

August 17, 2010

### BUY

Price **Rs 285** Target Price **Rs 400**

Sensex **18,051**

#### Price Performance

(%)	1M	3M	6M	12M
Absolute	(5)	(9)	17	77
Rel. to Sensex	(5)	(14)	4	51

Source: Bloomberg

#### Stock Details

Sector	Material Handling
Reuters	MCNL.BO
Bloomberg	MCNA@IN
Equity Capital (Rs mn)	311
Face Value (Rs)	10
No of shares o/s (mn)	31
52 Week H/L (Rs)	385/150
Market Cap (Rs bn/USD mn)	9/192
Daily Avg Vol (No of shares)	71770
Daily Avg Turnover (US\$ mn)	0.5

#### Shareholding Pattern (%)

	J'10	M'10	D'09
Promoters	45.7	45.7	45.7
FII/NRI	3.3	3.1	3.8
Institutions	13.0	12.8	12.3
Private Corp	7.4	7.4	7.2
Public	30.6	31.1	31.0

Source: Capitaline

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- McNally Bharat Q1FY11 performance below estimates – Revenue up 12% yoy to Rs2.8 bn, EBITDA margin down 130 bps yoy, EBITDA -9% yoy and APAT up 16% yoy to Rs62 mn
- McNally Sayaji headline numbers also disappoint – (1) Revenue up 17% yoy to Rs0.5 bn (2) EBITDA margin down 560 bps to Rs13.9% and (3) APAT declined 66% yoy to Rs15 mn
- Healthy order book of Rs48 bn – equivalent to 2.3X revenues and Order inflows of Rs10 bn in Q1FY11, offsets weak performance
- Weak performance not cause for concern – Retain earnings estimates of Rs24.3/Share and Rs30.3/Share for FY11E and FY12E respectively - Retain BUY

#### Standalone performance below estimates – Management remains unavailable for comment on weak performance

After 7 quarters of robust performance, McNally Bharat (MBE) reported subdued standalone performance in Q1FY11, below estimates – upfront attributed to lower revenue booking and sharp decline in EBITDA margins. Revenue growth was lower at 12.2% yoy to Rs2839 mn. EBITDA margins declined by 130 bps yoy to 5.5% (lowest in past 8 quarters) due to sharp rise in employee costs and other expenses and EBITDA declined 8.9% yoy to Rs156 mn. Despite decline in operating margins, APAT grew by 15.8% yoy to Rs62 mn, though below estimates - due to decline in interest costs and high other income. Management remained unavailable for comment on weak operating performance.

#### McNally Sayaji (MSE) also disappoints, but CMT Humboldt performance satisfactory

Headline numbers of MSE disappoints – (1) Revenues grew by 16.9% yoy to Rs522 mn (2) EBITDA margins decline 560 bps yoy to 13.9% (3) EBITDA decline 16.5% yoy to Rs72 mn and (4) RPAT decline 65.7% yoy to Rs15 mn. German business CMT Humboldt reported satisfactory performance with revenues of Rs760 mn, EBITDA of Rs30 mn and PBT of Rs24 mn.

#### Further accretion in order book with consolidated order backlog at Rs48 bn – offsets weak performance and arrests fall in stock price

MBE reported continued momentum in order inflows in Q1FY11 – bagged orders worth Rs10.4 bn – equivalent to 35.5% of FY11E target order flows. MBE bagged its 2<sup>nd</sup> BOP order worth Rs8.3 bn from MP Power Genco on EPC basis. Consequently, MBE's standalone order book increased to Rs42.0 bn – equivalent to robust 2.9X FY10 revenues. MBE's consolidated order book stood at Rs48.0 bn – (1) Rs42 bn for standalone operations (2) Rs2.5 bn for MSE and (3) Rs3.6 bn for German business. The healthy accretion in order book offset the weak operating performance, arresting fall in stock price.

#### Consolidated Financial Snapshot

Rs Mn

YE-	Net Sales	EBITDA (Core)	EBITDA (%)	APAT	EPS (Rs)	EPS %Chg	ROE (%)	P/E	EV/ EBITDA	P/BV
Mar										
FY09	11,132	1,028	9.2	301	6.6	(15.5)	9.3	45.6	10.9	4.2
FY10P	20,193	1,636	8.1	811	21.4	225.5	24.1	14.0	6.9	2.8
FY11E	25,477	2,162	8.5	987	24.3	13.2	20.7	12.4	6.0	2.2
FY12E	31,256	2,654	8.5	1,232	30.3	25.1	19.7	9.9	5.3	1.8

### Eyeing acquisition- now in pump manufacturing space

Some positive news-flows surrounding McNally Bharat – pursuing acquisition within broader capital goods. News reports hints at acquisition in Europe again. It is eyeing industrial pump manufacturer whose product portfolio includes boiler feeding pumps, specialized pumps and deep-sea submersible pumps.

### Maintain FY11E and FY12E earning estimates, Reiterate BUY

Upfront, Q1FY11 performance was below estimates led by lower revenue booking and high costs – prevalent in many ECI companies during the quarter. Though, management was unavailable for comment on weak performance, prima facie we believe that weak results are not a cause for concern. Infact, healthy accretion in order book will offset the weak operating performance and arrest downfall in stock price. We retain our earnings estimates for FY11E and FY12E at Rs24.3/Share and Rs30.3/Share respectively. Maintain BUY rating and target price of Rs400/Share.

#### Key Standalone Financials – Quarterly

Rs mn	Q1FY10	Q2FY10	Q3FY10	Q4FY10	Q1FY11	YoY (%)	QoQ (%)
<b>Revenue</b>	<b>2,530</b>	<b>3,052</b>	<b>3,325</b>	<b>5,624</b>	<b>2,839</b>	12.2	(49.5)
<b>Expenditure</b>	<b>2,359</b>	<b>2,839</b>	<b>3,095</b>	<b>5,216</b>	<b>2,683</b>	<b>13.7</b>	<b>(48.6)</b>
Consumption of RM	1,585	1,901	2,238	3,345	1,411	(11.0)	(57.8)
as % of sales	62.6	62.3	67.3	59.5	49.7		
Job Work Outsourcing Expenses	469	518	571	1,171	680	44.9	(41.9)
as % of sales	18.5	17.0	17.2	20.8	24.0		
Employee Cost	145	168	194	205	246	70.2	20.1
as % of sales	5.7	5.5	5.8	3.6	8.7		
Other expenditure	160	253	93	495	346	115.5	(30.2)
as % of sales	6.3	8.3	2.8	8.8	12.2		
<b>EBITDA</b>	<b>171</b>	<b>213</b>	<b>230</b>	<b>408</b>	<b>156</b>	<b>(8.9)</b>	<b>(61.8)</b>
Depreciation	14	0	13	15	18	24.3	21.8
<b>EBIT</b>	<b>157</b>	<b>212</b>	<b>217</b>	<b>394</b>	<b>138</b>	<b>(11.9)</b>	<b>(64.9)</b>
Other Income	3	3	13	13	15	451.9	16.4
Interest	79	112	136	69	60	(24.2)	(13.4)
<b>PBT</b>	<b>81</b>	<b>104</b>	<b>93</b>	<b>337</b>	<b>93</b>	<b>15.7</b>	<b>(72.4)</b>
Total Tax	27	15	24	122	32	15.3	(74.2)
<b>Adjusted PAT</b>	<b>53</b>	<b>88</b>	<b>70</b>	<b>215</b>	<b>62</b>	<b>15.8</b>	<b>(71.4)</b>
Extra ordinary items	0	-52	4	10	0	NA	(100.0)
<b>Reported PAT</b>	<b>53</b>	<b>36</b>	<b>74</b>	<b>224</b>	<b>62</b>	<b>15.8</b>	<b>(72.6)</b>
<b>Adjusted EPS</b>	<b>1.7</b>	<b>2.8</b>	<b>2.2</b>	<b>6.9</b>	<b>2.0</b>	<b>15.8</b>	<b>(71.4)</b>

Margins (%)						(bps)	(bps)
EBIDTA	6.8	7.0	6.9	7.3	5.5	(130)	-180
EBIT	6.2	7.0	6.5	7.0	4.9	(130)	-210
EBT	3.2	3.4	2.8	6.0	3.3	10	-270
PAT	2.1	2.9	2.1	3.8	2.2	10	-170
Effective Tax rate	34.0	14.9	25.2	36.3	33.9	(10)	-240

## Key Consolidated Financials

## Income Statement

Y/E, Mar (Rs. mn)	FY09	FY10P	FY11E	FY12E
<b>Net Sales</b>	<b>11,132</b>	<b>20,193</b>	<b>25,477</b>	<b>31,256</b>
<i>Growth (%)</i>	<i>101.1</i>	<i>81.4</i>	<i>26.2</i>	<i>22.7</i>
<b>Expenditure</b>	<b>10,105</b>	<b>18,557</b>	<b>23,315</b>	<b>28,602</b>
Materials Consumed	6,545	11,962	15,153	18,619
Employee Cost	668	1,482	1,858	2,240
Manufacturing Exp	2,119	3,750	4,766	5,913
Other Exp	773	1,363	1,539	1,831
<b>EBITDA</b>	<b>1,028</b>	<b>1,636</b>	<b>2,162</b>	<b>2,654</b>
<i>Growth (%)</i>	<i>143.2</i>	<i>59.2</i>	<i>32.2</i>	<i>22.7</i>
<b>EBITDA margin (%)</b>	<b>9.2</b>	<b>8.1</b>	<b>8.5</b>	<b>8.5</b>
Depreciation	95	141	168	197
<b>EBIT</b>	<b>933</b>	<b>1,495</b>	<b>1,994</b>	<b>2,457</b>
<b>EBIT margin (%)</b>	<b>8.4</b>	<b>7.4</b>	<b>7.8</b>	<b>7.9</b>
Other Income	-12	62	63	66
Interest expenses	331	417	601	701
<b>PBT</b>	<b>589</b>	<b>1,140</b>	<b>1,457</b>	<b>1,822</b>
Tax	288	330	470	590
<i>Effective tax rate (%)</i>	<i>48.9</i>	<i>28.9</i>	<i>32.3</i>	<i>32.4</i>
<b>Adjusted PAT</b>	<b>301</b>	<b>811</b>	<b>987</b>	<b>1,232</b>
<i>Growth (%)</i>	<i>34.7</i>	<i>169.2</i>	<i>21.7</i>	<i>24.9</i>
<b>Net Margin (%)</b>	<b>2.7</b>	<b>4.0</b>	<b>3.9</b>	<b>3.9</b>
(Profit)/loss from JVs/Ass/MI	96	144	157	194
<b>Adj. PAT After JVs/Ass/MI</b>	<b>205</b>	<b>667</b>	<b>830</b>	<b>1,038</b>
E/O items	231	(44)	-	-
<b>Reported PAT</b>	<b>435</b>	<b>623</b>	<b>830</b>	<b>1,038</b>
<i>Growth (%)</i>	<i>93.9</i>	<i>43.0</i>	<i>33.2</i>	<i>25.1</i>

## Cash Flow

Y/E, Mar (Rs. mn)	FY09	FY10P	FY11E	FY12E
<b>PBT</b>	<b>820</b>	<b>1,140</b>	<b>1,457</b>	<b>1,822</b>
Depreciation	95	141	168	197
Interest Provided	331	417	601	701
Other Non-Cash items	-134	-44	0	0
Chg in working cap	-1,184	-1,388	-1,940	-2,024
Tax paid	-137	-330	-470	-590
<b>Operating Cash flow</b>	<b>-209</b>	<b>-64</b>	<b>-185</b>	<b>106</b>
Capital expenditure	-1,471	-574	-250	-300
<b>Free Cash Flow</b>	<b>-1,680</b>	<b>-638</b>	<b>-435</b>	<b>-194</b>
Other income	0	1	2	3
Investments	136	-9	0	0
<b>Investing Cash flow</b>	<b>136</b>	<b>-8</b>	<b>2</b>	<b>3</b>
Equity Capital Raised	0	404	435	0
Loans Taken / (Repaid)	1,603	748	700	750
Interest Paid	-331	-417	-601	-701
Dividend paid (incl tax)	-39	-39	-56	-72
Income from investments	0	0	0	0
Others	0	0	0	0
<b>Financing Cash flow</b>	<b>1,232</b>	<b>696</b>	<b>479</b>	<b>-23</b>
<b>Net chg in cash</b>	<b>-312</b>	<b>50</b>	<b>46</b>	<b>-214</b>
Opening cash position	706	418	467	511
<b>Closing cash position</b>	<b>418</b>	<b>467</b>	<b>511</b>	<b>294</b>

## Balance Sheet

Y/E, Mar (Rs. mn)	FY09	FY10P	FY11E	FY12E
Equity share capital	311	311	342	342
Reserves & surplus	1,766	2,755	3,933	4,899
<b>Net worth</b>	<b>2,077</b>	<b>3,066</b>	<b>4,275</b>	<b>5,241</b>
<b>Minority Interest</b>	<b>123</b>	<b>267</b>	<b>424</b>	<b>619</b>
Secured Loans	2,130	2,880	3,580	4,330
Unsecured Loans	5	2	2	2
<b>Loan Funds</b>	<b>2,135</b>	<b>2,883</b>	<b>3,583</b>	<b>4,333</b>
Net deferred tax liability	142	142	142	142
<b>Total Liabilities</b>	<b>4,478</b>	<b>6,358</b>	<b>8,424</b>	<b>10,334</b>
Gross Block	2,590	3,219	3,469	3,769
Less: Depreciation	334	475	642	839
<b>Net block</b>	<b>2,255</b>	<b>2,745</b>	<b>2,827</b>	<b>2,930</b>
Capital work in progress	113	58	58	58
<b>Investment</b>	<b>15</b>	<b>25</b>	<b>25</b>	<b>25</b>
<b>Current Assets</b>	<b>9,265</b>	<b>14,137</b>	<b>18,805</b>	<b>23,594</b>
Inventories	773	943	1,190	1,460
Sundry debtors	6,935	10,783	14,652	18,832
Cash & bank balance	418	467	511	294
Loans & advances	1,139	1,943	2,452	3,008
Other current assets	0	0	0	0
<b>Current lia &amp; Prov</b>	<b>7,172</b>	<b>10,606</b>	<b>13,290</b>	<b>16,273</b>
Current liabilities	7,033	10,468	13,151	16,134
Provisions	139	139	139	139
<b>Net current assets</b>	<b>2,094</b>	<b>3,531</b>	<b>5,515</b>	<b>7,321</b>
Misc. exp	0.2	0.2	0.2	0.2
<b>Total Assets</b>	<b>4,478</b>	<b>6,358</b>	<b>8,424</b>	<b>10,334</b>

## Key Ratios

Y/E, Mar	FY09	FY10P	FY11E	FY12E
<b>Profitability (%)</b>				
EBITDA Margin	9.2	8.1	8.5	8.5
Net Margin	2.7	4.0	3.9	3.9
ROCE	21.2	29.5	28.4	27.3
ROE	9.3	24.1	20.7	19.7
RoIC	23.7	25.7	25.5	24.7
<b>Per Share Data (Rs)</b>				
EPS	6.6	21.4	24.3	30.3
CEPS	8.5	24.7	27.6	34.2
BVPS	70.8	107.2	137.4	171.3
DPS	1.3	1.3	1.6	2.1
<b>Valuations (x)</b>				
PER	45.6	14.0	12.4	9.9
P/CEPS	35.4	12.2	10.9	8.8
P/BV	4.2	2.8	2.2	1.8
EV / Sales	1.0	0.6	0.5	0.5
EV / EBITDA	10.9	6.9	6.0	5.3
Dividend Yield (%)	0.4	0.4	0.5	0.7
<b>Gearing Ratio (x)</b>				
Net Debt/ Equity	0.8	0.7	0.7	0.7
Net Debt/EBIDTA	1.6	1.3	1.3	1.4
Working Cap Cycle (days)	55.2	50.8	64.8	74.9

**Recommendation History: McNally Bharat Engineering – MCNA IN**

Date	Reports	Reco	CMP	Target
18.05.2010	<a href="#">McNally Bharat Q4FY10 Result Update</a>	Buy	313	400
02.02.2010	<a href="#">McNally Bharat Q3FY10 Result Update</a>	Buy	249	308
04.11.2009	<a href="#">McNally Bharat Q2FY10 Result Update</a>	Buy	181	255
31.07.2009	<a href="#">McNally Bharat Q1FY10 Result Update</a>	Buy	158	185

**Recent Research Reports**

Date	Reports	Reco	CMP	Target
12.08.2010	<a href="#">Bharati Shipyard Q1FY11 Result Update</a>	Reduce	236	196
04.08.2010	<a href="#">Punj Lloyd Q1FY11 Result Update</a>	Hold	121	132
02.08.2010	<a href="#">Elecon Engineering Q1FY11 Result Update</a>	Hold	93	96
29.07.2010	<a href="#">Voltas Q1FY11 Result Update</a>	Buy	208	234

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