Emkay Research

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Lakshmi Machine Works

Management Meet Update

Looking beyond TUFS…

BUY

Price	Target Price
Rs 2,726	Rs3,510
Sensex	14,080

Price Performance

(%)	1M	3M	6M	12M
Absolute	(1)	(3)	(27)	59
Rel. to Sensex	0	(15)	(29)	12

Source: Bloomberg

Stock Details

Sector	Textile
Reuters	LKMC.BO
Bloomberg	LMW@IN
Equity Capital	124
Face Value	10
52 Week H/L	4,250/1,523
Market Cap	33.7
Daily Avg Volume (No of sh)	6726
Daily Avg Turnover (US$)	0.5

Shareholding Pattern (%)

(31st Mar.'07)	
Promoters	25.3
FII/NRI	19.3
Institutions	20.3
Private Corp.	11.8
Public	23.3

Source: Capitaline

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We organized a management meet for the leading textile machinery manufacturer Lakshmi Machine Works (LMW). Following are the key takeaways:

Robust demand outlook

LMW currently has a market share of 55% in the domestic textile spinning machinery industry. The company is undergoing an expansion to increase its textile machinery production from 2.3mn spindles in FY07 to 3.5mn spindles in FY08. While India's share in the global textile industry is expected to increase from current 4% to 7% by FY12, the spinning segment of the industry would require 29mn spindles of additional capacity and an investment of Rs550bn to meet this requirement. Apart from the additional capacities, the replacement market also contributes to a significant size of opportunity for the company. Out of the 39.3mn spindles of installed capacity in India, 5-10% of the capacity is expected to be upgraded, modernized or replaced annually, which would be a big opportunity for the company going forward. The company management is confident and expects the growth in the domestic textile industry to continue.

Improving delivery the key differentiator

LMW's products are priced at 15-20% discount to its competitors. The company has a strong focus on R&D and has over a 100 patents for its products. The management claims that its products are similar in technology when compared to its competitors. With increasing automation and increased capacity, the company has also reduced its delivery time (from 20-24 months to 12-18 months), which has been the main reason for the customer to opt for competitor's products.

Tax benefits to improve profitability

The Value Added Tax (VAT) implementation in Tamilnadu with effect from 1st January 2007 has been positive for the company. The VAT implementation would help the company reduce the input costs due to the benefits arriving out of the VAT credits.

There was also an additional sales tax of 3% for sales in excess of Rs3bn within the state of Tamilnadu. This additional sales tax has been abolished and the company would enjoy the savings from the same for the full year FY08. The management expects the savings from this to be in the range of Rs20-25mn per month for the year FY08.

Healthy order book to drive revenue growth

LMW has a strong order book of Rs53.5bn (2.9x FY07 sales) executable in the next 18-24 months. The company management has expressed that they have not witnessed any kind of slow down in the order bookings. Although the likely expiry of TUFS in March 2007, led to the spurge in the order book size, the company has continued to witness the order inflows post TUFS extension. The management however stated that the order book may not sustain at these levels in the longer term because of the increase in the capacity and the reduction in the delivery time which together would improve the order process time and hence the revenues for the company.

The company's pricing

LMW's products are priced at 15-20% discount to its competitors. The company follows a strict pricing policy and does not entertain any differential pricing or discounts. The company's contracts contain the PRD clause by the way of which the price ruling at the time of delivery is the price charged to the customer. Over the years, the company has not faced a situation of cancellation of orders placed as the 10% advances paid by the customer get forfeited.

Increasing focus on machine tools and foundry

The machine tools and foundry business contributed to 9% of the revenues in FY07. In the machine tools business the company manufactures CNC machines, which are used to make auto components. The size of the machine tools market in India is in excess of Rs50bn out of which 75% is catered by the imports. The company has also introduced high yield machines such as vertical machining centers and horizontal machining centers, which are expected to yield higher margins going forward.

In the Foundry business, the company has a capacity to produce 4000 tons of high precision castings per month. The customers in the foundry business include, Siemens, GE, Wartsila, etc. The company is moving towards manufacturing machine castings, which involve high value addition and also yield higher margins.

On look out for acquisitions

LMW is a debt free company with cash on books in excess of Rs6bn. The company as a part of its growth strategy is also looking at inorganic growth through acquisitions mainly in the machine tools and foundry business, which the company wants to focus on and scale up. The company is also looking at acquiring technology in the textile machinery business.

EPCG license subsidies

The company receives an export subsidy (1.5-1.75%) for the supplies of the machineries made to the EPCG license holders as the sale is treated as deemed export. Earlier the company used to pass on 50% of these benefits to the EPCG license holders. From FY07, the company has decided to retain the entire benefit of the export subsidy with itself. The export subsidies for FY07 amounted to Rs326mn.

TUFS extension and the managements view

The Technology Up-gradation Fund Scheme (TUFS), which was set to expire on 31st March 2007, has been extended to March 2012. The TUFS benefit for the spinning segment has been fixed at 4% while it is 5% subsidy for the weaving and processing segments. The management believes that TUFS has been a catalyst for the growth of the company. However the company is increasingly looking at a growth beyond TUFS with high focus on productivity, technology and pricing.

Cost cutting measures

The company has taken various cost initiatives to improve the efficiency and profitability of the company. For instance: the company has reduced the types of sheet metals required in machinery manufacturing from 14 to 3. Further, the company has introduced laser-cutting technology for cutting the sheets. Earlier the sheets were being cut manually. Due to this initiative, the company not only saves on employee costs but also its sheet utilization has increased from 80% earlier to 95% now, thus resulting in lower scrap. The company has also installed windmill with a capacity of 24.8 MW, which would also result in the savings on account of the power costs.

Premium pricing cannot be ruled out

LMW has over the years developed the best of the technologies and has them patented. The company is amongst the only 2 integrated textile machinery manufacturers globally. The company has a strong team of over 200 employees dedicated for the R&D in the textile machinery business. While delivery of the machines is the only aspect for the customer to go for a competitor's product, the company through its capacity expansion and faster process time is working on improving its delivery time. With already few of the company's products being better and more efficient than the competitors, the company is working towards a premium pricing for its products vis a vis the competition over the long term.

Management guidance

The management of LMW has guided for the production of 3.5mn spindles in FY08 as against 2.3mn in FY07. The management expects a growth in excess of 40% for FY08. The company has not taken any price hike after the last hike in June 2005, and has further decided not to go for any price hike till March 2008. Although the company continues to feel the cost pressures from the rising cost of raw materials, the management expects the operating margins to improve due to the increase in productivity, improved technology and cost control initiatives of the company. The management has indicated that the rising rupee hasn't resulted in any sort of postponement of the installation of capacities. The management is focusing on significantly scaling up its machine tools and foundry business and expects it to grow by 30% CAGR over the next 2-3 years.

Outlook and Valuations

In the recent past the stock has been trading in the range of Rs2600-2800 levels. In spite of the robust order book (Rs53.5bn) of the company that provides strong growth visibility over the next two years, the stock has under performed the broad market due to the issues on sustainability of the future order inflows. We believe that the company's strong focus on R&D to offer better technology products and increase in capacity to address the longer delivery time would place the company on a better position as compared to the competition. The extension of TUFS till 2012 would continue to result in increase in the capacities in the domestic textile industry.

We believe that over the years LMW has demonstrated a strong ability to compete with global players in respect of pricing and technology. The company has also concentrated more on the domestic markets due to the robust available opportunity. With capacity expansion and the large order book getting executed over the next couple of years, we believe that the company would strongly compete with the global players not only in India but also overseas. We also expect the demand from replacement of textile machineries to provide significant opportunities going forward.

Apart from the textile machinery business, the company is focusing on increasing its revenue contribution from the machine tools and foundry business so as to provide stability in the revenue growth of the company. The company has decided to manufacture high value added machine tools castings to improve its profitability from the businesses.

In the event of any slow down in the domestic textile industry, the company is fully geared and capable to capture the global market as the products of the company match the best of the technologies globally and the pricing of the products is 15-20% lower than the competition.

The company has very strong ROE (40%) and ROCE (57%). The company also has a payout policy of 30% as dividends.

At current market price of Rs2726, the stock trades at 11.6x our expected EPS of Rs234 for FY2008E. We maintain our BUY recommendation on the stock.

Profit & Loss Rs mn

	FY05	FY06	FY07	FY08E
Net Sales	**10,031**	**13,187**	**18,992** z	**24,653**
Growth (%)	*48.4%*	*31.5%*	*44.0%*	*29.8%*
Raw Material	5,878	7,473	11,076	14,299
% to sales	*58.6%*	*56.7%*	*58.3%*	*58.0%*
Staff cost	851	1,055	1,286	1,664
% to sales	*8.5%*	*8.0%*	*6.8%*	*6.8%*
Other expenses	1,856	2,364	3,227	4,080
% to sales	*18.5%*	*17.9%*	*17.0%*	*16.6%*
EBIDTA (core)	**1,447**	**2,295**	**3,403**	**4,610**
% of Sales	*14.4%*	*17.4%*	*17.9%*	*18.7%*
Other Income	(4)	87	329	386
EBITDA	**1,442**	**2,382**	**3,732**	**4,996**
% of Sales	*14.4%*	*18.1%*	*19.7%*	*20.3%*
Interest	81	34	37	-
Depn & Amort.	262	387	688	776
PBT	1,100	1,961	3,008	4,220
EO Items	9	(82)	51	0
Tax	375	398	997	1,308
ETR	*34.1%*	*20.3%*	*33.1%*	*31.0%*
PAT	**733**	**1,481**	**2,062**	**2,912**
Growth (%)	*21.8%*	*101.9%*	*39.3%*	*41.2%*

Cash Flow Statement Rs mn

	FY05	FY06	FY07	FY08E
PBT	1,109	1,879	3,086	4,220
Depreciation	262	387	688	776
Other Income	(56)	(134)	(337)	(386)
Interest	30	-	-	-
Others	(508)	(721)	(66)	-
Change in WCap	305	3,402	2,312	(1,931)
Tax Paid	(65)	(94)	(907)	(986)
CFO	**1,076**	**4,718**	**4,775**	**1,693**
(Inc)/Dec in FA	(223)	(1,348)	(2,017)	(1,500)
(Inc)/Dec in Inv	51	(353)	-	-
Other Income	56	134	226	386
others			(6)	
CFI	**(116)**	**(1,567)**	**(1,797)**	**(1,114)**
Equity Issue	-	-	-	-
Net Borrowings	(573)	-	-	-
Dividend Paid	(140)	(212)	(764)	(423)
Interest	(30)	-	-	-
CFF	**(742)**	**(212)**	**(764)**	**(423)**
Incr/(decr) in cash	218	2,940	2,214	156
Cash beginning	522	972	3,912	6,126
Cash ending	972	3,912	6,126	6,282

Balance Sheet Rs mn

	FY05	FY06	FY07	FY08E
Equity Capital	124	124	124	124
Reserves	3,239	4,264	5,679	7,794
Networth	**3,362**	**4,387**	**5,803**	**7,918**
Total Debt	-	-	-	-
Deferred Tax Liabilities	79	166	305	643
Total CE	**3,441**	**4,553**	**6,108**	**8,561**
Gross Block	**7,264**	**8,016**	**9,595**	**11,095**
Less Depreciation	5,659	5,553	5,741	6,517
Net Fixed Assets	**1,606**	**2,463**	**3,854**	**4,578**
Investments	**662**	**1,015**	**1,022**	**1,022**
Inventory	1,471	1,412	1,631	1,995
Debtors	602	622	407	675
Cash and Bank	972	3,912	6,126	6,282
Loans & Advances	1,302	1,422	2,781	2,837
Total Curr. Assets	**4,347**	**7,369**	**10,944**	**11,790**
Current Liabilites	2,748	5,706	8,894	7,269
Provisions	462	594	1,211	1,570
Total Cur. Liab. & Prov.	**3,209**	**6,300**	**10,104**	**8,839**
Net Current Assets	**1,138**	**1,069**	**840**	**2,951**
Misc. Expenditure	36	6	-	-
Total Assets	**3,441**	**4,553**	**5,716**	**8,550**

Ratios

	FY05	FY06	FY07	FY08E
EBITDA %	14.4%	17.4%	17.9%	18.7%
EBIT%	11.8%	14.5%	14.3%	15.6%
NPM %	7.3%	11.2%	10.9%	11.7%
ROCE (avg) %	31.9%	49.9%	57.1%	57.5%
Adj. ROE %	21.7%	40.5%	39.5%	42.2%
Adj. EPS	59	125	164	234
Reported EPS	59	120	167	234
Cash EPS	988	1,719	234	324
Book Value	272	355	469	640
DPS	15	30	40	55
Payout %	28.8%	28.6%	27.4%	27.0%
Debtors days	17	17	10	10
Creditors days	54	55	67	65
Total Debt: Equity	0.1	-	-	-
Asset Turnover	3.8	4.2	4.4	3.9
PE (x)	46.6	22.0	16.7	11.7
Cash PE (x)	2.8	1.6	11.7	8.5
P/BV (x)	10.1	7.7	5.8	4.3
EV/Sales (x)	3.3	2.2	1.4	1.1
EV/EBITDA (x)	22.8	12.7	7.9	5.8
Dividend Yield %	0.5%	1.1%	1.5%	2.0%

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