CRISIL RESEARCH

CRISIL SME IER Independent Equity Research

Thejo Engineering Ltd

Detailed Report

Enhancing investment decisions

Explanation of CRISIL SME Fundamental and Valuation (CFV) matrix

The CRISIL SME CFV Matrix (CRISIL Fundamental and Valuation Matrix) addresses the two important analysis of an investment making process – Analysis of Fundamentals (addressed through SME Fundamental Grade) and Analysis of Returns (SME Valuation Grade) The SME fundamental grade is assigned on a five-point scale from grade 5 (indicating Excellent fundamentals) to grade 1 (Poor fundamentals). The SME valuation grade is assigned on a five-point scale from grade 5 (indicating strong upside from the current market price (CMP)) to grade 1 (strong downside from the CMP). This opinion is a relative assessment in relation to other SMEs in India. The assessment is based on a grading exercise carried out by industry specialists from CRISIL Research.

CRISIL SME Fundamental Grade	Assessment	CRISIL SME Valuation Grade	Assessment
5/5	Excellent fundamentals	5/5	Strong upside (>25% from CMP)
4/5	Superior fundamentals	4/5	Upside (10-25% from CMP)
3/5	Good fundamentals	3/5	Align (+-10% from CMP)
2/5	Moderate fundamentals	2/5	Downside (negative 10-25% from CMP)
1/5	Poor fundamentals	1/5	Strong downside (<-25% from CMP)

About CRISIL Limited

CRISIL is a global analytical company providing ratings, research, and risk and policy advisory services. We are India's leading ratings agency. We are also the foremost provider of high-end research to the world's largest banks and leading corporations.

About CRISIL Research

CRISIL Research is India's largest independent integrated research house. We provide insights, opinion and analysis on the Indian economy, industry, capital markets and companies. We also conduct training programs to financial sector professionals on a wide array of technical issues. We are India's most credible provider of economy and industry research. Our industry research covers 86 sectors and is known for its rich insights and perspectives. Our analysis is supported by inputs from our network of more than 5,000 primary sources, including industry experts, industry associations and trade channels. We play a key role in India's fixed income markets. We are the largest provider of valuation of fixed income securities to the mutual fund, insurance and banking industries in the country. We are also the sole provider of debt and hybrid indices to India's mutual fund and life insurance industries. We pioneered independent equity research in India, and are today the country's largest independent equity research house. Our defining trait is the ability to convert information and data into expert judgements and forecasts with complete objectivity. We leverage our deep understanding of the macro-economy and our extensive sector coverage to provide unique insights on micro-macro and cross-sectoral linkages. Our talent pool comprises economists, sector experts, company analysts and information management specialists.

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Last updated: August, 2014

Analyst Disclosure

Each member of the team involved in the preparation of the grading report, hereby affirms that there exists no conflict of interest that can bias the grading recommendation of the company.

Disclaimer:

Thejo Engineering Ltd

In investment mode

SME Fundamental Grade	**5/5 (Excellent fundamentals)**
SME Valuation Grade	**4/5 (CMP has upside)**

December 08, 2014

Fair Value	**₹ 219**
CMP	**₹ 200**

Thejo Engineering Ltd (Thejo) reported subdued profits in FY14 and H1FY15. While the domestic business continued to perform well led by healthy traction in services, the overseas investments (for marketing and technical teams) impacted EBITDA margin as overseas sales are yet to pick up. We expect margins to be under pressure in the near term but recover FY17 onwards following expected gradual increase in sales at the overseas locations led by the company's marketing efforts. Further, with the expected revival in the domestic economy, growth in Thejo's key end-user industries - mining, steel and power - is expected to bounce back leading to incremental demand. Driven by vast experience in the material handling industry, established client relationships and focus on R&D, Thejo is well placed to benefit in the medium to long term. We retain our SME fundamental grade of **5/5.**

Services to drive domestic revenues in the near term

Domestic services revenues have consistently posted healthy growth over FY14 and H1FY15 as companies typically focus on maintenance activities during a slowdown. This led to 9% and 26% y-o-y increase in domestic revenues (excluding trading income) in FY14 and H1FY15, respectively. We expect the performance of the domestic core sectors to remain muted in the near term which would continue to impact product sales but services momentum is likely to continue. We forecast the domestic business to post 20% CAGR over FY14-17 – services revenues are expected to grow at a CAGR of 28% while products revenues are expected grow slower at ~3% CAGR.

Healthy overseas opportunities; association with Bridgestone in Australia is a positive

Thejo has expanded its geographic presence to Australia, Brazil, Chile and Saudi Arabia, which, with large mining operations, offer immense opportunities to operations and maintenance (O&M) players such as Thejo. We expect the Australian market to lead growth in international revenues owing to the association with Bridgestone Corp. - a leading global conveyor belts manufacturer which acquired 26% stake in Thejo's Australian subsidiary in 2013. The other markets are expected to take some time to ramp up from the current nascent stage. We forecast international revenues (including exports from India and subsidiary sales) to grow at a CAGR of 30% over FY14-17 to ₹515 mn.

Revenues to grow at 22% CAGR over FY14-17; EBITDA margin to be subdued

We forecast consolidated revenues to grow at 22% CAGR over FY14-17 to ₹2.7 bn – services revenues are expected to grow at 29% CAGR and product revenues at 7% CAGR. EBITDA margin is expected to decline to 5% in FY15 from 9.7% in FY14 and then recover to 11% in FY17. PAT is expected to grow at 50% CAGR over FY14-17 to ₹115 mn.

Earnings estimates revised downwards; fair value maintained at ₹219 post roll forward

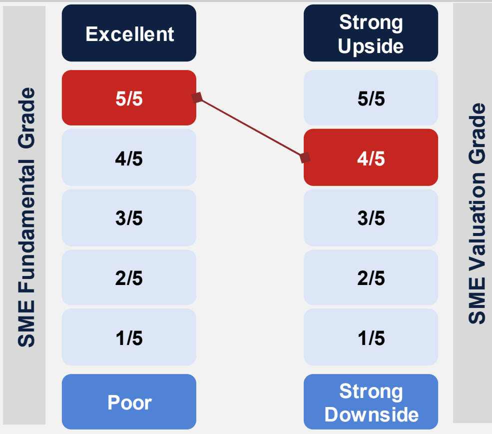
We have lowered our earnings estimates for FY15 and FY16 by 84% and 30%, respectively, to factor in investments in marketing and sales in the overseas markets. We continue to use the discounted cash flow (DCF) method to value Thejo. We have rolled forward our model by one year to FY16 and maintain the fair value at ₹219 per share. This fair value implies P/E multiples of 8.9x FY16E and 6.5x FY17E EPS.

KEY FORECAST

(₹ mn)	FY13	FY14	FY15E	FY16E	FY17E
Operating income	1,279	1,471	1,941	2,315	2,693
EBITDA	180	143	96	209	296
Adj net income	78	34	13	84	115
Adj EPS-₹	22.7	9.9	3.8	24.4	33.5
EPS growth (%)	(19.5)	(56.6)	(61.9)	550.7	37.2
RoCE (%)	25.1	13.6	6.1	16.6	21.7
RoE (%)	21.2	6.9	2.5	15.4	18.6
P/E (x)	8.8	20.3	53.2	8.2	6.0
P/BV (x)	1.4	1.4	1.3	1.2	1.0
EV/EBITDA (x)	4.6	6.6	10.3	5.0	3.7

Source: Company, CRISIL Research estimates

SME CFV MATRIX



KEY STOCK STATISTICS

NIFTY	8438
NSE EMERGE ticker	THEJO
Face value (₹ per share)	10
Shares outstanding (mn)	3.4
Market cap (₹ mn)/(US$ mn)	687/11
Enterprise value (₹ mn)/(US$ mn)	939/15
Free float (%)	42.9%

SHAREHOLDING PATTERN (AS ON MARCH 2014)

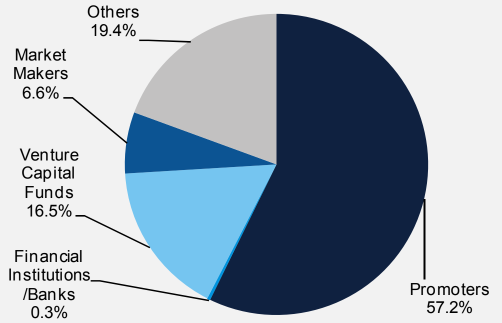


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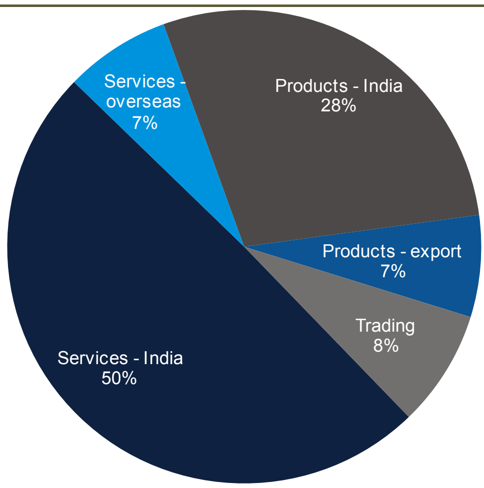
Table 1: Thejo Engineering – Business environment

Parameter	Products	Services
Revenue contribution (FY14)*	35%	57%
Revenue contribution (FY17E)*	24%	68%
Revenue CAGR (FY12-14)	-1% (declined due to weak product sales in India and lower exports to Australia due to loss of a client)	32%
Revenue CAGR (FY14-17E)	7% (to be led by increase in exports to Australia, Brazil and Chile)	29%
Product/service description	Rubber liners, screening components, hydrocyclones, pump spares, flotation cell and agitators, rubber lined pipes and fittings and others	Conveyor belt splicing, repairs, belt laying, pulley lagging and corrosion protection applications
Geographic presence	India, Australia, Brazil, Chile and Saudi Arabia	India, Australia, Saudi Arabia
Market position	The industry is highly fragmented with several small and regional players. Thejo has ~70% share in the outsourced O&M (services) business in India. It is a small player in the products business	
Demand drivers	■ Increase in capital expenditure and capacity addition in cement, mining, port, power and steel industries ■ Increase in contribution from private players in infrastructure development. Private players are more likely to outsource non-core activities such as operation and maintenance of conveyor systems ■ Thejo's rising penetration in international markets	
Key risks	■ Further slowdown in core sector investments in India ■ Ability to ramp-up sales in Australia, Brazil, Chile and Saudi Arabia ■ Volatility in raw material prices and forex rates	

** Balance is contributed by trading income*

Source: Company, CRISIL Research

Figure 1: Break-down of revenues in FY14



Source: Company

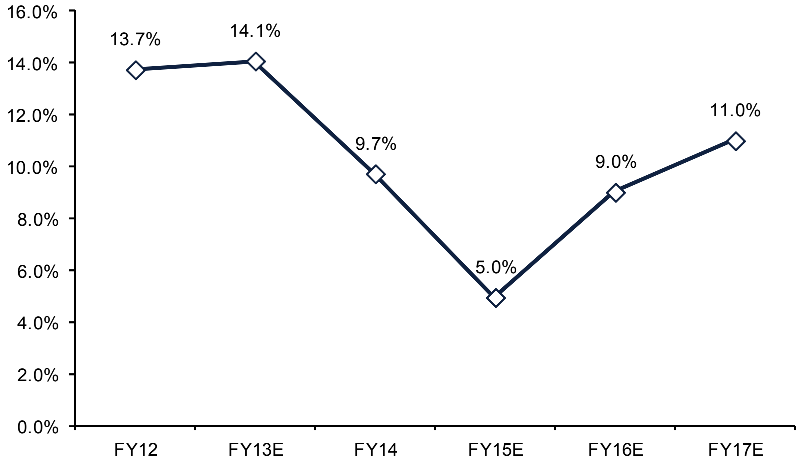
Grading Rationale

Profitability pressure in near term due to overseas investments

Having established its presence in the domestic market, Thejo is now focussing on opportunities in the overseas markets. It has set up operations in Australia, Brazil, Chile and Saudi Arabia – all have large mining operations and present healthy opportunities for O&M players such as Thejo. The company has recruited marketing and technical teams (Chile and Brazil have only marketing teams) in these regions. Since overseas revenues would pick up gradually, the company's profitability is expected to be under pressure in the near term; consolidated EBITDA margin declined to 9.7% in FY14 from 14.1% in FY13. We forecast consolidated EBITDA margin to decline further to 5% in FY15. However, increase in overseas revenues led by the company's marketing efforts is expected to push up margin to 11% by FY17.

The company has set up marketing and technical teams in overseas locations

Figure 2: Consolidated EBITDA margin to dip to 5% in FY15



Source: Company, CRISIL Research

Domestic business: Services to drive revenues over FY14-17

Despite a slowdown in the end-user industries such as mining, steel, power and ports, Thejo posted 9% and 26% y-o-y growth in domestic revenues (excluding trading income) in FY14 and H1FY15, respectively. While product sales were weak, services revenues grew 16% and 56% y-o-y in FY14 and H1FY15, respectively, as companies tend to focus on maintenance activities during a slowdown. Product sales were flat in FY14 and declined 21% y-o-y in H1FY15. We expect growth in domestic core sectors to remain muted in the near term which would continue to impact product sales but services momentum is likely to continue. We forecast the domestic business to post 20% CAGR over FY14-17 – services revenues are expected to grow at a CAGR of 28% while products revenues are expected grow slower at ~3% CAGR over this period. Over the medium-long term, the core industries are likely to recover with economic revival and resolution of issues such as coal in iron ore mining bans, which would lead to higher demand for material handling products as well as maintenance services. Thejo, being an experienced player with established relationships with marquee clients, is appropriately placed to benefit.

Table 2: Services to drive domestic revenues over FY14-17

	FY12	FY13	FY14	FY15E	FY16E	FY17E
Growth in services revenues	45%	32%	16%	47%	23%	15%
Growth in products revenues	-22%	29%	0%	-5%	0%	15%
Growth in total domestic revenues*	7%	31%	9%	28%	17%	15%

** Excluding trading income*

Source: Company, CRISIL Research

Table 3: Thejo's clientele includes leading players

Industry	Industry prospects
Mining	Coal India, National Mineral Development Corp, Kudremukh Iron Ore, MOIL
Steel	Steel Authority of India, Tata Steel, JSW Steel, Vizag Steel, Jindal Steel & Power, Qatar Steel
Power	NTPC, Jindal Power, Reliance Energy, Tata Power
Cement	Ultratech Cement, Ambuja Cement, Prism Cement, Lafarge India, Gujarat Ambuja, J.K. Lakshmi Cement, ACC, India Cements
Infrastructure	Lanco, Jaypee Group, Adani Group
Others	Hindalco, Reliance Industries, Tata Chemicals, Hindustan Zinc, ITC, Nirma, Essar Group, Ballarpur Industries, Century Pulp and Paper, Rashtriya Chemicals & Fertilizers, IFFCO

Source: Company

Overseas business: Healthy opportunities; ramp-up to be gradual

Due to limited scope for increase in market share in India, Thejo has expanded its geographic presence to countries such as Australia, Brazil, Chile and Saudi Arabia over the past few years. Given that these countries have large mining operations due to abundant availability of natural resources, we believe there are healthy opportunities for the company in these regions. We expect the Australian market to lead the growth in international revenues while other markets would take some time to contribute significantly to revenues from the current nascent stage. We forecast international revenues (including exports from India and subsidiary sales) to post a CAGR of 30% over FY14-17 to ₹515 mn.

Thejo has set up subsidiaries in Australia, Saudi Arabia and Brazil, and a marketing team in Chile

It also exports products directly to Australia from the parent company in India

Table 4: Selected countries with large mining operations for expansion

Country	Market position in mining	Contribution of mining to GDP
Australia	Largest producer of iron ore and bauxite, second largest producer of gold and zinc. Sizeable producer of uranium, coal, nickel and copper in large quantities	11% (2013-14)
Saudi Arabia	Key elements extracted include gold, silver and copper	NA
Chile	Largest global producer of copper and lithium. Also has large deposits of gold, silver, zinc, iron, lead and manganese	13% (2013)
Brazil	Largest global producer of Niobium, second largest producer of tantalite and iron ore. Also produces ornamental rocks, bauxite, tin, copper, kaolin, zinc and gold in large quantities	27% (2012)

Source: Industry sources

Australia to lead overseas business growth

The following factors are expected to help Thejo grow its services business in Australia over the next few years.

- **Increase in mining output:** While the mining investments in Australia are expected to slow down, the industry is now entering the ramp-up phase. Mining production in Australia is expected to grow at 5.4% CAGR over 2013-17 (as per the Bureau of Resources and Energy Economic, an economic research unit with the Department of

Industry, Government of Australia) driven by increase in iron ore and coal output, which would lead to ample opportunities for O&M players such as Thejo.

- **Business through Bridgestone:** Bridgestone, one of the leading global conveyor belt manufacturers, acquired 26% stake in Thejo Australia Pty in H1FY14. As per an arrangement between the two parties, Thejo now does maintenance related activities for conveyor belts installed by Bridgestone in Australia. Further, Bridgestone has also outsourced its splice kits manufacturing work to Thejo, which it was earlier importing from its Japan facility. This relationship has enabled Thejo to add new clients based in Australia in a short span of time. As per the management, it has executed orders worth ₹24 mn in the past 18 months through Bridgestone. Also, the company has recently become a registered vendor of Rio Tinto (a leading global mining player and a client of Bridgestone) in Australia. We believe Bridgestone's acquisition of a minority stake in Thejo's Australian subsidiary would continue to enable the company to grow its business faster and also presents an opportunity to cross sell its products to Bridgestone's clients.

Strengthening the sales team to drive the product business

Thejo's product exports declined to ₹115 mn in FY14 from ₹234 mn in FY12. This was mainly as its channel partner in Australia, Losugen Pty Ltd, was acquired by its Indian competitor Tega Industries Ltd. Thejo has now set up a branch in Perth for marketing its products and has also recruited three marketing professionals who were earlier associated with Losugen. This coupled with the opportunity to cross sell its products to clients added through Bridgestone is likely to lead to an increase in product exports to Australia from here on – as per the management, it recently bagged an order worth ₹80 mn from the largest gold mining company in Australia, which would be executed in FY16.

Recently, Thejo bagged a ₹80 mn product order in Australia

Australian and Saudi Arabian subsidiaries to break even in FY17

While the EBITDA margin of the domestic business remained healthy at 13.1% in FY14 (vs 14.2% in FY13; the dip was due to lower product sales and higher trading income) consolidated EBITDA margin declined by 440 bps y-o-y to 9.7% due to losses incurred in the subsidiaries as revenues were insufficient to cover the cost of the technical and marketing teams that the company has set up (Table 5). However, with the expected increase in revenues in the Australian and Saudi Arabian subsidiaries resultant of marketing efforts, we expect both the subsidiaries to break even in FY17 which would lead to an improvement in the consolidated EBITDA margin.

Table 5: Snapshot of performance of subsidiaries in FY14

Subsidiary	FY14 revenues (₹ mn)	% revenue growth y-o-y	FY14 PAT (₹ mn)
Thejo Australia Pty, Australia	81.3	295.8%	(63.5)
Thejo Hatcon Industrial Services Company LLC, Saudi Arabia	38.0	23.4%	(0.3)

Source: Company

Note: *Thejo has recently announced setting up of a subsidiary in Brazil which would be engaged in selling Thejo's products in the region. We believe a legal presence in the country would be beneficial for the company in the long run. However, given limited clarity on the structure of the entity, at this stage we continue to add the revenues and costs related to product sales in Brazil to the parent company in India.*

Competition in the domestic products business

Though competition in the services business is limited (Thejo has 70% market share in the organised industry), the company faces stiff competition is its products business from large domestic players including Tega Industries, Oriental Rubber Industries, etc. and from international players. Further, a slowdown in key end-user industries has intensified competition and has impacted growth of products revenues – in FY14, domestic products revenues remained flat y-o-y at ₹424 mn.

Thejo is the market leader in India in the services business

Table 6: Comparison of Thejo with players in the conveyor belt industry

Parameters	Thejo Engineering	Tega Industries	International Conveyors	Somi Conveyor Beltings	MIL Industries	Oriental Rubber Industries Ltd
Product / service	Manufactures accessories and spares for bulk material handling equipment, including rubber sheets, glues and vulcanising machines. Also provides O&M services for conveyor systems	Manufactures wear-resistant rubber components and specialised moulded wear resistant products for mineral processing applications and polyurethane lining	Leading manufacturer of PVC conveyor belts. Also engaged in wind power generation	Manufactures various grades of conveyor belts used for industrial applications of material handling in various industries such as mining, power, cement, fertiliser, steel, sugar and others	Manufactures corrosion resistant and abrasion resistant linings for chemical, fertiliser and other process industries, in India and abroad	Manufactures rubber conveyor belts and wear protection products. It markets these products in India and overseas
Market capitalisation (₹ mn)	687	Unlisted	1,924	305	Unlisted	Unlisted
Revenue (₹ mn)	1,471 (FY14)	6,346 (FY13)	1,349 (FY14)	655 (FY14)	370 (FY14)	3,246 (FY13)
EBITDA margins	9.7% (FY14)	22.6% (FY13)	14.7%(FY14)	16.9%(FY14)	20.1%(FY14)	13.4% (FY13)
PAT margin	2.3% (FY14)	12.7% (FY13)	3.5%(FY14)	5.5%(FY14)	11.7%(FY14)	5.6% (FY13

Source: Company reports

Focus on R&D to help maintain competitive position

Thejo has increased its focus on R&D, which would help it cater to client requirements and help differentiate itself in a competitive industry. It plans to increase its spend on R&D to ₹10-15 mn per annum from ₹7.5-10 mn in the previous years. Further, it set up a separate R&D centre in FY13 near its manufacturing units in Chennai. The centre has five dedicated personnel for research activities and is lead by Mr Zakaria George, who previously headed the R&D group of a leading tyre manufacturing company. Prior to this, the company carried out research related activities within the manufacturing facility itself. The new centre assists in developing customised products as a number of the company's orders in the products business involve product development. It is working on projects to develop environment-friendly solvents and reduce the cost of manufacturing key products through process and material improvements. Also, in order to attract and retain talent, the company has entered into a tie-up with Swinburne University of Technology in Australia in association with IIT Madras. Under this tie-up, the company's R&D centre has been approved by the two educational institutes for doctoral students to pursue their research.

The company has set up a dedicated R&D centre in Chennai in FY13

Key Risks

Inability to ramp-up overseas sales

Thejo has expanded its operations to Australia, Brazil, Chile and Saudi Arabia as these countries have large mining operations and, hence, offer opportunities to conveyor belt servicing and products player such as Thejo. The company has so far invested ~₹91 mn in setting up subsidiaries in Australia and Saudi Arabia. It has recruited marketing personnel and has also sent a number of technicians from India to Australia and Saudi Arabia for execution of orders. Some traction is evident in most of these countries. Its ability, or lack thereof, to scale up revenues in these geographies is a key monitorable.

Thejo has invested ~₹91 mn in the Australian and Saudi Arabian subsidiaries

Cyclicality of key end-user industries

Thejo's key end users include companies in the mining, steel, power, cement and infrastructure industries. The investments in these industries are linked to economic cycles and, hence, slowdown in regions where the company operates would impact volumes.

Change in policies; execution bottlenecks

Legislative actions such as the recent de-allocation of coal mines and the ban on iron ore mining in certain states over the past two years have impacted Thejo's end-user industries – mainly mining, steel and power. Further, execution hurdles caused due to issues such as environment and forest clearances, and delays in land acquisitions would impact Thejo's end users. These factors pose a risk to the company's future growth.

Management and Corporate Governance

A mix of professionals and promoters; founding promoters have taken up non-executive roles

Thejo's management is a mix of professionals and promoters which we believe has been critical in driving the company's growth. Promoters Mr K. J. Joseph and Mr Thomas John, who led the management until FY13, have now taken up non-executive roles. The management team is led by Managing Director V. A. George, who is a professional and has been associated with the company since 2007. Mr George is an engineering and management graduate with over 20 years of experience at senior management positions. He is supported by Mr Manoj Joseph (Mr K. J. Joseph's son) and Mr Rajesh John (Mr Thomas John's son) as Director-Marketing and Director-Sales, respectively; both are engineers and management graduates and have been associated with the company for over 10 years. Based on our interactions, we believe the company has a professional and experienced second line of management.

Management has been able to identify opportunities; bandwidth may be stretched due to overseas expansion

Focus on R&D is a competitive advantage

Thejo's management has been proactive in identifying opportunities and has introduced new products in the domestic market. Their focus on R&D has enabled them to meet client requirements and given them an edge over competitors. Over the past three years, the company has increased its geographic footprint and now provides products and services in Australia, Saudi Arabia, Ghana and Chile. Considering that there is large mining activity in these countries, we believe there are ample opportunities for Thejo. However, the management bandwidth may be insufficient to oversee both domestic and international operations; the same is a monitorable.

Professional relationship between the promoters is a monitorable

Mr John and his family own 37.19% of the company whereas Mr Joseph and his family own 44.98%. The promoters have well-defined responsibilities and complementary areas of expertise. Though the promoters and their sons enjoy a healthy professional relationship, it is a monitorable.

Good disclosure levels, experienced board and adequate governance systems

Disclosure levels sufficient to analyse the business

Based on our interaction with the management over the past two years and publically available information, we believe the management is transparent and disclosure levels of the company are good. Further, the information shared by the company is sufficient to analyse its business.

Independent directors are from diverse backgrounds

Experienced independent directors; regular attendance in board meetings

The board consists of 10 directors, of whom five are independent directors. The size of the board is appropriate for the current size of the company and the future progress envisaged. The board possesses diverse expertise in areas of management, finance, law and technology. The board is chaired by non-executive directors Mr K.J. Joseph and Mr Thomas John. The independent directors are qualified and experienced with strong standing in their respective fields. Also, they have been regular in attending board meetings – all independent directors have attended all or most of the board meetings held in FY14.

Adequate governance systems and processes in place

The company has all the necessary committees – audit, remuneration and investor grievance – in place to support corporate governance practices. The audit committee is chaired by an independent director, Mr M. P. Vijay Kumar, who is a chartered accountant.

Financial Outlook and Valuation

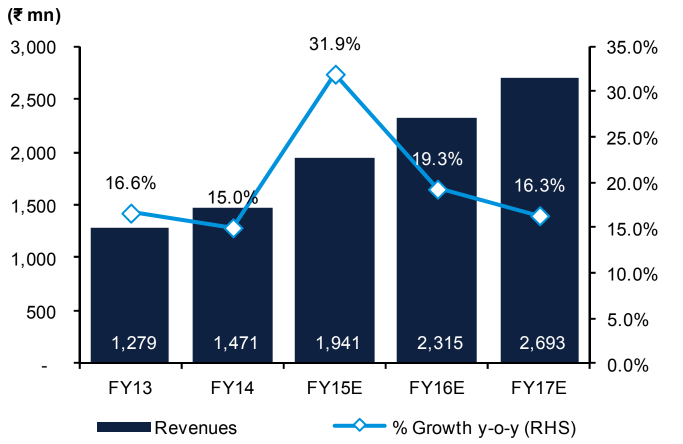
Revenues to grow at 22% CAGR over FY14-17

Revenue growth to be driven by domestic and overseas services business

CRISIL Research expects Thejo's consolidated revenues to grow to ₹2.7 bn by FY17 at a three-year CAGR of 22%. Services revenues are expected to grow at 29% CAGR over this period driven by growth in domestic services and ramp-up of operations of the Australian and Saudi Arabian subsidiaries. Products are expected to grow slower at 7% CAGR over the same period; while we expect product exports to increase to Australia, Brazil and Chile, domestic sales are expected to remain subdued due to slowdown in key end-user industries. The contribution of services to total revenues is expected to increase from 57% in FY14 to 68% in FY17.

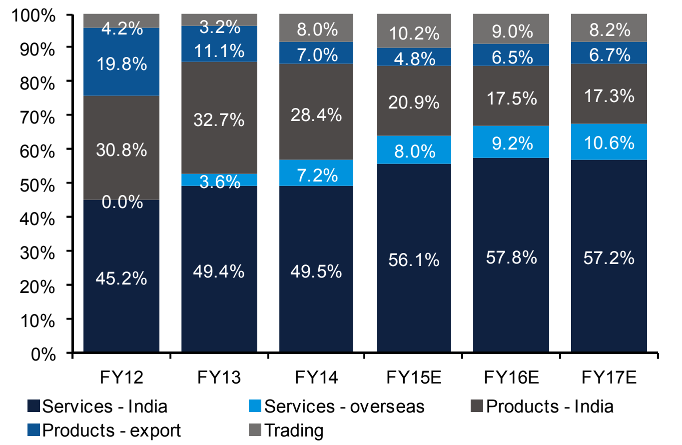
Income from low-margin rubber trading is expected to increase sharply to ₹220 mn in FY15 from ₹130 mn in FY14. Thejo has increased trading as it acts as a hedge against movement in rubber prices, which have been on a declining trend over the past few months. The company indicated that it sells rubber mostly to tyre manufacturing companies.

Figure 3: Revenues to grow at 22% CAGR over FY14-16



Source: Company, CRISIL Research

Figure 4: Revenue contribution from services to increase



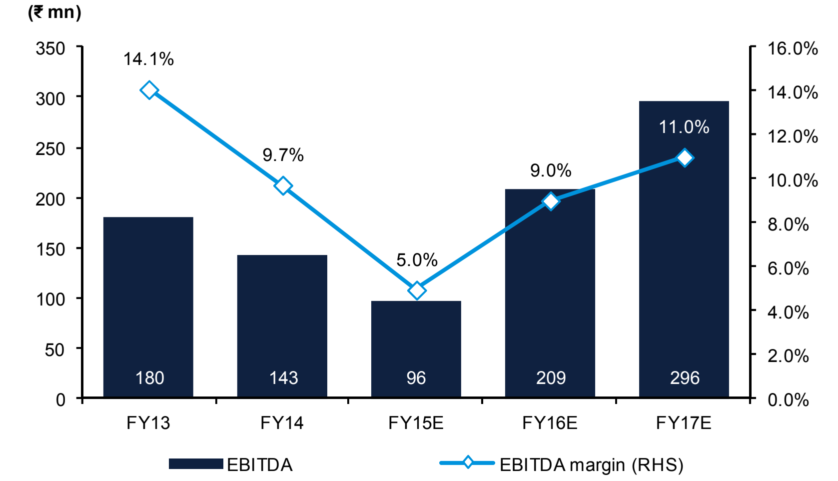
Note: *Calculated on gross revenues*

Source: Company, CRISIL Research

EBITDA margin to be under pressure due to overseas investments

In FY14, EBITDA margin contracted to 9.7% from 14.1% in FY13 due to losses incurred in the subsidiaries; they are expected to incur operating losses in FY15 as well. Also, Thejo has set up product sales team in Chile and a marketing subsidiary in Brazil during the year, but the revenues are yet to pick up. Further, the contribution of low-margin trading revenues is expected to increase. Accordingly, we forecast margin to further dip to 5% in FY15. However, with the pick-up in revenues in overseas locations, EBITDA margin is likely to recover to 11% in FY17.

Figure 5: EBITDA margin trend over FY13-17

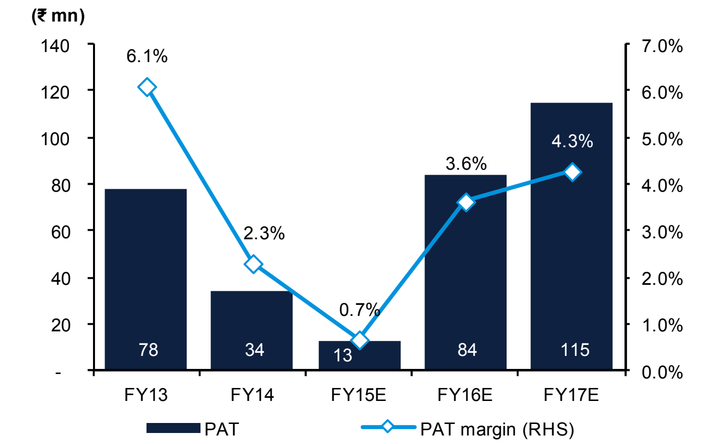


Source: Company, CRISIL Research

Expect adjusted PAT of ₹115 mn in FY17; return ratios to improve

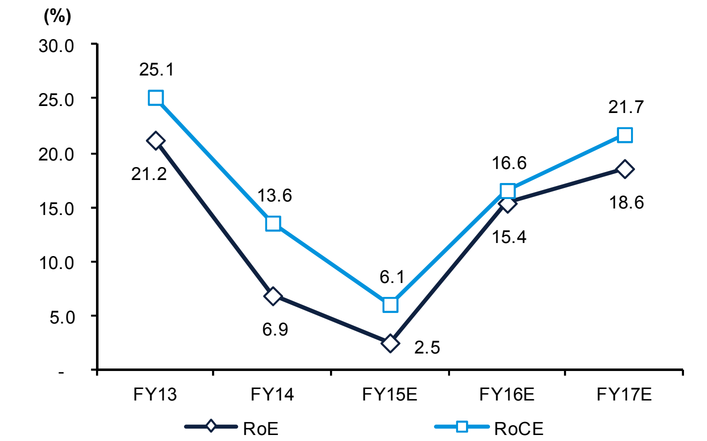
CRISIL Research estimates adjusted PAT to increase to ₹115 mn in FY17 from ₹34 mn in FY14 led by an increase in revenues and expansion in EBITDA margin. Return ratios are expected to improve too – we forecast RoE to increase to 18.6% in FY17 from 6.9% in FY14.

Figure 6: PAT margin to expand



Source: Company, CRISIL Research

Figure 7: RoE expected to improve



Source: Company, CRISIL Research

H1FY15 Results Snapshot (standalone)

Thejo's H1FY15 standalone earnings were below CRISIL Research's expectations.

- Revenues grew 33% y-o-y to ₹882 mn. Services revenues grew 56% y-o-y to ₹501 mn driven by increase in maintenance orders. Product revenues (adjusted for inter-segment sales) remained weak and declined 23% y-o-y to ₹201 mn. Trading income increased to ₹110 mn from ₹30 mn in H1FY14.
- EBITDA margin declined by 386 bps y-o-y to 7.8% due to increase in low-margin trading revenues. Also, the employee cost was higher than expected as the company recruited marketing personnel in Australia, Brazil and Chile (yearly cost of ₹50-55 mn).
- PAT declined 54% y-o-y to ₹14 mn.

Services revenues grew at 56% y-o-y in H1FY15

H1FY15 Results Summary (Standalone)

₹ mn	H1FY15	H2FY14	H1FY14	h-o-h (%)	y-o-y (%)
Net sales	822	871	617	(6)	33
Other operating income	3	1	3	157	(5)
Operating income	**824**	**872**	**620**	**(6)**	**33**
Raw material consumption	250	271	152	(8)	65
as % of operating income	30.4%	31.1%	24.5%	-69bps	585bps
Employee costs	261	232	207	12	26
Other expenditure	249	245	189	1	32
EBIDTA	**64**	**124**	**72**	**(48)**	**(11)**
EBIDTA margin	**7.8%**	**14.2%**	**11.7%**	**-638bps**	**-386bps**
Depreciation	21	16	12	34	79
EBIT	**43**	**108**	**60**	**(60)**	**(29)**
Interest	25	23	22	7	15
Other income	3	3	8	(22)	(67)
Extraordinary income/ (expenses)	-	(2)	-	NM	NM
PBT	**21**	**85**	**46**	**(76)**	**(56)**
Tax	6	29	16	(78)	(58)
Reported PAT	**14**	**56**	**31**	**(75)**	**(54)**
Adjusted PAT	**14**	**56**	**31**	**(75)**	**(54)**
Adjusted PAT margin	**1.7%**	**6.5%**	**5.0%**	**-474bps**	**-325bps**
No. of equity shares (mn)	3.4	3.4	3.4	-	-
Adjusted EPS (₹)	**4.1**	**16.4**	**9.0**	**(75)**	**(54)**

Source: Company

CRISIL RESEARCH

Earnings Estimates Revised Downwards

Particulars	Unit	FY15E			FY16E			FY17E
		Old	New	% change	Old	New	% change	
Revenue	₹ mn	1943	1941	0%	2401	2315	-4%	2693
EBITDA	₹ mn	214	96	-55%	283	209	-26%	296
EBITDA margin	%	11.0%	5.0%	-605bps	11.8%	9.0%	-276bps	11.0%
Adj. PAT	₹ mn	82	13	-84%	120	84	-30%	115
Adj. PAT margin	%	4.2%	0.7%	-356bps	5.0%	3.6%	-135bps	4.3%

Source: CRISIL Research estimates

Reasons for changes in estimates

Line item	FY15E	FY16E	FY17E
Revenues	Broadly maintained as lower product revenues are offset by increase in services revenues		Introducing FY17 estimates. We forecast revenue growth of 16.3% y-o-y in FY17. Services revenues are expected to grow at 18% y-o-y and product revenues at 13% y-o-y
EBITDA margins	Lowered as the cost of marketing products overseas and the losses in subsidiaries were higher than expected		EBITDA margin is expected to expand by 200 bps y-o-y due to improvement in overseas profitability driven by ramp-up in sales
PAT margins	Lowered due to reduction in EBITDA margin estimates		PAT is expected to increase by 37% y-o-y to ₹115 mn due to increase in sales and expansion in EBITDA margin

Valuation Grade: 4/5

We continue to use the DCF method to value Thejo. We have rolled forward our model by one year to FY16 and maintain the fair value of ₹219 per share. This fair value implies P/E multiples of 8.9x FY16E EPS and 6.5x FY17E EPS and P/B multiples of 1.3x FY16E book value and 1.1x FY17E book value. At the current market price of ₹200, the valuation grade is **4/5**.

Fair value maintained at ₹219

Key DCF assumptions

We have forecasted free cash flows from FY15 to FY25. The following are our assumptions:

- We have assumed cost of equity of 19.2% and a cost of debt of 13%.
- We have assumed a terminal growth rate of 3% beyond the explicit forecast period.

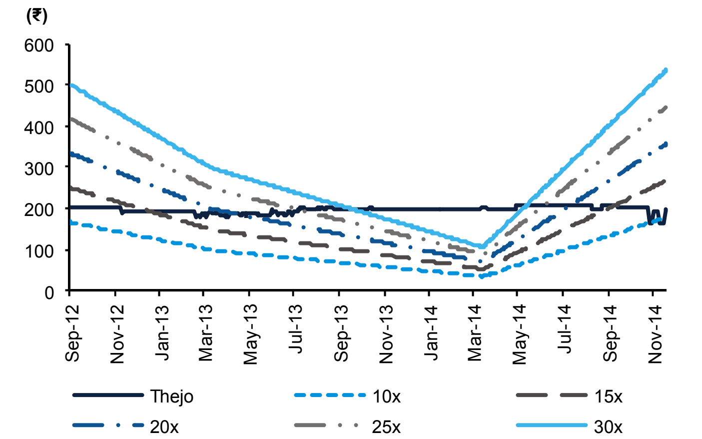
WACC computation

	FY15-25	Terminal value
Cost of equity	19.2%	19.2%
Cost of debt (post tax)	8.7%	8.7%
Debt : (debt + equity)	0.45	0.45
WACC	14.5%	14.5%
Terminal growth rate		3.0%

Sensitivity analysis to terminal WACC and terminal growth rate

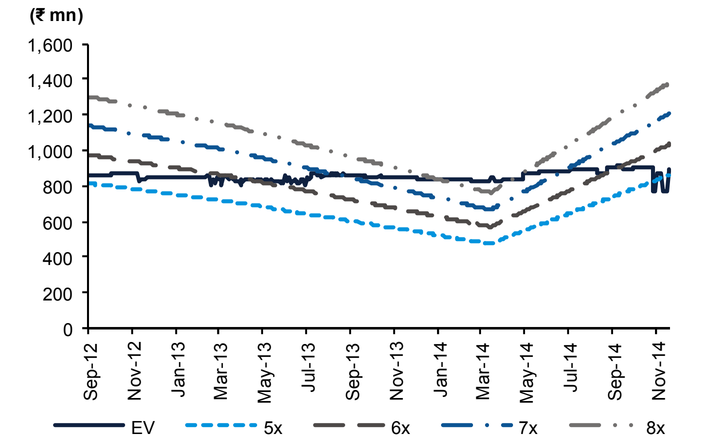
	Terminal growth rate					
Terminal WACC		1.0%	2.0%	3.0%	4.0%	5.0%
	12.5%	239	256	276	301	332
	13.5%	216	229	244	263	286
	14.5%	196	207	**219**	233	251
	15.5%	181	189	199	210	223
	16.5%	167	174	182	191	201

One-year forward P/E band



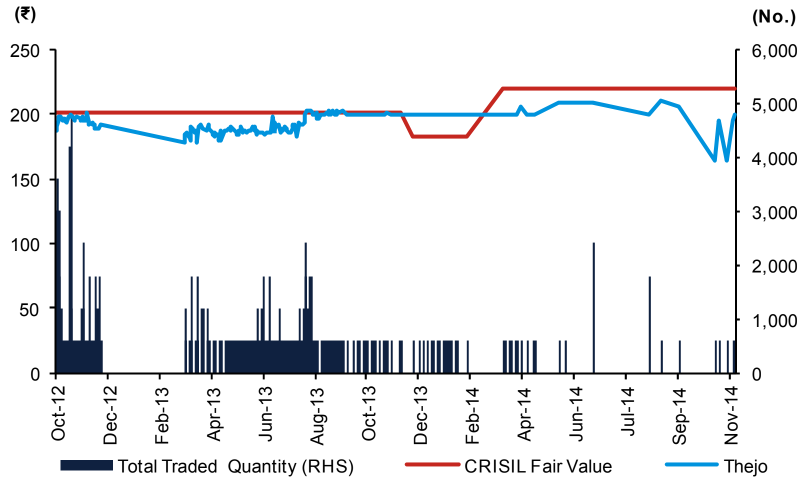
Source: NSE, CRISIL Research

One-year forward EV/EBITDA band



Source: NSE, CRISIL Research

Fair value since initiation



Source: NSE, CRISIL Research

CRISIL SME IER reports released on Thejo Engineering Ltd

Date	Nature of report	Fundamental grade	Fair value	Valuation grade	CMP (on the date of report)
9-Oct-2012	Initiating Coverage	5/5	₹201	3/5	₹187
9-Nov-2012	H1FY13 Result Update	5/5	₹201	3/5	₹198
12-Jun-2013	H2FY13 Result Update	5/5	₹201	3/5	₹185
27-Nov-2013	H1FY14 Result Update	5/5	₹182	3/5	₹200
09-May-2014	Detailed report	5/5	₹219	3/5	₹201
27-Jun-2014	H2FY14 Result Update	5/5	₹219	3/5	₹209
08-Dec-2014	Detailed report	5/5	₹219	4/5	₹200

Company Overview

Chennai-based Thejo was incorporated in 1986. The company is promoted by Mr K. J. Joseph and Mr Thomas John. It manufactures products for bulk material handling, mineral processing and corrosion protection for the mining, power, steel and cement industries. It also manufactures products for the conveyor belt industry in addition to providing services. The services business includes belt splicing, pulley lagging, installation of conveyor belts, etc. Thejo has three subsidiaries - (1) Thejo Australia Pty in Australia, (2) Thejo Hatcon Industrial Services Company LLC in Saudi Arabia and (3) Thejo Brasil Comercio E Servicios Ltda in Brazil. The subsidiaries in Australia and Saudi Arabia provide conveyor belt services while the one in Brazil has been set up for marketing and sales of products. In 2013, Bridgestone acquired 26% stake in Thejo Australia Pty.

Figure 7: Thejo's product and service offerings

Source: Company, CRISIL Research

CRISIL RESEARCH

Annexure: Financials (consolidated)

Income statement

(₹ mn)	FY13	FY14	FY15E	FY16E	FY17E
Operating income	**1,279**	**1,471**	**1,941**	**2,315**	**2,693**
EBITDA	**180**	**143**	**96**	**209**	**296**
EBITDA margin	**14.1%**	**9.7%**	**5.0%**	**9.0%**	**11.0%**
Depreciation	26	37	44	47	53
EBIT	**154**	**106**	**52**	**161**	**243**
Interest	38	45	55	67	78
Operating PBT	**116**	**61**	**(3)**	**94**	**165**
Other income	3	5	6	6	7
Exceptional inc/(exp)	-	-	-	-	-
PBT	**118**	**66**	**3**	**100**	**172**
Tax provision	40	50	10	27	57
Minority interest	-	(18)	(20)	(10)	-
PAT (Reported)	**78**	**34**	**13**	**84**	**115**
Less: Exceptionals	-	-	-	-	-
Adjusted PAT	**78**	**34**	**13**	**84**	**115**

Ratios

	FY13	FY14	FY15E	FY16E	FY17E
Growth					
Operating income (%)	16.6	15.0	31.9	19.3	16.3
EBITDA (%)	19.5	(20.5)	(32.8)	117.1	41.9
Adj PAT (%)	16.7	(56.6)	(61.9)	550.7	37.2
Adj EPS (%)	(19.5)	(56.6)	(61.9)	550.7	37.2
Profitability					
EBITDA margin (%)	14.1	9.7	5.0	9.0	11.0
Adj PAT Margin (%)	6.1	2.3	0.7	3.6	4.3
RoE (%)	21.2	6.9	2.5	15.4	18.6
RoCE (%)	25.1	13.6	6.1	16.6	21.7
RoIC (%)	22.9	10.0	7.1	16.9	19.9
Valuations					
Price-earnings (x)	8.6	19.8	51.9	8.0	5.8
Price-book (x)	1.4	1.3	1.3	1.2	1.0
EV/EBITDA (x)	4.5	6.4	10.2	4.9	3.7
EV/Sales (x)	0.6	0.6	0.5	0.4	0.4
Dividend payout ratio (%)	11.0	35.5	42.0	20.6	21.6
Dividend yield (%)	1.3	1.8	0.8	2.6	3.7
B/S ratios					
Inventory days	54	45	45	45	45
Creditors days	85	78	78	78	78
Debtor days	104	103	100	100	100
Working capital days	95	89	80	82	84
Gross asset turnover (x)	4.1	3.2	3.6	3.9	4.0
Net asset turnover (x)	7.6	5.2	5.8	7.0	7.5
Sales/operating assets (x)	7.3	5.1	5.7	6.9	7.4
Current ratio (x)	2.2	2.0	1.8	1.9	1.9
Debt-equity (x)	0.5	0.6	0.8	0.8	0.8
Net debt/equity (x)	0.3	0.5	0.6	0.7	0.7
Interest coverage (EBITDA)	4.7	3.2	1.7	3.1	3.8
Interest coverage (EBIT)	4.0	2.3	0.9	2.4	3.1

Per share

	FY13	FY14	FY15E	FY16E	FY17E
Adj EPS (₹)	22.7	9.9	3.8	24.4	33.5
CEPS	30.3	20.6	16.5	38.2	49.0
Book value	140.2	146.4	149.5	168.0	192.9
Dividend (₹)	2.5	3.5	1.6	5.0	7.2
Actual o/s shares (mn)	3.4	3.4	3.4	3.4	3.4

Balance Sheet

(₹ mn)	FY13	FY14	FY15E	FY16E	FY17E
Liabilities					
Equity share capital	17	34	34	34	34
Reserves	464	468	479	542	628
Net worth	**481**	**503**	**513**	**577**	**662**
Minorities	3	10	(10)	(20)	(20)
Convertible debt	-	-	-	1	1
Other debt	264	314	394	463	533
Total debt	**264**	**314**	**394**	**464**	**534**
Deferred tax liability (net)	(1)	8	8	8	8
Total liabilities	**747**	**835**	**905**	**1,029**	**1,184**
Assets					
Net fixed assets	231	335	331	334	380
Capital WIP	5	5	5	5	5
Total fixed assets	**236**	**340**	**336**	**339**	**386**
Investments	**19**	**24**	**24**	**24**	**24**
Current assets					
Inventory	144	143	197	222	251
Sundry debtors	402	462	588	702	815
Loans and advances	229	274	330	393	458
Cash & bank balance	122	72	77	87	91
Marketable securities	-	-	-	-	-
Total current assets	**898**	**951**	**1,192**	**1,404**	**1,615**
Total current liabilities	**405**	**481**	**647**	**739**	**841**
Net current assets	**493**	**471**	**545**	**666**	**774**
Intangibles/Misc. expenditure	**0**	**0**	**0**	**0**	**0**
Total assets	**747**	**835**	**905**	**1,029**	**1,184**

Cash flow

(₹ mn)	FY13	FY14	FY15E	FY16E	FY17E
Pre-tax profit	118	66	3	100	172
Total tax paid	(44)	(42)	(10)	(27)	(57)
Depreciation	26	37	44	47	53
Working capital changes	(46)	(28)	(70)	(110)	(105)
Net cash from operations	**54**	**33**	**(33)**	**11**	**63**
Cash from investments					
Capital expenditure	(149)	(141)	(40)	(50)	(100)
Investments and others	2	(5)	-	-	-
Net cash from investments	**(147)**	**(147)**	**(40)**	**(50)**	**(100)**
Cash from financing					
Equity raised/(repaid)	188	-	-	-	-
Debt raised/(repaid)	40	51	80	70	70
Dividend (incl. tax)	(10)	(14)	(6)	(21)	(30)
Others (incl extraordinaries)	(29)	27	4	0	0
Net cash from financing	**189**	**63**	**78**	**49**	**40**
Change in cash position	96	(50)	5	10	4
Closing cash	122	72	77	87	91

Half-yearly financials (standalone)

(₹ mn)	H1FY13	H2FY13	H1FY14	H2FY14	H1FY15
Operating income	**627**	**717**	**620**	**872**	**824**
Change (h-o-h)	-2%	14%	-14%	41%	-6%
EBITDA	**83**	**108**	**72**	**124**	**64**
Change (h-o-h)	-5%	31%	-33%	71%	-48%
EBITDA margin	**13.2%**	**15.1%**	**11.7%**	**14.2%**	**7.8%**
PAT	38	59	31	56	14
Adj PAT	**38**	**59**	**31**	**59**	**14**
Change (h-o-h)	-8%	57%	-48%	91%	-76%
Adj PAT margin	**6.1%**	**8.3%**	**5.0%**	**6.7%**	**1.7%**
Adj EPS	**11.1**	**34.6**	**9.0**	**17.1**	**4.1**

Source: CRISIL Research

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