Initiating Coverage - Sector: Engineering

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August 30, 2007

Tractors India Limited

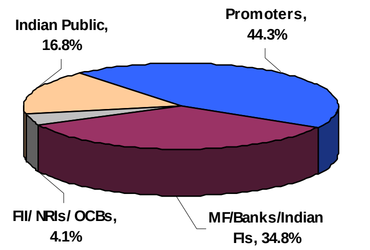
Buy

CMP: Rs 295 | **Target Price: Rs 390**

Key Data

Market Cap (Rs bn)	2.9
Market Cap (US$ mn)	70.0
52 WK High / Low	333 / 175
Avg Daily Volume	6175
Face Value (Rs)	10
BSE Sensex	14993
Nifty	4359
BSE Code	505196
NSE Code	TIL
Reuters Code	TILL.BO
Bloomberg Code	TIL IN

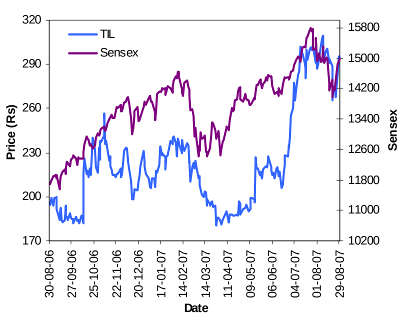
Shareholding Pattern (%)



Price Performance (%)

	Absolute	Relative
3 Months	33.9	29.9
6 Months	34.3	18.5
12 Months	50.4	22.5

Tractors India Limited vs BSE



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Capitalizing on opportunities...

TIL is the leading provider of technology-intensive and application-specific heavy engineering equipment for core infrastructure sectors. It conducts business under three main divisions viz Material Handling Group (MHG), Construction Equipment Group (CEG) and Power Systems Solutions Group (PSS).The company is on a fast growth track with robust demand coming up for its products from various infrastructure sectors

Investment Argument

- Infrastructure investments to the tune of US$ 450bn are planned by the government in the 11th Plan. Since TIL's products cater to the demand of various core infrastructure sectors, we expect TIL to benefit by way of increased demand for its products.
- The MHG segment is expected to maintain its dominant position in the Cranes with competitive edge over its competitors. To further drive growth, the company has improved its focus on manufacturing of port equipment and also announced Rs 1,750mn capex plan to expand the current crane capacity. We anticipate TIL's revenue to witness a CAGR of 37.6% in this segment over FY2007-09E
- Increased demand for mining equipments in coal, iron ore and limestone industry and growth in retail malls, IT/ITES and service industries would drive the performance of CEG and PSS segment respectively. We expect the CEG and the PSS segment to witness a CAGR of 25% and 20% over FY2007-09E respectively.
- In line with the global concept of providing equipments on rent, TIL has recently ventured into this business by opening up its own rental stores. The revenue contribution from this new initiative is likely to increase as TIL plans to increase the number of stores to 30 from the current 3 stores in next 2 years.

Valuations

At CMP of Rs 295 the stock trades at a P/E of 10.2x and 9.8x on our Consolidated FY2008 and FY2009 EPS estimates of Rs 28.9 and Rs 30.2 respectively. **We Initiate Coverage on the stock with a 'Buy' recommendation and 12-month Target Price of Rs 390.**

Key Financials (Standalone)

Y/E March (Rs mn)	FY2006	FY2007E	FY2008E	FY2009E
Net Sales	**4,584**	**5,687**	**7,193**	**9,403**
% chg	*37.2*	*24.0*	*26.5*	*30.7*
Net Profit	**119**	**184**	**268**	**318**
% chg	*74.9*	*54.9*	*45.6*	*18.7*
EPS (Rs)	**12.2**	**18.9**	**23.9**	**25.1**
EBITDA Margin (%)	8.6	7.8	8.8	9.2
P/E (x)	24.2	15.6	12.3	11.7
P/CEPS (x)	12.1	9.7	8.3	6.6
ROE (%)	16.3	21.6	17.5	14.1
ROCE (%)	16.2	25.5	18.8	16.6
P/BV (x)	4.0	3.4	2.2	1.7
EV/Sales (x)	0.9	0.7	0.6	0.5
EV/EBITDA (x)	10.4	8.1	6.7	5.3

Source: Company; FQ Research

Business Profile

TIL's business (standalone) primarily comprises of 3 segments viz:

- **Material Handling Group (MHG)-**

  TIL is engaged in manufacture of Diesel Hydraulic/Electric Cranes/ Carrier Units. The company enjoys around 75 % market share in the Cranes business. The company has technical tie-ups with global players like Grove Worldwide (USA), National Cranes (USA), Famac (Poland) and Paceco (USA). This segment cater to the demand of wide array of core infrastructure sectors such as oil and petrochemicals, roads, steel plants, ports, cement and construction. The company faces insignificant competition in cranes business over 30MT capacity and thus enjoys an edge over its competitors. The company is also increasingly focusing on adding to its existing portfolio more value added high tonnage offerings.

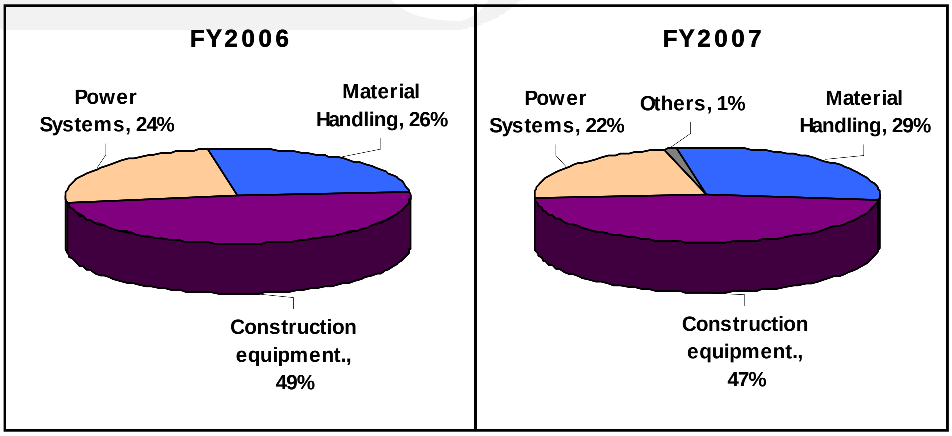
- **Construction Equipment Group (CEG)**

  This segment provides product and application solutions for the entire range of Caterpillar Earthmoving and Construction Equipments in India. The company has exclusive rights to sell Caterpillar products and spares in Northern and Eastern India on a commission basis. The product range comprises of Excavators, Dumpers, Loaders and Motor graders. These products are primarily used in Roads & highway sector and also in coal, limestone and iron ore mining.

- **Power Systems Solution Group (PSS)**

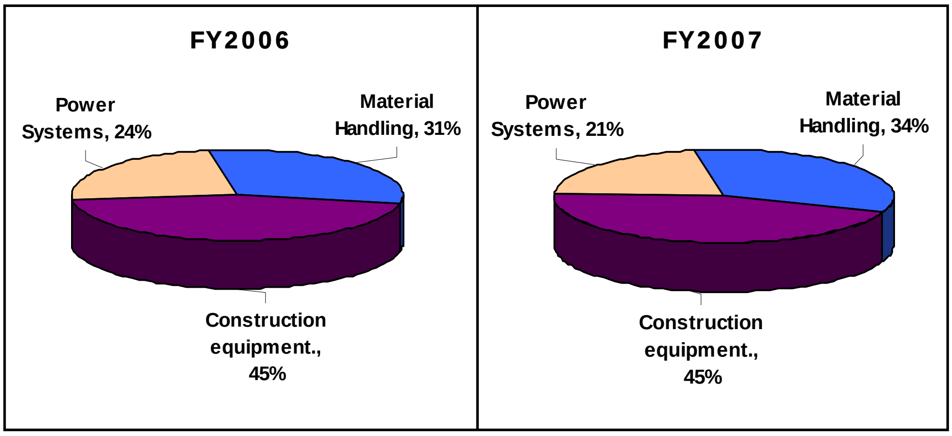
  Generator sets offered by TIL incorporate Caterpillar and Hindustan power Plus diesel/gas engines. The generators are assembled, sold and serviced by TIL, in diesel, gas and heavy fuel configurations. TIL also packages a range of Gensets and undertakes erection and commissioning of all relevant installations. These generators are used in retail malls, IT/ITES industry, precision manufacturing industry and various service industries. The company has also introduced the concept of 'Power on rent' in India and is expected to reap the first mover advantage from this initiative.

Exhibit 1: Revenue Mix- Segment wise



Source: Company, FQ research

Exhibit 2: Profit Mix- Segment wise



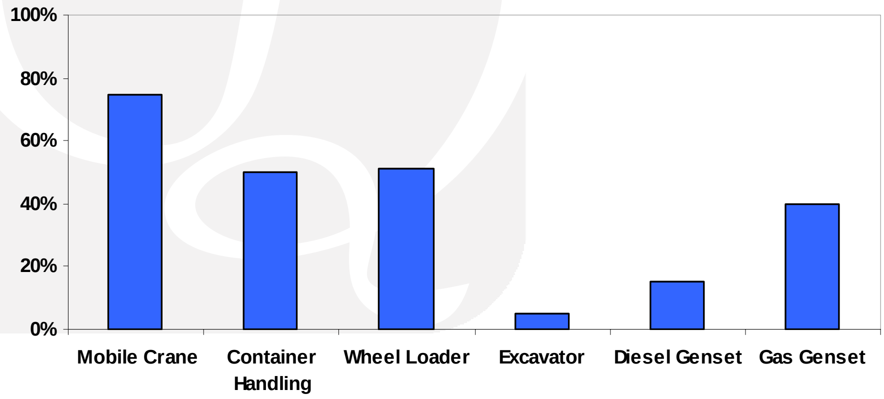
Source: Company, FQ research

Subsidiaries

TIL has three subsidiaries viz:

- Myanmar Tractors limited (81% holding)
- Tractors Nepal Limited (100% holding)
- TIL Overseas Pte Limited, Singapore (100% holding)

Exhibit 3: Market Share in India- All Segments (Product-wise)



Source: Company, FQ research

Investment Rationale

Increased infrastructure spending in 11th plan- A Huge opportunity

TIL's products cater to the needs of the following infrastructure user sectors:

- Mines
- Oil & Petrochemicals
- Power
- Irrigation
- Steel
- Defense
- Engineering & Construction
- Agro industries
- Ports
- Railways
- Cement
- Fertilizers
- Chemical Plants
- Hotels
- Hospitals

TIL is banking on the huge investments in infrastructure development planned by the government. The government has planned to increase its thrust on infrastructure by increasing the planned investment in the 11th Plan by around 163% as compared with the anticipated investment in the 10th Plan. The anticipated investment in the 10th plan was US$ 171bn and in the 11th plan the investment is estimated at US$ 450bn. The break-up of the investments planned in various sectors in the 11th plan vis-à-vis the 10th plan are as follows:

Exhibit 4: Aniticipated and projected investments in 10th and 11th plan

	10th Plan (Anticipated)			11th Plan (Projected)		
Sector	**Rs. Bn.**	**US$ Bn**	**Share**	**Rs. Bn.**	**US$ Bn**	**Share**
Power	2769	62	36	5257	117	28
Roads	1245	28	16	3687	82	20
Railways	798	17	10	2714	60	15
Telecom	883	20	12	2311	51	12
Irrigation	1120	25	15	1831	41	10
Water/Sntn.	612	14	8	1064	26	6
Ports	34	0.75	0.4	870	19	5
Airports	41	0.9	0.5	408	9	2
Others	174	4	2	558	12	3
Total	**7675**	**171**		**18700**	**456**	

Source: Company, FQ Research

The 11th plan aims at investment in modernization of ports for managing effectively the enhanced traffic which is likely to grow at 17% p.a. There has also been major private participation in Port modernization from Dubai Port World, Singapore Port Authority and Mercer Airport. Privatisation of Delhi and Mumbai Airports along with upgradation of other metro airports will attract investment in the aviation sector. Investments in the Road and Railway sector are likely to get a boost with Governments initiative in upgrading the transport network in the country. The construction and mining sector is likely to grow at 15% p.a in future. As TIL's products cater to the demand of almost all the user sectors, we expect TIL to benefit from the huge infrastructure investments planned in the 11th plan.

Material Handling Group

National Maritime Development Programme – the key driver

About 95% of volume and 70% by value of India's international trade is carried through maritime transport. With a view to improve the port sector by creating additional facilities to handle growing traffic, the Government has chalked out a National Maritime Development Programme (NMDP) and is in the process of implementing it. The government plans to invest around Rs 610bn till FY2014 for implementation of the programme.

Exhibit 5: Existing and proposed capacity as envisaged in NMDP

Port	Capacity as on 31st Mar 04 (in mn tonnes)	Proposed Capacity by 2013-14 (in mn tonnes)	Proposed Invst. (Rs bn)
Kolkata Dock System	9.8	21.6	47.2
Haldia Dock System	34.1	73.8	15.2
Paradip Port Trust	39.0	92.3	24.0
Vishakhapatnam Port Trust	49.2	130.0	35.4
Ennore Port Trust	12.0	61.8	43.2
Chennai Port Trust	41.8	61.6	21.8
Tuticorin Port Trust	15.8	45.8	30.0
Cochin Port Trust	15.5	58.5	78.9
New Mangalore Port Trust	30.3	55.9	71.5
Murmugao Port Trust	23.5	57.2	8.1
Mumbai Port Trust	40.4	58.8	19.5
JNPT	33.1	94.9	158.8
Kandla Port Trust	45.0	105.6	49.9

Source: Company, FQ Research

Under the NMDP, 228 projects have been identified for implementation in two phases through public-private partnership. To meet the projected traffic of 705.84mn tonnes to be handled by 2013-14 at major ports, a capacity of 917.59mn tonnes has been estimated. ***The implementation of the NMDP programme will generate substantial demand for port handling equipments in years to come.***

Increased focus on Port handling equipments

With an objective of capitalizing on the huge opportunity coming up in the Port sector, TIL has started increasing its focus on value added high tonnage offerings in the port handling equipment area. Under the MHG segment, TIL already manufactures products like Rough Terrain Truck & Industrial Cranes, Lorry Loaders and Reach Stackers. In addition to this, TIL, with technical tie-ups with global players, has ventured into new areas of manufacturing value added high tonnage equipments like Electric Level Luffing Cranes (Bulk Cargo) and Rubber Tyred Gantry Cranes (currently imported). For the manufacturing of Rubber Tyred Gantry Cranes, TIL has entered into technical tie-up with Paceco, USA (Paceco has 30% market share world-wide in this type of port equipment).

The demand for the port equipment is likely to increase in future with the implementation of the NMDP and we expect TIL to benefit significantly from the same.

Capex Plans

TIL is setting up a green field capacity at a cost of Rs 1750mn for manufacturing material handling, construction and mining equipment. The company will be funding this expansion through a mix of debt and equity in the ratio of 1:1. The factory would be set up on a 300 acre plot and manufacture coal handling equipment for steel plants and road machinery equipment, which would supplement the Caterpillar equipment range. We expect the new capacity to be operational in Q3FY2009 and the same has been taken into consideration while projecting the FY2009E numbers. We expect the revenues of this segment to grow at a CAGR of 36.7% over FY2007-09E

Cost Cutting measures may lead to margin improvement.

Some of the main raw material for this segment includes steel and chassis on which the material handling structures are fitted. Out of the total raw material requirements, 40% are imported which includes steel. TIL is considering to procure similar grade steel from SAIL which can be available at a lower cost resulting in cost saving. This can help TIL in improving its margins in this segment. However we have not factored in this possibility in our projections. Any development on this front would help TIL in improving its performance.

Construction Equipment Group

Sole dealership rights in Northern and Eastern India

Huge investments are coming up in construction and mining industry in the northern and eastern belt. TIL has exclusive rights to sell Caterpillar products and spares in Northern and Eastern India and it does so on a commission basis. Caterpillar products have a good demand in various user sectors mainly due to the long term savings derived from using its equipment.

TIL primarily supplies equipment for Coal, iron ore and limestone mining. We foresee huge opportunity coming up for TIL in the Coal mining industry. The Working Group for Coal & Lignite for formulation of 11th Plan has assessed a coal demand of 731.10 MT by terminal year of 11th Plan i.e. 2011-12. The annualized growth rate of coal demand is expected to be about 9% over 10th Plan terminal year demand of 474.18 Mt. In order to meet this increased demand the Ministry of Coal has proposed a capital outlay of around Rs 419.6bn. The increased mining activity would translate into additional demand for mining equipment.

Demand for Caterpillar's products on a rise

In FY2007, because of worldwide demand growth, availability of machines from Caterpillar was on allocation basis. Hence, TIL was unable to meet the entire demand in India thereby restricting its growth in sales to 21% in FY2007 as compared to 47% in FY2006. However, it is understood that Caterpillar is eyeing Indian Markets on a priority basis and has planned to increase its focus on India. We believe that the supply conditions will ease out and we expect this segment's sales to grow at a CAGR of 25% over FY2007-09E.

Power Systems Solution Group

Banking on power shortage and increased demand

The issue of power shortage is still prevalent in India and is likely to continue in years to come. For India to sustain the growth rate of 9% and above, adequate supply of power is necessary. TIL is well equipped to bank on this opportunity and is slowly emerging as the total power solutions provider.

Generator sets offered by TIL incorporate Caterpillar and Hindustan power Plus diesel/gas engines. Caterpillar is the largest manufacturer of medium speed and high speed diesel engines in the world and its products are well accepted across various industries. The generators are assembled, sold and serviced by TIL, in diesel, gas and heavy fuel configurations. TIL also undertakes erection and commissioning of all relevant installations. These generators find applications in retail malls, IT/ITES industry, manufacturing industry and various service industries. Considering strong backing from Caterpillar and robust demand from various user industries, we expect revenues from this segment to witness a CAGR of 20% over FY2007-09E.

Equipment on Rent- a New Initiative

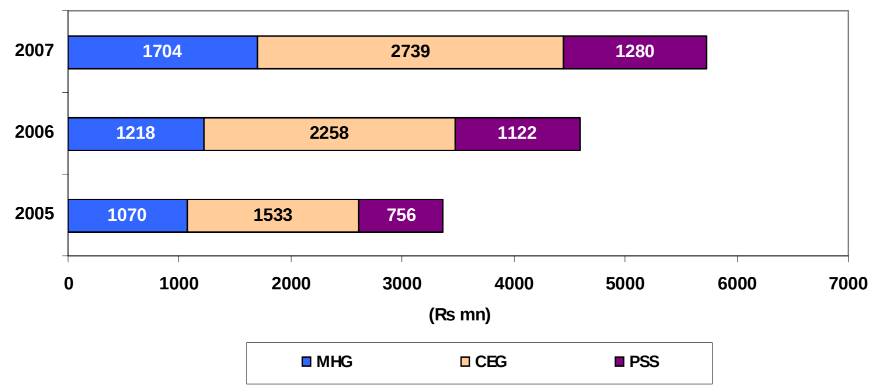
In line with the global concept of providing equipments on rent, TIL has recently ventured into this business by opening up its own rental stores. TIL will be providing construction, mining and power equipments on rental basis. The equipment offered on rent will be new or almost new which makes TIL offering very different from the service offered by other rental companies. Through introduction of this concept, TIL is aiming customers who are reluctant to lock-up capital in purchasing equipment and prefer the flexibility in capital expenditure thus ensuring optimal utilization of resources. The company's entire rental fleet of machines is allotted to buyers for three years and these machines don't require repairs for five years.

TIL currently owns 3 rental stores and plans to expand its rental business by setting up about 30 rental outlets in next 2 years through internal accruals. We expect TIL to benefit out of these initiatives in years to come which will provide it with additional stream of revenues. We expect the new initiative to contribute revenues of around Rs 120mn in FY2008E and Rs 240mn in FY2009E. We have taken into consideration the same while projecting our FY2008E and FY2009E numbers.

Future Outlook

TIL has managed to maintain a steady growth in the top line and bottom line in past with its sales witnessing a CAGR of 30% and its net profit witnessing a CAGR of 60% over FY2005-07. This growth was primarily due to robust demand for company's products from the port , construction and mining industry. The MHG, CEG and PSS segments topline grew at a CAGR of 26%, 34% and 30% respectively over FY2005-07.

Exhibit 6: Revenue break-up (FY2005-07)

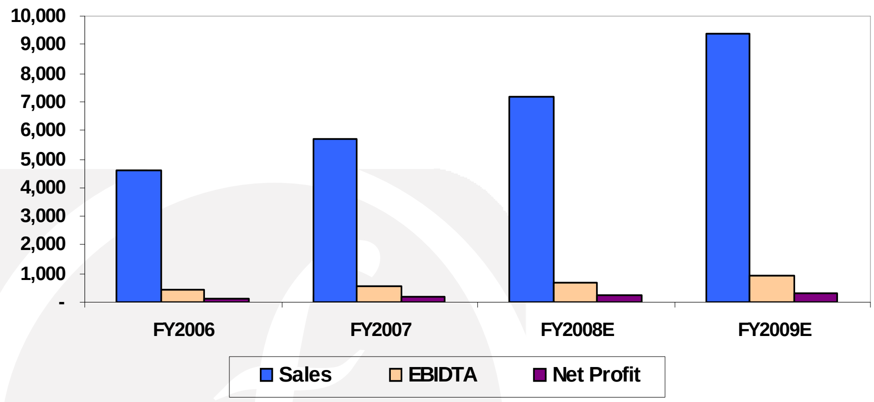


Source: Company, FQ research

Revenues (standalone) to grow at a CAGR of 29% over FY2007-09E

Going forward we expect TIL's top line to witness a CAGR of 29% over FY2007-09E mainly driven by MHG and CEG segment. Considering robust demand for TIL's equipments, its expansion plans and its increased focus on manufacturing of port equipment, we expect the MHG segment's topline to witness a CAGR of 37.6% over FY2007-09E. Increased demand for mining equipments in coal, iron ore and limestone industry and growth in retail malls, IT/ITES and service industries would drive the revenues of CEG and PSS segment. We expect the CEG and the PSS segment to witness a CAGR of 25% and 20% over FY2007-09E respectively.

Exhibit 7: Improving Sales, EBIDTA and Net profit



Source: Company, FQ research

Margins likely to improve due to increased contribution from MHG segment

The MHG segment has the highest margins among all the three segments operated by TIL. With increased focus and additional investments coming up in this segment we expect the MHG segments revenues to grow at the fastest pace. This would mean higher profit contribution from the MHG segment, thus helping TIL in improving its overall margins.

Subsidiaries to strengthen the consolidated performance

TIL have three subsidiaries primarily engaged in selling Caterpillars products viz:

- **Myanmar Tractors limited (81% holding) -** Business in Myanmaar is done jointly by Myanmar Tractors Limited and TIL Overseas Pte. Ltd where TIL overseas Pte. Ltd. sells Prime Products and Parts on F.O.B basis, Myanmaar Tractors provide after sales service, rental on genset/ construction/ earthmoving equipment/ technical support etc.
- **Tractors Nepal Limited (100% holding) -** This subsidiary carry on the business of refurbishing and servicing of earthmoving equipments, Diesel Generator sets and material Handling equipments.
- **TIL Overseas Pte Limited, Singapore (100% holding) -** The prinicipal activities of this company is to carry on the business of imports and exports of equipment and machinery parts in relation to the construction industry. This company also carries out joint activities with Myanmar subsidiary.

The improved performance of the Singapore and Myanmar subsidiary in FY2007, enabled TIL to clock a 41% growth in consolidated revenues from Rs 5427mn in FY2006 to Rs 7665mn in FY2007. The consolidated net profit improved by 73% in FY2007 from 135mn in FY2006 to Rs 233mn in FY2007. TIL overseas Pte. Ltd was the main contributor in this growth as its top line and bottom-line improved by a whooping 335% and 266% respectively. The topline performance of the Myanmar Tractor Ltd was dismal with its sales declining by 15% in FY2007 over FY2006; however its net profit grew by 105% in the same period mainly due to improvement in the operating margins.

Going ahead the revenues from the subsidiaries are likely to increase by 15% in FY2008E and FY2009E. We estimate the subsidiaries to contribute around Rs 5 to the standalone EPS of TIL, both in FY2008E and FY2009E on fully diluted equity.

Valuation

We have assumed an equity dilution in our projections taking into consideration the capex plans. At CMP of Rs 295 TIL trades at a P/E of 12.3x and 11.7x on our standalone FY2008 and FY2009 EPS estimates of Rs 23.9 and Rs 25.12 respectively. On the basis of consolidated numbers, the stock trades at a P/E of 10.2x and 9.8x on our Consolidated FY2008 and FY2009 EPS estimates of Rs 28.9 anf RS 30.2 respectively. **We Initiate Coverage on the stock with a 'Buy' recommendation and 12-month Target Price of Rs 390**

Profit & Loss Statement (Standalone) Rs mn

Y/E March	FY2006	FY2007	FY2008E	FY2009E
Net Sales	**4584**	**5687**	**7193**	**9403**
% chg	*37.2*	*24.0*	*26.5*	*30.7*
Total Expenditure	4189	5231	6562	8542
EBIDTA	**395**	**456**	**631**	**861**
(% of Net Sales)	*8.6*	*7.8*	*8.8*	*9.2*
Other Income	49	94	50	50
Depreciation& Amortisation	120	112	132	251
Interest	136	152	137	172
PBT	**188**	**286**	**412**	**489**
(% of Net Sales)	*4.1*	*5.0*	*5.7*	*5.2*
Tax	70	103	144	171
(% of PBT)	*37.1*	*35.8*	*35.0*	*35.0*
PAT	**119**	**184**	**268**	**318**
Extraordinary Item	17	33	0	0
Adj PAT	**101**	**151**	**268**	**318**
% chg	*52.0*	*48.8*	*77.4*	*18.7*

Balance Sheet (Standalone) Rs mn

Y/E March	FY2006	FY2007	FY2008E	FY2009E
SOURCES OF FUNDS				
Equity Share Capital	97	97	112	126
Preference Shares	25			
Reserves& Surplus	630	755	1,414	2,119
Shareholders Funds	**727**	**852**	**1,526**	**2,245**
Total Loans	1,241	846	1,367	1,717
Deffered Tax Liability	36	17	17	17
Total Liabilities	**2,028**	**1,715**	**2,909**	**3,978**
APPLICATION OF FUNDS				
Gross Block	1,244	1,234	1,981	3,278
Less: Acc. Depreciation	460	503	635	886
Net Block	**784**	**731**	**1,345**	**2,392**
Capital Work-in-Progress	1	6	510	43
Investments	**45**	**75**	**77**	**232**
Current Assets	2,547	2,687	3,459	4,557
Current liabilities	1,349	1,784	2,483	3,246
Net Current Assets	**1,198**	**903**	**976**	**1,311**
Total Assets	**2,028**	**1,715**	**2,909**	**3,978**

Cash Flow Statement (Standalone) Rs mn

Y/E March	FY2006	FY2007	FY2008E	FY2009E
Profit before tax	188	286	412	489
Depreciation	120	112	132	251
Change in Working Capital	140	(291)	28	285
Direct taxes paid	70	103	144	171
Cash Flow from Operations	**99**	**587**	**372**	**284**
Inc./ (Dec.) in Fixed Assets	18	(48)	1,118	577
Free Cash Flow	**81**	**636**	**(746)**	**(293)**
Inc/ (dec) in investment	(9)	30	2	155
Issue of Equity/ Preference	-	-	15	15
Inc/ (dec) in loans	76	(395)	521	350
Dividend Paid (Incl. Tax)	7	10	2	4
Others	(167)	(284)	252	(180)
Cash Flow from Financing	**(83)**	**(670)**	**789**	**189**
Inc./(Dec.) in Cash	(12)	(4)	45	50
Opening Cash balances	**21**	**9**	**5**	**50**
Closing Cash balances	**9**	**5**	**50**	**100**

Key Ratios (Standalone)

Y/E March	FY2006	FY2007	FY2008E	FY2009E
Valuation Ratio (x)				
P/E	24.2	15.6	12.3	11.7
P/E (Cash EPS)	12.1	9.7	8.3	6.6
P/BV	4.0	3.4	2.2	1.7
EV / Sales	0.9	0.7	0.6	0.5
EV / EBITDA	10.4	8.1	6.7	5.3
Per Share Data (Rs)				
EPS	12.2	18.9	23.9	25.1
Cash EPS	24.5	30.4	35.8	44.9
DPS	2.0	3.0	2.5	2.5
Book Value	75	88	136	178
Returns (%)				
ROE	16.3	21.6	17.5	14.1
ROCE	16.2	25.5	18.8	16.6
Dividend Payout	16.4	15.9	10.5	10.0
Operating Ratio				
Inventory(Days)	69	61	65	65
Debtors (Days)	112	85	85	85
Debt / Equity (x)	0.6	0.5	0.5	0.4

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Website: www.finquestonline.com

Ratings (Returns)	Buy > 15%	Hold 0-15%	Sell > -10%