Texmaco Rail & Engineering

Industry	CMP	Recommendation	Buying Range	Target	Time Horizon
Construction & Engineering	Rs. 104	BUY at CMP and add on declines	Rs. 104 - 90	Rs. 125 -147	4 - 6 Quarters

HDFC Scrip Code	TEXRAI
BSE Code	533326
NSE Code	TEXRAIL
Bloomberg	TXMRE
CMP as on 15 Oct-16	104
Equity Capital (Rs Cr)	21
Face Value (Rs)	1
Equity O/S (Cr)	21
Market Cap (Rs cr)	2185
Book Value (Rs)	47
Avg. 52 Week Volumes	575105
52 Week High	155
52 Week Low	89

Shareholding Pattern (%)	
Promoters	54.7
Institutions	33.2
Non Institutions	12.1

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Company Background

Texmaco Rail & Engineers (Tex Rail), as one of the largest freight car manufacturer in the country, has seized the opportunity to expand its operations from product into project segments to participate in the areas of Railway signaling, communication and track work with plans to further diversify into electric traction and railway traffic management system. The acquisition of Kalindee Rail Nirman (Engineers) catapults it into the category of a 'total rail solution provider', and it has already been expanding its operations at numerous sites across the country.

Further, Tex Rail has joined hands with leading multinationals to take a leap into the field of Locomotive Assemblies and Metro Coaches with high value addition and huge growth potential. Yet another major diversification the Company has embarked upon is in the field of Steel Bridges with large upcoming demand, where the Company expects to make its mark with its massive fabrication capacity. In the non-Indian Railways segment during year FY16, Company had received orders for 751 wagons, valued Rs210cr.

The Order Book Position of the company including its subsidiaries stood at 3700 crore as on Jun 2016 (2.5x FY16 revenues). In Nov 2014, the company had raised ~Rs300cr through a QIP by issuing 2.8cr shares at Rs107 per share. Tex Rail is currently in the process of amalgamating Kalindee Rail. Company has proposed to issue 106 shares of Tex Rail for every 100 shares of Kalindee Rail. Hence, additional shares issued by Tex Rail will be 1.75cr shares, thus total equity shares would increase to 22.8cr shares from current 21cr shares. Tex Rail gross D/E as on FY16 stood at 0.4x. But with cash and cash equivalents of Rs400cr so on net basis company remains debt free.

View & Valuations

We expect revenue CAGR of 21% over FY16-19E, driven by its heavy engineering and steel foundry segments and EPC division led by Kalindee and Bright Power. The heavy engineering segment is expected to record revenue CAGR of 20% during FY16-19E. We expect an EBITDA CAGR of 61% over FY16-19E due to low base effect and driven by volume growth. We expect incremental volumes growth will lead to higher absorption of fixed cost resulting overall margin improvement for the company. Over FY13-FY15, muted volumes (slack demand from coal and iron ore) and depressed realisations due to competitive pricing has severely affected margins as operating leverage turned negative. This would lead to higher absorption of fixed cost, thereby causing margin improvement as well. We expect an EBITDA margin of 14% in FY19E from 7.7% in FY16 although this is still lower than the historical average of ~15% during FY11-13. We forecast Rs134cr PAT and Rs5.9 EPS in FY19E. Historically Railway stocks has traded expensive compared to other Midcap stocks and we believe the trend is likely to continue in future (>30x PE multiple). We recommend BUY on Tex Rail at current price of Rs104 and add on declines to Rs90. We assign PE of ~25x based upon FY19E earnings and arrive price targets of Rs125 and Rs147.

Investment Rationale

Heavy engineering

This division comprises rolling stocks (wagons, coaches and electric locomotive components & assemblies), hydro-mechanical equipment, and bridges & heavy structures.

Wagons

Tex Rail produces conventional wagons along with commodity-specific wagons. Indian Railways is its largest customer. Now, company has started supplying wagons to the defense sector. It caters to other customers, including container freight operators and industries involved in the production of commodities. It has manufacturing facilities at Agarpara and Sodepur in West Bengal. The company has a production facility to manufacture electrical multiple units (EMU), diesel electric multiple units (DEMU) and mainline electric multiple units (MEMU) coaches, passenger coaches, locomotive shells & assemblies and sub-assemblies. Its coach manufacturing facility is at Sodepur, West Bengal, as a part of the traction and coaching division.

Hydro-Mechanical equipment

Tex Rail is a leading manufacturer of hydro-mechanical equipment in India. The company offers "one stop" solution to customers from designing to commissioning of hydro-mechanical equipment and providing after-sales services. It manufactures components, such as radial &vertical gates, flap gates, hoists, gantry & electric overhead travelling ("EOT") cranes and other heavy steel structures, including barrage equipment. It has also forayed into refurbishment and replacement work opportunities in existing hydro projects and barrage equipment. This division manufactures steel superstructure, hull blocks and other parts of bridges & flyovers for large bridges for railways as well as roads at its manufacturing facilities at Panihati and Sodepur near Kolkata. It has also started delivering steel girders for railway bridges in Bangladesh through IRCON International. Its primary competitors include Larsen & Toubro, Bridge and Roof India.

Demand from defense and private sector improves The GoI's focus on the defense sector has opened new avenues of wagon demand. Enquiries from the private sector too have started after being subdued over the past few years. We believe with industrial demand start picking up, this segment will further inflate overall demand for wagons. In the non-IR segment during year FY16, Company had received orders for 751 wagons, valued Rs210cr.

Merger with Kalindee Rail Nirman Engineers; Tex Rail - Best player in the Railway theme

Kalindee Rail Nirman (Kalindee) became a subsidiary of the Company with effect from 31st August, 2015, the merger scheme of Kalindee with Tex Rail has been approved by the High Court, Calcutta. The approval of the High Court, Delhi, where the Kalindee's Registered Office is located, is still awaited.

Kalindee Rail has proven credentials in the field of Signaling and Telecom supported a consortium comprising, Mitsui and Hitachi, Japan, along with Tex Rail to bag the largest Signaling and Telecom contract in Western Dedicated Freight Corridor (DFC), and the work on the same would start during the current year. The combined synergy will provide with a wide range of offerings, from track laying, civil construction, structural fabrication, signalling (including route relay), telecommunications & auto fare collection as well as end products, such as wagons, coaches and locomotive shells & assemblies.

In Nov 2014, the company had raised ~Rs300cr through a QIP by issuing 2.8cr shares at Rs107 per share. Tex Rail is currently in the process of amalgamating Kalindee Rail. Company has proposed to issue 106 shares of Tex Rail for every 100 shares of Kalindee Rail. Hence, additional shares issued by Tex Rail will be 1.8cr shares, thus total equity shares would increase to 22.8cr shares from 21cr shares.

Kalindee is currently focused on closing all the old legacy contracts and concentrating on the more challenging and lucrative new projects where the Company has begun participating aggressively. Further, with a view to expand the customer base, there has been a shift in the Kalindee's strategy during the year for diversifying increasingly into DFC and Metro Rail projects. This will help to de-risk the overall business configuration of Kalindee going forward.

With foray in high-tech projects, Kalindee has built a team of technical and experienced professionals who can effectively contribute in the Company's goal of high growth with sustainability. With the acquisition of Kalindee Rail and Bright Power, Tex Rail is ideally placed to exploit opportunities in rail infrastructure segment which is the focus area for Indian Railways ambitious modernization plan. In the non-IR segment during year FY16, Company had received orders for 751 wagons, valued Rs210cr. The Order Book Position of the company including its subsidiaries stood at 3700 crore as on Jun 2016 (~2.5 years visibility).

A Total Rail Solutions Provider

Tex Rail, as the largest freight car manufacturer in the country, has seized the opportunity to expand its operations from product into project segments to participate in the areas of Railway signaling, communication and track work with plans to further diversify into electric traction and railway traffic management system. Tex Rail's acquisition of Kalindee Rail Nirman (Engineers) catapults it into the category of a 'total rail solution provider', and it has already been expanding its operations at numerous sites across the country.

Further, Tex Rail has joined hands with leading multinationals to take a leap into the field of Locomotive Assemblies and Metro Coaches with high value addition and huge growth potential. Yet another major diversification the Company has embarked upon is in the field of Steel Bridges with large upcoming demand, where the Company expects to make its mark with its massive fabrication capacity.

We believe demand for electric multiple units (EMU) & diesel multiple units (MEMU) for inter-city and short-distance travel provides great opportunity for players like Tex Rail. It also will increase demand for upgraded AC coaches in express trains, and coaches for trains, such as the Rajdhani & Shatabdi, and high frequency locomotives, which help in speedier movement of trains.

JVs and Agreement update

Tex Rail – Wabtec [Joint Venture] (Oct 2014)

Wabtec (Westinghouse Air Brake Technologies) a leading global provider of products for rail cars, Locomotives had formed joint venture with Tex Rail to provide hi tech freight products and services in Oct 2014.

Tex Rail – ROSOBORONEXTPORT [MoU] (Jul 2016)

Texmaco Rail & Engineering has signed a pact with ROSOBORONEXPORT (ROE), the sole state intermediary agency for Russia's exports/imports of defense related and dual use products, technologies and services for Defence production.

The MoU is for modernization of Armoured vehicles operated by Indian Army in Jul 2016. The JV would help in cost effective upgraded solutions for in service Armoured Vehicles as a part of make in India initiatives. The collaborations would further boost Tex Rail's financials in the next 2-3 years.

Q1 FY17 Result update

During Q1FY17, Tex Rail reported net sales of Rs185cr, +93% yoy, backed by higher ordering from both IR and the private sector which fuels a volume recovery. EBITDA margins during Q1FY17, improved 115 bps yoy to ~5.1% on account of better operating efficiencies, higher capacity utilization. Raw material costs as a percentage of sales fell significantly to ~75.8% vs. ~96% yoy. Higher operating performance, higher other income (+45.5% YoY), lower interest cost led Tex Rail to report net profit of Rs12cr vs. net loss of Rs1.5cr.

Strong Balance sheet

Tex Rail has a strong balance sheet with cash of ~Rs4bn as on FY16. The company had raised Rs300cr in FY15, which provides it the flexibility to acquire a company or to infuse money to scale up business of Kalindee Rail. Tex Rail D/E as on FY16 stood at 0.4x. But with cash & cash equivalents of Rs400cr; so on net basis company remains debt free as on FY16.

Industry Overview

The central government has chosen railways as one of important driver for capital formation given the huge potential and multiplier impact it can have on the economy (~5x). Government has put together a plan to significantly step up investment in Indian Railways (IR). It has planned an investment of over Rs 8.5 trillion over next five years, more than 3x over previous five years. In efforts to sustainably turn around railways, focus is not only on investment, but also other long term structural reforms to bring in efficiency, accountability and transparency. While investment plan might sound ambitions, sound financial plan makes it more reliable. While putting mammoth organization like railways on track is a tall task, over the past one year many creditable steps have been taken which is expected to start bear fruits. We believe IR has the potential to emerge as the next engine of growth in capital investments in India over the next decade.

Setting up of Dedicated Freight Corridor (DFC) DFC's (eastern & western of ~3,300km) would lead to decongestion of freight and passenger traffic on main routes, speed up delivery Additionally, container traffic and coal traffic would be an important constituent of the WDFC and EDFC respectively. By December 2017, government plans to commission the first stretch and complete a third of the total by mid-2018 & full length by December 2019. DFCs will benefit by 1) creating 20x freight carrying capacity to meet demand (speed to treble to over 70 kmph, hence more trains can be run) carrying capacity/wagon to 6x (incl double stacking & longer rakes), 2) freeing up passenger capacity (70% of freight to shift to DFC).

With a view to attract private investment, IR is working towards improving ease of doing business with railways. IR is also working on other issues like accounting reforms and decentralization to ensure sustainable turnaround. Indian Railways market share has dropped in freight traffic from 60% in 1980 to 34% in FY14. In order to regain market share IR is to focus on 1) Expanding freight basket 2) Rationalizing the tariff structure 3) Building terminal capacity 4) Nurturing Customers.

Out of investments of Rs8.5trn, the biggest focus areas are 1) Network decongestion 2) Network expansion (including electrification) and 3) Safety with an aim to reduce operating ratios and increase earning capacity of IR. We expect EPC (L&T / KEC / Kalpataru / Kalindee / Tata projects etc.) companies would be the beneficiaries followed by equipment companies like Siemens / Titagarh / Tex Rail / ABB / BEML.

Complete Rail solutions provider post Kalindee and Bright Power acquisition; Expect Rs134cr PAT in FY19E

We expect revenue CAGR of 21% over FY16-19E, driven by its heavy engineering and steel foundry segments and EPC division led by Kalindee and Bright Power. The heavy engineering segment is expected to record revenue CAGR of 20% during FY16-19E. We expect an EBITDA CAGR of 61% over FY16-19E due to low base effect and driven by volume growth; we have factored in 630bps margin expansion over FY16-19E. We expect incremental volumes growth will lead to higher absorption of fixed cost resulting overall margin improvement for the company. Over FY13-FY15, muted volumes (slack demand from coal and iron ore) and depressed realisations due to competitive pricing has severely affected margins as operating leverage had turned negative. Now, this would lead to higher absorption of fixed cost, thereby causing margin improvement as well. We expect EBITDA margin of 14% in FY19E from 7.7% in FY16 although this is still lower than the historical average of ~15% during FY11-13. Strong operating performance and lower finance costs would lead to 88% PAT cagr over FY16-19E. We forecast Rs134cr PAT and Rs5.9 EPS for the company in FY19E. Historically Railway stocks has traded expensive compared to other Midcap stocks and we believe the trend is likely to continue in future (>30x PE multiple). We recommend BUY on Tex Rail at current price of Rs104 and add on declines to Rs90 We assign PE of ~25x based upon FY19E earnings and arrive price targets of Rs125 and Rs147 over the next 4-6 quarters.

Risks & Concerns

Dependency on the Indian Railways for a large portion of its wagon orders; IR provides a majority of revenue for the company. If IR reduces its volume of business with Tex Rail or don’t release sizable orders then Company’s business, financials and prospects maybe adversely affected.

Competitive pressure may lead to lower margin
Wagon manufacturing industry has 10-12 players though large players include Titagarh, Tex Rail and BEML. Cost competitiveness coupled with meagre ordering environment can hurt Tex Rail’s order book and profitability in future.

Delay in execution may lengthen WC cycle
It is possible that despite receiving orders and mobilizing main raw materials, execution may be delayed, due to a delay in finalizing design parameters for the newly developed wagons by Integral Coach Factory (ICF) and Rail Coach Factory (RCF), which had been assigned the responsibility by IR. In that case, the company has to keep higher inventory, thereby taking hit on working capital.

Financial Summary (Rs cr)

(Rs Cr)	FY14	FY15	FY16	FY17E	FY18E	FY19E
Sales	469	463	985	1207	1451	1690
EBITDA	41	44	76	118	184	236
Net Profit	17	14	13	43	95	134
EPS (Rs)	1.0	0.7	0.6	2.0	4.2	5.9
P/E	108.8	153.8	162.8	50.8	25.0	17.6
EV/EBITDA	61.6	57.8	33.2	21.3	13.7	10.7
RoE	3.0	1.9	1.6	3.7	8.2	10.4

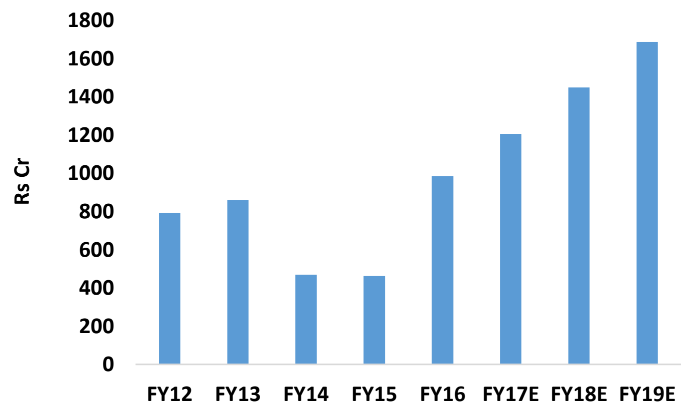
Source: Company, HDFC sec Research, ^ indicates Standalone

Peer Group Comparison

Company (FY18E)	Revenues (Rs cr)	EBITDA (%)	PAT (Rs cr)	FY18E PE (x)	FY16 PE (x)	Debt (Rs cr)	D/E (x)
Texmaco Rail & Engg.	1451	12.7	95	25	163	395	0.35
BEML (Rail, Defence & Mining)	3883	6.4	157	25.8	72	520	0.20
Titagarh Wagons	1529	8.1	52	27.3	NA	315	0.30

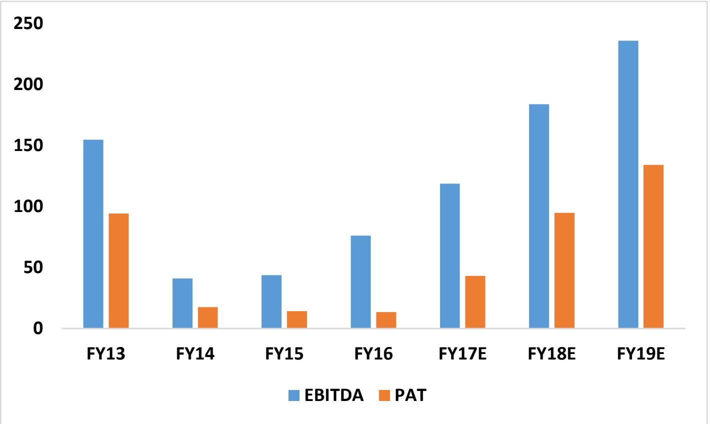
Source: Company, HDFC sec Research, NA - Titagarh posted loss in FY16

Revenue to post 21% cagr over FY16-19E



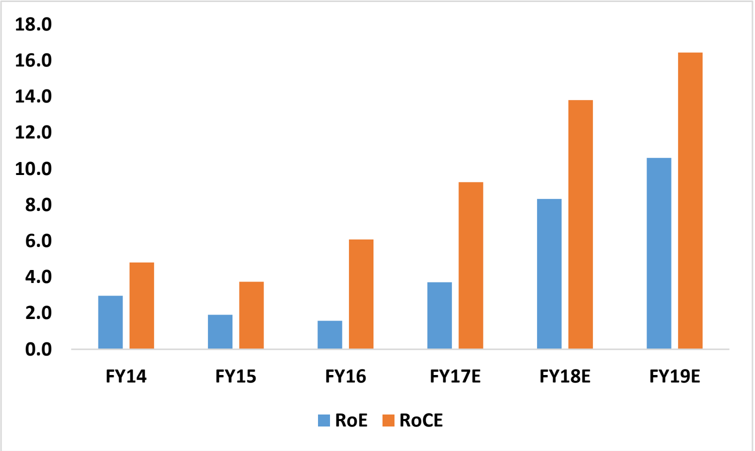
Source: Company, HDFC sec Research

EBITDA and PAT to witness robust growth momentum



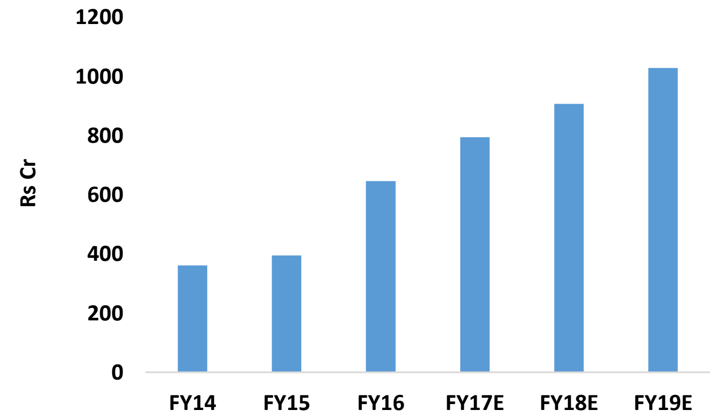
Source: Company, HDFC sec Research

Return Ratios to improve (%)



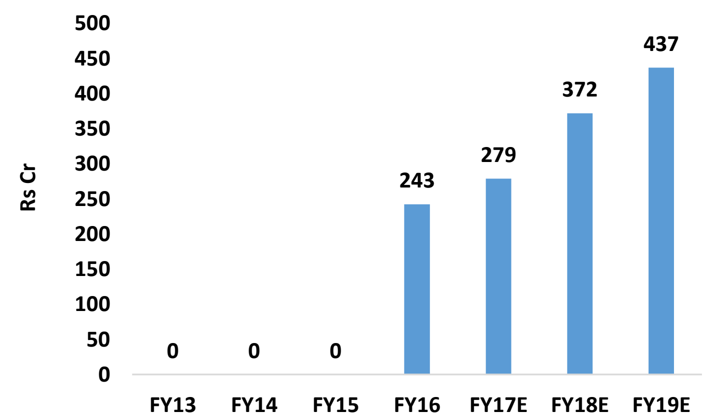
Source: Company, HDFC sec Research

Projected Revenue growth for Heavy Engg. Segment



Source: Company, HDFC sec Research

EPC Segment Revenues



Source: Company, HDFC sec Research

Income Statement (Consolidated)

(Rs Cr)	FY14^	FY15^	FY16	FY17E	FY18E	FY19E
Net Revenue	**469**	**463**	**985**	**1207**	**1451**	**1690**
Growth (%)	**-45.4**	**-1.4**	**113.0**	**22.5**	**20.2**	**16.5**
Operating Expenses	429	419	909	1089	1267	1454
EBITDA	**41**	**44**	**76**	**118**	**184**	**236**
Growth (%)	**-73.5**	**6.6**	**74.3**	**55.9**	**55.3**	**28.4**
EBITDA Margin (%)	**8.7**	**9.4**	**7.7**	**9.8**	**12.7**	**14.0**
Depreciation	12	15	17	21	24	26
EBIT	29	29	59	98	160	210
Other Income	23	24	31	41	50	65
Interest	10	12	39	49	45	42
PBT	**19**	**17**	**20**	**48**	**115**	**168**
Tax	2	3	6	11	27	43
RPAT	**17**	**14**	**13**	**43**	**95**	**134**
Growth (%)	**-81.5**	**-18.4**	**-5.4**	**220.5**	**120.3**	**41.8**
EPS	1.0	0.7	0.6	2.0	4.2	5.9

Source: Company, HDFC sec Research, ^ indicates Standalone

Balance Sheet (Consolidated)

(Rs Cr)	FY14^	FY15^	FY16	FY17E	FY18E*	FY19E*
SOURCE OF FUNDS						
Share Capital	18	21	21.0	21.0	22.8	22.8
Reserves	574	872	888	927	1046	1150
Shareholders' Funds	**592**	**893**	**988**	**1027**	**1147**	**1251**
Long term Debt	8	15	8	29	62	49
Net Deferred Taxes	-5	-2	2	5	8	11
Long Term Provisions & Others	4	2	5	7	9	12
Total Source of Funds	**612**	**921**	**1003**	**1068**	**1227**	**1323**
APPLICATION OF FUNDS						
Net Block	208	210	364	398	420	457
Investment	112	144	13	13	13	13
Long Term Loans & Advances	13	15	111	121	140	159
Total Non Current Assets	**333**	**368**	**487**	**532**	**573**	**629**
Inventories	210	239	327	341	417	477
Trade Receivables	192	150	509	592	696	796
Cash & Equivalents	14	40	68	67	59	56
Other Current Assets	268	548	523	519	478	440
Total Current Assets	**684**	**977**	**1427**	**1519**	**1651**	**1768**
Trade Payables	204	184	366	458	560	667
Other Current Liab & Provisions	200	240	585	565	530	506
Total Current Liabilities	**404**	**424**	**951**	**1023**	**1089**	**1172**
Net Current Assets	279	553	476	496	561	596
Total Application of Funds	**612**	**921**	**1003**	**1068**	**1227**	**1323**

Source: Company, HDFC sec Research, ^ indicates Standalone, * - post Kalindee Merger

Cash Flow Statement (Consolidated)

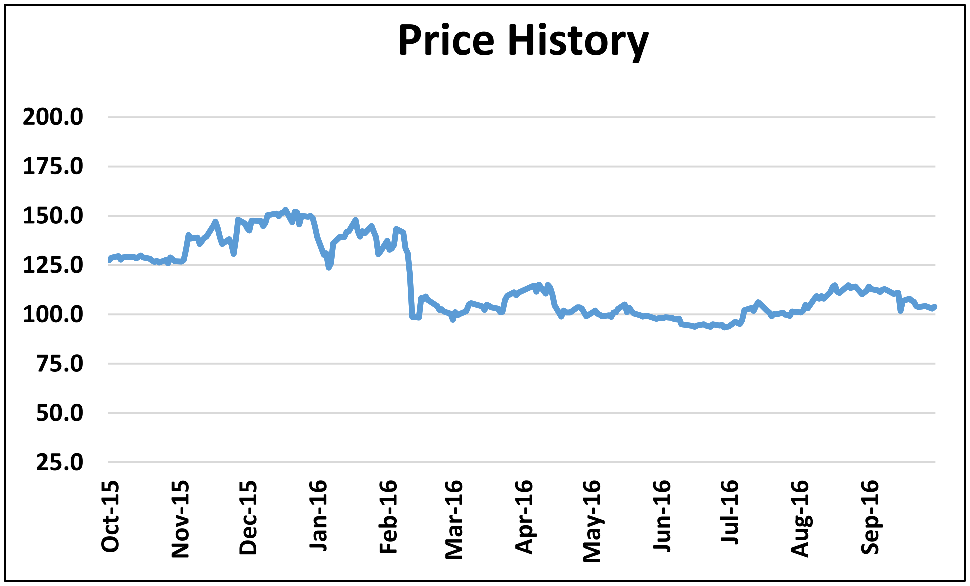
(Rs Cr)	FY14	FY15	FY16	FY17E	FY18E	FY19E
Reported PBT	19	17	20	48	115	168
Non-operating & EO items	-23	-24	-31	-41	-50	-65
Interest Expenses	10	12	39	49	45	42
Depreciation	12	15	17	21	24	26
Working Capital Change	51	-246	112	-18	-71	-35
Tax Paid	-2	-3	-6	-11	-27	-43
OPERATING CASH FLOW (a)	**67**	**-229**	**151**	**48**	**37**	**93**
Capex	-57	-211	-38	-45	-53	-58
Free Cash Flow	10	-440	114	3	-16	35
Investments	-46	-32	131	0	0	0
Non-operating income	23	24	31	41	50	65
INVESTING CASH FLOW (b)	**-80**	**-219**	**125**	**-4**	**-3**	**7**
Debt Issuance / (Repaid)	-2	7	-7	21	33	-13
Interest Expenses	-10	-12	-39	-49	-45	-42
FCFE	-1	-445	68	-25	-28	-21
Share Capital Issuance	0	3	0	0	2	0
Dividend	-5	-6	-6	-17	-32	-48
FINANCING CASH FLOW (c)	**-17**	**-8**	**-52**	**-46**	**-42**	**-103**
NET CASH FLOW (a+b+c)	**-29**	**-456**	**224**	**-1**	**-8**	**-4**

Source: Company, HDFC sec Research

Key Ratio (Consolidated)

Key Ratios (%)	FY14	FY15	FY16	FY17E	FY18E	FY19E
EBITDA Margin	8.7	9.4	7.7	9.8	12.7	14.0
EBIT Margin	6.2	6.2	6.0	8.1	11.0	12.4
APAT Margin	3.7	3.1	1.4	3.6	6.5	8.0
RoE	3.0	1.9	1.6	3.7	8.2	10.4
RoCE	4.8	3.7	6.1	9.3	13.6	16.1
Solvency Ratio						
Net Debt/EBITDA (x)	-2.8	-9.1	-0.1	-0.1	0.1	0.1
Net D/E	-0.2	-0.4	0.0	0.0	0.0	0.0
Interest Coverage	4.1	3.6	2.0	2.4	4.1	5.6
PER SHARE DATA						
EPS	1.0	0.7	0.6	2.0	4.2	5.9
CEPS	1.6	1.4	1.4	3.0	5.2	7.1
BV	32.5	42.5	47.0	48.8	50.4	54.9
Dividend	0.3	0.3	0.3	0.7	1.2	1.8
VALUATION						
P/E	108.8	153.8	162.8	50.8	25.0	17.6
P/BV	3.2	2.4	2.2	2.1	2.1	1.9
EV/EBITDA	61.6	57.8	33.2	21.3	13.7	10.7
EV / Revenues	5.4	5.5	2.6	2.1	1.7	1.5
Dividend Yield (%)	0.2	0.2	0.2	0.7	1.2	1.7

Source: Company, HDFC sec Research



Rating Definition:

Buy: Stock is expected to gain by 10% or more in the next 1 Year.

Sell: Stock is expected to decline by 10% or more in the next 1 Year.

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