

## McNally Bharat Engineering

### Performance Highlights

Parameter (Rs cr)	1QFY11	1QFY10	% yoy	Angel Est	% diff
Sales	284	253	12	379	(25)
EBITDA	16	17	(9)	30	(49)
EBITDA margin (%)	5.5	6.8		8.0	
PAT	6	5	16	11	(46)

Source: Company, Angel Research

McNally Bharat Engineering (MBE) posted disappointing set of numbers for 1QFY2011, and well below our estimates. MBE has robust order book of Rs4,803cr (2.4x FY2010E consolidated revenues) led by the power sector, which lends high revenue visibility. **We maintain our Buy recommendation on the stock.**

**Muted sales growth impacts PAT:** For 1QFY2011, MBE posted muted yoy sales growth of 12%, while EBITDA margin came in lower at 5.5% (6.8%) due to which EBITDA de-grew by 9%. PAT registered 16% yoy growth to Rs6cr. MBE's subsidiary, McNally Sayaji (MSE), also posted disappointing performance for the quarter clocking yoy sales growth of mere 17%, while EBITDA margin contracted by 700bp to 13.9%. PAT declined by a substantial 64% to Rs1cr

**Outlook and Valuation:** We have revised our estimates downwards to factor in the poor 1QFY2011 performance posted by the company and its subsidiaries. We have pruned our EBITDA margin estimates. We believe that an improving economic scenario (indicated by revival in the IIP), the continuous government focus on infrastructure spend and a pick-up in private capex augurs well for the companies providing EPC solutions for the core sectors of the economy. Hence, over FY2010-12E, we estimate the company to register a CAGR of 28% and 24% in sales and profit, respectively. Moreover, at Rs283, the stock is available at attractive valuations of 10x FY2012E earnings and 5x FY2012E EV/EBITDA. Hence, we maintain a Buy on the stock, with a revised Target Price of Rs406 (Rs486).

### Key Financials (Consolidated)

Y/E March (Rs cr)	FY2009	FY2010E	FY2011E	FY2012E
<b>Net Sales</b>	<b>1,115</b>	<b>2,019</b>	<b>2,501</b>	<b>3,332</b>
% chg	101.0	81.1	23.9	33.2
<b>Adj Profit</b>	<b>39.7</b>	<b>65.0</b>	<b>74.1</b>	<b>99.2</b>
% chg	91.1	63.9	14.0	33.9
EBITDA (%)	9.8	7.9	8.5	8.7
<b>FDEPS (Rs)</b>	<b>12.8</b>	<b>20.9</b>	<b>21.7</b>	<b>29.0</b>
P/E (x)	22.2	13.5	13.1	9.8
P/BV (x)	4.2	3.3	2.6	2.1
RoE (%)	21.7	27.2	22.9	23.4
RoCE (%)	29.4	27.0	27.2	28.1
EV/Sales (x)	0.9	0.5	0.5	0.4
EV/EBITDA (x)	9.7	7.0	5.9	4.8

Source: Company, Angel Research

## BUY

CMP	Rs283
Target Price	Rs406

Investment Period	Months
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### Stock Info

Sector	Capital Goods
Market Cap (Rs cr)	881
Beta	1
52 Week High / Low	385/156
Avg. Daily Volume	52089
Face Value (Rs)	10
BSE Sensex	18,402
Nifty	5,531
Reuters Code	MCNL.BO
Bloomberg Code	MCNA@IN

### Shareholding Pattern (%)

Promoters	30.6
MF / Banks / Indian Fls	22.3
FII / NRIs / OCBs	19.3
Indian Public / Others	27.8

Abs. (%)	3m	1yr	3yr
Sensex	11.4	22.6	27.5
McNally	(5.0)	74.4	63.7

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**Exhibit 1: 1QFY2011 performance (standalone)**

Y/E March (Rs cr)	1QFY11	1QFY10*	% chg	FY2010*	FY2009	% chg
<b>Total Revenue</b>	<b>284</b>	<b>253</b>	12.2	<b>1448</b>	<b>968</b>	49.6
Total RM	209	205		833	612	36.1
as % of sales	74	81		58	63	
<b>Gross Profit</b>	<b>75</b>	<b>48</b>	57.0	<b>615</b>	<b>356</b>	
Gross margin (%)	26	19		42	37	
Staff cost	25	14	70.2	71	44	62.3
as % of sales	9	6		5	5	
Other Expenses	35	16	115.5	445	254	75.4
as % of sales	12	6		31	26	
Total Exp	268	236	13.7	1349	910	48.3
as % of sales	95	93		93	94	
<b>EBITDA</b>	<b>16</b>	<b>17</b>	(8.9)	<b>99</b>	<b>58</b>	<b>70.4</b>
<b>EBITDA margin (%)</b>	<b>5.5</b>	<b>6.8</b>		<b>6.8</b>	<b>6.0</b>	
Depreciation	2	1	24.3	5	2	98.8
EBIT	14	16		94	134	
EBIT %	4.9	6.2		6.5	7.6	
Other Income	1	0		3	6	(46.8)
Interest	6	8	(24.2)	34	33	3.7
PBT	<b>9</b>	<b>8</b>	15.7	<b>63</b>	<b>28</b>	123.3
Extra-ord Items	<b>0</b>	<b>0</b>		<b>4</b>	<b>(23)</b>	
PBT	<b>9</b>	<b>8</b>		<b>59</b>	<b>51</b>	
Total tax	3	3	15.3	20	17	14.9
Tax rate	34	34		32	62	
<b>PAT</b>	<b>6</b>	<b>5</b>	15.8	<b>39</b>	<b>34</b>	14.3
<b>PAT (%)</b>	<b>2.2</b>	<b>2.1</b>		<b>2.7</b>	<b>3.5</b>	
Adj PAT	<b>9</b>	<b>8</b>	15.7	<b>43</b>	<b>19</b>	123.3
Adj PAT (%)	<b>3</b>	<b>3</b>		<b>3</b>	<b>2</b>	
Equity	31	31		31	31	
EPS (Rs)	2.0	1.7	15.8	12.5	10.9	14.3
Adj EPS (Rs)	3.0	2.6	15.7	13.8	6.2	123.3

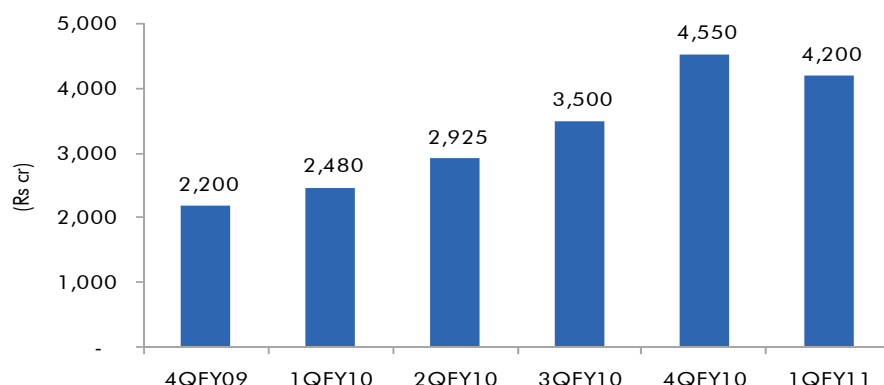
Source: Company, Angel Research. \*Note: numbers adjusted for transfer of product division to subsidiary

**Muted sales growth:** MBE's standalone revenues grew by a mere 12% for the quarter to Rs284cr. Subsidiary MSE (adj for transfer of MBE's product division) posted yoy sales growth of mere 17% to Rs52cr. However, we expect its business prospects to recover during the rest of the year and the company's order booking to pick up in 2QFY2011.

**Strong order inflow continues**

MBE's (standalone) order inflow has increased from Rs2,200cr in 4QFY2009 to Rs4,200cr in 1QFY2011(3x FY2010 standalone revenues), registering a yoy growth of 69%. On a consolidated basis, we estimate the company's order book to be Rs4,803 at the end of 1QFY2011 (2.4x FY2010E consolidated revenues). Currently, the company has also bid for orders worth Rs3,200cr.

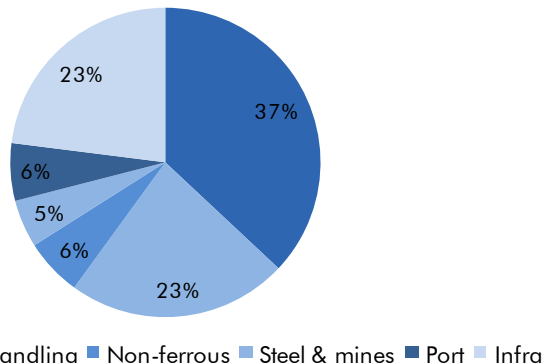
**Exhibit 2: Quarterly order book trend**



Source: Company, Angel Research

On a yearly basis, the company’s order inflow has been on the rise having increased from Rs406cr in FY2005 to Rs3,835cr in FY2010, posting a CAGR of 57% over the mentioned period. The company ended FY2010 with an order book of Rs4,550cr; on a consolidated basis we peg the company’s order book at Rs5,150cr.

**Exhibit 3: SBU-wise break-up of order book (Standalone)**



Source: Company, Angel Research

**Subsidiaries post subdued performance**

McNally Sayaji (MSE), which is a key contributor to the company’s overall profit, also posted lacklustre numbers for the quarter. Total sales grew by a mere 17% to Rs52cr due to lower volume growth, while EBITDA margin declined by 700bp to 14% on account of higher contribution from low-margin business. Lower EBITDA margin resulted in PAT falling 64% to Rs1cr. It has an order book of Rs248cr (0.8x FY2010E revenues), which grew 13% qoq over 4QFY2010 (Rs220cr).

**Exhibit 4: McNally Sayaji - 1QFY11 performance**

Parameter (Rs cr)	1QFY10	1QFY11	% yoy
Sales	44	52	17
EBITDA	9	7	(23)
EBITDA margin (%)	21	14	
PAT	4	1	(64)

Source: Company, Angel Research

The CMT unit posted total income of Rs76cr with EBITDA margin of 4% and PAT of Rs2cr for 1QFY2011. The unit had an order book of Rs355cr at the end of quarter, up 42% than the 4QFY2010 order book position of Rs250cr.

## Investment Arguments

**Opportunities abound:** Total upcoming opportunity for MBE is expected to be in the region of Rs51,600cr over FY2010-15E. Over the long term, the port and steel sectors are likely to witness highest cumulative opportunity to the tune of Rs22,200cr. The power and mining sectors are expected to be the key growth drivers for the company in the near term. Pertinently, the government's focus on the power sector, "Power for all by 2012", indicates the substantial Rs8,800cr potential opportunity that the sector is likely to offer. The mining industry also has similar opportunities coming up in the near future.

**Strong order book:** MBE registered CAGR of 57% in order inflow during FY2005-10E, increasing from Rs406cr to Rs3,835cr. It may be noted here that even during the global meltdown in FY2009, the company registered substantial growth of 101% in sales on account of being present in diverse sectors. Overall, order inflow has been robust on improving economic environment, higher government investments and private capex in basic infrastructure and the power segment. MBE's current consolidated order book (end of 1QFY2011) stands at Rs4,803cr or 2.4x FY2010 consolidated revenues, which provides high revenue visibility.

**Rich experience in both turnkey solutions and products:** MBE has rich experience of over 49 years in EPC activities including designing and developing Balance of Plants (BoPs), and supplying and installing material handling equipment for the core sectors. MBE provides turnkey solutions in the areas of power, steel, aluminium, material handling and mineral beneficiation. Thus, MBE's strong skill-set developed over a period of time places it in an advantageous position to capitalise on the vast upcoming opportunities with industrial capex set to increase going ahead. Apart from having rich experience in executing different types of EPC contracts, MBE has a wide-ranging product and technology portfolio on the back of which it is able to offer complete solutions to its clients. For instance, subsidiary, McNally Sayaji Engineering (MSE) manufactures a wide range of products that MBE requires for its projects. MBE through its subsidiaries and strategic tie-ups has access to various technologies required for BoP, which strengthens its portfolio and helps in bagging orders. Subsidiaries, EMW (Hungary) and Humboldt Wedage (Germany), hold innovator technology in ash handling and mineral processing.

## Outlook and Valuation

We believe that an improving economic scenario (indicated by a revival in the IIP), the continuous government focus on infrastructure spend and pick-up in private capex augurs well for the companies providing EPC solutions to the core sectors of the economy. The overall emerging opportunities for MBE are expected to be around Rs51,600cr over FY2010-15E. Over the longer term, the port and steel sectors are likely to offer the highest opportunity of Rs22,200cr, while the power and mining sectors are likely to be the key growth drivers in the near term. The government's strong focus on the power sector, through "Power for all by 2012", is expected to result in an expansion of generation capacity in the sector, leading to higher opportunities for the BoP players.

We believe that MBE is well placed to seize the upcoming opportunities in the above-mentioned sectors, due to the following reasons: 1) Vast experience in the

different EPC segments across sectors, 2) Presence in the high-margin product segment through its subsidiary, McNally Sayaji, and 3) Access to key global technology for ash handling and mineral beneficiation.

We have revised our estimates downwards to factor in the poor 1QFY2011 performance posted by the company and its subsidiaries. We have reduced our EBITDA margin estimates.

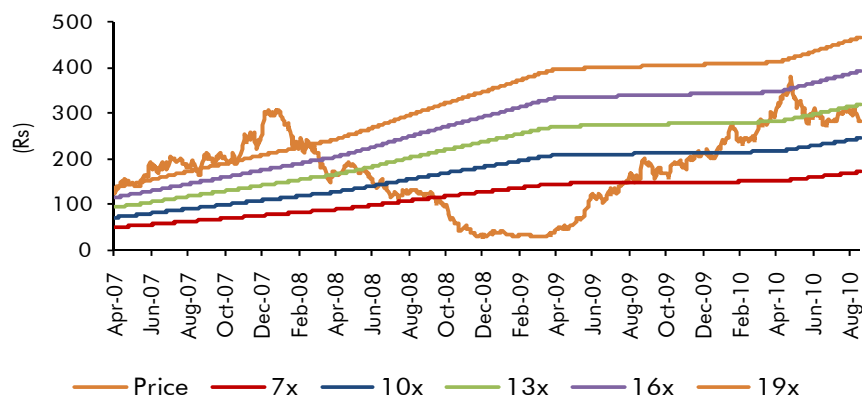
#### Exhibit 5: Change in estimates

Rs cr	Old		New		% chg	
	FY2011E	FY2012E	FY2011E	FY2012E	FY2011E	FY2012E
Sales	2,501	3,332	2,501	3,332	-	-
EBITDA	241	318	211	288	(12.4)	(9.4)
EBITDA margin (%)	9.7	9.6	8.5	8.7		
Adj PAT	94	119	74	99	(20.8)	(16.4)
EPS (Rs)	27.4	34.7	21.7	29.0	(20.8)	(16.4)

Source: Company, Angel Research

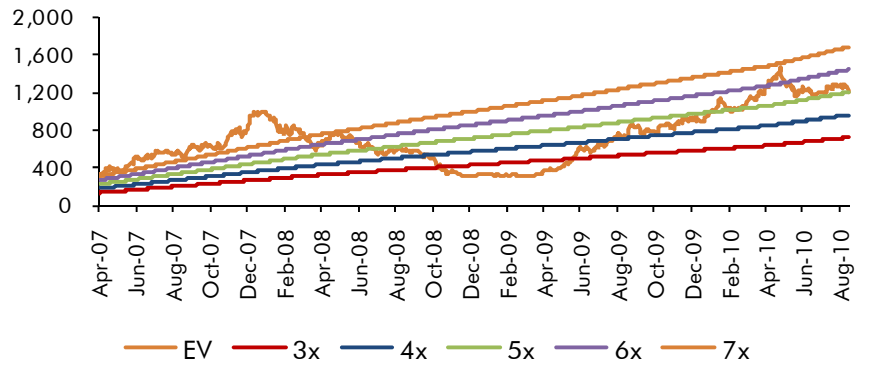
Going ahead, over FY2010-12E, we estimate the company to register a CAGR of 28% and 24% in sales and profit, respectively. At Rs283, the stock is available at attractive valuations of 10x FY2012E earnings and 5x FY2012E EV/EBITDA. **We maintain a Buy on the stock, with a revised Target Price of Rs406 (Rs486).**

#### Exhibit 6: One-year forward rolling P/E band



Source: C-line, Angel Research

**Exhibit 7: One-year forward EV/EBITDA band**



Source: C-line, Angel Research

**Profit & Loss Statement**

Y/E March (Rs cr)	FY07	FY08	FY09	FY10E	FY11E	FY12E
Gross sales	517	565	1,130	2,051	2,542	3,390
Less: Excise duty	13	13	23	40	50	66
<b>Net Sales</b>	<b>504</b>	<b>552</b>	<b>1,107</b>	<b>2,011</b>	<b>2,493</b>	<b>3,323</b>
Other operating income	2	2	8	8	8	8
<b>Total operating income</b>	<b>506</b>	<b>555</b>	<b>1,115</b>	<b>2,019</b>	<b>2,501</b>	<b>3,332</b>
% chg	49.9	9.6	101.0	81.1	23.9	33.2
Total Expenditure	475	510	1,007	1,860	2,289	3,044
Net Raw Materials	309	305	654	1,191	1,476	1,966
Other Mfg costs	31	43	70	121	150	200
Personnel	28	42	78	162	200	267
Other	14	24	25	61	75	97
<b>EBITDA</b>	<b>31</b>	<b>45</b>	<b>108</b>	<b>159</b>	<b>211</b>	<b>288</b>
% chg	64.6	45.1	141.5	47.0	33.1	36.2
(% of Net Sales)	6.1	8.1	9.8	7.9	8.5	8.7
Depreciation & Amortisation	2	2	10	15	19	24
<b>EBIT</b>	<b>29</b>	<b>42</b>	<b>99</b>	<b>144</b>	<b>192</b>	<b>263</b>
% chg	85.2	46.1	132.3	46.1	33.5	37.1
(% of Net Sales)	5.8	7.7	8.9	7.2	7.7	7.9
Interest & other Charges	12	13	39	42	76	109
Other Income	7	2	3	6	8	12
(% of PBT)	28.4	7.0	4.2	5.6	6.8	7.1
<b>Recurring PBT</b>	<b>24</b>	<b>31</b>	<b>62</b>	<b>108</b>	<b>124</b>	<b>166</b>
% chg	213.5	33.0	97.1	73.5	15.4	34.0
Extraordinary Expense/(Inc.)	(4)	1	20	4	-	-
<b>PBT (reported)</b>	<b>19</b>	<b>32</b>	<b>82</b>	<b>112</b>	<b>124</b>	<b>166</b>
Tax	3	10	29	36	42	56
(% of PBT)	10.9	31.8	46.4	33.7	34.0	33.9
<b>PAT (reported)</b>	<b>17</b>	<b>22</b>	<b>53</b>	<b>75</b>	<b>82</b>	<b>110</b>
Add: Share of earnings of associate	-	-	-	-	-	-
Less: Minority interest (MI)	0	0	5	6	7	7
Prior period items	-	-	4	-	-	-
<b>PAT after MI (reported)</b>	<b>17</b>	<b>22</b>	<b>48</b>	<b>69</b>	<b>75</b>	<b>103</b>
<b>ADJ. PAT</b>	<b>16</b>	<b>21</b>	<b>40</b>	<b>65</b>	<b>74</b>	<b>99</b>
% chg	213.6	33.0	91.1	63.9	14.0	33.9
(% of Net Sales)	3.1	3.8	3.6	3.2	3.0	3.0
<b>Basic EPS (Rs)</b>	<b>5.8</b>	<b>7.2</b>	<b>12.8</b>	<b>20.9</b>	<b>23.8</b>	<b>31.9</b>
<b>Fully Diluted EPS (Rs)</b>	<b>5.8</b>	<b>7.2</b>	<b>12.8</b>	<b>20.9</b>	<b>21.7</b>	<b>29.0</b>
% chg	209.9	24.2	76.3	63.9	3.6	33.9



**Balance Sheet**

Y/E March (Rs cr)	FY07	FY08	FY09	FY10E	FY11E	FY12E
<b>SOURCES OF FUNDS</b>						
Equity Share Capital	27	29	31	31	34	34
Preference Capital	-	-	-	-	-	-
Reserves & Surplus	70	129	177	239	345	435
<b>Shareholders Funds</b>	<b>96</b>	<b>158</b>	<b>208</b>	<b>270</b>	<b>379</b>	<b>469</b>
Minority Interest	0	0	12	18	25	32
Total Loans	117	63	214	316	379	568
Deferred Tax Liability	1	1	14	13	13	11
<b>Total Liabilities</b>	<b>214</b>	<b>222</b>	<b>448</b>	<b>617</b>	<b>795</b>	<b>1,081</b>
<b>APPLICATION OF FUNDS</b>						
Gross Block	78	99	201	271	381	476
Less: Acc. Depreciation	33	37	33	48	68	92
<b>Net Block</b>	<b>45</b>	<b>62</b>	<b>168</b>	<b>223</b>	<b>313</b>	<b>384</b>
Capital Work-in-Progress	11	19	11	11	11	11
Goodwill / Intangibles	0	0	58	58	58	58
<b>Investments</b>	<b>4</b>	<b>14</b>	<b>2</b>	<b>2</b>	<b>2</b>	<b>2</b>
<b>Current Assets</b>						
Cash	55	71	42	90	99	146
Loans & Advances	67	100	114	188	294	467
Other	281	400	771	1,009	1,418	1,838
Current liabilities	249	444	717	964	1,400	1,824
<b>Net Current Assets</b>	<b>153</b>	<b>127</b>	<b>209</b>	<b>324</b>	<b>411</b>	<b>626</b>
Others	-	-	-	-	-	-
<b>Total Assets</b>	<b>214</b>	<b>222</b>	<b>448</b>	<b>617</b>	<b>795</b>	<b>1,081</b>

**Cash flow statement**

Y/E March (Rs cr)	FY07	FY08	FY09	FY10E	FY11E	FY12E
Profit before tax	19	32	82	112	124	166
Depreciation	9	8	13	57	96	133
Change in Working Capital	(11)	37	(118)	(69)	(82)	(171)
Less: Other income	-	-	-	-	-	-
Direct taxes paid	(0)	(4)	(14)	(36)	(42)	(56)
<b>Cash Flow from Operations</b>	<b>17</b>	<b>73</b>	<b>(37)</b>	<b>63</b>	<b>96</b>	<b>72</b>
(Inc.)/ Dec. in Fixed Assets	(11)	(29)	(147)	(70)	(110)	(95)
(Inc.)/ Dec. in Investments	(0)	(8)	15	-	-	-
Inc./ (Dec.) in loans and advances	-	-	-	-	-	-
Other income	-	-	-	-	-	-
<b>Cash Flow from Investing</b>	<b>(11)</b>	<b>(37)</b>	<b>(133)</b>	<b>(70)</b>	<b>(110)</b>	<b>(95)</b>
Issue of Equity	5	19	-	-	44	-
Inc./ (Dec.) in loans	40	(27)	160	102	63	189
Dividend Paid (Incl. Tax)	(2)	(3)	(4)	(5)	(7)	(10)
Others	(9)	(9)	(18)	(42)	(76)	(109)
<b>Cash Flow from Financing</b>	<b>34</b>	<b>(21)</b>	<b>139</b>	<b>55</b>	<b>23</b>	<b>70</b>
Inc./ (Dec.) in Cash	40	15	(31)	48	9	47
<b>Opening Cash balances</b>	<b>16</b>	<b>56</b>	<b>73</b>	<b>42</b>	<b>90</b>	<b>99</b>
<b>Closing Cash balances</b>	<b>56</b>	<b>71</b>	<b>42</b>	<b>90</b>	<b>99</b>	<b>146</b>

**Key ratio**

Y/E March	FY07	FY08	FY09	FY10E	FY11E	FY12E
<b>Valuation Ratio (x)</b>						
P/E (on FDEPS)	48.6	39.2	22.2	13.5	13.1	9.8
P/CEPS	43.6	35.2	17.9	11.0	10.4	7.8
P/BV	7.9	5.1	4.2	3.3	2.6	2.1
Dividend yield (%)	0.4	0.4	0.4	0.7	0.9	1.1
EV/Sales	1.6	1.4	0.9	0.5	0.5	0.4
EV/EBITDA	26.5	17.7	9.7	7.0	5.9	4.8
EV / Total Assets	3.8	3.6	2.3	1.8	1.6	1.3
<b>Per Share Data (Rs)</b>						
EPS (Basic)	5.8	7.2	12.8	20.9	23.8	31.9
EPS (fully diluted)	5.8	7.2	12.8	20.9	21.7	29.0
Cash EPS	6.5	8.0	15.8	25.7	27.3	36.2
DPS	1.0	1.1	1.3	2.0	2.5	3.0
Book Value	36.0	55.1	66.8	86.8	110.7	137.3
<b>Dupont Analysis</b>						
EBIT margin	5.8	7.7	8.9	7.2	7.7	7.9
Tax retention ratio	89.1	68.2	53.6	66.3	66.0	66.1
Asset turnover (x)	3.4	3.8	4.1	4.3	4.1	4.1
ROIC (Post-tax)	17.4	19.8	19.6	20.6	20.9	21.4
Cost of Debt (Post Tax)	10.9	10.0	15.2	10.6	14.5	15.2
Leverage (x)	0.7	0.1	0.4	0.8	0.8	0.8
Operating ROE	21.8	21.2	21.4	28.9	25.8	26.6
<b>Returns (%)</b>						
ROCE (Pre-tax)	15.5	19.4	29.4	27.0	27.2	28.1
Angel ROIC (Pre-tax)	18.6	30.8	24.4	27.4	27.6	28.2
ROE	17.7	16.3	21.7	27.2	22.9	23.4
<b>Turnover ratios (x)</b>						
Asset Turnover (Gross Block)	6	6	7	9	8	8
Inventory / Sales (days)	11	15	17	25	24	25
Receivables (days)	164	210	176	210	205	205
Payables (days)	108	132	108	120	122	125
Working capital cycle (ex-cash) (days)	53	46	41	32	39	41
<b>Solvency ratios (x)</b>						
Net debt to equity	0.6	(0.1)	0.8	0.8	0.7	0.9
Net debt to EBITDA	1.9	(0.5)	1.6	1.4	1.3	1.5
Interest Coverage (EBIT / Interest)	2.7	4.2	2.7	3.4	2.5	2.4

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### Disclosure of Interest Statement

### McNally Bharat

1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	Yes
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

*Note: We have not considered any Exposure below Rs 1 lakh for Angel, its Group companies and Directors.*

<b>Ratings (Returns) :</b>	Buy (> 15%) Reduce (-5% to 15%)	Accumulate (5% to 15%) Sell (< -15%)	Neutral (-5 to 5%)
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