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Areva T&D

Outperformer

Rs 1,588

Sensex: 14,993

August 30, 2007

Mukul Jain

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Key Figures

(Rs m)

Y/e Dec	'05 (9m)	'06	'07E	'08E
Net Sales	8,695	13,514	18,651	26,180
EBITDA	635	1,668	2,891	4,136
PAT	363	991	1,720	2,466
PAT Gr. (%)	76.5	173.3	73.6	43.4
EPS (Rs)	9.1	24.8	43.1	61.8

Key Ratios

(%)

Y/e Dec	'05 (9m)	'06	'07E	'08E
EBITDA Mar.	7.3	12.3	15.5	15.8
RoCE	18.1	46.8	47.5	48.4
RoE	17.5	45.2	46.1	46.8

Valuations

(x)

Y/e Dec	'05 (9m)	'06	'07E	'08E
PER	174.7	63.9	36.8	25.7
EV / Sales	7.2	4.6	3.3	2.4
EV / EBITDA	98.3	37.3	21.5	15.0
MCap / Sales	7.3	4.7	3.4	2.4

Key Data

Bloomberg Code : ATD@IN
Reuters Code : ALST.BO

Shareholding Pattern (%)

Promoters : 66.7
Foreign : 2.2
Inst./non-Promoters : 16.8
Public & Others : 14.3

Price Relative to Sensex (%)

1 month : 5.4
3 months : 14.6
12 months : 110.0

Shares Outstanding : 40m
Market Cap : Rs 63,333m
\$1,541m

Average Volume
(3 months) : 49,952 shares

(Price as on August 29, 2007)

Power to grow...

We initiate coverage on Areva T&D with 'Outperformer' rating and a target price of Rs 1855 (30x CY08 earnings), implying a 17% upside potential. Areva T&D is the third largest transmission and distribution player globally with a significant presence in the Indian T&D space. We believe that Areva with its high-end technology systems would be in a position to garner major share of business as India progresses towards a high voltage grid. Also the company's strategy of bidding for high margin orders would help it to sustain its high return ratios.

For the period FY07 to FY09, we expect CAGR of 57.7% in net profit on the back of revenue CAGR of 24.7%. At the CMP of Rs 1,588, the stock is available at 36.8x and 25.7x CY07E and CY08E earnings of Rs 43.1 and Rs 61.8 respectively.

Highlights

- The Indian electricity grid is moving towards the next stage in its life cycle with the emergence of the national grid. PGCIL has been introducing higher voltage lines and plans to introduce lines higher than 765kV in a phased manner. Areva, with the technical backing of its parent would be one of the major beneficiaries.
- Areva currently has an order book of Rs 24.2bn, 1.8x its CY06 sales, providing visibility of earnings for next few years. The company has won the first ever 765 kV substation order. It is setting up a 765kV transformer manufacturing facility to garner business in the high voltage segment. We believe order inflow would continue to be strong and would outpace the revenue growth.

Stock price performance

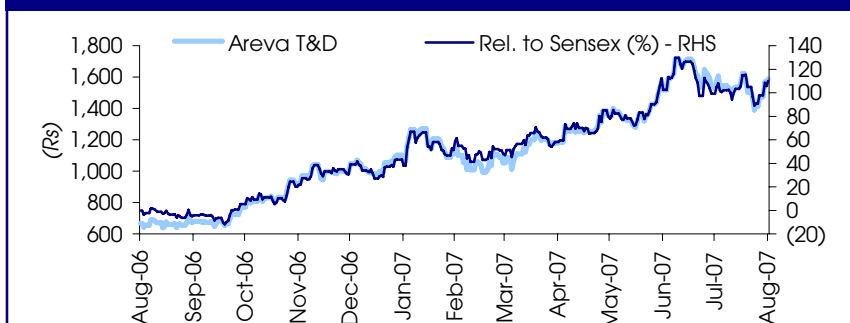


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Investment Highlights

Major beneficiary of grid expansion

The Indian electricity grid is moving towards the next stage in its life cycle with the emergence of the national grid. The government, as part of its ongoing efforts in power development, has given a lot of attention to the national grid. This grid is expected to almost triple from the existing 14,100 MW at the end of the Tenth Plan to 37,150 MW at the end of the 11th Plan. This should help the government transfer power from the coal rich locations in the eastern part of the country to high-demand industrialized areas in the west, north and south of the country.

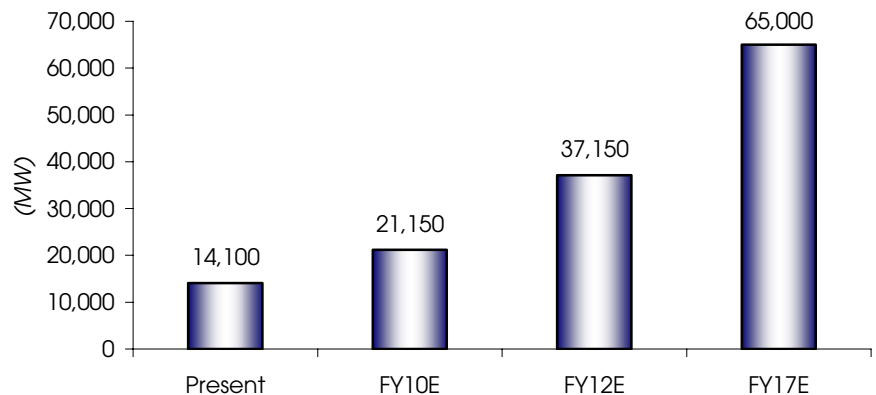
National grid capacity to increase 2.6x over FY07 - FY12

Table 1: T&D grid system in India

	Conceived In	Formed In
State Grid	1948	Mid 1950's
Regional Grid	1964	1970's
National Grid	1997	Under Construction

Source: Ministry of Power

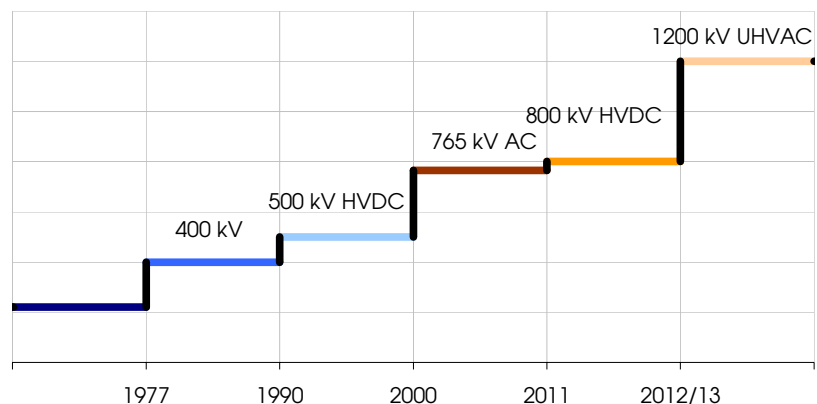
Chart 1: Grid Expansion



Source: PGCIL, PL Research

PGCIL gradually introducing high voltage lines

Chart 2: Expanding technology frontiers



Source: PGCIL, PL Research

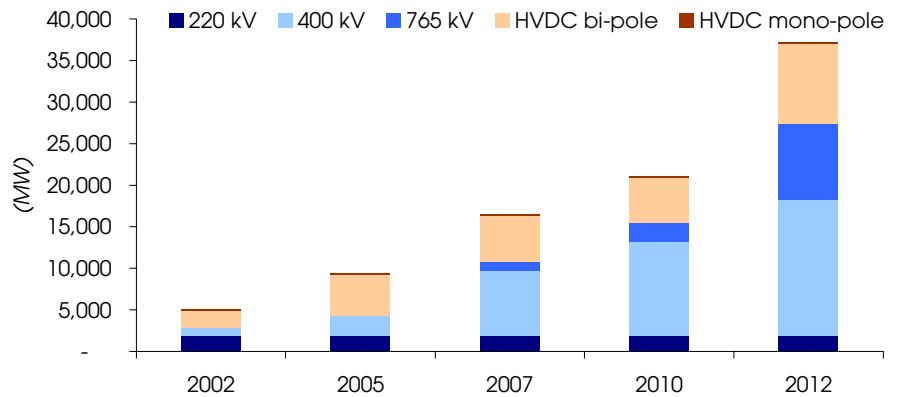
India moving towards higher end T&D systems

The proportion of higher voltage systems is expected to increase in an attempt to reduce T&D losses. With the expansion of the National grid, the government plans to increase the proportion of higher voltage lines. Areva currently has set up 2000MW HVDC lines in the country (20% market share) and would be one of the major beneficiaries of this expansion, as the company possesses technology to cater upto the highest range.

PGCIL has been introducing higher voltage lines and plans to gradually introduce lines higher than 765kV as well in a phased manner. Areva, with the technical backing of its parent would be one of the major beneficiaries. Infact Areva has supplied and commissioned the first 765kV substation in the country (NTPC Sipat power plant, project cost Euro 31.5m) in January 2007.

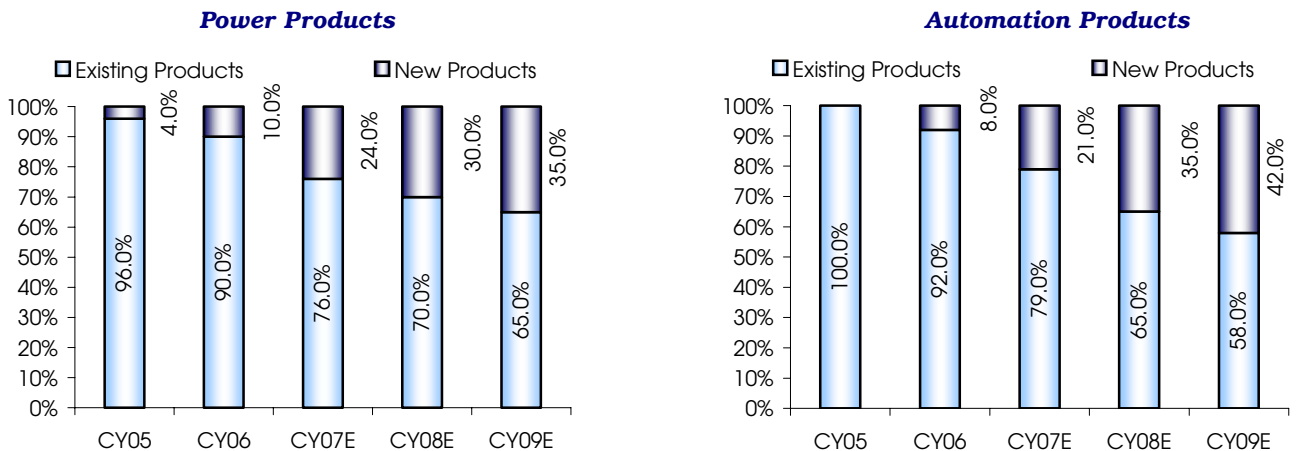
Areva possesses high end T&D systems

Chart 3: Higher proportion of higher end systems



Source: PGCIL, Ministry of Power, PL Research

Chart 4: Parent concentrating on developing new technologies



Source: Company Data, PL Research

New opportunities emerging from industrial space

Given the high capacity utilization in most sectors, industrial capex is a necessity for the Indian corporate sector. NCAER estimates that 96% of Indian companies are operating at near full capacity. We expect industrial capex to pick up significantly over the next 3-5 years.

Table 1: Industrial Capex over FY08-12

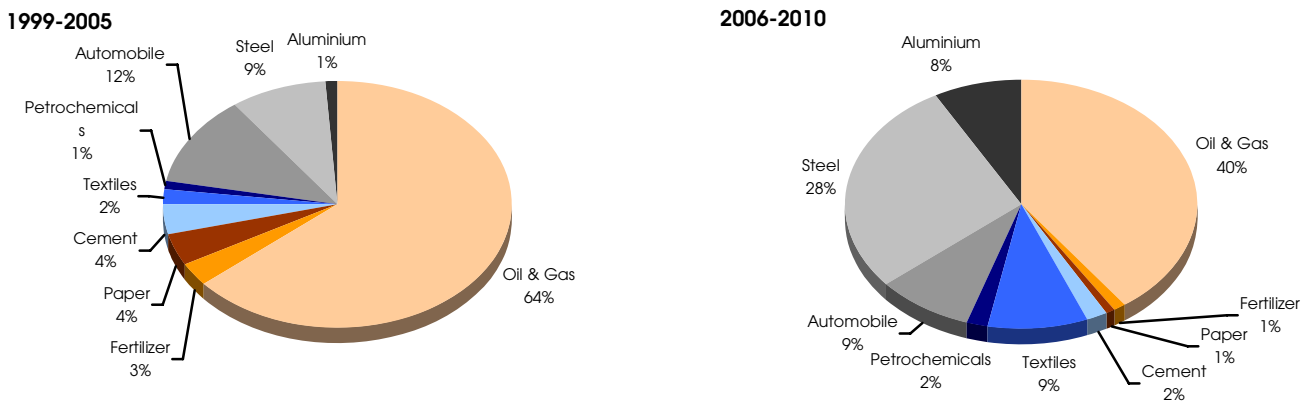
(Rs bn)

Industry	Investment
Steel	1,400
Oil & Gas	1,637
Aluminium	475
Cement	400
Auto	420
Telecom	1,271
Total	5,603

Source: CrisInfac, PL Research

The capex plans of corporates to expand capacities through Greenfield as well as brownfield expansions also opens up new demand drivers for the company's products. The main demand is flowing from metals, mining, process and oil & gas industry. Apart from electrical work, these projects also involve a lot of automation work, thereby offering significant business for Areva.

Chart 5: Capex mix



Source: CrisInfac

Timely capex to garner opportunities in the Indian T&D space

Areva plans to spend Rs 4bn for greenfield as well as brownfield expansion. It currently has 8 manufacturing facilities and is adding 3 more facilities at Baroda, Hosur and Chennai. Areva is setting up a new facility for 765kv transformers at Baroda at a cost of Rs 2bn, an instrumentation transformer plant and an R&D lab at Hosur and an HV switchgear facility at Chennai. The company is doubling its transformer manufacturing capacity to 18,000MVA by CY10 and also increasing its switchgear capacity by 60% during the same period. This timely capex should help the company to cater to the huge demand emerging from the infrastructure space.

**Order Book growth to continue**

Areva currently has an order book of Rs 24.2bn, 1.8x its CY06 sales, providing visibility of earnings for next few years. The company has won the first ever 765 kV substation order from NTPC, being the only fully integrated 765kV substation supplier in the country. It is also setting up a 765kV transformer manufacturing facility to garner business in the high voltage segment as and when orders are allocated for these. The company is expanding its current facilities as well as setting up new facilities to capture the opportunity in the Indian market.

Table 2: Recent Order Wins*(Rs m)*

Customer	Value	Scope of Work
Power Segment		
Madhya Pradesh Power Transmission Company	1,150	22X160MVA 220/132/33 kV Autotransformers 4X100MVA 220/33/33 kV winding transformers
NTPC (Dadri, Korba & Farakka)	800	400 kV substation package
GETCO	220	220 kV substation project with power transformers
Punjab State Electricity Board	220	11 kVA control panels project - 925 Nos
PGCIL	130	DMS SCADA scheme for Meghalaya
Industry Segment		
Essar Steel	630	Design to commissioning of 220kV, 18bays switchyard on turnkey basis 4 Nos - 160MVA, 220kV & 3 Nos - 90MVA, 220kV Power Transformers
NALCO	280	Control & Regulation system for smelter
Utkal Alumina	182	220kV switchyard with power transformers
Engineers India	130	11kV panels with numerical relays & automation (BRPL, IOCL & Nalco)
GIS		
NHPC (Subansiri Lower Hydro Plant)	1,323	18 Bays 400kV GIS & 8 Bays 145kV GIS
Bhartiya Nabhikiya Vidyut Nigam	685	500MW Fast Breeder Reactor Project
Maharashtra State Electricity Transmission Co.	339	1st GIS Order on complete turnkey basis

Key Risks

Alteration in government's plans

**Delay in government plans
might hamper growth
prospects**

Though the government has established ambitious targets for the power sector, however the real challenge for the government would be to commission the projects as per schedule. Also any change in government plans might hamper the future revenues.

The government has achieved only 56.7% out of its target for the Xth Plan. We believe that the achievement could be as high as 70% in the XIth plan considering that already orders have been placed for equipment worth 51,000MW and remaining is expected to be ordered by December 2007. With an increase in generation facilities, we expect T&D to pick up at the same pace, favoring companies such as Areva.

Table 3: Capacity Addition Targets & Achievement

Plan	Target (MW)	Actual (MW)	% Achievement
V th (74-79)	12,000	10,000	83.3
VI th (80-85)	20,000	14,000	70.0
VII th (85-90)	22,000	21,000	95.5
VIII th (92-97)	31,000	16,000	51.6
IX th (97-02)	40,000	19,000	47.5
X th (02-07)	41,000	23,250	56.7
XI th (07-12E)	78,000	54,600	70.0

Source: Ministry of Power, PL Research

Delay in Execution of Projects

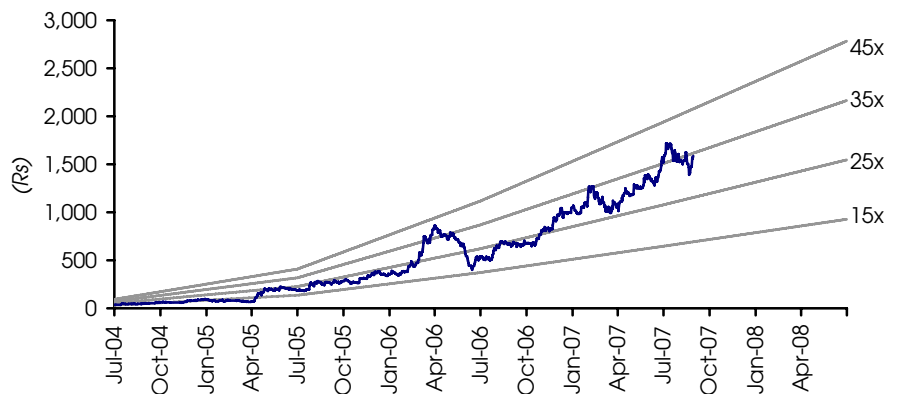
The company is undertaking huge expansion projects worth Rs 4bn. Any delays in execution of plans might hinder growth of the company and thus have a negative effect on the estimates.



Valuations

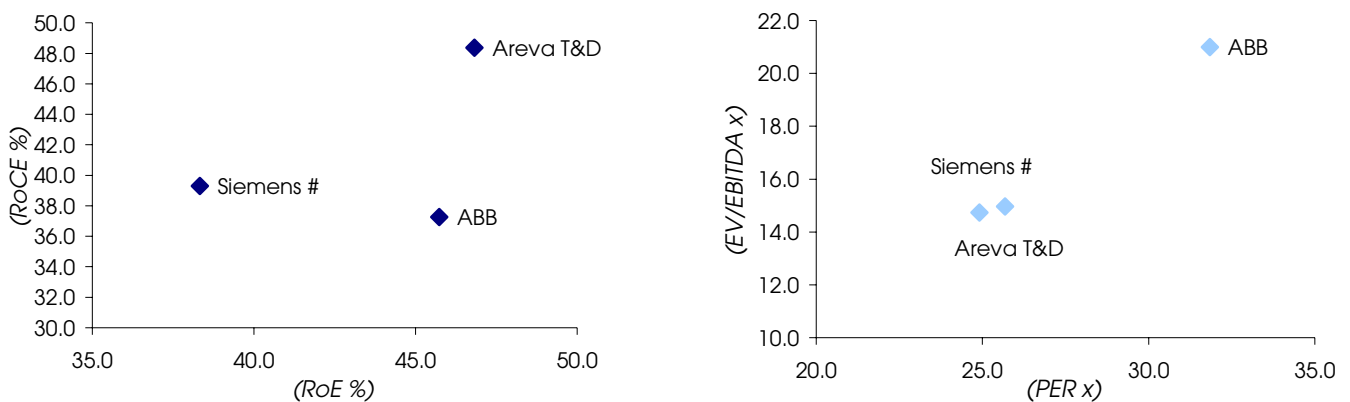
For the period FY07 to FY09, we expect CAGR of 57.7% in net profit on the back of revenue CAGR of 24.7%. At the CMP of Rs 1,588, the stock is available at 36.8x and 25.7x CY07E and CY08E earnings of Rs 43.1 and Rs 61.8 respectively. Areva enjoys attractive return ratios with RoE at 46.1% and RoCE at 47.5%. We believe with attractive ratios and high margins Areva should trade at a higher multiple than comparable. We initiate coverage on Areva T&D with an 'Outperformer' rating and a target price of Rs 1855 (30x CY08 earnings), implying an upside of 17% from current levels.

Chart 6: 1 Yr. Forward PE Band



Source: MetaStock, PL Research

Chart 7: Peer Comparison CY08

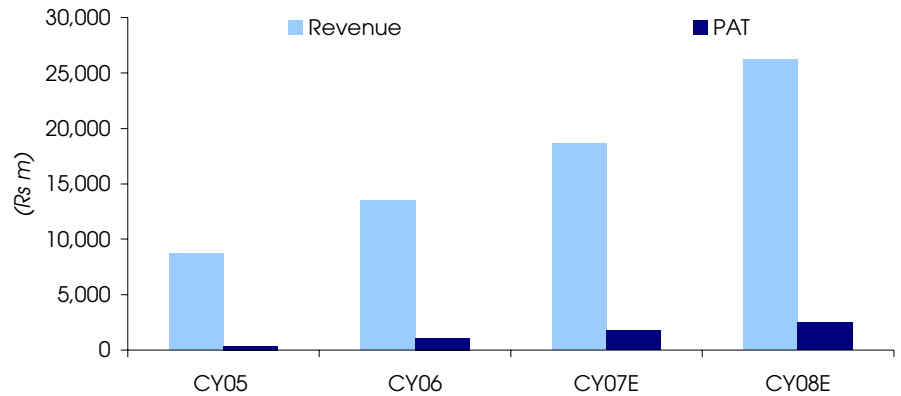


Source: Company Data, PL Research

Y/e Sept

Financial Overview

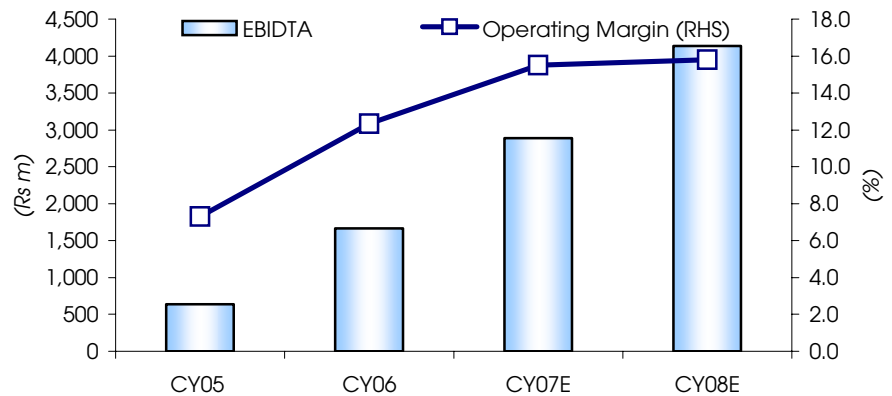
Chart 8: PAT to grow at a 57.7% CAGR on the back of 24% revenue CAGR



Source: Company Data, PL Research

High margins leading to higher return ratios

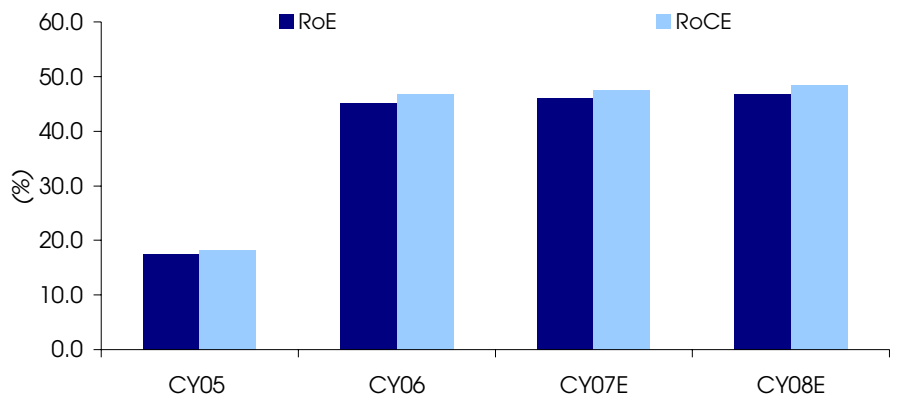
Chart 9: Operating leverage to continue to play...



Source: Company Data, PL Research

Areva has the best return ratios amongst peers

Chart 10: ...Driving return ratios upwards



Source: Company Data, PL Research

Company Background

Areva is globally the leader in nuclear technology and third largest in T&D business. The company possesses the highest end of technology for T&D systems. It supplies products, systems and services for electricity transmission and distribution. They are used to regulate, switch, transform and dispatch electric current in electric power networks connecting the power plant to the final user. Its customers are electric utilities as well as the oil, mining and metals, wind energy, paper and glass, transportation, and power engineering industries.

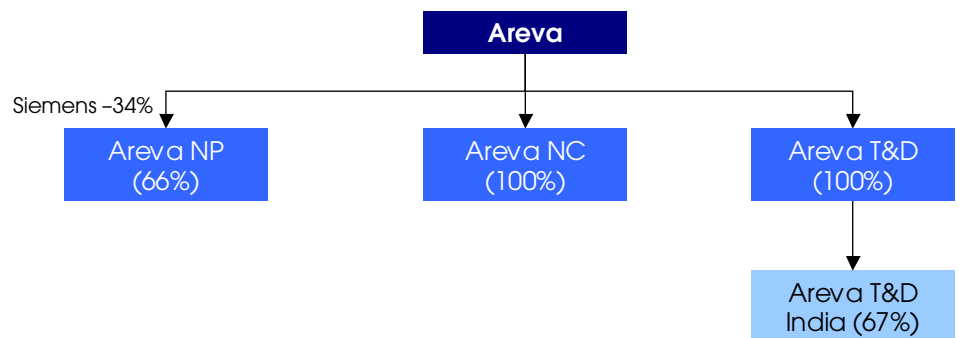
Areva in India has 8 manufacturing facilities with 3,300 people. The company is expanding capacity at these particular facilities along with setting up of three new plants. The company manufactures high voltage and low voltage equipment for transmission and distribution space.

Group Background

Areva, a French PSU, has manufacturing facilities in 41 countries and a sales network in more than 100 countries. It offers customers technological solutions for power generation and electricity transmission and distribution. It is the world leader in nuclear power and the third largest in the T&D space.

Parent inovating and looking to continuously introduce new products

Chart 11: Holding Structure



Source: Company Data, PL Research

Genesis

Areva T&D India, was earlier part of Alstom India until September 16, 2005. Alstom India's roots can be traced to The English Electric Company of India Limited, which was originally incorporated on March 13, 1957. In its early years it used to manufacture relays at Chennai and medium voltage switchgears at Kolkata. During this period GEC set up a manufacturing unit for transformers at Naini. In the early 90's GEC Alstom was formed and a new manufacturing unit for HV circuit breakers was set up at Chennai. Alstom was formed in 1998 and a manufacturing unit for vacuum interrupters was set up at Kolkata. Finally in the latter part of 2005, Areva T&D was formed as a result of Areva acquiring Alstom's global Transmission and Distribution (T&D) business.

In the latter part of CY06, Areva hived off its non T&D business to Alstom Energy for a consideration of Rs.414 m. The products in this segment included motors, drives, and industrial fans. Areva decided to hive off this relatively low margin business in order to focus exclusively on T&D. Over a period of time, Areva T&D has moved from doing rural electrification projects, due to low technology requirements to a portfolio of superior technology products, such as GIS, HVDC and high voltage transformers, thereby extracting higher margins from the business.

Financials

Income Statement

(Rs m)

Y/e Dec	9M CY05	CY06	CY07E	CY08E
Order Book inflow assumptions	-	-	24,000	33,540
Net Sales	8,695	13,514	18,651	26,180
Expenditure				
Raw Materials	6,135	9,317	12,869	18,143
<i>% of Sales</i>	<i>70.6</i>	<i>68.9</i>	<i>69.0</i>	<i>69.3</i>
Employee Costs	739	947	1,176	1,541
<i>% of Sales</i>	<i>8.5</i>	<i>7.0</i>	<i>6.3</i>	<i>5.9</i>
Other Expenditure	1,187	1,582	1,715	2,360
<i>% of Sales</i>	<i>13.6</i>	<i>11.7</i>	<i>9.2</i>	<i>9.0</i>
Total Expenditure	8,060	11,846	15,760	22,044
EBIDTA	635	1,668	2,891	4,136
<i>% of Sales</i>	<i>7.3</i>	<i>12.3</i>	<i>15.5</i>	<i>15.8</i>
Other Income	56	86	94	99
Depreciation/Amortisation	96	115	147	172
Interest	1	31	41	46
PBT	594	1,607	2,797	4,017
Total Tax	231	616	1,077	1,550
<i>Effective Tax Rate (%)</i>	<i>38.9</i>	<i>38.3</i>	<i>38.5</i>	<i>38.6</i>
PAT	363	991	1,720	2,466
Extraordinary Items	-	98	-	-
Adj. Profit	363	1,089	1,720	2,466

Areva concentrating on high technology incentive orders - to lead to higher margins

Balance Sheet
(Rs m)

Y/e Dec	9M CY05	CY06	CY07E	CY08E
Sources of Funds				
Equity	399	399	399	399
Reserves	1,795	2,556	4,113	5,824
Shareholders Funds	2,194	2,955	4,512	6,222
Total Debt	100	200	225	275
Deferred Tax Liability	(137)	(168)	(222)	(299)
Total	2,157	2,987	4,515	6,198
Application of Funds				
Gross Block	2,100	2,655	4,105	5,205
Less Acc. Depreciation	1,545	1,660	1,807	1,979
Net Block	555	995	2,298	3,226
Capital work In progress	181	-	-	-
Total Fixed Assets	736	995	2,298	3,226
Investments	97	97	97	97
Current Assets	6,949	8,921	12,118	16,355
<i>Days</i>	<i>309</i>	<i>293</i>	<i>275</i>	<i>266</i>
Inventory	1,858	2,406	3,397	4,667
<i>Days</i>	<i>82</i>	<i>79</i>	<i>77</i>	<i>76</i>
Sundry Debtors	4,020	5,205	7,345	9,967
<i>Days</i>	<i>178</i>	<i>171</i>	<i>167</i>	<i>162</i>
Cash	414	488	297	404
Loans & Advances	658	823	1,079	1,318
Current Liabilities & Provisions	5,625	7,027	9,998	13,480
Creditors	5,223	6,518	9,334	12,611
<i>Days</i>	<i>232</i>	<i>214</i>	<i>212</i>	<i>205</i>
Provisions	402	508	663	869
Net current Assets	1,324	1,895	2,120	2,875
Total	2,157	2,987	4,515	6,198

Cash Flow
(Rs m)

Y/e Dec	9M CY05	CY06	CY07E	CY08E
Net Cash Flow from Operations	330	971	1,234	1,817
Net Cash Flow from Investing	(85)	(922)	(1,450)	(1,760)
Net Cash Flow from Financing	(187)	25	25	50
Change in Cash	59	74	(191)	107
Opening Balance	211	414	488	297
Closing Balance	270	488	297	404

**Key Ratios**

Y/e Dec	9M CY05	CY06	CY07E	CY08E
Asset Based Ratios (%)				
ROCE	18.1	46.8	47.5	48.4
ROE	17.5	45.2	46.1	46.8
Growth Ratios (%)				
Sales	12.2	55.4	38.0	40.4
EBITDA	60.5	162.9	73.3	43.1
PAT	76.5	173.3	73.6	43.4
EPS	76.5	382.5	73.6	43.4
Per Share (Rs)				
EPS	9.1	24.8	43.1	61.8
BV	55.0	74.1	113.1	156.0
CEPS	11.5	27.7	46.8	66.2
DPS				
FCPS	3.0	(1.4)	0.9	8.0
Margins (%)				
EBITDA	6.6	11.2	14.1	14.5
PAT	3.8	6.6	8.4	8.6
Tax Rate	38.9	38.3	38.5	38.6
Valuations (x)				
P/E	174.7	63.9	36.8	25.7
P/CEPS	138.2	57.3	33.9	24.0
P/BV	28.9	21.4	14.0	10.2
EV/EBITDA	98.3	37.3	21.5	15.0
EV/Sales	7.2	4.6	3.3	2.4
Market Cap/Sales	7.3	4.7	3.4	2.4
Balance Sheet Ratios				
Debtor Days	178.5	171.1	166.7	162.3
Inventory Days	82.5	79.1	77.1	76.0
Creditor Days	231.9	214.3	211.9	205.3
Net Working Capital Days	55.6	51.2	41.5	40.1
Gross Debt : Equity (x)	0.05	0.07	0.05	0.04
Net Debt: Equity (x)	(0.14)	(0.10)	(0.02)	(0.02)
Other Ratios (%)				
Raw Material/Net Sales	70.6	68.9	69.0	69.3
Employee Expenses/Net Sales	8.5	7.0	6.3	5.9
Other Income to PBT	9.5	5.3	3.4	2.5
Dividend Payout	30.9	13.9	9.5	7.5



Notes



Prabhudas
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PL's Recommendation Scale

BUY	: > 15% Outperformance to BSE Sensex	Outperformer	: 5 to 15% Outperformance to Sensex
Market Performer	: -5 to 5% of Sensex Movement	Underperformer	: -5 to -15% of Underperformance to Sensex
Sell	: <-15% Relative to Sensex		

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