company, Man Financial Research Estimates

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