Mcnally Bharat Engineering Company Ltd.

EQUITY REPORT

July 19, 2013

BSE Code: 532629 **NSE Code:** MBECL **Reuters Code:** MCNL.BO **Bloomberg Code:** MCNA:IN

McNally Bharat Engineering Company Limited (MBEC) is India's leading engineering company catering turnkey solutions in the areas of Power, Steel, Aluminium, Material Handling etc. Its order backlog is diverse with power accounting for 38% of backlog, followed by steel, mining & port sector (29%), infrastructure/oil & gas (26%) and remaining 7% coming from process plants. In FY'13 it has order booking of ₹39.1 bn and order backlog of ₹55.4 bn which strengthened firm's hope to earn ~₹30.0 bn in FY'14 vs. ₹20.9 bn in FY'13.

Investor's Rationale

- MBEC is currently sitting on a huge order backlog of ~₹55.4 bn out of which over ₹8 bn orders are from public sector. Going ahead, the firm is cautiously stepping up while choosing the projects and believes to add ~₹30-40 bn of order book by the end of FY'14. With this we expect the firm to convert reasonable bids into final order by FY'14 that will surely add to its turnover to ~₹30.0 bn.

- The government enhanced focused towards power sector in the 12th year plan has created a significant opportunities for MBEL, a prime order segment for MBEC. The government target for adding 76,000 MW of electricity capacity in the 12th Plan and 93,000 MW in the 13th Year Plan has opened a long way for the company to go for.

- MBEC recorded a net loss of ₹0.2 bn in FY'13 against a net profit of ₹0.7 bn in FY'12 driven by the impairment loss of ₹0.4 bn, on account of diminution in value of investment in MBE Cologne Engineering GmbH, Germany. However, we expect that the situation will improve in next couple of years and will clock a reasonable net profit of ~₹295 mn by FY'14 driven by its huge order book in line.

- The firm burdened with a massive debt of ~₹7 bn in FY'13 (standalone) on high borrowing cost. The management aims to shed ₹6 bn by FY'14 via flow of retention money ₹3.4 bn that will help to slash borrowing cost and hence the debt load. Also, the firm is concentrating more on cash positive business and order which will require less working capital. Besides, the firm is also re-looking on the entire portfolio of the business to make itself a debt free company.

Key risk

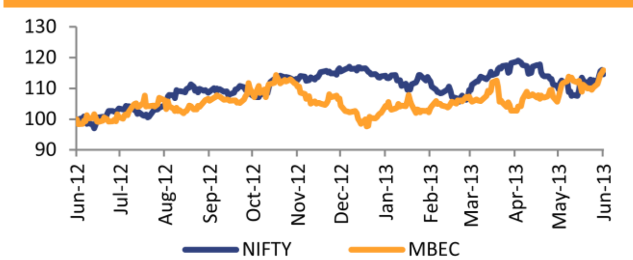
Government's policy paralysis: MBEC, being an EPC player needs to take governmets approval for project implementation. Unfortunately, the firm is facing the single biggest bottleneck i.e delay in getting goverments consent regarding the project execution which in turn impacting the existing as well as orders in pipeline.

Market Data	
Rating	**BUY**
CMP (₹)	48
Target (₹)	**59**
Potential Upside	~22.9%
Duration	Long Term
Face Value (₹)	10
52 week H/L (₹)	121.0 /41.6
Adj. all time High (₹)	318.5
Decline from 52WH (%)	60.7
Rise from 52WL (%)	14.3
Beta	1.1
Mkt. Cap (₹ bn)	1.5
Enterprise Value	12.0

Fiscal Year Ended

Y/E	FY12A	FY13A	FY14E	FY15E
Revenue (₹bn)	26.7	27.0	30.4	34.3
EBITDA (₹bn)	1.8	1.6	2.0	2.5
Net Profit (₹bn)	0.6	(0.2)	0.3	0.6
Adj EPS (₹)	21.1	(5.9)	7.5	74.7
P/E (x)	2.3	(8.1)	6.4	0.6
P/BV (x)	0.4	0.5	0.4	0.1
EV/EBITDA (x)	4.5	7.3	5.7	3.6
ROCE (%)	14.5	8.3	10.4	13.6
ROE (%)	18.1	(6.0)	6.9	13.1

One year Price Chart



Shareholding Pattern	Jun'13	Mar'13	Diff.
Promoters	32.28	32.28	-
FII	0.65	3.22	(2.57)
DII	14.2	14.27	(0.07)
Others	52.87	50.23	2.64

During 12th Plan, the Govt. of India has planned to invest ₹41 lakh crore in Infrastructure sector, which is double of the 11th plan. Keeping this in mind MBEC has identified Infrastructure & Construcion business as Key growth area.

MBEC- A leading engineering company

MBEC, headquartered at Kolkata, is a part of the Williamson Magor Group. The company is a leading engineering company and enagaged in providing turnkey solution in the areas of Power, Steel, Aluminium, Material Handling, Mineral Beneficiation, Pyro processing, Pneumatic Handling of powdered materials including fly ash handling and high concentrate disposal, coal washing, port cranes, civic and industrial water supply etc. MBEC has forayed into new businesses, such as oil and gas, cement EPC and nuclear power. In April 2012, it acquired 99.9% interest in MBE Coal & Mineral Technology India Private Limited. MBEC has completed over 300 plants of various types in the areas of Bulk Material Handling, Mineral Processing, Coal Washing, Power, Steel, Alumina, Ash Handling and disposal, Port Cranes, Infrastructure and Water Management. With over 1,000 Engineers, MBEC has built in-house capabilities for basic & detailed Engineering for civil, structural, mechanical, piping, electrical, Instrumentation & automation, project management, Supply Chain Management, manufacturing, Quality Control, construction, erection, commissioning & after sales service which includes Operation & Maintenance.

Based on the business scenario within the country and Company's extended capacity, MBEC has set a higher benchmark of performance for the year to come.

Business Overview- at a glance

MBEC's Projects

Power Project Division	Process Projects Division	Cement, Steel, Mining & Ports Division (CSMPP Division)	Infrastructure Projects & Construction Division	Competency
Balance of Plant for Thermal Power	Mineral Beneficiation	Steel Projects	Infrastructure Projects & Construction	Project Management
Balance of Plant for Thermal Power	Aluminium	Port / Shipyard, Mining & Stockyard EquipmentPort	Industrial Construction	Design & Engineering
Coal Handling Plant	Coal Washery	Material Handling	Building and Township	Structural Fabrication
Water	Oil & Gas	Cement	Transportation	Piping Ducting & Utilities
Customer Service	Oil & Fertilizers & Chemicals			Equipment erection & Installation
				Tankage Work

Robust order book to lift topline to ~₹30 bn in FY'14

MBEC undeterred to upgrade its order book is persistently focused in bagging profitable and cash positives order. With the execution of piled orders the firm is anticipating to earn an income of ~₹30.0 bn in the current fiscal.

The company has notably raised its order backlog to ₹55.4 bn in FY'13 from ₹38.5 bn in FY'12 which is an encouraging sign in uncertain milieu. MBEC persistently bidding to attain its ambitious plans of bagging orders in high rise building and other industrial construction projects, has recently received an order for Construction & Rehabilitation & Resettlement Colony at Hazaribagh for a value over ₹2.6 bn and an order for Civil & Structural Works for development of Residential Towers & Villas at Chennai worth ₹0.4 bn. This order line will help the firm to support its construction segment and further assist to expand it as well.

During Q4FY'13, MBEC secured major export order valued of US$ 52 mn from Africa which is a mineral rich continent providing tremendous opportunities to MBEC. Moreover, showing incredible potential, the construction division of the company realized significant growth and booked order worth ₹12.2 bn in FY'13 and have an order book of ₹13.0 bn, currently.

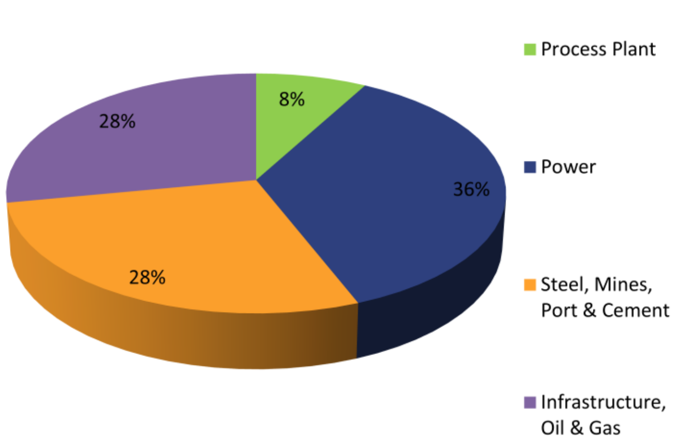
MBEC that has successfully finalized over 300 plants of various types in the areas of Bulk Material Handling, Mineral Processing etc. and has further aligned some major projects for FY'14:

The company pipeline orders to be executed in FY'14 are majorly from power and infrastructure sector bagged in FY'13. Notably, construction division alone has grabbed ₹12.2 bn of orders in the previous fiscal.

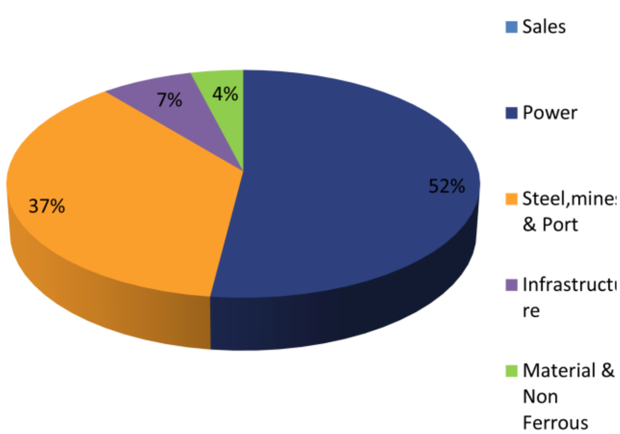
- ✓ 132KV Line Bays and Feeder Bays at different Thermal Power Stations for a value of ₹0.2 bn.
- ✓ The orders for the Supply and Installation of a Coal Handling Plant Package for a consideration amount of ~₹1.1 bn.
- ✓ MBEC received an order for Civil & Structural Works for a Refinery Project amounted at ₹1.7 bn.
- ✓ Secured an order for complete Balance of Plant Equipment at Vizag Power plant (1X300 MW) worth ₹5.1 bn.

With this huge lined up projects, the momentum in order inflows is expected to continue in coming quarters, firming the hope of the company to generate revenue of ~₹30.0 bn in FY'14.

Break-up of Order Book:Division-Wise (FY'13)



Break-up of Sales (FY'13)



MBEL has bagged orders from ACC worth ₹7.3 bn to execute 9,000-tpd capacity cement plant which will open the door for the company to enter into new business.

Bagged first ever cement plant project from ACC, route to foray into new business

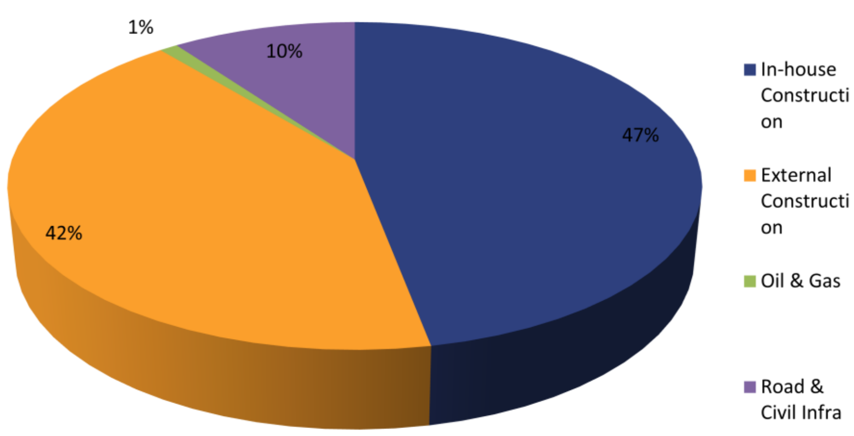
After achieving significant turnover of ₹20.9 bn in FY13, MBEL reached another milestone via bagging cement contract. Since long, the company that was continuously putting efforts to foray in new sectors such as cement and now it has has finally put the foundation stone by grabbing its very first EPC contract in cement sector from Associated Cement Companies (ACC). The contract worth ₹7.3 bn from ACC is for establishing a 9000t/day (~2.9Mt/yr) brownfield cement facility at its existing plant at Jamul, Chhattisgarh. With this achievement, the firm expects that its entry in the sector will unlock new business opportunities as an EPC contractor for the Indian cement industry. Further, the company's firm believe showed that it is in a position to grab more orders in the months down the line. The company's hunger for innovation in design and project management and equally concerened to mitigate the project impediments are likely to encounter the challenges and hence safeguarding its growth prospect. We expect that once the execution gets started will start showing results via improved top line and bottom line.

The company has strengthen its equipment bank in order to maintain a smooth labour flow to avoid delay in project execution.

MBEC judiciously eying expected hitches for smooth project flow

MBEC truly looking beyond borders is well equipped in assessing the project from all the angles (mainly risk). The Indian Construction Industry (increased in value at a CAGR of 15.10% in FY'13) is struggling with labour crunch (employs 30-35 mn Indians) which could directly or indirectly impact company's construction sector as well as orders. Considering the shortage, MBEC has already invested substantial amount to strengthen its equipment bank. This will allow it to handle the situation in an organized manner and further assist to increase execution scale and growth opportunity. With MBEC's firm step to prepare itself to meet competition head on and to execute the recent tapped projects smoothly, we estimate that it will assist it in all other infra projects on road.

Break-up of Order Book: SBU Infrastructure



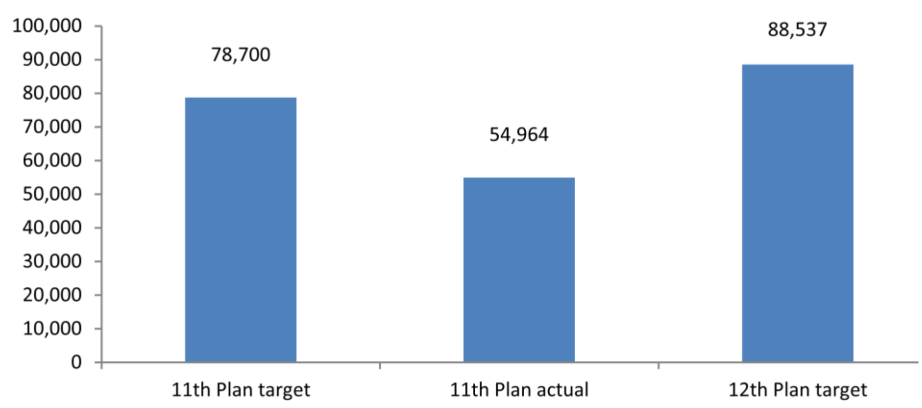
EPC Industry Outlook

India's Manufacturing, construction and mining sector together contributes ~30% to economy's GDP growth (up 4.8% in Q4FY'13 as against 4.7% in Q3FY'13), showing strong correlation between India's growth story and the infrastructure industry. The more investment in the industry leads to more job and growth of GDP thus growing the economy which then leads to more investment in the sector.

Besides, during the 12th plan period, the government has decided to invest ₹41 lakh crore in infrastructure. The sector wise investment covered includes power, roads & bridges, railways, oil&gas, ports etc.

Despite economic uncertainities, the government has optimistically decided to invest ₹41 lakh crore in infrastructure. Besides, it has also planned to increase the power generation capacity to to 88,537 MW in its 12th plan.

Power Generation (Values in MW)



Source Planning Commission - 12th 5 year plan*

The Governemnt in its 11th 5 year plan has slipped a bit to accomplish the power generation target of 78,700 MW and achieved 54,964 MW.

The planning commission in its 12th plan (2012-17) has decided to raise the thermal power capacity addition to 67,686 MW from 50,757 MW achieved in 11th plan. The Central Electricity Authority (CEA) believes that there will be a requirement of 1,100 BoP packages (12th plan) including coal & ash handling plants, cooling towers, fuel oil system etc. and MBEC has a tight hold on these fields.

Further, the firm that earned 37% of its revenue from steel, mines & port in FY'13 believes that the government initiative to bolster infrastructure sector will further provide opportunities to MBEC. Besides, the government has planned to increase the steel capacity to 142 million TPA by 2018 based on projection of 8% GDP growth by FY'15. Meanwhile, the company is eying to negotiate for a coal washery project worth ₹5.0 bn in Africa.

Mcnally receiving 28% of its order from Infrastructure, oil& gas sector has strengthened its team to actively participate in boosting the infra sector.

On industrial front, Government of India is pro-actively taking initiatives in promoting R&D and improving engeneering serices.

Government initiatives: The Indian government has been pro-actively taking initiatives in promoting R&D activities and improving engineering services to fill the huge gap between demand and supply of engineers. With the World Bank's support the Govt has been conducting the 'technical education quality improvement programme', under which 127 engineers institutions were covered in first phase in 2002-2009 and it aims to cover 190 engineering institutions in 2nd phase, from 2010-2014 , all together it will provide good pool of engineers in EPC Industry.

Rise in material cost, sluggish development in infrastructure and rising competition are some of the major logjams to MBEC's growth. Howevert, it has framed different strategies to slove it as well.

MBEC's bottlenecks to growth & its endeavour to ease the risks

- **Rise in input cost**

The Company's business floats around the usage of key commodities like coal, steel, copper, etc, and the adverse rupee movements is denting the raw material costs.
However, in a bid to save itself from operational cost, the company got risk mitigation strategies to monitor all operations on real time basis, thereby taking corrective actions and reducing risk.

- **Slower infrastructural development**

The slower economic growth is facing slower infrastructure growth that need a push from public as well as private sector.
MBEC has increased its focus by strenthening the mangement team in Infrastrucure and have gained significant success in obtaining orders in this sector.

- **Increasing Competition**

MBEC is continuously facing increased compition in many areas of its operations due to large number of existing and emerging players .
To tackle the increasing competition in the domestic market, it is focusing on international market mainly in countries like Africa, Central Asia and South East Asia. The company has also opened offices in South Africa to carry out engineering contracts in Africa.

Muted financial performance in FY'13

Fuelled by its huge order book with a growth of 199% at ₹39.1 bn in FY'13 against ₹13.04 bn in FY'12, MBEC notched 1.5% YoY growth in sales against decline of 41% in FY'12. In Dec'12, MBEC received first ever EPC contract in Cement Sector from ACC with an order of ₹7.33 bn and its all time large export order from Africa worth US$ 52 mn. Moreover, it was a challenging year for the company with the problems of shortage of contract labour, to cater to increase in execution scale.

MBEC has invested substantial amount to strengthen its equipment bank and will allow handling the situation in well-organized way. Prices of major inputs are showing the signs of firming up, even though EBITDA of the company grew 10% YoY in FY'13, as most of the contracts have price variation clause and have not much impact on the margin on the unexecuted portion of the contracts.

However, the compnay reported a loss of ₹0.23 bn in FY'13 dragged by higher increase in depreciation and interest cost. MBEC witnessed sharp deterioration in working capital, up from 78 days in FY'12 to 107 days in FY'13 mainly due to delay in receipt of retention money from a key customer and expect to recover about ₹2 bn in Sep'13. Consequently, consolidated debt shot up by 56% YoY to ₹10.2 bn.

Despite the several hitches in pertaining moribund economy, the management is putting all potential efforts in securing orders as well as executing them on time so as to enjoy better results, going ahead.

Balance Sheet (Consolidated)

Y/E (₹mn)	FY12A	FY13A	FY14E	FY15E
Share Capital	311	393	393	393
Reserve and surplus	3,319	3,501	3,927	4,614
Net Worth	**3,630**	**3,895**	**4,320**	**5,007**
Minority Int	562	486	486	486
Loan funds	6,526	10,189	9,680	8,712
Long term provisions	1,108	1,348	1,416	1,486
Current Liabilities	15,808	16,353	17,988	19,904
Deferred tax liability (net)	116	54	48	43
Other long term liabilities	350	116	104	94
Total Equity & Liabilities	**28,101**	**32,440**	**34,041**	**35,732**
Fixed Assets	4,052	4,068	4,108	4,149
Investments	462	943	943	943
Loans & Advances	2,877	3,045	3,197	3,357
Current Assets	20,658	24,265	25,667	27,151
Other Non-current Assets	52	120	126	133
Total Assets	**28,101**	**32,440**	**34,041**	**35,732**

Profit & Loss Account (Consolidated)

Y/E (₹mn)	FY12A	FY13A	FY14E	FY15E
Total Operating Income	**26,679**	**27,028**	**30,440**	**34,355**
Operating Expenses	24,898	25,380	28,426	31,837
EBITDA	**1,781**	**1,648**	**2,014**	**2,518**
Depreciation	264	306	342	376
Exceptional Items	259	0	0	0
EBIT	**1,776**	**1,342**	**1,672**	**2,141**
Interest	925	1,368	1,231	1,133
PBT	**851**	**(26)**	**441**	**1,008**
Tax	189	193	132	343
Profit after tax	**662**	**(219)**	**309**	**665**
MI/Share of Profit&Loss of Associate	6	13	14	16
Net Profit	**656**	**(232)**	**295**	**649**

Key Ratios (Consolidated)

Y/E	FY12A	FY13A	FY14E	FY15E
EBITDA Margin (%)	6.7	6.1	6.6	7.3
EBIT Margin (%)	6.7	5.0	5.5	6.2
NPM (%)	2.5	(0.9)	1.0	1.9
ROCE (%)	14.5	8.3	10.4	13.6
ROE (%)	18.1	(6.0)	6.9	13.1
Adj EPS (₹)	21.1	(5.9)	7.5	74.7
P/E (x)	2.3	(8.1)	6.4	0.6
BVPS (₹)	116.8	99.0	109.0	568.3
P/BVPS (x)	0.4	0.5	0.4	0.1
EV/Operating Income (x)	0.3	0.4	0.4	0.3
EV/EBITDA (x)	4.5	7.3	5.7	3.6
EV/EBIT (x)	4.5	8.9	6.8	4.2

Valuation and view

MBEC with prolific product portfolio and major orders in line is likely to post a sustainable growth rate both in its top line as well as in EBIDTA level.

Looking ahead, the company mutually (including at McNally Sayaji and overseas subsidiaries) is projecting to witness a topline of around ₹30.0 bn in FY'14 and expects to maintain consolidated operating EBIDTA at the level of 8-9%. Meanwhile, the settlement of the impediments like tight liquidity conditions and deteriorating working capital will further aid comfort for long term growth prospect.

At a current market price (CMP) of ₹47.5, the stock trades at 6.4x FY14E and of 0.6x FY15E, earnings. We recommend 'BUY' with a target price of ₹59, which implies potential upside of ~22.9% to the CMP from 1 year persctpeive.

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