

## Titagarh Wagons Ltd.

<b>Price Band</b>	: Rs540 - 610 per share	<b>March 24, 2008</b>
<b>Issue open during</b>	: March 24 - 27, 2008	
<b>Recommendation</b>	: <b>Await Listing</b>	
<b>Book Running Lead Managers</b>	: Kotak and JM Financial	
<b>To list on</b>	: NSE & BSE	
<b>Grading (Fitch)</b>	: 3 / 5	
<b>Market Cap post-listing</b>	: Rs11.25Bn \$277.8mn (based on the cap price)	

IPO of 2.383mn equity shares of Rs10 each, comprising of fresh issue of 2.068mn shares (Rs126.15Cr) and offer for sale of 0.315mn shares, aggregating to Rs145.41Cr or \$35.9mn (at the cap price)

### Shareholding Pattern

Shareholder Categories	Pre-issue		Post-issue	
	No. of shares	% Holding	No. of shares	% Holding
Promoters & Promoter Group	9,295,984	56.8%	8,980,327	48.7%
Employees	0	0.0%	15,000	0.1%
QIBs excluding Mutual Funds	6,199,125	37.9%	7,549,323	40.9%
Mutual Funds	0	0.0%	71,063	0.4%
Non-Institutional Investors	878895	5.4%	1,115,772	6.1%
Public	0	0.0%	710,630	3.9%
<b>Total</b>	<b>16,374,004</b>	<b>100.0%</b>	<b>18,442,115</b>	<b>100.0%</b>

### Recommendation - Await Listing

- Titagarh Wagons Ltd. (TWL) is predominantly a railway wagon manufacturer (80% of FY07 sales) catering to the needs of Indian Railways (IRs) and non-Indian Railways customers (NIRs).
- In order to de-risk its business model, TWL is diversifying into earth moving and mining equipment. Further, it has acquired a steel foundry and is in the process of setting up a wheelset assembly and axle machining shop, leading to backward integration.
- In order to develop aluminium wagons which are lighter and more efficient than the steel wagons, TWL has signed a JV with FreightCar America, a leading manufacturer of wagons. It has also signed various other international JVs / MOUs for various products, creating entry barriers for competition. (See page 3)
- We believe the healthy order book of Rs753Cr will get reflected in the financials in the next two years. Also the strong balance sheet with low post-issue gearing of 0.09x would help in exploring new opportunities including acquisitions. However, we believe the industry's pricing power may be under pressure going forward, which may cap margin expansion.
- Of the fresh issue proceeds of Rs126.15Cr, TWL has definite plans to deploy only Rs70Cr towards setting up of EMU, axle machining and wheelset assembly facility, modernisation of existing facilities and a corporate office. For the balance, there are no definite plans. TWL may require to infuse a further Rs35Cr into Cimmco Birla to help turn around the latter's operations, which may prove to be a challenge.
- The revenue and net earnings saw aggressive growth during FY04-07, @ CAGR of 69.6% and 90% respectively. Due to the higher base, we expect growth trajectory to taper off (CAGR of 39.5% and 34.9%) over FY07-10.
- Positives include robust growth prospects of both industry (potential to divert road freight to cheaper railway freight) and company and presence of high profile pre-IPO investors including GE Capital, Blackstone and ChrysCapital.
- Our concerns include poor track record of the promoter group in shareholder wealth creation (no dividends from group companies Continental Valves Ltd. and Titagarh Steels Ltd.) and also poor corporate governance track record (delisting of Continental Valves Ltd. from the BSE during 1999-2003).
- The IPO pricing, at 18.5x FY09 and 15.7x FY10 earnings, is expensive vis-à-vis domestic peer Texmaco (16.5x FY09 and 12.5x FY10) and larger global peers FreightCar America (14.8x FY09 and 12.7x FY10) and American Rail Industries (9.5x FY09 and 8.7x FY10). (See page 5 for Valuation matrix). Given the robust growth prospects of the industry and strong company fundamentals, we recommend investors to await listing (please refer ratings structure on page 7).

**Company & Promoter Background**

Incorporated in 1997, Titagarh Wagons Ltd. is engaged in the business of manufacturing Railway Wagons, Bailey bridges, Heavy Earth Moving and Mining equipment, Steel and SG iron castings.

Mr. J.P. Chowdhary, Executive Chairman, has over 45 years of experience in the manufacturing sector.

Mr. Umesh Chowdhary, MD, has over 17 years of experience.

**Business overview**

TWL derived 80% of revenues from railway wagons in FY07.

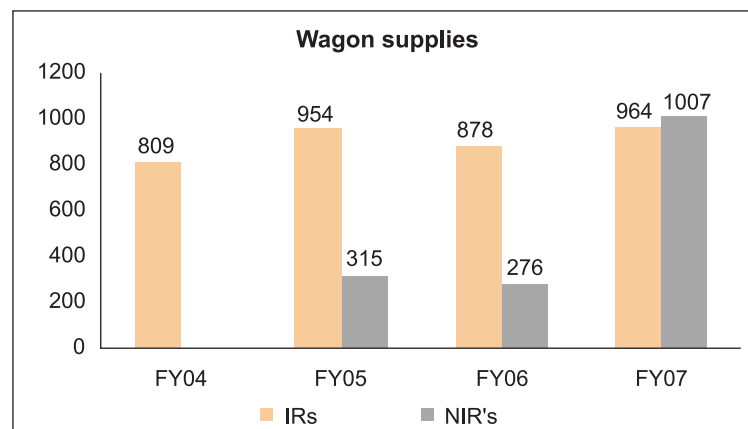
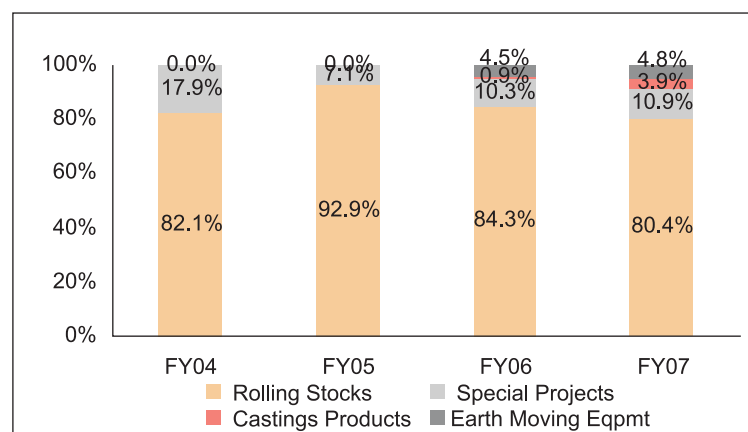
As an industry partner to the Defence Research and Development Organization (DRDO), it also manufactures products for the Indian defence establishment, such as special purpose wagons, shelters and other engineering equipments.

**Backward integration through acquisition of a division of Hyderabad Industries**

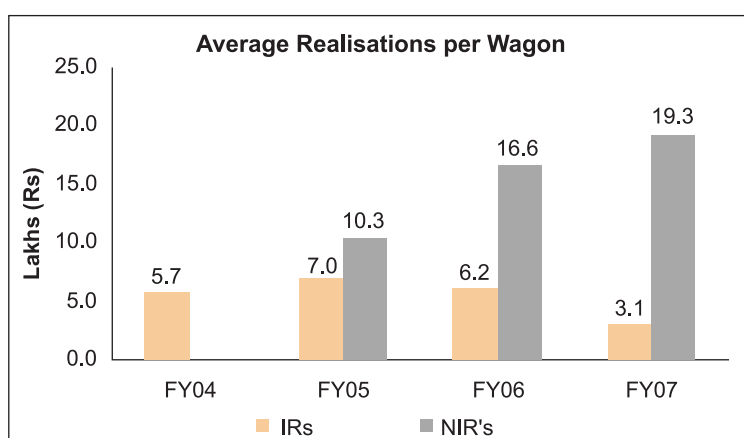
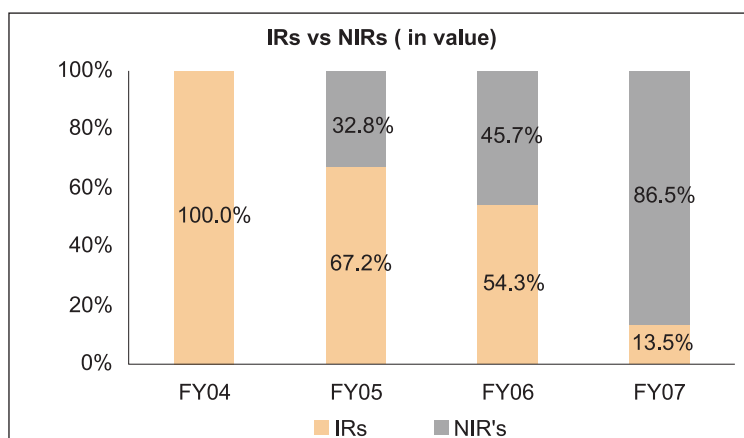
TWL acquired a heavy engineering division of Hyderabad Industries Ltd. located at Uttarpara, West Bengal. The unit has a steel foundry, a fabrication cum machining facility and access to a rail siding.

The acquisition strengthens TWL's existing product profile and offers backward integration, as the steel castings manufactured at the steel foundry are used in wagon manufacturing. This unit also manufactures a range of heavy earth moving and mining equipment.

**Revenue Mix**



Shift of emphasis to Non-Indian railway customers in FY07



Increase in free supplies (bogies and couplers) by Indian Railways led to drop in average realisations

### International alliances

Name of JV partner	Purpose
JV with FreightCar America Inc	Aluminium coal hopper, Aluminium coal gondola and other wagon products in selected countries in South Asia (including India) and Africa.
MOU with Kawada Industries, Japan	Fabrication and construction of steel ridges.
MOU with Miner Enterprises inc, USA	Manufacturing of electro pneumatic door equipment for Hopper wagons
MOU with GEEquipment Services	Vendor financing, maintaining and servicing the equipment while on lease, provide financing solutions to TWL, etc
Agreement with Stadler Rail, Switzerland and Molinari Rail, Australia	Mass Rapid Transport System (MRTS) project in Mumbai

### Major Non-railway customers

- CONCOR
- NTPC
- Chowgule Group
- MSPL Ltd.
- Taurian Iron & Steel Co. Pvt Ltd.

### Order book (Jan 1, '08 \*)

	(RsCr)
Rolling stock division	669.39
Special projects	51.48
Heavy Earth Moving and Mining Division	25.31
EMU	6.94
<b>Total</b>	<b>753.11</b>

\*Includes the estimated costs of wheelsets

**Critical supplies and suppliers**

Raw material	Name of Supplier
Wheelsets	CNR Datong Electric Locomotive Company, Rail Wheel Factory
Bogies and couplers	Titagarh Steels (Group company)
Steel plates	SAIL, Essar Steel, Tata Steel

**Wagon Industry**

**No. of Wagons in India**

Year	Total wagons on line (units)	Growth (p-o-p)
1950-51	205,596	-
1960-61	307,907	49.8%
1970-71	383,990	24.7%
1980-81	400,946	4.4%
1990-91	346,102	-13.7%
2000-01	222,193	-35.8%
2002-03	214,760	-3.3%
2003-04	227,752	6.0%
2004-05	222,409	-2.3%
2005-06	207,983	-6.5%
2006-07	207,719	-0.1%

(Source: Indian Railways Annual report)

The bulk of IR's wagon requirement is met by public and private sectors supplemented by Railway workshops. During FY07, of the 24,341 wagons produced, 2227 were manufactured by Railway workshops and the balance 22,113 was outsourced from the wagon industry comprising of private and public sector wagon manufacturers.

Given that IR has around 207,000 wagons and an annual demand of around 8-10%, we believe the demand to be around 16,000-20,000 wagons p.a. Industry sources estimate current production to be around 10,000 wagons p.a. TWL's market share is estimated at 20% in FY07, on the basis of no. of wagons sold.

Attractive growth opportunities on account of:

- Wagon leasing
- Replacement demand for wagons
- New wagon designs for private players
- International strategic alliances
- Wagon Investment Scheme

Railways carried freight of approx. 785mn tonnes during FY07. The number is likely to grow to approx. 1100mn tonnes by FY12. In view of the prospective increase in freight traffic, IR has introduced Wagon Investment Scheme on Public-Private Partnership (PPP) model to cater to the increasing demand for wagons.

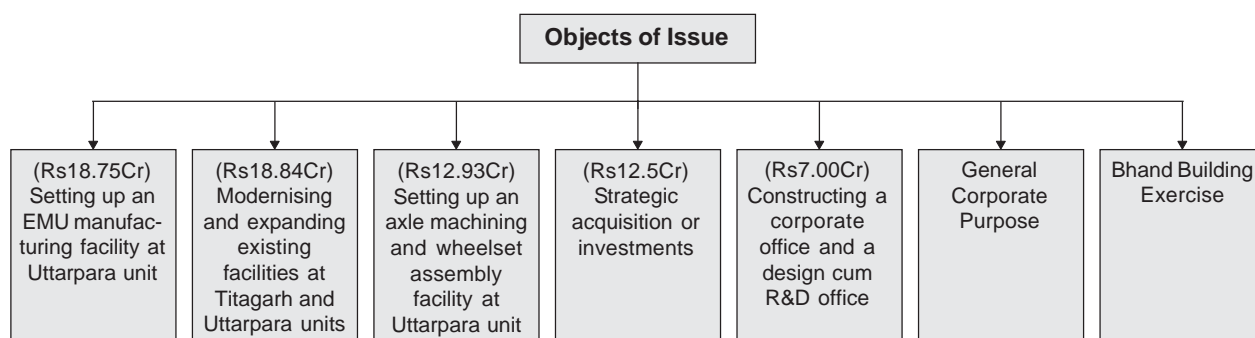
Under the scheme, individuals as well as corporate entities as producers and association are eligible to participate for procurement of wagons (BCN, BOXN, BTPN, BOST and BOBRN). The benefits to the customers under the scheme are as under:

- i) Assured supply of a guaranteed number of rakes every month.
- ii) Rebate in freight for a specified period depending upon the type of wagons procured.
- iii) Bonus rakes for Engine On Load (EOL) customers.
- iv) No maintenance charges required to be paid.

# K E Y N O T E

The scheme is being liberalized to include special purpose wagons and wagons of higher capacity and better designs.

- Dedicated freight corridor  
IR has proposed the creation of a dedicated freight corridor, solely for carrying freight trains including containers. The corridor is proposed to come up by FY12. As per the proposal, on the western side, Jawaharlal Nehru Port will be linked to NCR and further North to Ludhiana. Also, an eastern corridor will connect Ludhiana with Kolkata via the NCR.
- Container Privatisation
- Potential for attracting road freight



## Means of finance

The fund requirements would be met primarily through the IPO.

## Valuation matrix

	EPS			Price 24 Mar 08	P/E (x)		
	FY08	FY09	FY10		FY08	FY09	FY10
FreightCar America *	1.87	2.41	2.80	35.6	19.1	14.8	12.7
American Rail Ind.*	1.80	2.02	2.22	19.2	10.7	9.5	8.7
Texmaco	55.00	76.60	100.90	1261	22.9	16.5	12.5
Titagarh Wagons	25.67	33.03	38.85	610	23.8	18.5	15.7

\* Figures in \$

## Keynote Capitals's estimates (RsCr)

Particulars	FY08	FY09	FY10
Sales	420.00	609.00	761.25
Net Profit	47.33	60.90	71.63
EBITDA margin	17.2%	16.5%	15.8%
EPS (Rs)	25.67	33.03	38.85
P/E (x)	23.8	18.5	15.7
P/B (x)	2.9	2.5	2.2

## Investment concerns

- Growth prospects linked to Government policy
- Global shortage of wheelsets, a critical raw material may impact profitability
- Poor corporate governance and shareholder wealth creation track record of the promoter group

**Profit and loss statements**
**(RsCr)**

For period ending	31.03.03	31.03.04	31.03.05	31.03.06	31.03.07	30.09.07
<b>Net Sales</b>	<b>46.54</b>	<b>57.53</b>	<b>108.54</b>	<b>120.07</b>	<b>280.41</b>	<b>207.53</b>
Raw Materials	30.66	37.20	77.01	77.58	184.64	135.18
Staff costs	0.54	0.70	0.96	5.26	8.52	4.16
Other Mfg Exps	5.70	8.69	12.75	12.41	26.35	19.56
Admin & other exps.	4.35	3.30	4.11	5.58	10.55	10.65
Selling & Distn exps	0.31	0.25	0.55	0.81	1.39	0.58
Misc.Exps. written off	0.00	0.00	0.00	0.19	0.19	0.10
<b>Total Expenditure</b>	<b>41.57</b>	<b>50.14</b>	<b>95.37</b>	<b>101.83</b>	<b>231.64</b>	<b>170.22</b>
<b>EBIDTA</b>	<b>4.97</b>	<b>7.39</b>	<b>13.17</b>	<b>18.24</b>	<b>48.77</b>	<b>37.31</b>
Other Income	0.63	0.58	1.19	4.40	3.64	4.04
Interest	0.31	0.60	1.82	2.22	5.70	3.10
<b>EBDT</b>	<b>5.29</b>	<b>7.37</b>	<b>12.54</b>	<b>20.42</b>	<b>46.71</b>	<b>38.25</b>
Depreciation	0.58	0.72	1.03	1.56	1.90	1.02
<b>EBT</b>	<b>4.71</b>	<b>6.65</b>	<b>11.51</b>	<b>18.86</b>	<b>44.80</b>	<b>37.23</b>
Total Tax	1.54	2.40	4.19	6.01	15.62	12.93
<b>PAT before ADJ.</b>	<b>3.17</b>	<b>4.25</b>	<b>7.32</b>	<b>12.85</b>	<b>29.19</b>	<b>24.30</b>
ADJ due to Tax consid.	0.06	0.38	2.35	-1.17	-3.00	1.73
PAT post ADJ.	3.24	4.63	9.68	11.68	26.19	26.02
EBIDTA margin	10.7%	12.8%	12.1%	15.2%	17.4%	18.0%
Net margin	6.8%	7.4%	6.7%	10.7%	10.4%	11.7%
EPS (Rs)	23.33	31.27	53.85	79.98	19.86	16.53
Book value (Rs)	52.1	80.4	143.5	392.2	64.8	142.4

**Balance Sheets**
**(RsCr)**

As at,	31.03.03	31.03.04	31.03.05	31.03.06	31.03.07	30.09.07
<b>Sources of Funds</b>						
Paid-up Equity Capital	1.36	1.36	1.36	1.61	14.70	14.70
Advance against Share Capital	0.00	0.00	0.00	0.00	0.00	<b>88.00</b>
Reserves & Surplus	5.72	9.57	18.16	61.42	80.56	106.63
<b>Total Shareholders Funds</b>	<b>7.08</b>	<b>10.93</b>	<b>19.52</b>	<b>63.03</b>	<b>95.26</b>	<b>209.32</b>
Secured Loans	0.00	0.00	1.15	15.92	30.00	20.36
Unsecured Loans	5.82	7.64	12.74	8.65	5.05	5.05
<b>Total Debt</b>	<b>5.82</b>	<b>7.64</b>	<b>13.89</b>	<b>24.57</b>	<b>35.05</b>	<b>25.40</b>
<b>Total Liabilities</b>	<b>12.91</b>	<b>18.58</b>	<b>33.41</b>	<b>87.60</b>	<b>130.30</b>	<b>234.73</b>
<b>Applications of Funds</b>						
Gross Block	9.50	13.04	19.72	27.64	29.98	31.44
Less : Accumulated Depn	1.77	2.49	3.50	5.04	6.90	7.92
<b>Net Block</b>	<b>7.73</b>	<b>10.55</b>	<b>16.22</b>	<b>22.61</b>	<b>23.08</b>	<b>23.52</b>
CWIP	0.00	0.11	0.25	5.93	12.09	14.65
Investments	1.71	1.49	0.29	0.62	0.81	2.01
<b>Curr. Assets, Loans and Adv.</b>						
Inventories	3.96	6.73	9.10	36.67	77.74	101.64
Sundry Debtors	4.83	6.64	10.75	23.75	45.90	44.67
Cash & Bank Balances	4.24	6.24	24.41	47.96	45.31	139.59
Other Current Assets	0.19	0.17	0.27	0.49	0.75	2.44
Loans and Advances	2.95	3.25	2.33	33.76	25.62	47.22
Total Curr. Assets	16.17	23.02	46.86	142.62	195.31	335.55
Current Liabilities	10.65	14.69	25.88	77.41	93.86	127.49
Provisions	1.40	1.12	3.24	6.30	7.11	13.71
Total Curr. Liabilities	12.05	15.81	29.11	83.71	100.96	141.20
<b>Net Current Assets</b>	<b>4.12</b>	<b>7.22</b>	<b>17.75</b>	<b>58.91</b>	<b>94.35</b>	<b>194.35</b>
Deferred Tax Liability (Net)	0.65	0.80	1.10	1.25	0.61	0.29
Less: Misc. exp. not written off	0.00	0.00	0.00	0.78	0.58	0.48
<b>Total Assets</b>	<b>12.91</b>	<b>18.58</b>	<b>33.41</b>	<b>87.60</b>	<b>130.30</b>	<b>234.73</b>

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Subscribe with a medium term view	:	stock can deliver only over 6-8 months after listing
Subscribe with a long term view	:	value can only be realised over 12-18 months
Await listing	:	good fundamentals; consider valuations on listing

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