TD Power Systems

22 January 2015

Reuters: TDPS.BO; Bloomberg: TDPS IN

Initiating Coverage

Value 'Generator'

TD Power Systems (TDPS) is a leading manufacturer of AC generators for diverse prime movers such as steam, gas, hydro and wind turbines as well as diesel and gas engines and a key supplier to renowned global OEMs (original equipment manufacturers) like Siemens, GE and Voith Hydro with huge export potential. With a strong product portfolio and added benefit of high-technology customised products with low-cost Indian manufacturing, TDPS is witnessing a surge in its export order book (up 115% YoY to Rs2.2bn as of 1HFY15-end). We expect a 45% CAGR in export order inflow of generators over FY14-FY17E driven by rising penetration among existing OEMs, fresh tie-ups with new OEMs and diversification in untapped verticals. Further, TDPS is undergoing a business transformation by scaling down its power projects business (36% of FY14 revenue) and focusing solely on manufacture of generators (14.8% operating margin in FY14) resulting in generators forming 86%/95% of FY17E consolidated revenue/EBITDA, respectively. We expect TDPS to report a 1,080bps rise in EBITDA margin over FY14-FY17E, leading to a 55% earnings CAGR over the same period. We have assigned Buy rating to TDPS with a target price of Rs628, up 55% from the current market price, based on 25xFY17E EPS.

Robust scale-up in exports likely: Our channel checks suggest an annual addressable market size of US$9bn for TDPS based on its generator portfolio across prime movers. This provides a significant opportunity for scale-up of exports for TDPS in the foreseeable future. Export order book of TDPS increased 115% YoY to Rs2.2bn as of 1HFY15-end, accounting for 57% of the generator segment's order book. We expect export order inflow to register a strong 45% CAGR over FY14-FY17E, leading to a healthy rise in exports as a percentage of total order inflow of generators - from 40.5% in FY13 to 67.8% in FY17E.

Hydro, gas and steam generators to be growth drivers: Generators for hydro, gas engine and steam turbines are likely to be key volume growth drivers for TDPS. It expects a sharp uptick in generator off-take from marquee OEMs like Voith Hydro (by 2x to 3x from current revenue of Rs700mn) and GE Jenbacher (GE sells 1,500 gas engines annually, TDPS supplied 50 generators over the past year to GE for initial approval and aims to attain 20%-25% market share). Rising penetration in existing OEMs, fresh tie-ups with new OEMs and diversification in untapped verticals (marine and locomotive) will provide a strong boost to order inflow.

Power project division to be scaled down: TDPS is in the process of scaling down EPC business (24% of FY14 revenue) in a year's time after executing its pending order book worth Rs723mn comprising two projects. TDPS has no plan to grow its TG island business (12% of FY14 revenue) and wants to solely focus on core generator manufacturing business. This will lead to healthy business transformation, with high-margin generator segment's share in consolidated revenue rising from 64% in FY14 to 86.3% in FY17E and make TDPS financially strong.

Strong financial health to aid valuation: With healthy revenue traction and an improved operating leverage, EBITDA margin of TDPS is expected to rise 1,080bps from 4.1% in FY14 to 14.9% in FY17E. A strong improvement in return ratio profile likely (RoIC jumping from 1.4% in FY14 to 20.6% in FY17E), rise in fixed-asset turnover (from 1.2x in FY14 to 1.6x in FY17E), healthy free cash flow generation (Rs1.3bn over FY15E-FY17E), high net-cash per share (Rs53 in FY14, likely to rise to Rs69 in FY17E) and a stable working capital cycle will bring TDPS on a strong financial footing with a 55% earnings CAGR likely over FY14-FY17E.

Y/E March (Rsmn)	FY13	FY14	FY15E	FY16E	FY17E
Net sales	5,871	4,802	6,039	6,249	7,408
EBITDA	495	198	440	786	1,106
Net profit	417	227	372	607	836
EPS (Rs)	12.6	6.8	11.2	18.3	25.1
EPS growth (%)	*(36.7)*	*(45.6)*	*64.0*	*63.0*	*37.6*
EBITDA margin (%)	*8.4*	*4.1*	*7.3*	*12.6*	*14.9*
PER (x)	32.2	59.3	36.1	22.2	16.1
P/BV (x)	2.7	2.7	2.5	2.3	2.1
EV/EBITDA (x)	21.9	59.0	26.2	14.4	10.1
Dividend yield (%)	*0.5*	*0.6*	*0.7*	*1.2*	*1.7*
RoIC (%)	*15.2*	*1.4*	*7.0*	*14.7*	*20.6*
RoE (%)	*8.4*	*4.4*	*7.0*	*10.6*	*13.2*

Source: Company, Nirmal Bang Institutional Equities Research

BUY

Sector: Capital Goods

CMP: Rs405

Target Price: Rs628

Upside: 55%

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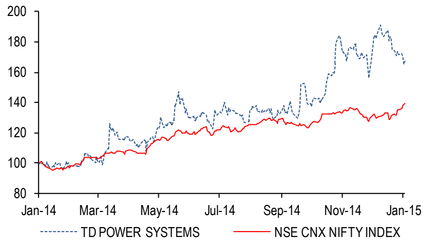
Key Data

Current Shares O/S (mn)	33.2
Mkt Cap (Rsbn/US$mn)	13.6/220.6
52 Wk H / L (Rs)	479/226
Daily Vol. (3M NSE Avg.)	134,515

Share holding (%)	4QFY14	1QFY15	2QFY15
Promoter	61.7	61.7	54.1
FII	20.7	21.1	17.0
DII	6.6	6.6	16.1
Corporate	11.1	10.6	12.9

One-Year Indexed Stock Performance



Price Performance (%)

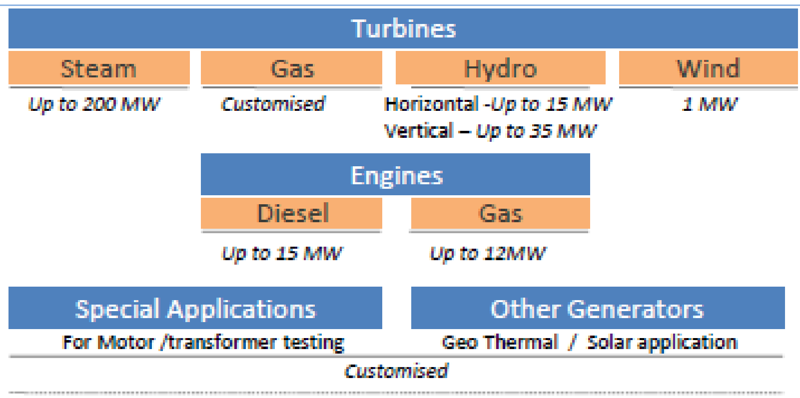
	1 M	6 M	1 Yr
TD Power Systems	(9.3)	25.5	65.6
Nifty Index	5.3	12.8	38.2

Source: Bloomberg

Business overview

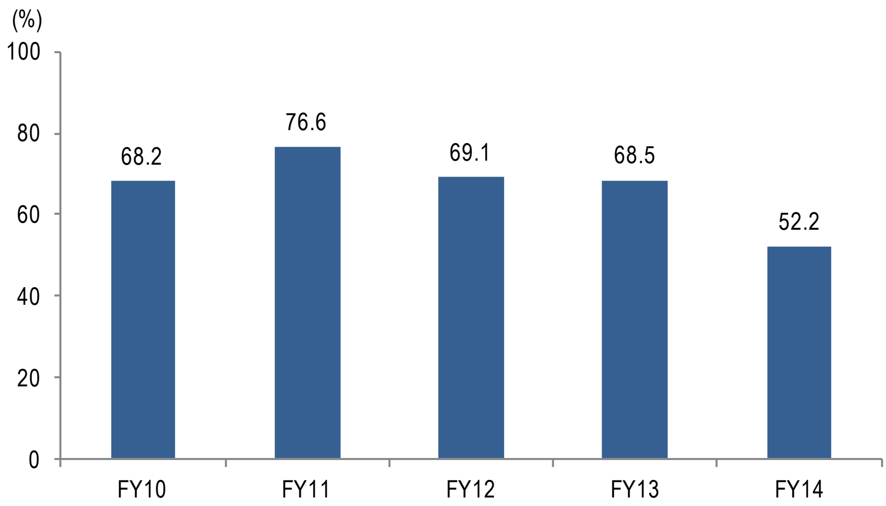
Incorporated in 1999, TDPS is one of the leading manufacturers of AC generators for a diverse range of prime movers such as steam, gas, hydro and wind turbines as well as diesel and gas engines. The company has developed in-house capability to manufacture generators up to 52MW (after absorbing initial technology received from Toyo Denki, Japan, of up to 25MW) and has entered into technology and licensing agreements with global players of repute to manufacture and supply generators. It has tied up with Siemens for steam generators, Voith Hydro for hydro generators and Sicme Motori for wind generators. TDPS is capable of supplying generators across turbine applications like steam (up to 200MW), gas (customised), hydro (horizontal up to 15MW and vertical up to 35MW) and wind (1MW). It also makes generators for diesel engines (up to 15MW) and gas engines (up to 12MW). The company supplied 2,471 generators as of 1HFY15-end with an aggregate output capacity of 19,500MW, with 508 generators being exported in over 62 countries. Among key product applications, steam generators accounted for 44% of revenue, while hydro generators contributed 39% in FY14. TDPS is a key supplier to renowned global OEMs like Siemens, GE and Voith Hydro with huge export potential. A large portion of generator sales take place through OEMs, but TDPS has been able to diversify its customer base well with its top 10 customers accounting for 52% of FY14 revenue compared to 77% in FY11. The generator business accounted for 64%/61% of FY14/1HFY15 consolidated revenue, respectively.

Exhibit 1: Generator portfolio of TDPS for turbines, engines and other applications



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Generator revenue contribution from top 10 customers



Source: Company, Nirmal Bang Institutional Equities Research

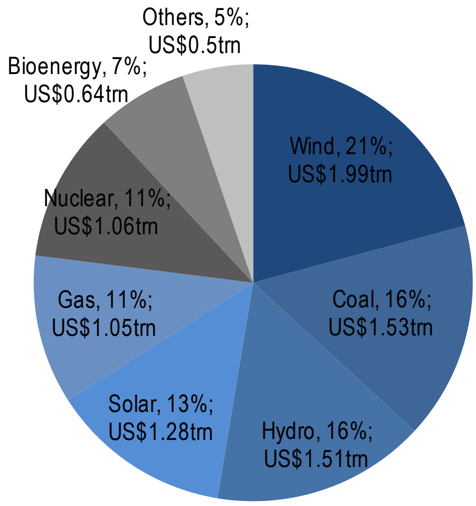
TDPS also has presence in power project business where it offers TG island package (up to 52MW) encompassing a scope of turbine, generator and associated auxiliaries. It also undertakes complete EPC of steam turbine power plants (up to 150MW) through a wholly-owned subsidiary called DF Power Systems. The company has completed 107 TG island projects with aggregate output capacity of 2,152MW in key geographies like India, Uganda, Kenya, Zambia and the Philippines. In EPC business, TDPS completed 11 projects with aggregate output capacity of 943MW. The power project business accounted for 36%/39% of FY14/1HFY15 revenue, respectively.

Investment rationale

Strong capex lined up in global power generation industry

International Energy Agency (IEA) expects US$16.4trn investments in the power sector over 2014-35,as per its World Energy Outlook 2014 report. Out of the total investment, US$9.56trn is likely to be invested in power generation, US$1.8trn in power transmission and US$5trn in power distribution. The key drivers of power sector investments are likely to be power demand growth, environmental regulations and the replacement cycle. The huge capex spending of US$9.56trn in power generation (encompassing boiler, turbine, generator and other balance of plant equipment) provides a strong growth opportunity for TDPS as it has a portfolio of AC generators across various fuel sources as well as various prime movers. Further, by being a key supplier to renowned global OEMs, TDPS is able to participate in power generation investment worldwide and is not confined by any geographical limitations.

Exhibit 3: Global investment in power generation over 2014–35 at US$9.56trn



Source: World Energy Outlook 2014 - IEA, Nirmal Bang Institutional Equities Research

Our channel checks suggests an annual addressable global AC generator market size of US$8bn-US$9bn for TDPS based on its product offering and considering its maximum output capacity (MW range) per fuel source. The global generator market for wind turbine is the largest at US$5bn, followed by steam (below 52MW) and marine at US$1bn each. The market size of hydro, gas and locomotive generators works out to US$500mn per annum each.

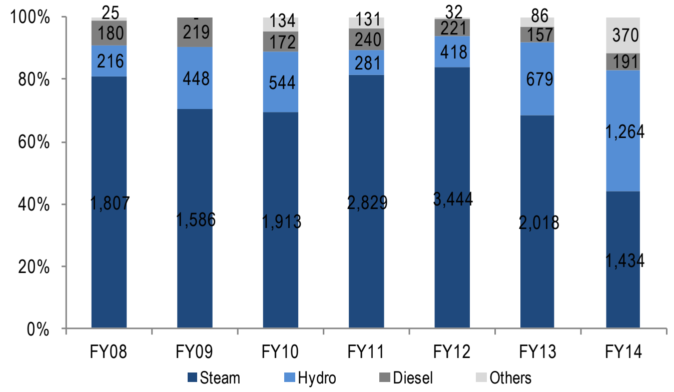
Exhibit 4: Addressable market opportunity for TDPS annually across fuel sources

Generator for key fuel source	Global market size per annum
Wind	US$5bn
Steam (below 52MW)	US$1bn
Hydro	US$500mn
Gas	US$500mn
Marine	US$1bn
Locomotive	US$500mn

Source: Industry, Company, Nirmal Bang Institutional Equities Research

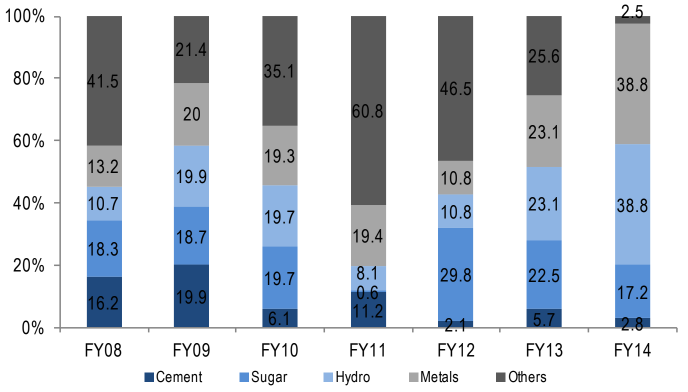
Having presence across verticals like steam, hydro, diesel, gas and wind helps TDPS to address the power generation capex across a large spectrum of fuel sources as well as enables it to mitigate business concentration risk. A case in point is the recent slowdown over the past three years in capex of steam segment being offset by a sharp pick-up in hydro segment. Similarly, TDPS supplies generators to wide-end user industries, thereby benefiting from capex spending across the economy irrespective of the order of sectoral revival.

Exhibit 5: TDPS generator sales - fuel source-wise



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 6: TDPS generator sales - key end-user industries



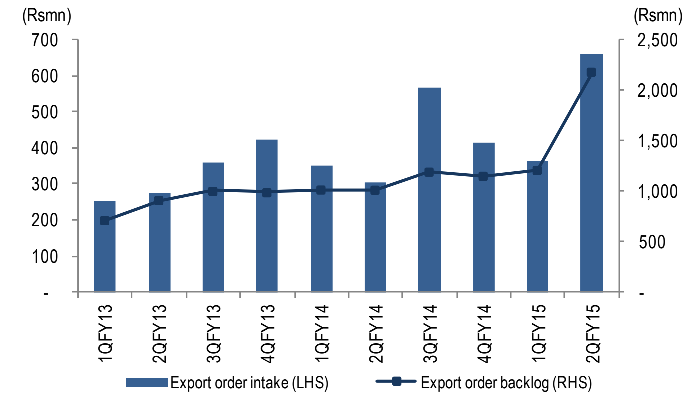
*Note: * Others include chemicals, food, paper, textile, process, wind, distillery, fertilisers etc. Source: Company, Nirmal Bang Institutional Equities Research*

Exports to drive strong growth in generator sales

Driven by a healthy order book and rising penetration in export markets, the generator business is expected to be a strong growth driver for TDPS. The segment reported a 19% YoY growth in revenue in 1HFY15, while its order inflow rose 54% YoY over the same period. In order to benefit from a further scale-up in exports and likely revival in domestic demand, TDPS incurred a capex of Rs2.3bn to expand its existing manufacturing plant of up to 52MW generators (Rs1.1bn capex) and to set up an additional manufacturing plant to cater to 52MW-200MW steam turbine generator market (Rs1.2bn capex) and currently has the capacity to manufacture generators worth Rs9bn.

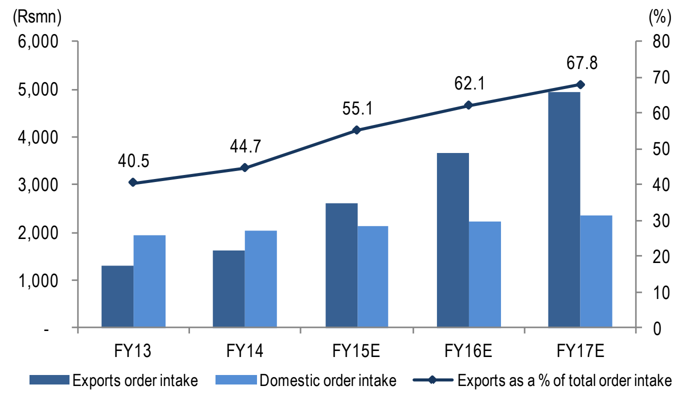
While the order book of generator segment of TDPS grew 37% YoY to Rs3.9bn as of 1HFY15-end, export order book increased 115% YoY to Rs2.2bn, accounting for 57% of generator segment's order book. Consequently, the share of exports in total generator revenue rose from 39.1% in FY14 to 61.7% in 1HFY15 and is likely to stay elevated with a stronger growth traction expected in exports. Rising penetration among existing OEMs, fresh tie-ups with new OEMs and diversification in untapped verticals (like marine and locomotive) will provide a strong boost to export order inflow going forward. We expect export order inflow to register a strong 45% CAGR over FY14-FY17E, leading to nearly quadrupling of export order inflow - from Rs1.3bn in FY13 to Rs4.9bn in FY17E. With the domestic market remaining stagnant, we are not factoring any meaningful recovery for the same and have factored in only a 5% CAGR rise in domestic order inflow in FY13-FY17E - from Rs1.9bn in FY13 to Rs2.3bn in FY17E. Consequently, exports, as a percentage of total order inflow of generators, are likely to rise from 40.5% in FY13 to 67.8% in FY17E.

Exhibit 7: Trend in export orders for generators



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 8: Domestic and export order inflow estimate



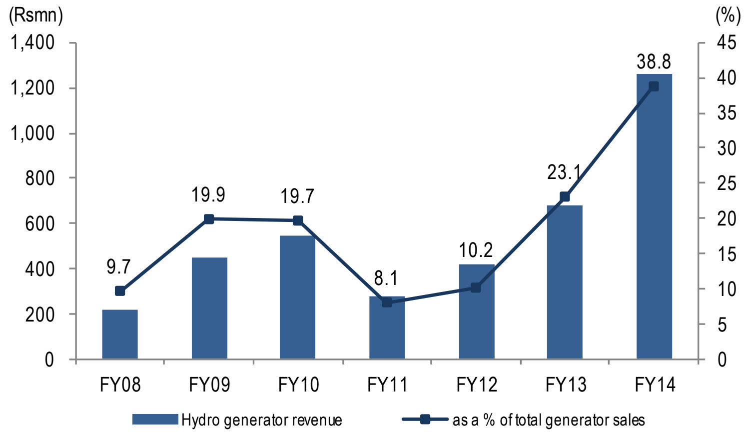
Source: Company, Nirmal Bang Institutional Equities Research

Hydro generators scaling up strongly

TDPS manufactures and supplies hydro generators up to 35MW (for vertical generators) and 15MW (for horizontal generators) and counts Voith Hydro GmbH (Germany) as a marquee OEM client. Buoyed by strong capex world-wide in the hydro power segment over the past three years, off-take for TDPS's hydro generator has been robust, with revenue rising from Rs281mn in FY11 to Rs1.2bn in FY14. The share of hydro generators in total generator sales rose sharply from 8.1% in FY11 to 38.8% in FY14. The management expects the growth traction to continue driven by sustained strong capex spending in hydro power segment as well as a healthy order pipeline of Voith Hydro. The global addressable market size in hydro generators for TDPS, considering its maximum output capacity (MW range), is US$500mn per annum. Considering its FY14 revenue of Rs1.26bn in hydro generator segment, the indicative global market share of TDPS works out to only 4.2%, providing it an ample scope to scale up. In the domestic market, TDPS has a market share of 70% where the key local competitor is Bharat Heavy Electricals (BHEL) while globally TDPS competes with Andritz, Alstom and Jeumont Electric.

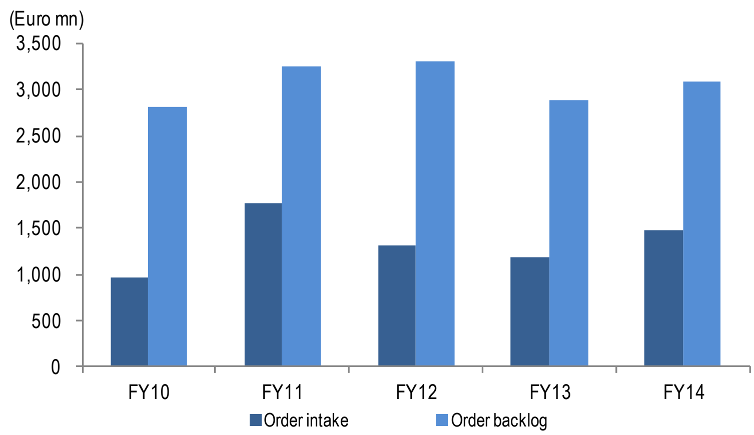
TDPS shares a strong relationship with Voith Hydro since the past five years and has jointly developed technology for hydro generators with Voith Hydro for which it does not have to pay any royalty. Voith Hydro sources 20%-25% of its total hydro generator requirement from TDPS, thus making it one among its top three vendors. Future scalability from Voith Hydro remains strong as TDPS aims to meet up to 50% of Voith Hydro's requirement over a period of time, and believes it can increase its revenue from this company by 2x to 3x (from Rs700mn-Rs800mn currently) to Rs2bn. The commentary from Voith Hydro indicates that it is optimistic about future growth potential in hydro-power segment. In FY14, Voith Hydro reported order inflow of euro1.47bn, up 24% YoY from euro1.19bn in FY13. Compared to FY14 revenue of euro1.31bn, Voith Hydro had a healthy order book of euro3.1bn as of FY14-end (year ending September 2014). South America (mainly Brazil), North America and Europe are key demand drivers for Voith Hydro. Currently, a third of the world's hydro-electric power is produced by Voith Hydro including major projects such as Niagara Falls (1903), Itaipu (1976), and Three Gorges Dam (2003). Alstom and Andritz are the other two large hydro turbine OEMs, while Chinese players Harbin and Dongfang Electric also provide hydro turbines.

Exhibit 9: Hydro generator revenue trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 10: Voith Hydro order book and intake trend



Source: Company, Nirmal Bang Institutional Equities Research

Gas engine generator is a game changer

In FY13, TDPS received technical qualification from GE Jenbacher, Austria, to supply generators for its gas engines, becoming its second approved supplier. It generally takes TDPS up to three years to get empanelled with an OEM, during which it develops customised generator as per client's specifications and gets it approved and tested by OEMs. Out of six types of gas engines made by GE Jenbacher, TDPS received approval to supply generators for three types of engines while the remaining three types are currently under testing. The qualification by GE Jenbacher can prove to be a game changer for TDPS as the potential of generator supply for GE Jenbacher's gas engines is enormous.

TDPS has supplied over 50 generators to GE Jenbacher till now over the past year, amounting to Rs400mn-Rs500mn, while it will supply 50 more over the next year after which a strong scale-up is likely. GE Jenbacher makes 1,500 gas engines a year, for which one of its largest generator vendors is Cummins, which also happens to be its key competitor. So it is in GE Jenbacher's best interests to reduce its dependence on Cummins and develop a new vendor base. Even if TDPS meets 20%-25% of GE Jenbacher's requirement, it will translate to a huge business opportunity for TDPS with an annual off-take of 300-400 generators. The existing relationship of TDPS with other GE group companies like GE Transportation USA and GE Brazil (where TDPS has granted a limited licence to GE to manufacture generators using TDPS' design for Brazilian market) could also help TDPS in scaling up the value chain with GE Jenbacher. Further, TDPS can also make inroads into other global OEMs of gas engines by virtue of being GE Jenbacher's approved supplier. TDPS expects strong traction in gas engine generator business worldwide, with America, Africa, Australia and Indonesia being the key contributors.

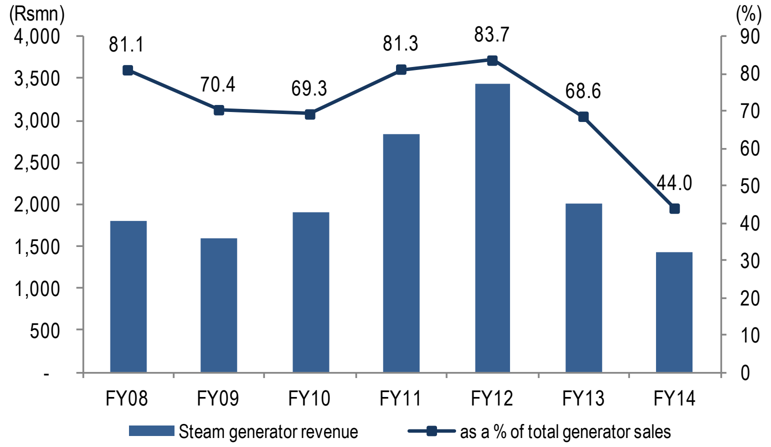
Steam generator – A large but subdued market

Steam generator was traditionally the largest segment for TDPS, accounting for 70%-84% of total generator sales in FY08-FY12. However, over the past three years, the global steam turbine market has moderated while the domestic market continues to remain subdued, thereby affecting the generator off-take of TDPS. The steam generators posted revenue of Rs1.4bn in FY14, while the global addressable market up to 52MW stands at US$1bn translating to an indicative global market share of 2.4% for TDPS. Its revenue is equally divided between domestic and export markets currently. TDPS operates in two categories of steam generators: (a) 1MW to 52MW and (b) 52MW to 200MW. TDPS received initial technology from Toyo Denki, Japan, for up to 25MW steam generators, which the company scaled up in-house up to 52MW. For 52MW to 200MW category, TDPS signed a long-term licensing agreement with Siemens AG, Germany, to get the technological knowhow to manufacture two-pole AC generators by paying a royalty.

The domestic market for up to 52MW generators fell from its peak of 3,000MW in FY12 to 700MW in FY15 because of economic slowdown. Siemens India is a key OEM client for TDPS in this category as it has sourced its entire generator requirement from TDPS since 2002. TDPS also supplies generators in this category to other steam turbine OEMs like Triveni Turbine as well as boiler OEMs like Thermax, Thyssenkrupp, ISGEC and Cethar Vessels. Many generators supplied to domestic OEMs are deemed exports for TDPS, as they are eventually destined for international markets. The 1MW to 52MW category is likely to rebound in India with expected economic revival as well as a likely uptick in captive power generation market in India. Exports are also likely to fare better as global capex slowdown over the past three years seems to have bottomed out. Further, TDPS has tied up with a couple of more European OEMs who can provide additional source of volume uptick. TDPS has a 80% domestic market share in steam generators up to 52MW where it competes with BHEL (15% market share) and WEG Brazil (5% market share). Globally, it competes with ABB, Siemens, GE, Emerson, Fuji, Mitsubishi, Toshiba etc.

However, the 52MW to 200MW category, for which TDPS incurred a capex of Rs1.2bn to set up the manufacturing plant, will take time to revive. TDPS currently does not export generators in this category as it does not possess any reference which takes two to three years to fructify. It also does not have any sourcing agreement with Siemens AG as the latter also makes generators. TDPS has supplied two generators of 67.5MW each for Bhuvneshwar Power in this category (largest rated generators made by TDPS thus far), while it is currently executing an order for two more generators of 67MW each for Reliance Industries. All these four generators were sourced from TDPS by Siemens India. TDPS expects modest revenue of Rs500mn from the 52MW-200MW steam generator category over the next two years.

Exhibit 11: Steam generator revenue trend



Source: Company, Nirmal Bang Institutional Equities Research

Wind generators – Selective focus because of high competition

TDPS makes generators for wind turbines up to 1MW through a technology transfer agreement signed in 2008 with Sicme Motori SrL, Italy. TDPS has supplied wind generators to large global wind turbine OEMs like WinWind, Kenersys and GE Wind while in the domestic market Genesis and Nu Power Technologies are its key clients. Even though wind generators is a large market worldwide with a US$5bn annual order placement potential, TDPS plans to remain selective as the segment suffers from intense competition leading to very low realisation for generator manufacturer. As the manufacturing plant of TDPS is fungible, whereby the company can make generator of any fuel source, it makes commercial sense for TDPS to focus on more profitable generators like hydro, gas and steam rather than undertaking low-margin wind generator orders.

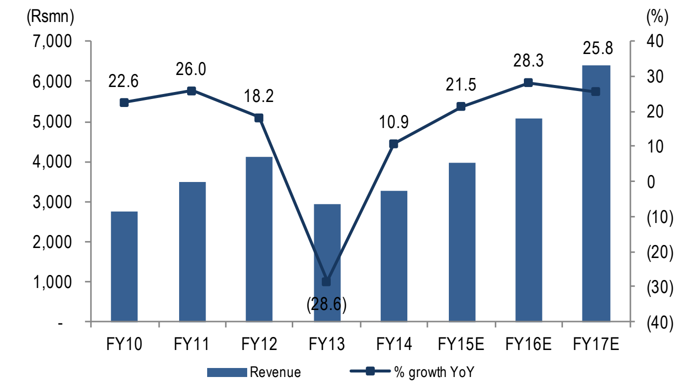
Generators for marine and locomotives – Huge untapped potential

Among the large global verticals to whom TDPS currently does not supply generators includes marine applications (US$1bn per annum market) and locomotive – both diesel and electric (US$500mn per annum market). As the manufacturing plant of TDPS is fungible in nature, it can tap this future potential by either developing technical expertise in-house or by tying up with a global OEM/technological partner. With the benefit of a low-cost manufacturing base in India as well as considering the strong OEM tie-up track record, TDPS should not find it too difficult to achieve such global tie-ups, especially at a time when the world is favourably looking at India as a manufacturing base. Future penetration into two of the large verticals which remained unexplored so far by TDPS - marine and locomotive - can unlock a potential annual addressable opportunity worth US$1.5bn.

Generator segment to post strong growth along with improved profitability

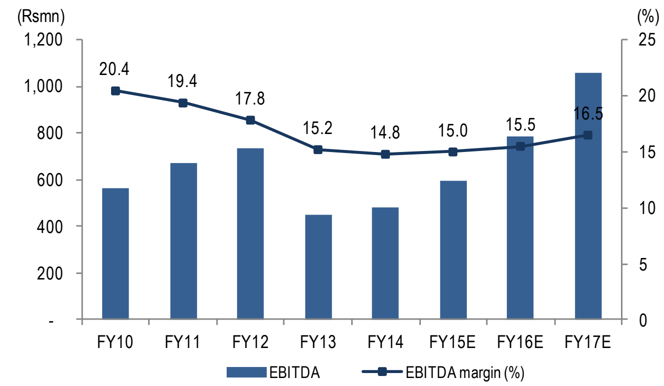
Rising export market penetration and a strong scale-up in hydro and gas engine generators along with a revival in steam generators will lead to robust growth in the generator business of TDPS. We expect TDPS to report a 25.2% revenue CAGR over FY14-FY17E compared to a 2.2% CAGR decline registered over FY11-FY14. With improved operating leverage, we expect EBITDA to post a 29.8% CAGR over FY14-FY17E compared to a 10.6% CAGR decline posted in FY11-FY14. Operating margin is likely to rise 170bps over a three-year period - from 14.8% in FY14 to 16.5% in FY17E.

Exhibit 12: Generator segment's revenue trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 13: Generator segment's profitability trend



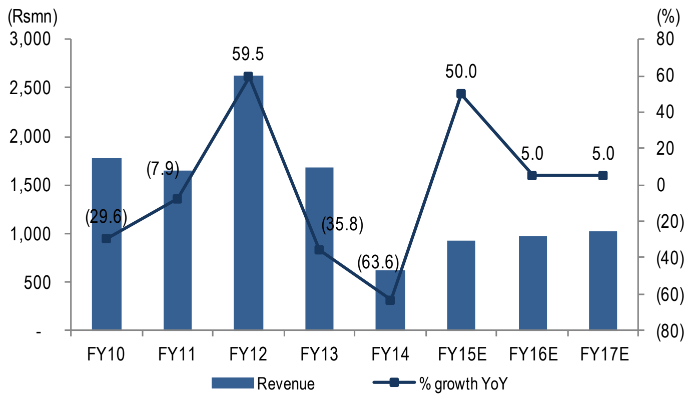
Source: Company, Nirmal Bang Institutional Equities Research

TG island business to remain steady

In power project business, TDPS executes steam turbine generator (TG) island projects up to 52MW, combining the company's generators with Japanese turbines (from Shin Nippon). As of 1HFY15-end, the company completed 107 TG island projects with an aggregate output capacity of 2,152MW. The key geographies where TG island projects were executed includes India, Uganda, Kenya, Zambia and the Philippines. TG island project segment accounted for 12% of FY14 consolidated revenue and 14.4% of FY14 consolidated EBITDA. The segment has been negatively impacted by lack of new orders in the domestic market over the past three years and as a result of which its revenue posted a 28% CAGR decline - from Rs1.6bn in FY11 to Rs613mn in FY14.

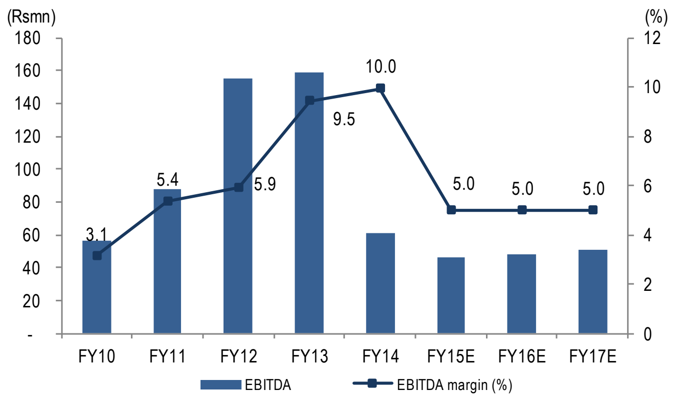
While TDPS has an order book worth Rs1.4bn in the TG island business as of 1HFY15-end, it does not expect this segment to grow significantly because of severe competition as well as the fact that TDPS ends up competing with its own clients of generator business (steam turbine OEMs like Siemens and Triveni Turbine). The company expects a flat revenue profile of Rs900mn-Rs1bn per annum over the next three years. TDPS has framed a strategy of not compromising on the working capital/payment terms while bidding. Its criteria to bid for orders include healthy advances from customers and the backing of Letter of Credit (LC) for orders. The management is careful about not blocking the working capital in the power project business. TDPS expects to make a 5%-6% EBITDA margin in this segment with a relatively risk-free business profile because of the low/negative working capital cycle. Consequently, we have factored in a flat revenue profile over FY15E-FY17E with an operating margin of 5%.

Exhibit 14: TG island segment's revenue trend



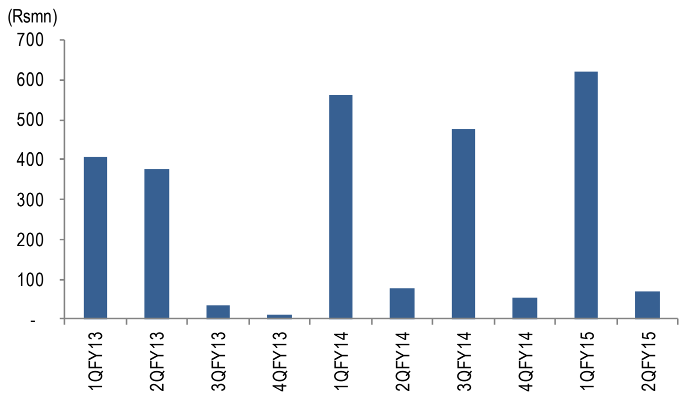
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 15: TG island segment's profitability trend



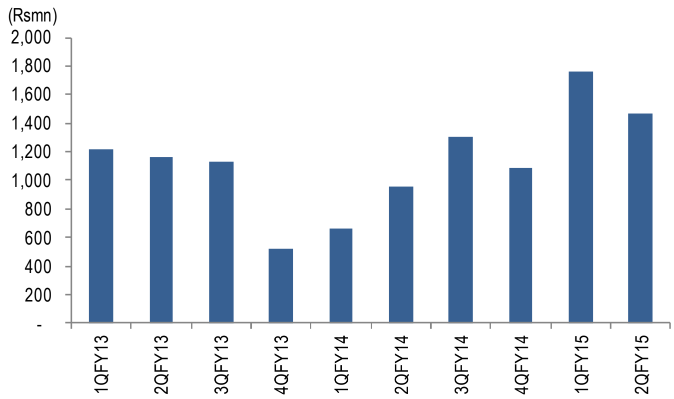
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 16: TG island segment's order inflow trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 17: TG island segment's order book trend



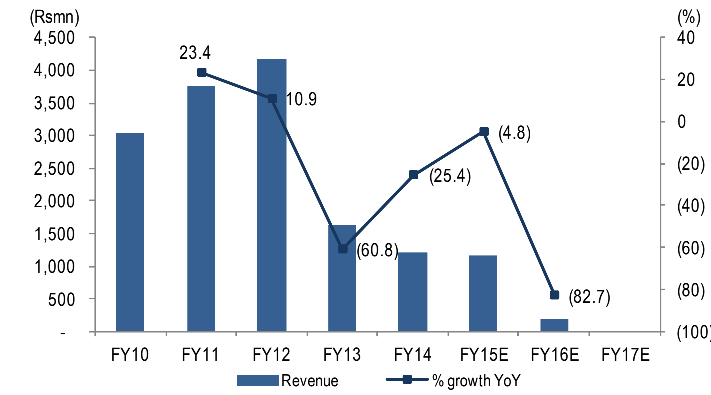
Source: Company, Nirmal Bang Institutional Equities Research

EPC projects to be scaled down

TDPS executes EPC contract of a steam turbine power plant up to 150MW through its wholly-owned subsidiary, DF Power Systems (DFPS). Under EPC projects, TDPS does in-house designing, engineering and supply of generators while all other products like boiler, turbine, balance of plant and other auxiliaries are sourced from outside. EPC project is a purely domestic business where TDPS has executed 11 projects till date with an aggregate output capacity of 943MW. EPC segment has been negatively impacted by lack of new orders in the domestic market over the past three years and as a result of which its revenue posted a 31% CAGR decline - from Rs3.8bn in FY11 to Rs1.2bn in FY14 but still accounts for 23.9% of FY14 consolidated revenue. With delay in execution and unabsorbed overheads, it reported an operating loss of Rs119mn in FY14. However, TDPS has remained careful about not compromising its working capital cycle/payment terms while bidding for orders and have thus far maintained a negative capital employed in the EPC business.

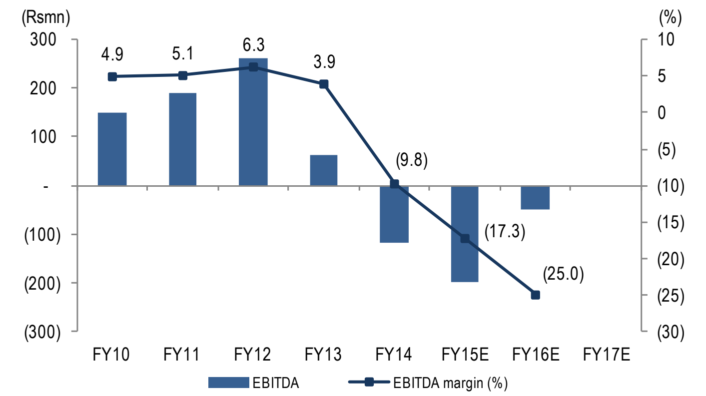
With intense competition negatively impacting EPC business, the management has decided to scale it down in order to focus more on the core business of manufacturing generators. Consequently, the company has not accepted any new orders for the past four quarters and the order book of its EPC division remains low at Rs723mn comprising two orders - a cement plant in Karnataka and a waste heat recovery plant in Raipur, Chhattisgarh. The company also decided to back out from an EPC order worth Rs2.2bn from a north-east paper manufacturing company as the renegotiation of commercial terms was found to be unfavourable. We have factored in Rs200mn/Rs50mn EBITDA losses in EPC business in FY15E/FY16E, respectively, because of business down-sizing and pending order book completion costs.

Exhibit 18: EPC segment's revenue trend



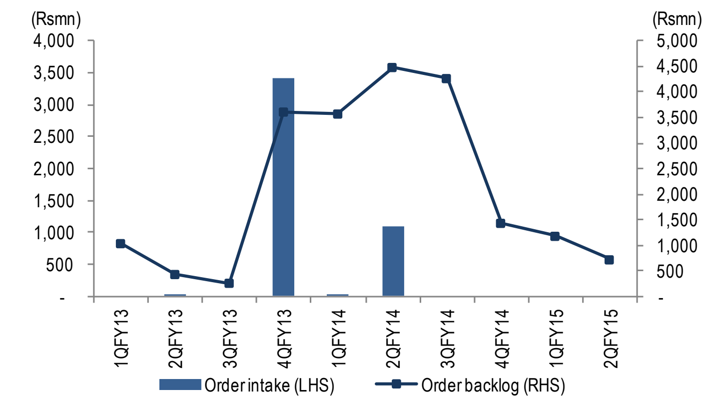
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 19: EPC segment's profitability trend



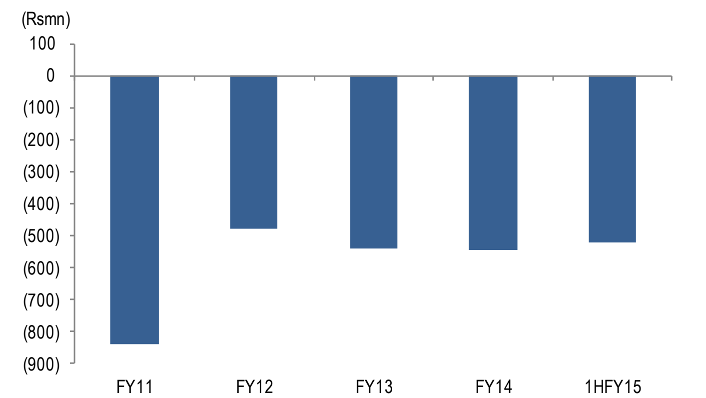
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 20: EPC segment's order inflow and backlog trend



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 21: EPC segment's negative capital employed trend



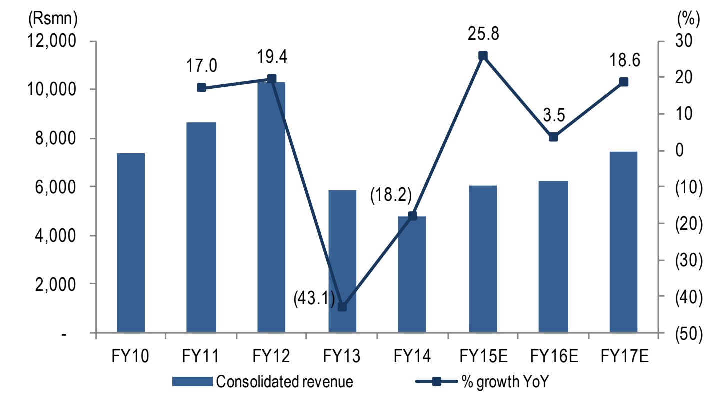
Note: As per segmental capital employed data excluding un-allocable amount

Source: Company, Nirmal Bang Institutional Equities Research

Financial overview

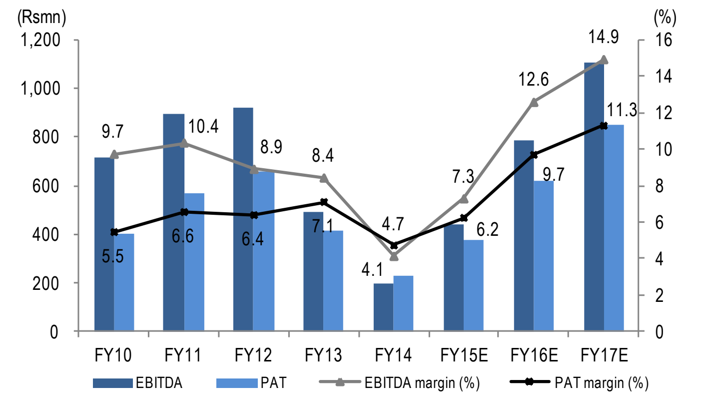
We expect TDPS to post a consolidated revenue CAGR of 15.5% over FY14-FY17E compared to a 17.8% CAGR decline reported over FY11-FY14. Top-line growth is likely to be primarily driven by a 25.2% revenue CAGR in the generator business over the same period, resulting in its share in total revenue rising from 64% in FY14 to 86.3% in FY17E. TG island segment's revenue is likely to post a 18.3% CAGR over FY14-FY17E because of a low base of FY14, but is likely to remain in the range of Rs900mn-Rs1bn over the next three years. Its contribution to total consolidated sales is expected to rise from 12.0% in FY14 to 13.7% in FY17E. EPC segment (23.9% of FY14 revenue) will be downsized over the next two years and will cease to exist in FY17. We expect a healthy growth in profitability over FY14-FY17E, driven by a sharp rise in contribution of high-margin manufacturing segment along with strong benefits of improved operating leverage as well as scale-down in power project segment. EBITDA is likely to post a 77.4% CAGR over FY14-FY17E (compared to a 39.5% CAGR decline in FY11-FY14) on a low base. Generator segment is expected to contribute 95.4% of consolidated EBITDA in FY17E, leading to a sharp increase in operating margin profile of TDPS - from 4.1% in FY14 to 14.9% in FY17E. PAT is likely to post 55% CAGR over FY14-FY17E (compared to a 26.3% CAGR decline posted over FY11-FY14) which can result in net profit margin scaling up from 4.7% in FY14 to 11.3% in FY17E.

Exhibit 22: Trend in consolidated revenue



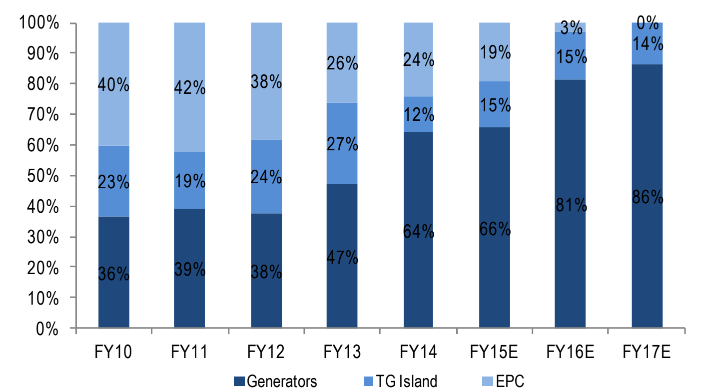
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 23: Trend in consolidated profitability



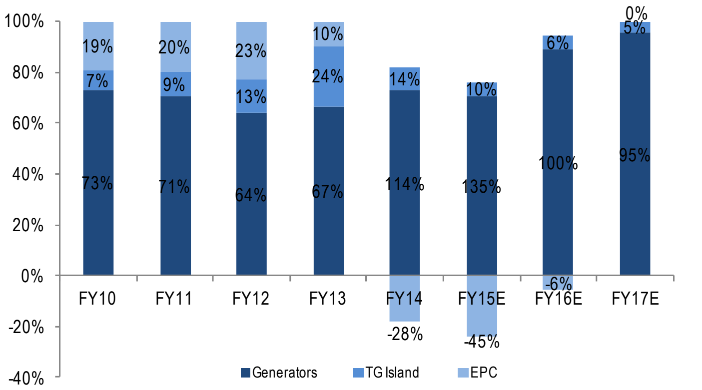
Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 24: Segment-wise revenue mix



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 25: Segment-wise EBITDA mix



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 26: Key assumptions

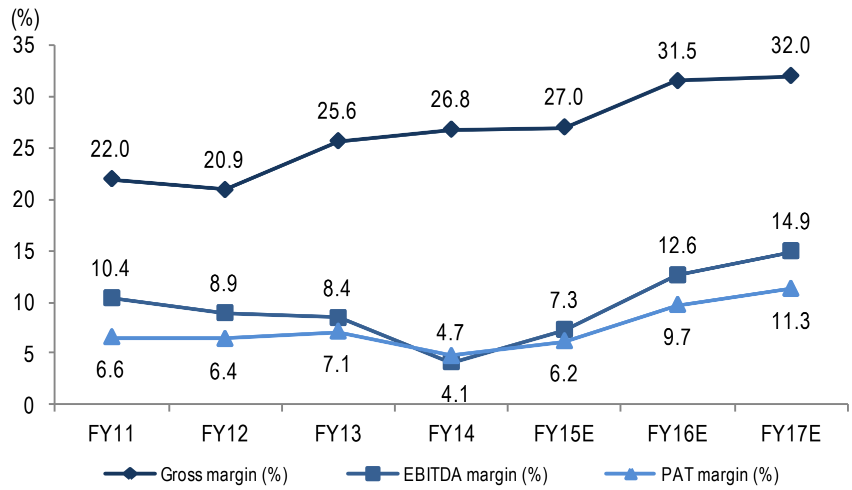
	FY10	FY11	FY12	FY13	FY14	FY15E	FY16E	FY17E
(A) Generator revenue	2,763	3,480	4,115	2,940	3,259	3,961	5,083	6,394
% growth YoY	*22.6*	*26.0*	*18.2*	*(28.6)*	*10.9*	*21.5*	*28.3*	*25.8*
EBITDA (net of inter-segmental)	565	674	734	447	482	594	788	1,055
Operating margin (%)	*20.4*	*19.4*	*17.8*	*15.2*	*14.8*	*15.0*	*15.5*	*16.5*
(B) TG island revenue	1,783	1,643	2,621	1,682	613	920	965	1,014
% growth YoY	*(29.6)*	*(7.9)*	*59.5*	*(35.8)*	*(63.6)*	*50.0*	*5.0*	*5.0*
EBITDA	56	88	155	159	61	46	48	51
Operating margin (%)	*3.1*	*5.4*	*5.9*	*9.5*	*10.0*	*5.0*	*5.0*	*5.0*
(C) EPC revenue	3,046	3,758	4,166	1,633	1,218	1,159	200	-
% growth YoY	*1,015.8*	*23.4*	*10.9*	*(60.8)*	*(25.4)*	*(4.8)*	*(82.7)*	-
EBITDA	150	191	261	64	(119)	(200)	(50)	-
Operating margin (%)	*4.9*	*5.1*	*6.3*	*3.9*	*(9.8)*	*(17.3)*	*(25.0)*	-

Source: Company, Nirmal Bang Institutional Equities Research

Rising margin profile

With a strong margin traction in generator manufacturing segment and a negative working capital cycle in power project business (leading to project business purchases remaining under control), TDPS has been able to constantly improve its gross margin. However, lack of operating leverage with unabsorbed staff costs and other expenses led to a decline in operating and net profit margins, despite rising gross margin. However, a strong pick-up in order inflow likely over FY14-FY17E will lead to a healthy revenue growth traction. With the benefits of operating leverage flowing in, the profitability trend is likely to improve going forward. We expect gross margin to improve from 26.8% in FY14 to 32.0% in FY17E while operating/net profit margins are likely to go up from 4.1%/4.7% in FY14 to 14.9%/11.3%, respectively, in FY17E.

Exhibit 27: Margin profile



Source: Company, Nirmal Bang Institutional Equities Research

DuPont analysis – declining total asset turnover suppresses RoE

Total asset turnover declined sharply from 3.2x in FY11 to 0.9x in FY14 on account of lower revenue as well as commissioning of new manufacturing facility for steam generators of 52MW-200MW worth Rs1.2bn (which operates at low single-digit capacity utilisation rate) leading to more than doubling of gross block over FY12-FY15E. Declining total asset turnover along with lack of financial leverage led to suppressed return ratios, with RoE declining from 30.2% in FY11 to 4.4% in FY14.

Exhibit 28: DuPont analysis

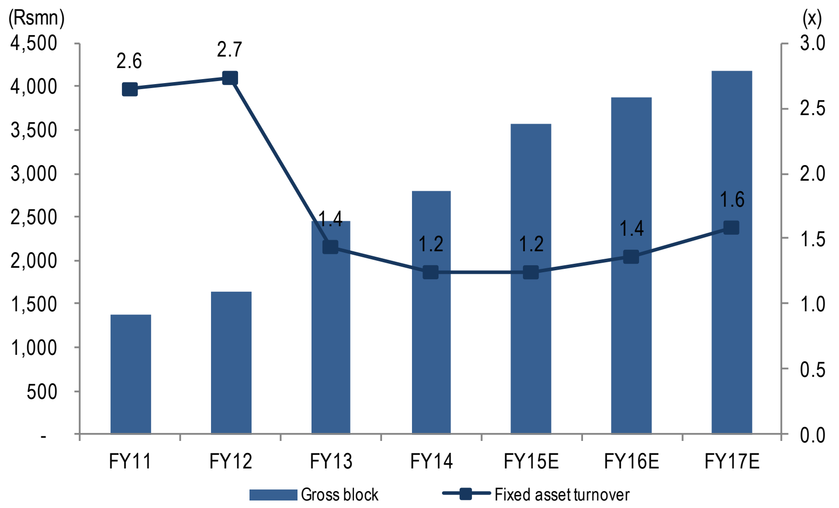
	FY11	FY12	FY13	FY14	FY15E	FY16E	FY17E
PAT margin (%)	*6.6*	*6.4*	*7.1*	*4.7*	*6.2*	*9.7*	*11.3*
Total asset turnover (x)	3.2	2.1	1.1	0.9	1.0	1.0	1.1
Financial leverage (x)	1.5	1.1	1.1	1.2	1.1	1.1	1.1
RoE (%)	*30.2*	*14.3*	*8.4*	*4.4*	*7.0*	*10.6*	*13.2*

Source: Company, Nirmal Bang Institutional Equities Research

Fixed asset turnover to rise, albeit constraints from 52MW-200MW gross block

Of the FY15E gross block of Rs3.5bn, gross block for the 1MW-52MW generator application amounts to Rs2.3bn while gross block for 52MW-200MW generator application amounts to Rs1.2bn. Both the applications are not fungible with each other as generators up to 52MW are four-pole machines running at 1,000rpm while 52MW-200MW generators are two-pole machines running at 750rpm. While the Rs2.3bn gross block can achieve asset turnover of 3x, in line with its historical peak, lack of orders in 52MW-200MW category will ensure a much lower asset turnover in Rs1.2bn gross block, thereby keeping return ratios relatively subdued in the foreseeable future also. Assuming entire gross block is for generator business, the fixed-asset turnover is set to increase from 1.2x in FY14 to 1.6x in FY17E driven by improved capacity utilisation and asset turnover in 1MW-52MW category (current capacity utilisation at 55%) on the back of robust order inflow.

Exhibit 29: Fixed asset turnover trend

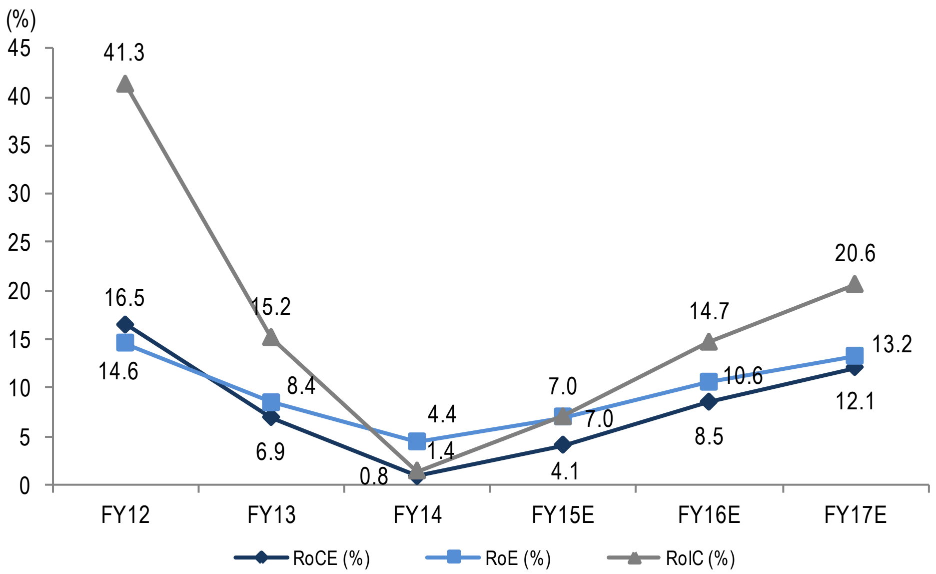


Source: Company, Nirmal Bang Institutional Equities Research

Return ratios set to improve

We expect the return ratios to rise from here on, aided by recovery in profitability, completion of capex programme worth Rs2.3bn (with only maintenance capex required henceforth) and improving asset turnover and capacity utilisation in the 1MW-52MW generator segment. We expect RoCE to rise from 0.8% in FY14 to 12.1% in FY17E, while RoE is likely to increase from 4.4% in FY14 to 13.2% in FY17E. However, healthy cash in the books is keeping the return ratios suppressed. In this context, it is preferable to judge TDPS on the basis of RoIC ratio, which is expected to jump from 1.4% in FY14 to 20.6% in FY17E.

Exhibit 30: Trend in return ratios

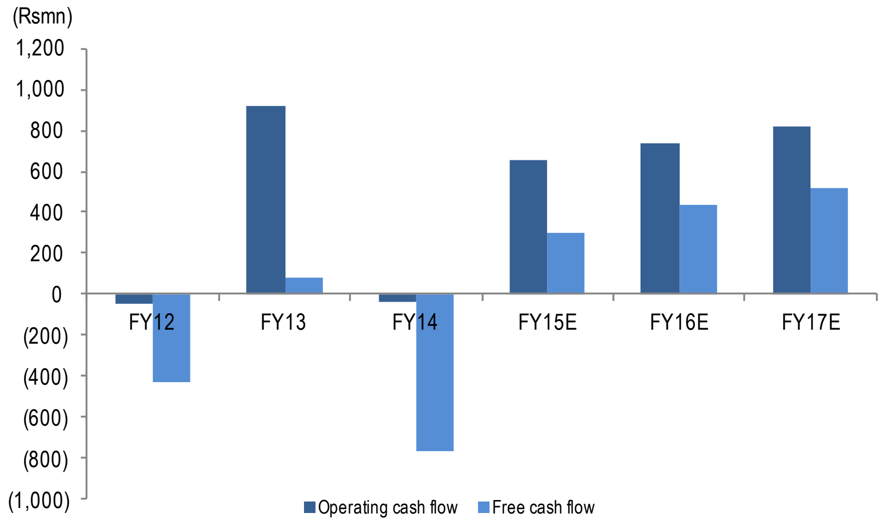


Source: Company, Nirmal Bang Institutional Equities Research

Healthy cash flow generation over FY15E-FY17E

We expect healthy cash flow generation over the next three years, driven by rising profitability and revenue contribution from generator segment, scale-down of power project segment, completion of capex programme (with only maintenance capex required henceforth) and a stable working capital cycle. We expect TDPS to generate operating cash flow of Rs2.2bn and free cash flow of Rs1.3bn over FY15E-FY17E.

Exhibit 31: Operating/free cash flow trend

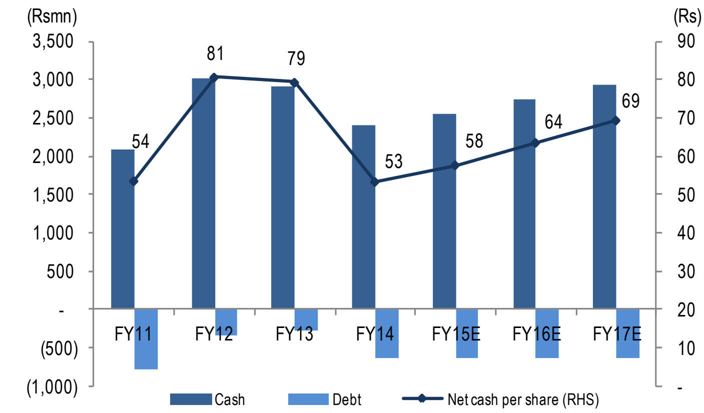


Source: Company, Nirmal Bang Institutional Equities Research

Huge cash balance

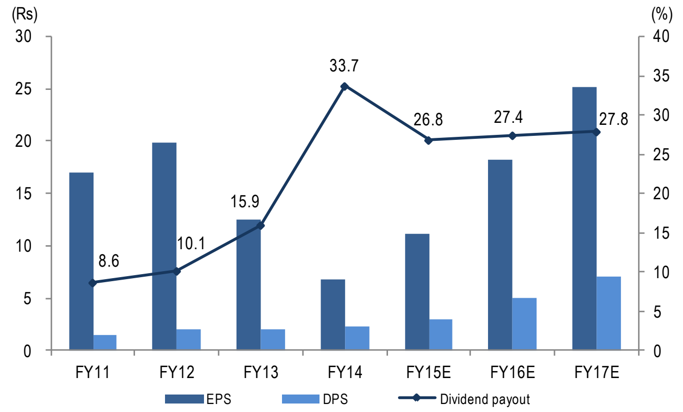
TDPS has a huge cash balance on its books amounting to Rs2.4bn in FY14. Excluding debt of Rs630mn, net cash balance works out to Rs1.8bn translating to Rs53/share. At the CMP of Rs405, net cash balance works out to 13% of its current market capitalisation. Further, we expect net cash to rise to Rs58/Rs64/Rs69 per share in FY15E/FY16E/FY17E, respectively, driven by healthy operating performance. With limited requirement of incremental capex over the next few years, there is a strong possibility of a sharp rise in dividend payout or share buyback to utilise the cash balance better. We expect a 27% dividend payout rate over FY15E-FY17E period.

Exhibit 32: High amount of cash per share



Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 33: Dividend payout trend

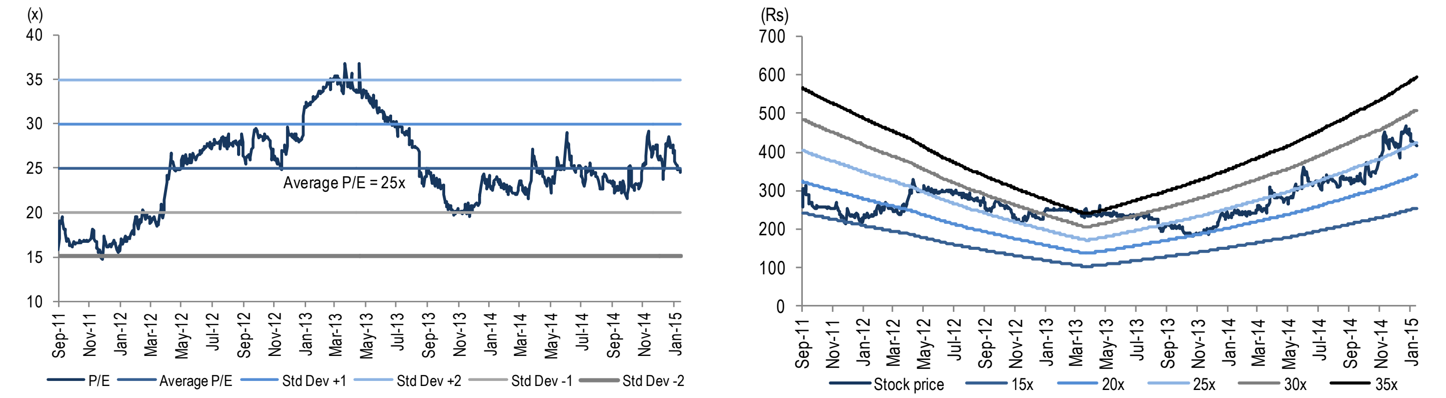


Source: Company, Nirmal Bang Institutional Equities Research

Outlook and valuation

TDPS stock has traded at an average one-year forward P/E of 25x since listing in September 2011 – despite economic uncertainty in India as well as a business slowdown phase for the company over FY11-FY14. TDPS is undergoing a business transformation by scaling down its EPC project business and increasing the focus on core generator manufacturing business. This will lead to a sharp rise in generator segment's contribution to consolidated revenue from 64% in FY14 to 86.3% in FY17E. With rising penetration among existing OEMs, fresh tie-ups with new OEMs and diversification in untapped verticals, TDPS is set to register a strong 25.6% CAGR in order inflow over FY14-FY17E. With healthy revenue traction and an improved operating leverage benefit, operating margin will be boosted by 1,080bps - from 4.1% in FY14 to 14.9% in FY17E. A strong improvement in return ratio profile (RoIC jumping from 1.4% in FY14 to 20.6% in FY17E), rise in fixed-asset turnover (from 1.2x in FY14 to 1.6x in FY17E), healthy free cash flow generation (Rs1.3bn over FY15E-FY17E), high net cash per share (Rs53 in FY14, likely to rise to Rs69 in FY17E) and a stable working capital cycle will bring TDPS on an even stronger financial footing with a 55% earnings CAGR likely over FY14-FY17E. Strong management pedigree, high technology-oriented focus, market leader status in generators, strong future scalability and a robust financial franchise warrants a premium valuation for TDPS in the capital goods industry. We have valued the stock at 25xFY17E EPS of Rs25.1 with a target price of Rs628, up 55% from the current market price, and assigned a Buy rating to it.

Exhibit 34: One-year forward P/E



Source: BSE, Nirmal Bang Institutional Equities Research

Key risks

- Captive and co-generation power producers in the industrial sector are key markets for generators. Any adverse government policy or economic climate which affects the investment activity in the industrial sector can hamper growth prospects of TDPS.
- TDPS primarily supplies generators to global OEMs. Any break-down in relationship with key global OEMs can affect generator off-take and, thereby, revenue traction.
- Any unforeseen rise in competitive intensity can hurt margins and affect market share.
- Any sharp rise in commodity prices – if it cannot be passed on to customers - will hurt margins. Steel and copper are major raw materials, while the import content is 20%.
- High volatility in foreign exchange rates - if it cannot be passed on to customers - can affect margins.

Company background

Incorporated in 1999, TDPS is one of the leading manufacturers of AC generators for a diverse range of prime movers such as steam, gas, hydro and wind turbines as well as diesel and gas engines. As of 1HFY15-end, TDPS supplied over 2,471 generators globally with an aggregate output capacity of 19,500MW, including 508 generators exported to 60 countries. The company has developed in-house capability to manufacture generators up to 52MW and entered into technology and licensing agreement with global players of repute to manufacture and supply generators. It has tie ups with Siemens for steam generators, Voith Hydro for hydro generators and Sicme Motori for wind generators. The company is further expanding its portfolio of steam generators to up to 200MW through a licensing agreement with Siemens. The generator business accounted for 64% of FY14 revenue of TDPS. A large portion of generator sales take place through OEMs, but TDPS has been able to diversify its customer base well with its top 10 customers accounting for 52% of FY14 revenue compared to 77% in FY11. TDPS also has a presence in power project business where it offers TG island package (up to 52MW) and complete EPC of steam turbine power plants (up to 150MW). The company has completed 107 TG island projects with aggregate output capacity of 2,152MW in key geographies like India, Uganda, Kenya, Zambia and the Philippines. In EPC business, TDPS has completed 11 projects with aggregate output capacity of 943MW. The power project business accounted for 36% of FY14 revenue. TDPS became a public limited company in September 2011.

Exhibit 35: Manufacturing facilities located at Debaspet, Bangalore

Source: Company

Exhibit 36: Key promoters

Source: Company

Financials (consolidated)

Exhibit 37: Income statement

Y/E March (Rsmn)	FY13	FY14	FY15E	FY16E	FY17E
Net sales	5,871	4,802	6,039	6,249	7,408
% growth	*(43.1)*	*(18.2)*	*25.8*	*3.5*	*18.6*
Raw material costs	4,365	3,516	4,409	4,280	5,037
Staff costs	532	607	664	637	682
Other overheads	479	481	526	545	583
Total expenditure	5,376	4,604	5,599	5,463	6,302
EBITDA	495	198	440	786	1,106
% growth	*(46.2)*	*(59.9)*	*122.0*	*78.6*	*40.6*
EBITDA margin (%)	*8.4*	*4.1*	*7.3*	*12.6*	*14.9*
Other income	308	341	365	401	441
Interest costs	34	36	41	50	50
Depreciation	124	150	191	231	250
Profit before tax	644	354	573	906	1,247
Tax	227	126	201	299	412
Extraordinary items	-	(3)	-	-	-
Net profit	417	227	372	607	836
Net profit margin (%)	*7.1*	*4.7*	*6.2*	*9.7*	*11.3*
EPS (Rs)	12.6	6.8	11.2	18.3	25.1
% growth	*(36.7)*	*(45.6)*	*64.0*	*63.0*	*37.6*

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 38: Cash flow

Y/E March (Rsmn)	FY13	FY14	FY15E	FY16E	FY17E
EBIT	371	49	249	555	856
(Inc.)/dec. in working capital	328	(425)	90	(99)	(265)
Cash flow from operations	**699**	**(377)**	**339**	**456**	**591**
Other income	308	341	365	401	441
Depreciation	124	150	191	231	250
Interest paid (-)	(34)	(36)	(41)	(50)	(50)
Tax paid (-)	(175)	(118)	(201)	(299)	(412)
Net cash from operations	**922**	**(40)**	**654**	**739**	**821**
Capital expenditure (-)	(843)	(724)	(350)	(300)	(300)
Net cash after capex	**79**	**(764)**	**304**	**439**	**521**
Dividends paid (-)	(75)	(89)	(117)	(194)	(272)
Inc./(dec.) in short-term borrowing	(73)	360	-	-	-
Inc./(dec.) in long-term borrowing	-	-	-	-	-
Inc./(dec.) in total borrowings	(73)	360	-	-	-
(Inc.)/dec. in long term loans & adv	(49)	(5)	(43)	(50)	(55)
(Inc.)/dec. in investments	-	-	-	-	-
Cash from financial activities	**(197)**	**266**	**(159)**	**(245)**	**(327)**
Others	-	(3)	-	-	-
Opening cash	3,022	2,905	2,404	2,548	2,742
Closing cash	2,905	2,404	2,548	2,742	2,936
Change in cash	(118)	(501)	144	194	194

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 39: Balance sheet

Y/E March (Rsmn)	FY13	FY14	FY15E	FY16E	FY17E
Share capital	332	332	332	332	332
Reserves	4,608	4,743	4,999	5,412	5,975
Net worth	4,941	5,076	5,331	5,744	6,307
Short-term loans	270	630	630	630	630
Long-term loans	-	-	-	-	-
Total loans	270	630	630	630	630
Deferred tax liability (net)	137	146	146	146	146
Liabilities	**5,348**	**5,851**	**6,107**	**6,520**	**7,083**
Gross block	2,447	2,788	3,578	3,878	4,178
Depreciation	449	594	785	1,016	1,266
Net block	1,998	2,194	2,793	2,862	2,912
Capital work-in-progress	162	540	100	100	100
Investments	-	-	-	-	-
Long term loans and advances	416	421	463	514	568
Inventories	530	863	910	924	1,055
Debtors	1,778	2,218	2,399	2,448	2,841
Cash	2,905	2,404	2,548	2,742	2,936
Short term loans and advances	630	1,040	910	1,027	1,319
Total current assets	5,844	6,525	6,767	7,142	8,152
Creditors	1,323	1,688	1,993	1,970	2,208
Other current liabilities & provisions	1,749	2,141	2,024	2,128	2,442
Total current liabilities	3,072	3,829	4,017	4,098	4,650
Net current assets	2,772	2,696	2,751	3,044	3,502
Total assets	**5,348**	**5,851**	**6,107**	**6,520**	**7,083**

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 40: Key ratios

Y/E March	FY13	FY14	FY15E	FY16E	FY17E
Per share (Rs)					
EPS	12.6	6.8	11.2	18.3	25.1
Book value	148.7	152.7	160.4	172.8	189.8
Valuation (x)					
P/E	32.2	59.3	36.1	22.2	16.1
P/BV	2.7	2.7	2.5	2.3	2.1
EV/EBITDA	21.9	59.0	26.2	14.4	10.1
EV/sales	1.8	2.4	1.9	1.8	1.5
Return ratios (%)					
RoCE	6.9	0.8	4.1	8.5	12.1
RoE	8.4	4.4	7.0	10.6	13.2
RoIC	15.2	1.4	7.0	14.7	20.6
Profitability ratios (%)					
EBITDA margin	8.4	4.1	7.3	12.6	14.9
EBIT margin	6.3	1.0	4.1	8.9	11.6
PAT margin	7.1	4.7	6.2	9.7	11.3
Turnover ratios					
Total asset turnover ratio (x)	1.1	0.9	1.0	1.0	1.1
Debtor days	111	169	145	143	140
Inventory days	33	66	55	54	52
Creditors days	111	175	165	168	160
Solvency ratios (x)					
Debt-equity	0.1	0.1	0.1	0.1	0.1
Interest coverage	10.8	1.3	6.1	11.0	17.0

Source: Company, Nirmal Bang Institutional Equities Research

Disclaimer

Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to15%

SELL < -5%

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