



## Railway Budget 2007-08

### Capex binge of Railways to continue

Railway minister Lalu Prasad Yadav continues to guide the Indian Railways (IR) on a profitable growth path. Announcing his fourth budget for the IR today, he indicated that the capital expenditure (capex) binge of IR would continue. In a move to boost IR's key revenue stream (ie freight), the minister also extended major concessions on the freight rate front. He also reduced the passenger fares in a bid to increase the passenger traffic. The other salient features of the Railway Budget 2007-08 are an impressive reduction in the operating cost of IR, significant policy shifts to turn around the loss-making businesses of the national carrier, continued freight rationalisation and an increase in the capex of IR to make the railways more competitive.

The major beneficiaries of these moves are likely to be Texmaco, Kalindee Rail Nirman Engineers (Kalindee Rail) and Stone India. A few days back, in our special note "Turnaround Express going strong", dated February 22, 2007, we had mentioned how we expected companies like Hind Rectifiers, Simplex Casting, Stone India and Texmaco to show a healthy growth in their earnings on the back of the growing capex of IR.

Besides these companies, oil refiners, cement, steel and iron ore companies would benefit from the railway budget

due to the reduction announced in the freight rates, though the impact on earnings is expected to be marginal.

The highlights of Railway Budget 2007-08 are as follows.

- ♦ *Freight rates unchanged:* There would be no increase in the freight rates; however, the freight on diesel and petrol has been brought down by 5%, while that on iron ore and limestone has been cut by 6%. Also, passenger fares will be cut across the board.
- ♦ *Announcement of some freight schemes:* The budget includes changes in certain freight schemes, namely Empty Flow Direction Freight Discount Scheme (a 30% discount vs a 20% for the incremental loading in the empty flow direction and a 40% discount on bagged consignments like cement, fertilisers and wheat), an incremental freight discount scheme for non-peak season (15% for all commodities except coal, coke and iron ore) and the announcement of a commodity-based freight policy (an exclusive package for cement to be announced on April 1).
- ♦ *Best ever operating ratio:* The operating ratio of IR is likely to be 78.7% for FY2006-07, which is the best ever for IR and one of the best in the world. This ratio helped IR to improve its cash surplus before dividends during the year, which stood at Rs20,000 crore.

### Preparing for the 11th Five-Year Plan

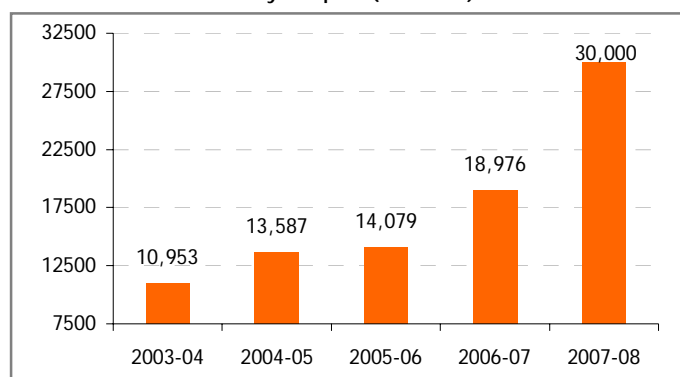
FY2008 will be the first year of the 11th Five-Year Plan. Hence the railway minister has also made some key announcements regarding IR's targets for the 11th Plan. We believe that these announcements would ensure that the Turnaround Express stays on track and continues to provide good business for railway vendors, besides handing out some obvious benefits to the industry and passengers. Some of these announcements are as follows.

- ♦ A target of 1,100MMT freight loading and 840 crore passengers has been set for the terminal year of the 11th Plan.
- ♦ Construction of eastern and western dedicated freight corridors at a cost of Rs30,000 crore will commence from 2007-08 for completion during the 11th Plan.

- ♦ The container traffic to be increased to 100MMT by 2011-12.
- ♦ Most of the metre-gauge lines will be converted into broad-gauge lines by the end of this five-year plan.
- ♦ High-speed passenger corridors to be constructed to run trains at a speed of more than 300 kilometre per hour.
- ♦ The production of rolling stock will be doubled compared with the previous plan. The production of high-horse power and energy efficient locos to be increased.
- ♦ Manifold increase in investment in information technology to increase IR's earnings, ensure effective utilisation of its human and physical resources, and facilitate long-term policy decisions.

- ♦ **Containerisation:** The minister announced his vision to increase the container traffic to 100 million metric tonne (MMT) by 2011-12. Plans have also been announced to introduce triple-stack container trains on diesel routes and double-stack container trains on electrified routes.
- ♦ **Total capex plan of Rs30,000 crore for FY2007-08:** The total capex of IR for FY2007-08 is expected to be Rs30,000 crore, which includes outlays of Rs1,610 crore for new lines, Rs2,404 crore for gauge conversion, Rs300 crore for electrification and Rs722 crore for metropolitan transport projects. The outlay for the safety related plan heads includes Rs3,360 crore for track renewal, Rs597 crore for bridge works, Rs1,597 crore for signal and telecom works, Rs551 crore for the construction of road over/under bridges and Rs500 crore for road safety. The balance is expected to be used to acquire rolling stocks and modernise railway lines.
- ♦ **Freight corridor work to start in 2007-08:** The construction of the eastern and western dedicated freight corridors will start in 2007-08. These will be completed during the 11th Five-Year Plan at a cost of about Rs30,000 crore. About 50% of the traffic moves on the Golden Quadrilateral in spite of just 16% of rail network, leading it to be congested. Hence the IR is considering the feasibility of constructing East-West, East-South, North-South and South-South corridors. The freight corridors will improve not only the efficiency of freight transport but also the speed of passenger trains on regular routes.

Growth in Indian Railways Capex (Rs crore)



Source: Railway Budget Documents

### Key beneficiaries

**Beneficiaries of the capex measures:** Texmaco, Hind Rectifiers, Stone India and Kalindee Rail.

We expect Texmaco, Kalindee Rail, Stone India and Hind Rectifiers to be the key beneficiaries of the increased capex announced for procuring rolling stock. In fact, the rail minister has announced that it plans to double the production of the rolling stock in the 11th Plan compared with the previous plan. Such measures will improve the revenue visibility of the above companies.

Amongst the companies that we had not mentioned in the special report, we believe that Kernex Micro will be a key beneficiary too. The railway minister announced that the testing of the anti-collision device (ACD; a product that Kernex Micro specialises in) will be complete by March 2007. Given the fact that 2007-08 is the last year for incurring expenses under the Special Railway Safety Fund, we expect the demand for ACDs to increase substantially in the next year.

**Beneficiaries of freight measures:** Oil refiners, cement and steel companies

- ♦ **Oil refiners:** Oil refiners like Hindustan Petroleum Corporation and Bharat Petroleum Corporation are the direct beneficiaries of the 5% reduction in the freight rates. There could be a marginally negative impact of this reduction on Indian Oil Corporation though, given that the company's pipeline tariffs are pegged to rail freight. The impact of the measures announced in the budget on the earnings of these companies will be marginal.
- ♦ **Cement companies:** The rail budget is positive for the cement pack due to the announcement of the following measures.
  - Freight rate for limestone cut by 6%—neutral, as most of the cement plants are located near limestone mines.
  - The empty flow direction freight discount on cement has been increased to 40%—neutral, as cement generally is not transported in open wagons as required by the announcement.
  - To better address the needs of the customers transporting major commodities by rail, the railway minister has proposed a new commodity-based tariff policy, which is likely to be announced by April 1 with an exclusive package for cement.
- ♦ **Steel and Iron ore companies:** Steel and iron ore companies would be the beneficiaries of the 6% cut in the iron ore freight cost.

Company Name	Supply	Price	TTM EPS	PER	Mcap to TTM Sales
Bharat Earth Movers	Rolling stock	1130.0	51.9	21.8	1.7
Hind Rectifiers	Equipment for rolling stock	800.0	77.9	10.3	1.3
Kalindee Rail	Construction	176.3	7.4	23.9	1.3
Stone India	Equipment for rolling stock	158.6	14.6	10.9	1.5
Texmaco	Rolling stock	930.0	24.1	38.6	2.3
Simplex Casting	Equipment for rolling stock	46.4	7.5	6.2	0.2

The author doesn't hold any investment in any of the companies mentioned in the article.

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