

Stone India Ltd

(Outperformer)

CMP
Rs. 170

TARGET PRICE
Rs. 240

Short Report

POTENTIAL UPSIDE
35-40%

TIME FRAME
6 Months

- **Proxy for growth in Railways**
- **Key beneficiary of Railways' efforts to improve its safety performance**
- **Entered into ASEAN market**
- **Tie-up with Sumitomo Electric Industries opens up a Rs. 175-crore market for air springs**
- **Cashing in on Rs. 700 crore opportunity in Metropolitan transport**
- **Undisputed leader in locomotive brake systems**
- **Part of multi billion Duncan Goenka Group**

Stone India, a part of GP Goenka group, is a multi-product engineering company and is serving the Indian railroad industry for over seven decades. SIL is the undisputed leader in locomotive brake systems and has a huge range of mechanical and electrical products for the railroad industry. It is the largest manufacturer and supplier of high quality brake systems, train lighting alternators and pantographs for the railways. It also manufactures few critical products for defence tanks and armoured vehicles. Going forward, the company aims to become a complete railway solutions company which manufactures every component.

Business

Broadly, company has segmented its product profile into following three categories:-

Carriage business: SIL manufactures and deals in pneumatic equipments like distributor valves, brake cylinders, angle cocks, dirt collectors, hoses, slack adjuster apart from compact air braking system of carriage & freight stock for railway rolling stock operation. Recently it has developed its own patented beam mounted brake system for all types for freight wagons.

Locomotive business: Under this category it produces & markets brake systems, centrifugal lube oil filter and regenerating type "Vaporid" air dryers for Diesel and Electric Locomotives. In addition the company specializes in conversion of vacuum to air brake system in locomotives.

Train Power business: SIL manufactures and supplies brushless alternators, electronic rectifier regulators and pantographs. Alternators are actually power generators used in the coaches and pantographs are used in the electric locomotives & electric multiple units to draw power from the overhead traction.

Investment Rationale

- **Proxy for growth in Railways and higher expenditure on Railway safety**

The on going major restructuring of Indian Railways and large scale capacity expansion of its network augurs well for SIL which is well poised to take on all the future opportunities in line with its strength & core competencies.

Over the next five years, Railways will spend several thousand crore rupees for expansion of railway transport capacity. About 20000 km of high-density network will witness new investment, translating into demand of 11000 new wagons, 200 diesel and 200 electric engines. For FY08, the spending on rolling stocks is estimated at Rs 5,500 crore (Rs 55 billion). This will propel higher demand for different equipment used in rolling stock and wagons.

Further, railways' has announced an investment of 30000 crore for the construction of eastern and western dedicated freight corridors, to increase container traffic to 100 MT by 2011-12, from the present 20 MT.

Being a leader in different kinds of brake system used for carriage and freight, diesel locomotive and electric locomotives, generating 90 per cent of its revenues from railways and a market share of 25-30 per cent, Stone India will directly benefit from railways' large scales expansion plans.

- **Key beneficiary of Railways' efforts to improve its safety performance**

Faster, safer and timely than ever before, working on this theme Railway Minister has earmarked Rs. 17000 crore as Special Railway Safety Fund. One of such measures includes, making provisions for air dryers to avoid malfunctioning of the sensitive air brake equipment on rolling stock such as distributor valves by removing the moisture in the compressed air supplied from locomotives. All new as well as rebuilt diesel locos are planned to provide with air dryers.

SIL manufactures "Vaporid", a very compact dryer having inbuilt after filter, for continuous drying of incoming air for Electric and Diesel Loco Brake System. We expect SIL to witness large order inflows for air dryers.

- **Tie-up with Sumitomo Electric Industries opens up a Rs. 175-crore market for air springs**

Sumitomo Electric Industries, a supplier of air springs for Japan's 'bullet' trains, would lend suitable technical might to Stone India in its participation in the Indian Railways' move towards rolling stock and components technology up-gradation. Indian Railways plans to replace mechanical suspension system with pneumatic system and install air springs in high-speed trains. Indian Railways proposes to upgrade existing 25,000 coaches through retro-fitting of air spring and pneumatic suspension system. The company's pneumatic suspension control system coupled with the air spring technology would give it an edge in manufacturing and installation of the complete pneumatic suspension system for a new coach or retro-fit of old coaches.

Further, orders will come lot more easily as the Indian Railways presses forward for the Delhi-Mumbai Industrial Corridor project with financial backing from a consortium of Japanese companies.

- **Entered into ASEAN market with Malaysia-based Telewira Tegas SDN BHD**

Company has entered the Asian rail market and has appointed Telewira Tegas SDN BHD, Malaysia, as an exclusive agent for turnkey project work relating to freight car, passenger coach and locomotive up gradation and maintenance for Malaysian railways. It has also been exporting air brake system to internationally reputed wagon manufacturer in China.

- **Cashing in on Rs. 700 crore opportunity in Metropolitan transport**

Railway minister has earmarked about Rs 700 crore (Rs 7 billion) for metropolitan transport. Looking at this, SIL entered into an exclusive understanding with ZRJC, Guangzhou, China for manufacturing & supply of air conditioning system along with microprocessor based control system for passenger coach rolling stock & metro coaches.

- **Superior Technology and Products**

SIL has entered into collaboration with several global industry leaders for its high technology products. Faiveley S.A. of France, SAB of Sweden, WABTEC Corporation of USA, SAB WABCO of France etc are a few of them.

- **De-risking its business model**

In order to de-risk its business model, company is looking to increase the revenue from projects & services area for which it is executing a huge order for refurbishment and up gradation of 1115 wagons from ministry of defence. Notably, SIL is the only private company selected to execute this order which was earlier done by Indian railways.

- **New Products**

SIL recently executed a technical collaboration agreement with SMA Technologie AG, Germany, for manufacturing of 180 KVA auxiliary power converter for Indian railways. This high value product will be manufactured in the new upcoming facility in Nalagarh, Himachal Pradesh.

Financials

During the quarter ended September 2007, company's topline grew 13.8% to Rs. 19.78 crores against Rs. 17.4 crores during the same period last year. Expenditure for the quarter stood at Rs. 15.88 crores against Rs. 14.2 crores in the corresponding quarter last year, growing by 11.83%. Led by slower growth in expenditure, Operating profit grew 22.5%. Operating profit margins for the quarter stood at 19.73% against 18.32% during the same period last year.

During the quarter ended September 2007, other income fell by 60%, interest expenses and depreciation expenses climbed up by 62% and 31% respectively. Bottomline grew 11.5% to Rs. 3.16 crores against Rs. 2.84 crores in September 2006. Net profit margins declined marginally to 16% against 16.31% during September 2006.

Diluted EPS after Extraordinary items for the quarter stood at Rs. 4.16 against Rs. 3.76 during September 2006.

Particulars	Value(Rs. crore)			
	30-Sep-07 3 Months	30-Sep-06 3 Months	Y-o-Y Growth (%)	30-Jun-07 3 Months
Net Sales	19.78	17.38	13.79	21.09
Expenditure	15.88	14.20	11.83	16.58
Operating Profit	3.90	3.19	22.51	4.51
Other Income	0.08	0.20	-59.70	0.00
PBIDT	3.98	3.39	17.63	4.51
Interest	0.60	0.37	61.89	0.48
PBDT	3.38	3.02	12.20	4.03
Depreciation	0.21	0.16	30.63	0.21
PBT	3.18	2.86	11.17	3.82
Tax	0.01	0.02	-38.10	0.03
PAT	3.16	2.84	11.53	3.79
Extraordinary Items				0.01
Net Profit	3.16	2.84	11.53	3.78
Diluted EPS after Extraordinary items (Rs.)	4.16	3.76	10.55	4.97
Operating Profit Margin (%)	19.73	18.32		21.36
Net Profit Margin (%)	15.99	16.31		17.92
Equity	7.60	7.54		7.60
Book Value (Rs. / Share))	30.32	-		-

Valuation

Led by Indian Railways large scale expansion plan, higher expenditure on safety and performance, the company is expected to grow at healthy rates. At the CMP of Rs. 170 the stock trades at 9.44x of FY08E EPS of RS. 18. Applying a conservative P/E multiple of 13.5, we arrive at a target price of Rs. 240 within 6 months, representing an upside of 40%.

Rating

Out performer	Large cap	10% or more
	Mid Cap	20% or more
	Small cap	30% or more
Performer	Large cap	Between 5 to 10%
	Mid Cap	Between 10 to 15%
	Small cap	Between 15 to 20%
Under performer	Large cap	-10 %or more
	Mid Cap	-15 %or more
	Small cap	-20% or more

Disclaimer

This report is for informational purposes only and contains information, opinion, material obtained from reliable sources and efforts have been made to avoid errors and omissions and is not to be construed as an advice or an offer to act on views expressed therein or an offer to buy and/or sell any securities or related financial instruments and the authors shall not be responsible and/or liable to anyone for any direct or consequential use of the contents thereof. Its reproduction of the contents of this report in any form or by any means without prior written permission of the publisher is prohibited. All disputes shall be subject to the exclusive jurisdiction of Delhi courts only.

[Website - www.rfinance.com/research.aspx](http://www.rfinance.com/research.aspx), [Mail: research@rrfcl.com](mailto:research@rrfcl.com)