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ISGEC Heavy Engineering Limited (ISGEC) formerly known as The Saraswati Industrial Syndicate limited is an India-based heavy engineering company. It manufactures and sells heavy engineering equipment in India and internationally. It offers process equipment, including reactors, high pressure vessels, shell and tube heat exchangers, columns and towers, boiler drums, and power plant equipment; and boilers comprising pulverized coal boilers, bagasse and biomass boilers, atmospheric fluidized bed combustion boilers, circulating fluidized bed combustion boilers, oil and gas fired boilers, waste heat recovery boilers, slop fired boilers, and spares. In addition, it offers iron castings for pump and compressor, chemical and dye stuff, soda ash, tool and dies, machine tools, steel plant, and paper industries; and liquefied gas containers. Further, the company provides contract manufacturing services; and EPC solutions for power plants, as well as manufactures and sells sugar.

Investment Rationale

Diversified revenue stream safeguards against cyclical uncertainties – ISGEC caters to Power, Oil & Gas, Fertiliser, Steel, Cement, Automobile, Defence, Sugar, Cement and Chemicals Sector. Adding to its domestic revenues, it has been able to increase its exports contribution from less than 20% a couple of years back to more than 30% in FY13/FY14. **This diversification shields the company's operations from downturn in a particular sector and also ensures strong order book position.**

Sustainable order book to drive revenue growth by ~30% by FY15E - The order book of the company remains quite strong with some factories having excess orders beyond its capacity to produce. This may lead to overall increase in margins in the coming quarters. As of March 2014, ISGEC had an order book worth ~₹45,000 mn on a standalone basis executable roughly in 14-18 months, which enlightens the revenue growth visibility. Moreover new contracts from ISGEC Hitachi Zoshen project and Foster Wheeler PC and CFBC projects will give the company a head start against existing competition, translating into better sales and higher revenue. On the back of these arguments we expect the revenue to grow by ~30% by FY15E.

JV with Foster Wheeler entails robust revenue outlook – Keeping up with its policies of strategic partnerships, the company entered yet another JV with Foster Wheeler for PC and CFBC projects recently. This JV will further unlock another set of opportunities for long term high margin growth for ISGEC over and above its current business.

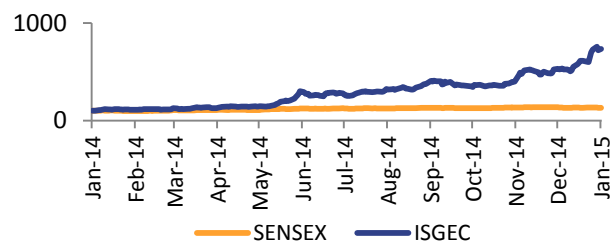
Market Data

Rating	BUY
CMP (₹)	5,895.0
Target (₹)	7,186.0
Potential Upside	~21.9%
Duration	Long Term
Face Value (₹)	2.0
52 week H/L (₹)	6068.5/800.5
Adj. all time High (₹)	6068.5
Decline from 52WH (%)	2.9
Rise from 52WL (%)	636.4
Beta	2.2
Mkt. Cap (₹bn)	43.4
Enterprise Value (₹bn)	43.0

Fiscal Year Ended

Y/E	FY13A	FY14A	FY15E	FY16E
Revenue (₹bn)	25.1	14.4	33.3	37.2
EBITDA (₹bn)	1.4	0.9	2.5	3.1
Net Profit (₹bn)	0.7	0.5	1.2	1.4
EPS (₹)	98.3	62.9	159.2	190.4
P/E (x)	60.0	93.7	37.0	31.0
P/BV (x)	7.1	6.7	5.7	4.9
EV/EBITDA (x)	30.9	49.0	17.1	13.5
ROCE (%)	13.4	8.5	19.6	21.1
ROE (%)	11.9	7.1	15.4	15.7

One year Price Chart



Shareholding Pattern

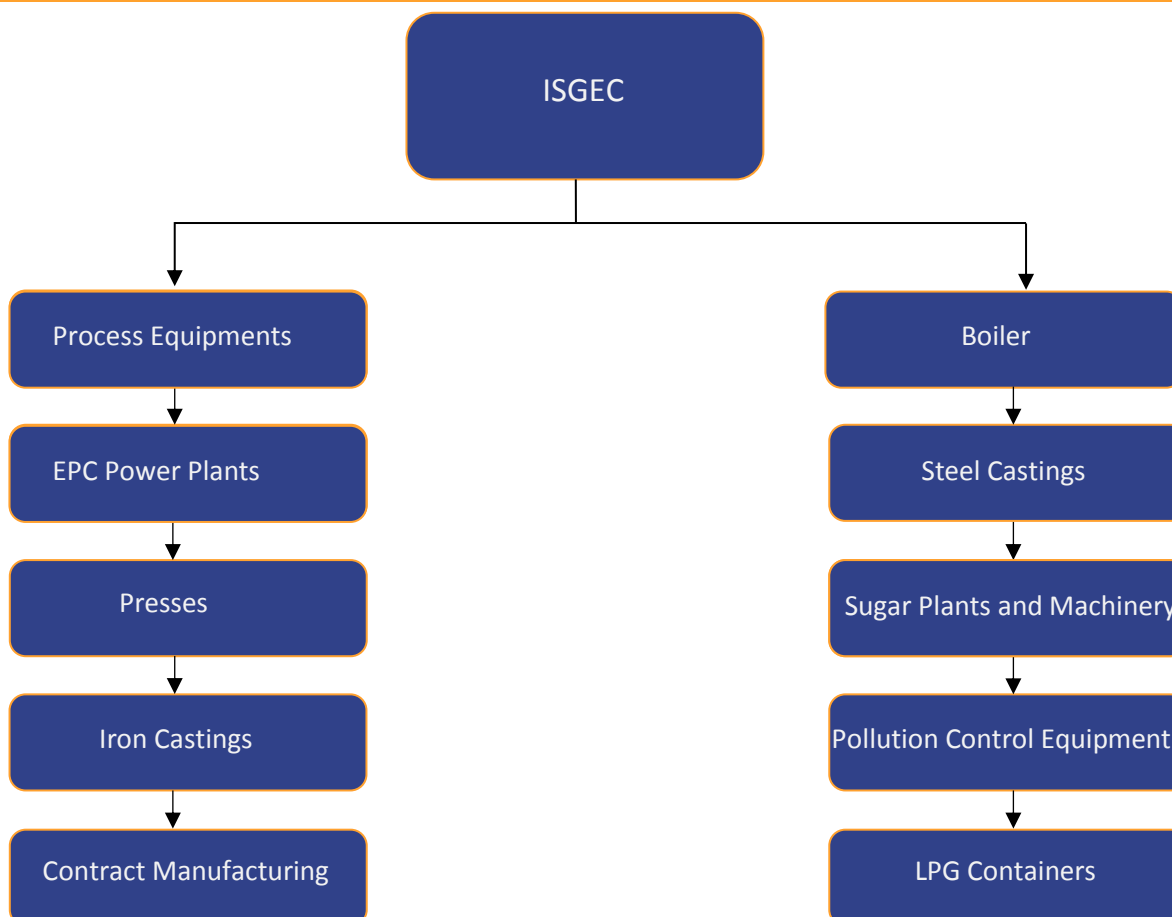
Shareholding Pattern	Sep'14	Jun'14	Diff.
Promoters	62.13	62.14	(0.01)
FII	1.10	0.70	0.4
DII	0.49	0.48	0.01
Others	36.28	36.68	(0.4)

ISGEC is a diversified heavy engineering company with interests in Process Equipment, EPC Power Plants, Boilers, Sugar Plants & Machinery, Mechanical & Hydraulic Presses, Castings, Contract Manufacturing, and Trading.

ISGEC Heavy Engineering Ltd.

Isgec Heavy Engineering (ISGEC) has a history of eighty years and is a diversified heavy engineering company with interests in Process Equipment, EPC Power Plants, Boilers, Sugar Plants & Machinery, Mechanical & Hydraulic Presses, Castings, Contract Manufacturing, and Trading. Established in 1946, the initial business of the company was of sugar production (sugar mill) and the company later diversified into heavy engineering. In 1964, they established a JV with John Thompson that was known as ISGEC John Thompson (IJT). In 1981, ISGEC acquired stake from John Thompson in the JV and also acquired majority stake in UP Steels. Both these companies were subsequently amalgamated into ISGEC Heavy Engineering Limited. In FY 2011 the company changed its name from Saraswati Industrial Syndicate Ltd. to Isgec Heavy Engineering Ltd. All businesses were consolidated and now marketed under a common brand name – ISGEC. Unlike many engineering players that are heavily dependent on a single industry, ISGEC has an extremely diversified revenue stream like sugar machineries, power machineries and others. It is this diversified revenue streams coming from sales to more than 70 countries that has helped the company to consistently grow from ₹3 bn revenue in 2001 to ₹30 bn revenues in 2013 without facing any significant headwinds during the recessionary period post 2008. On the manufacturing side, ISGEC has its facilities spread across 250 acres of land at various locations across Yamunanagar, Dahej, Bawal & Muzaffarnagar in India. ISGEC enjoys number uno position for a turnkey project provider to sugar plants.

Strategic Business units of ISGEC



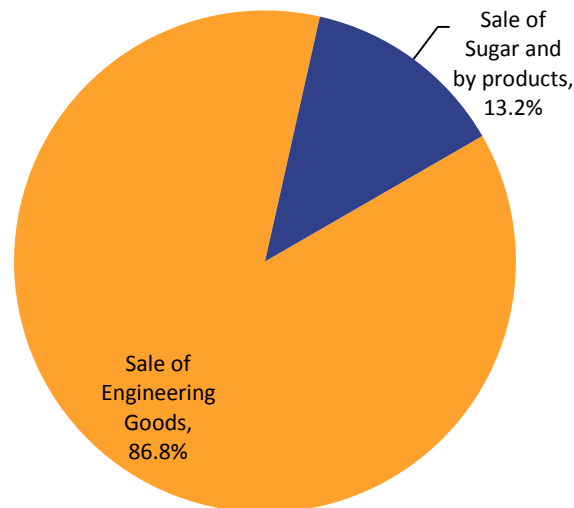
Strong sales growth led to higher net revenue subsequently translating into a 31.9% surge in the bottom-line.

Showcased strong numbers in Q2FY15

ISGEC has reported a healthy performance in Q2FY15 with net sales/income from operations grew modestly by 17.4% YoY at ₹8,206.5 mn against ₹6,990.3 mn for the same period of last year. In line with strong sales growth coupled with better operating leverage have translated into the robust growth of the EBIT.

Profit from operations before other income, finance costs and exceptional items reported a sturdy growth of 54.4% YoY at ₹567.5 mn as against ₹367.5 mn last year, which translated into 120 bps expansion in operating margin. As a result, net profit for the period surged by 31.9% at ₹412.5 mn, which translated into ₹56.10 per basic and diluted share on before and after extraordinary items against ₹46.07 per basic and diluted share on before and after extraordinary items for the same period of last year.

Revenue bifurcation



The company reported a strong 19% YoY growth in the net sales/income from operations for the six months ending Sep' 14 at ₹14,835.1 mn on the back of robust order execution.

H1FY15 performance portrays strong growth story

The half yearly performance also remained impressive with the company reporting a strong 19% YoY growth in the net sales/income from operations for the six months ending Sep' 14 at ₹14,835.1 mn against ₹12,432.5 mn for the same period of last year, arising from strong order execution. Further, the company witnessed a remarkable growth in its EBIT, up by ~78% YoY at ₹897.5 mn against ₹502.1 mn for the same period of last year. As a result, net profit grew impressively by ~37% YoY to ₹664.5 mn or ₹90.37 per basic and diluted share on before and after extraordinary items.

Robust balance sheet position

ISGEC has maintained strong financial position over the years with near zero debt. The liabilities majorly comprise of advances from customers for project execution. Advances can vary from 10% to 20% of the order size. We believe that the company's policy of not financing its client and never taking orders without advance along with improving business climate and strategic partnerships can thereby lead to reasonable operational leverage thus safeguarding the balance sheet of the company in the long run.

ISGEC has been able to increase its exports contribution from less than 20% a couple of years back to more than 30% in FY13/FY14.

Diversification in various sectors ensures steady revenue

ISGEC has a dynamic presence across various sectors and geographies. It caters to Power, Oil & Gas, Fertiliser, Steel, Cement, Automobile, Defence, Sugar, Cement and Chemicals Sector. Adding to its domestic revenues, it has been able to increase its exports contribution from less than 20% a couple of years back to more than 30% in FY13/FY14. It has a very strong name that has emerged as one of the leading players in Sugar Machineries segment across the world. ISGEC has emerged as a leading Sugar Machinery and Sugar Boiler manufacturer both in domestic as well as international markets. It also received a number of orders for export and the Company is striving to become a world leader in this business in the next few years. The Division successfully commissioned its largest Sugar Mills of the size of 1150 mm x 2290 mm (45" x 90") and a sugar refinery for the first time during H1FY15 and also secured a further order for a sugar refinery.

The company has also been able to make inroads into a lot of geographies in the power boilers segments as well. In recent years it had embarked on supplying turnkey power plants. Additionally, it also supplies the Turbo set and balance of plant. The Boiler Division of ISGEC has ventured into new products such as Heat Recovery Steam Generators, Waste Heat Recovery Boilers and Pin Hole Grate Boilers. **We believe that the company's presence across different verticals provide it the benefit of a broad product portfolio and a strong order book, making the company financially viable.**

Strong order book

ISGEC is riding high on its strong order book profile. As of March 2014, ISGEC had an order book worth ~₹45,000 mn on a standalone basis executable roughly in 14-18 months, which enlightens the revenue growth visibility. Moreover, orders in the JV –ISGEC Hitachi Zosen that will focus on the process equipment to fertilizer industry will increase the existing capacity of the Plant from 8,000 MT per year to 13,000 MT per year gradually. The traction in its entire business is reasonably good with strong demand from exports. Besides, the debottlenecking task taken by the new government will fructify anytime in the next 1-2 years churning significantly better revenues. The Automobile and Automobile Components manufacturing sector, major consumer of Presses produced by the Machine Building Division, faced further slowdown during FY14. This affected the order booking of this Division. The Container sub-division of the Process Equipment Division has had a record billing and order booking during the period including large export orders. The order book of the Joint Venture Company is healthy. The Company manufactures products having long manufacturing cycle. Consequently, a number of orders booked in the previous year will be delivered in the current financial year. Therefore, the financial results of the Joint Venture Company for the current financial year are likely to be good.

We believe that the uptick in the domestic capex cycle along with recovery in the domestic environment and the company's plan to forge new partnerships also brightens the company's order intake outlook. Albeit, cyclical trends in consuming industries may affect future order inflows, although this risk is partly mitigated by the geographical diversification of the company's order book.

ISGEC's strategic associations keep it ahead of competition. The Management plans to look for new technologies and new diversification areas so as to broaden its portfolio of products and also move into higher value added products/projects.

Standing against macro-economic atrocities the stock is going strong and has given a return of more than 600% just in the period of a year.

Strategic Partnerships pave way for higher value additions

ISGEC flourishes on various strategic partnerships. The company entails a plethora of business units translating into strong clientele which ensure technological advancement and competitive advantage. For example its latest project ISGEC Hitachi Zosen Ltd. which is a joint venture between ISGEC Heavy Engineering Ltd., India & Hitachi Zosen Corp., and Japan. It has been set up to cater to the specialized & critical Process Equipment requirements of refineries, fertilizer & petrochemical industries, across the world. The joint venture brings together state-of-the-art technical & engineering skills of Hitachi Zosen and the manufacturing expertise of ISGEC. It will take over ISGEC's existing manufacturing facilities at the port town of Dahej (Gujarat), giving it easy access to the global market. The joint venture, manned by personnel from India and Japan, is actively supported by both ISGEC and Hitachi Zosen, in all its activities, including design and marketing.

The Management plans to look for new technologies and new diversification areas so as to broaden its portfolio of products and also move into higher value added products/projects.

Foster Wheeler's PC and CFBC technology new breakthrough

Recently ISGEC showcased advancement in pulverized coal (PC) and circulating fluidized bed combustion (CFBC) boilers based on its licensing agreement with Foster Wheel, a global market leader in these technologies. This technology will offer better heat rates and avoid the use of circulating pumps for higher subcritical pressure boilers.

Meanwhile, PC boilers provided by ISGEC to its client OPG Power for its 180 MW plant in Chennai is nearing completion and is likely to be commissioned soon.

As regards the CFBC technology, the Foster's Wheelers technology offers the customers widest possible fuel flexibility in addition to base fuels like pet coke and biomass. CFBC also eliminates the need for expensive equipment for NO and SO emissions from boilers. So far, CFBC has demonstrated boiler availability exceeding 95% resulting in increased revenues and profitability for users. The compact separate cyclone design results in improved combustion efficiency and smaller footprint of the boiler. ISGEC has successfully commissioned recent CFBC boilers in the record time of 15-16 months. We believe that this achievement will add to the competitive advantage of the company thus aiding it to establish a firmer foot in the heavy engineering market space.

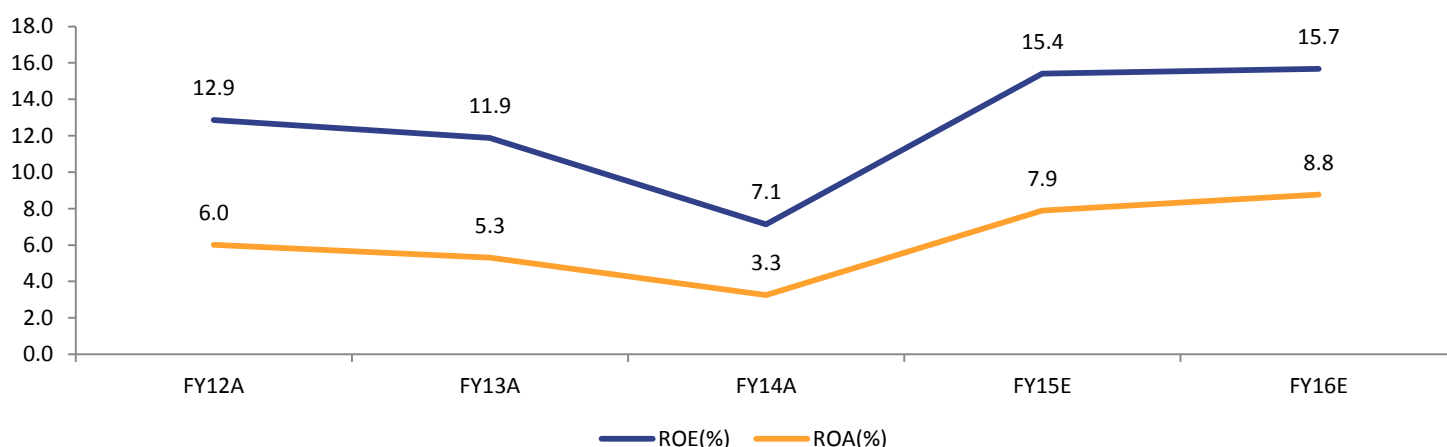
Company going strong despite macro-economic uncertainties

The company witnessed growth in turnover, margins and order bookings during H1FY15 despite depressed economic conditions both in India and overseas. Input prices remained suppressed during most of the period. ISGEC, however, due to its intensive efforts in marketing, technology up-gradation and cost control, has been able to achieve reasonable growth. The appreciation of Indian currency will, however, affect the competitiveness of the Company in exports which now form a significant portion of its turnover. The Management continues to make aggressive efforts to up-grade technology and diversify the activities of various units. Certain businesses may continue to be affected due to severe slowdown in sectors such as Automobile, Oil & Refinery and Power sectors. However, they do not pose a menace for the company given its diversified nature.

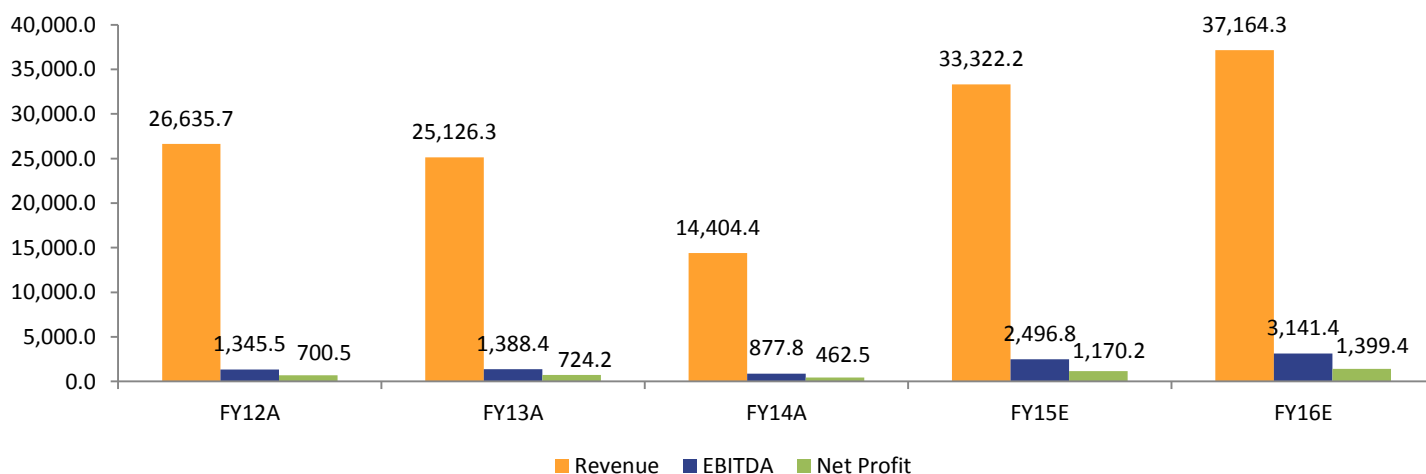
Key Concerns

- The domestic sugar segment is experiencing stress on account of high cane pricing recommended by the UP state government. Almost all the sugar mills in UP have taken a joint decision to cease crushing during the current season, until the Rangarajan formula (pass back only 70% of the sugar prices as cost of sugar cane) is implemented by the state government.
- In the engineering segment, the company is currently executing projects totaling 470 MW, including a domestic EPC project of 180MW for the OPG group which is due for commissioning in the next 6-8 months. Once the OPG group order is executed, there would not be any major domestic orders on hand and the company does not expect finalization of any other Indian orders in the medium term either from the engineering or sugar segment.

Return ratios to stay elevated



Projected Revenue and Net Profit (₹mn)



Balance Sheet (Consolidated)

Y/E (₹mn)	FY13A	FY14A*	FY15E	FY16E
Share Capital	73.7	73.5	73.5	73.5
Reserve and surplus	6,019.8	6,407.5	7,517.2	8,856.1
Net Worth	6,093.5	6,481.0	7,590.7	8,929.6
Loans	2,764.3	3,482.9	1,453.8	1,335.1
Other Long term Liabilities	1,035.6	1,043.2	975.2	975.2
Deferred tax liability	187.0	196.5	137.2	137.2
Long term Provisions	1,268.8	1,327.4	1,520.4	1,581.2
Current Liabilities	12,632.5	13,077.1	15,186.2	16,238.9
Capital Employed	23,981.7	25,608.1	26,863.5	29,197.2
Fixed Assets	4,363.2	4,412.8	4,521.8	4,747.9
Long term loans and advances	123.8	135.1	106.3	116.9
Non-Current Investments	1,265.6	1,265.6	1,522.2	1,674.4
Other non-current assets	200.3	16.6	0.0	0.0
Current Assets	18,028.8	19,778.0	20,713.2	22,658.0
Capital Deployed	23,981.7	25,608.1	26,863.5	29,197.2

Key Ratios (Consolidated)

Y/E	FY13A	FY14A*	FY15E	FY16E
EBITDA Margin (%)	5.5	6.1	7.5	8.5
EBIT Margin (%)	5.1	5.8	6.4	6.9
NPM (%)	2.9	3.2	3.5	3.8
ROCE (%)	13.4	8.5	19.6	21.1
ROE (%)	11.9	7.1	15.4	15.7
EPS (₹)	98.3	62.9	159.2	190.4
P/E (x)	60.0	93.7	37.0	31.0
BVPS(₹)	826.9	881.8	1,032.8	1,214.9
P/BVPS (x)	7.1	6.7	5.7	4.9
EV/Operating Income (x)	23.6	38.7	14.8	12.2
EV/EBITDA (x)	30.9	49.0	17.1	13.5

*The company changed its financial year from September to March w.e.f September'13. The figures for FY14A are for six months ending Mar'14.

Profit & Loss Account (Consolidated)

Y/E (₹mn)	FY13A	FY14A*	FY15E	FY16E
Net Sales	25,126.3	14,404.4	33,322.2	37,164.3
Expenses	23,737.8	13,526.6	30,825.5	34,022.9
EBITDA	1,388.4	877.8	2,496.8	3,141.4
Other Income	426.1	233.9	378.1	321.4
Depreciation	541.6	278.7	753.5	904.1
EBIT	1,272.9	833.0	2,121.5	2,558.7
Net Interest cost	225.0	130.4	172.4	156.9
Profit Before Tax	1,047.8	702.6	1,949.0	2,401.8
Tax	323.7	240.1	778.8	1,002.4
Net Profit	724.2	462.5	1,170.2	1,399.4

Valuation and view

ISGEC is well positioned vis-a-vis the domestic capex revival as well as international demand. Its capable management and the thrust to continuously improve its competencies in the heavy engineering area should enable it to bag large orders and thereby gives visibility for 2-3 years period. Its policies of thriving on strategic partnerships have aided the company in being financially viable along with increasing its market presence and safeguarding its position. Albeit, there are concerns on the sugar pricing and the slowing down domestic orders, we expect that the timely execution of existing orders, increasing exports share in the revenue pie and a growing sugar segment will not strain the top-line.

At the CMP of ₹5,895.0, the stock is trading at an EV/EBITDA multiple of 17.1x for FY15E and 13.5x FY16E. We estimate an EV/EBITDA of 12.0x for FY16E and place a target of ₹7,186.0 implying a potential upside of 21.9% from long term perspective.



Indbank Merchant Banking Services Ltd.
I Floor, Khiviraj Complex I,
No.480, Anna Salai, Nandanam, Chennai 600035
Telephone No: 044 – 24313094 - 97
Fax No: 044 – 24313093
www.indbankonline.com

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