

**OVERVIEW: Bearing's Industry:**

Bearings can be defined as the engineered machine elements that help reduce energy loss induced by friction in the rotary motion parts of various equipment and machinery. There are different types of bearings, including ball bearings, roller bearings and plain bearings. With the growth chalked across the engineering sector as well as the automotive sector, there is more impetus being given in terms of financials as well as designing for better quality equipments' which would help enhance the overall operational paradigm and also ensure better efficiency in the daily operations. This leads us to infer that the prospect of market growth of bearings is closely linked to growth in the production of high-performance industrial equipment and machinery.

The current Indian bearing industry size is approximately Rs85bn. The demand for the bearing industry largely depends on:

**Automotive sector (contributes nearly 48% to the bearing industry)**

The automotive segment demand is further categorized into OEMs (Original Equipment Manufacturers) and after-market sales. The Indian automotive aftermarket is estimated to grow at around 10-15% to reach USD16.5bn by 2021 from around USD7bn in 2016. It has the potential to generate up to USD300bn in annual revenue by 2026. (As per IBEF reporting). The Indian auto industry as rightly said is in the midst of structural growth cycle with the domestic economy growth of 6-7% being the major supporter. All of the optimism in the industry going forward would give first hand advantage to the bearing industry, which are one of the essential components required.

**Industrial sector (52% of the demand by this segment)**

Growth in the industrial sector is one of the vital figures that affect the Gross Domestic Product (GDP) in India. In 2016-17, the contribution of Industrial sector to GDP was 29%. Heavy machinery and industrial sectors dominate growth in the use of bearings. With the Indian Government giving more emphasis to infrastructure development through various schemes like Make in India, Power for All, 100 Smart Cities to mention a few; this would boost the industrial sector as a whole. With the implementation of GST, there has been a slowdown in the GDP growth rate due to the initial glitch, however it should settle gradually in a quarter or two leading to a turnaround in industrial growth.

**Railways coming into Limelight:**

Indian Railways growth has been strong over the years during FY07-16 with revenues that increased at a CAGR of 6.4% to USD25.2bn in FY16. It has been estimated to be around USD44.5bn by the end of FY20. The revenues are expected to expand at a CAGR of 9.07% during FY07-20E. Overall there are various initiatives been taken by the government to ramp up on growth of the Railways through different schemes and funding plans. Below mentioned chart indicates the kind of growth seen in the wagon segment of railways which would be ramped up gradually with the emphasis on the Indian Railways segment.



Source: Indian Railways Website

| SNAPSHOT  |               |        |        |        |
|---|---------------|--------|--------|--------|
| 52 week H / L                                   | Mcap (INR mn) |        |        |        |
| 921 / 570                                       | 60,022        |        |        |        |
| Face value: 10                                  |               |        |        |        |
| BSE Code  | NSE CODE      |        |        |        |
| 522113  | TIMKEN        |        |        |        |
| Annual Performance                              |               |        |        |        |
| (Rs mn)   | FY15          | FY16   | FY17   | FY18E  |
| Sales (Net)                                     | 9,290         | 10,497 | 10,527 | 11,778 |
| EBITDA  | 1,332         | 1,622  | 1,580  | 1,826  |
| EBITDA (%)                                      | 14%           | 15%    | 15%    | 16%    |
| Other Income                                    | 59            | 58     | 99     | 208    |
| Interest  | 6             | 9      | 8      | 14     |
| Depreciation                                    | 162           | 225    | 289    | 460    |
| PBT   | 1,223         | 1,447  | 1,382  | 1,560  |
| PAT   | 807           | 918    | 972    | 1,029  |
| Equity ( Rs mn)                                 | 680           | 680    | 680    | 680    |
| EPS (INR)                                       | 12            | 14     | 14     | 15     |
| Quarterly Performance                           |               |        |        |        |
| Parameters (Rs mn)                              | Dec-16        | Mar-17 | Jun-17 | Sep-17 |
| Sales (Net)                                     | 2,445         | 2,605  | 2,999  | 3,102  |
| EBITDA  | 238           | 376    | 424    | 538    |
| EBITDA (%)                                      | 10%           | 14%    | 14%    | 17%    |
| Other Income                                    | 22            | 43     | 20     | 148    |
| Interest  | 2             | 2      | 2      | 4      |
| Depreciation                                    | 69            | 80     | 112    | 116    |
| PAT   | 113           | 257    | 219    | 373    |
| Equity ( Rs mn)                                 | 680           | 680    | 680    | 680    |
| Ratio Analysis                                  |               |        |        |        |
| Parameters (Rs mn)                              | FY15          | FY16   | FY17   | FY18E  |
| EV/EBITDA (x)                                   | 44.9          | 36.8   | 37.9   | 33.0   |
| EV/Net Sales (x)                                | 6.4           | 5.7    | 5.7    | 5.1    |
| M Cap/Sales (x)                                 | 6.5           | 5.7    | 5.7    | 5.1    |
| M Cap/EBITDA (x)                                | 45.1          | 37.0   | 38.0   | 32.9   |
| Debt/Equity (x)                                 | 0.0           | 0.0    | 0.0    | 0.0    |
| ROCE (%)  | 29%           | 30%    | 24%    | 24%    |
| Price/Book Value (x)                            | 13.7          | 11.3   | 9.7    | 8.4    |
| P/E (x)   | 74.4          | 63.3   | 61.8   | 58.3   |
| Share Holding Pattern as on 30th September,2017 |               |        |        |        |
| Parameters                                      | No of Shares  | %      |        |        |
| Promoters                                       | 5,09,99,988   | 75.0   |        |        |
| Institutions                                    | 82,11,641     | 12.1   |        |        |
| Public  | 87,88,355     | 12.9   |        |        |
| TOTAL   | 6,79,99,984   | 100.0  |        |        |

Source: Annual Report

Note: All the data is calculated as per Market Price on 20th December 2017

## Timken India Limited

**BUY**

**CMP: Rs. 883**

**TARGET PRICE: Rs. 1200**

**TIME : 12 months**

**About the company:**

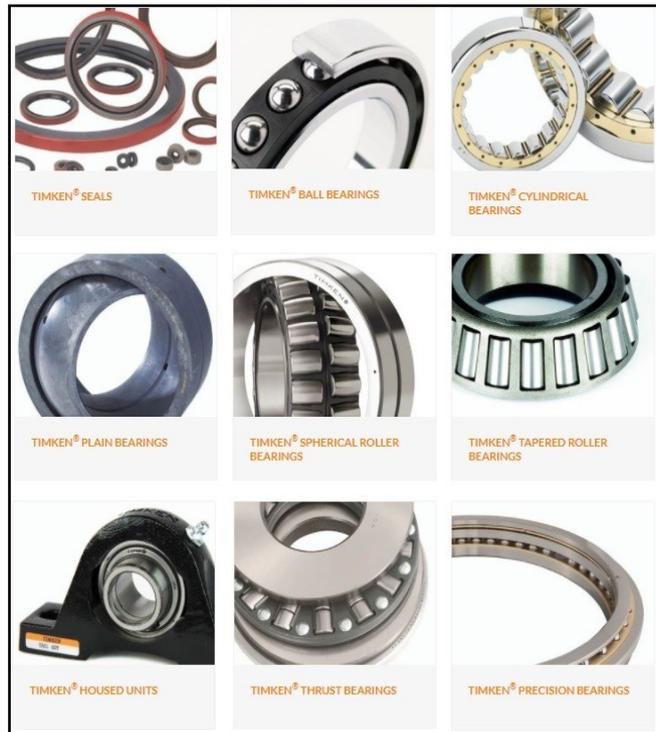
Timken India Limited (Timken) was incorporated in 1987 as Tata Timken Limited (TTL), a joint venture between Tata Iron and Steel Company (TISCO) and The Timken Company of USA, a world leader in tapered roller bearings. Both the companies held 40% stake in the Joint Venture, however in 1999, The Timken Company of USA acquired the stake from TISCO and changed the name of the company to Timken India Limited.

Timken India Limited (Timken), subsidiary of Timken Company is a market leader in tapered roller bearings and components in India and holds the distinction of being the only indigenous manufacturer of freight application bearings for railways in the listed entity. It provides roller bearings which are used in locomotives, engines, wagons, passenger coaches and wheels. The manufacturing facility of the company is at Jamshedpur with the extended service footprint in Raipur. Timken has led the industry with significant breakthroughs in the bearing technology. Timken offers friction management solutions that maximize performance, fuel-efficiency and equipment life. Wherever parts move and turn, Timken products and services can make things run a little smoother, safer and more efficiently. The company has Mr. Sanjay Koul as the Chairman and Managing director.

Timken offers a growing portfolio of engineered bearings, mechanical power transmission products and industrial services to keep industries moving efficiently and reliably.

The product range can be broadly categorized across:

- **Engineered bearings:** Timken's engineered bearings feature precision tolerances, proprietary internal geometries and quality materials. Our tapered, spherical, cylindrical, thrust, ball, plain, miniature, precision and housed unit bearings deliver strong performance, consistently and reliably.
- **Mechanical Power Transmission products:** Timken offers a growing mechanical power transmission product portfolio designed to improve the reliability and efficiency of industrial equipment and machinery. Philadelphia Gear drives, Carlisle belts, Drives chain and augers, Lovejoy couplings, R+L Hydraulics and Interlub lubrication systems provide customers a variety of solutions that keep industry in motion.
- **Industrial services:** The Timken industrial services portfolio offers bearing and power system rebuilds and repair services that can return components or entire systems to like-new specifications. It basically overhauls products throughout the customers' drive train, including switch gears, electric motors and generators, gear drives, bearings, couplings and central panels, as well as provides up-tower wind turbine and crane repair.



Source: Company's Website

**INVESTMENT RATIONALE**

**(A) Diverse Markets Catered:**

The company caters to a wide range of markets with its diversified product offerings. Each of these segments place the company in a sweet-spot to grab on the opportunities from each of them.

Timken India works directly with large OEM customers and with end users through a network of authorized distributors to make design and application recommendations with the perspective to optimize performance and reliability. The Timken Technology Centre in Bangalore provides customers access to engineering expertise and the latest technological advancements. It also offers a breadth of bearing repair and related mechanical power transmission services to support heavy industries, and in Raipur, it services and repairs a variety of large industrial gear boxes.

| Timken Market   |                     |                      |
|-----------------|---------------------|----------------------|
| Defence         | Commercial Vehicles | Automotive           |
| Mining          | Agriculture         | Construction         |
| Metals          | Energy              | Industrial Equipment |
| Civil Aerospace | Rail                | Power Equipment      |

Source: Company's Website

**INVESTMENT RATIONALE (contd.)**

**(B) Railways- The Key Growth Driver:**

Indian Railways has been in the limelight with the negatives and the measures chalked to get rid of the loopholes. One of the key focus areas for the Indian Railways is to optimize the freight loading capacity and cut costs. There have been initiatives started towards the modification of the existing BOXN open wagons to newly designed axle load wagon which will enhance the load capacity. Also in terms of ramp up; in the past it has been witnessed that there is a slow-down in the tenders for wagons by the railways. As and when the Government declares orders for wagons, Timken will be benefitted as wagons require roller bearings and Timken masters in manufacturing technology. Further with the Government focusing on the High Speed, High Safety coaches, this would be a new market to tap as existing coaches would require modification/replacement in a phased manner.

**Dedicated Freight Corridor (DFC):** The company is the technical partner for Indian Railways for dedicated freight corridor (DFC) project. This should also provide the visibility in terms of the lucrativeness from the Railways.

**What is Dedicated Freight Corridor (DFC)?**

The Dedicated Freight Corridor Corporation of India Limited (DFCCIL) is a corporation run by the Ministry of Railways (India) to undertake planning & development, mobilisation of financial resources and construction, maintenance and operation of the Dedicated Freight Corridors. Once completed, the dedicated freight corridors will enable Indian Railways to improve its customer orientation and meet market needs more effectively. (As per Wikipedia). DFCCIL has the mandate of developing six DFCs across the country, of which the Eastern DFC and the Western DFC are being built at present.

| Particulars      | From                  | To                           | Distance |
|------------------|-----------------------|------------------------------|----------|
| Western Corridor | Dadri (Uttar Pradesh) | Jawaharlal Nehru Port Mumbai | 1468 Km  |
| Eastern Corridor | Ludhiana (Punjab)     | Dankuni (West Bengal)        | 1760 Km  |

Planned:

| Particulars          | From      | To                           | Distance |
|----------------------|-----------|------------------------------|----------|
| East-West Corridor   | Kolkata   | Jawaharlal Nehru Port Mumbai | 2000 Km  |
| North-South Corridor | Delhi     | Chennai                      | 2173 Km  |
| East Coast Corridor  | Kharagpur | Vijayawada                   | 1100 Km  |
| South- West Corridor | Chennai   | Goa                          | 890 Km   |

Timken draws nearly ~25% of its revenue from the Indian Railways through tapered roller bearings and boasts of its association with the Indian railways in the freight segment with nearly ~50% share. In India, the freight application is only on tapered roller bearings. (Timken is the leader in providing bearings for the freight application). Timken also partners with Indian railways on the refurbishment and reconditioning of those bearings, with Indian railways focusing on increasing the number of high speed trains. All of these should add visibility to the revenue growth going forward. Hence, uptick in railway spending and upcoming rolling stock orders for DFC is the key to bet on.

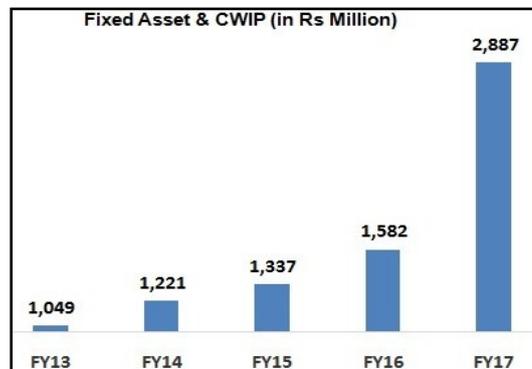
Overall with the gradual focus increasing on the Railways which is the need of the hour for the overall development of the economy; it stands favourable for the company with the kind of expertise and hold on the market that it

**(C) Ramp-up in Capacity and Capex:**

The company has doubled its capacity in FY16-17 which is visible from the chart of Fixed Assets and CWIP, a CAGR growth of 29% from FY13 to FY17. This shows existence of untapped demand recognized by the company and accordingly measures were taken for the same.

Capacity Expansion :

- Of the total railway bearing demand, approx 60% comes from freight while the balance comes from the non-freight segment.
- Higher wagon demand would arise from commissioning of DFC as well as replacement demand for wagons
- Indian Railways targets to increase its passenger carrying capacity



Source: Annual Report

Considering all of these and sensing the kind of opportunity that would arise from these, Timken has undertaken capex in the Jamshedpur plant to augment the existing Rail bearing capacity & TRB capacity to cater to increasing local and global demand. The new rail facility has been completed and new grind lines within the facility would be operational in FY17-18. The company has spent Rs1,169mn for the same (as per the AR). With regards to the Tapered rolling bearing capacity expansion, it is been undertaken through the expansion of new cup, cone and roller capacity. The company has spent Rs450mn on the same.

**INVESTMENT RATIONALE (contd.)**

Jamshedpur plant was awarded the International Railway Industry Standard (IRIS) certification, making Timken as the only MNC bearing company in India to have both AAR & IRIS certification. This enables Timken India to export rail products even to European market.

Overall with the expanded capacity being operational, the company would be in a better position to capitalize on the increasing demand with better revenue visibility going forward.

**(D) Diverse Offerings Across Industries:**

The major segments into which the business of the company can be broadly classified are Indian Railways (approx. 25% contribution), automotive industry (approx. 25% contribution) especially from commercial vehicles & tractors, industrial applications (25% of the contribution) and the rest from aftermarket & services.

In each of the segments catered, the company has a strong clientele base for its offerings. In the auto space leading CV players are served by the company. Also in the industrial front, different segments like steel, cement, construction, power generation & aerospace are under the gamut of offerings. Diversification is what insulates the revenues from sectoral volatility.

Further, to be present across the value chain, the company has been gradually expanding its product portfolio by adding products related to the mechanical power transmission like coupling, housed units, high performance grease and lubrication systems.

Timken aims at improving its system reliability by providing value offering to customers and partnering in their operations to increase efficiency and enhance performance. So the aim is to transform from bearing refurbishment and extensively focus on beyond the bearings portfolio.

**(E) Recent Deal with ABC Bearings:**

The company had recently announced the merger of ABC Bearings Limited (ABC Bearings is a manufacturer of tapered, cylindrical and spherical roller bearings, and slewing rings) which is likely to conclude by March, 2018. The merger will bring significant operational synergies and will expand the capacity, customer base and company's locally produced product breadth and improve market share in commercial vehicles and off-highway segment. Shareholders of ABL will get five TIL shares in exchange for eight of ABL. This implies a 77% premium to ABL's market price of Rs238 at the time of the deal

**Cruz :**

ABL's take over may lead to an equity dilution in the near term, but is certainly earnings accretive as TIL will gain capacity and market share along with a wider portfolio. Timken is a leader in the India bearing market and the acquisition of ABC Bearings will expand its capacity, customer base and locally produced product breadth. The demand for bearings in India is growing and the addition of ABC Bearings will give it the ability to increase participation in local and export markets.

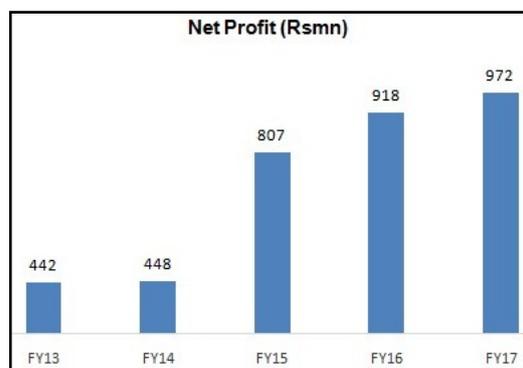
As indicated in the recent conference call, the management said that ABC bearing Limited capacity utilization was merely 40% of the installed capacity. But post the regulatory approval, the company will ramp up the capacity utilization which will help the company cater to domestic and export market.

**Financials:**

- **GST for the Company :**  
The implementation of GST is expected to facilitate ease of doing business and provide a stimulus to the investments and growth in the core segments. This gives a positive outlook for the Medium Commercial Vehicles and Heavy Commercial Vehicles with new norms in place.
- The company is virtually Debt-Free
- Consistent growth in Sales/EBITDA/PAT



Source: Annual Report



Source: Annual Report

**December 21, 2017**

**PICK OF THE MONTH**  
**Timken India Limited**

**VOL-3, NO-27**

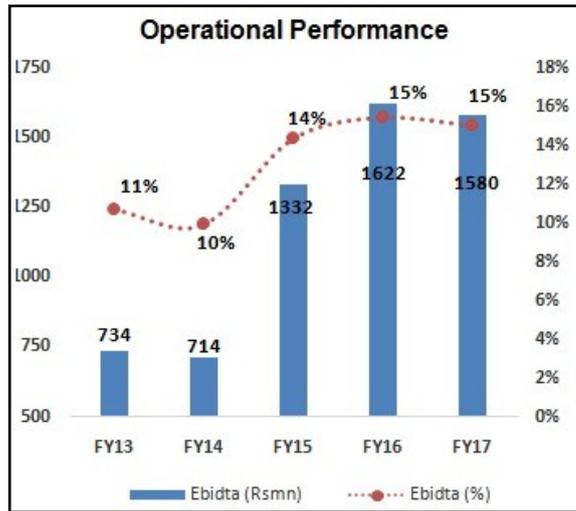
**BUY**

**CMP: Rs. 883**

**TARGET PRICE: Rs. 1200**

**TIME : 12 months**

**INVESTMENT RATIONALE (contd.)**



Source: Annual Report

**Risks and concerns:**

- The performance of the company largely depends on the demand and growth of manufacturing and core infrastructure sectors in India. Any fluctuations in the same could be a risk to the company.
- Any changes in the industrial environment or government policies could impact the demand of the finished products, impacting the demand of products of the company.
- Metal components are the key raw material of the products of the company. Any fluctuations in the prices or supply of raw material could be a risk to the company.

**Outlook and valuations:**

The rising government spending in the railway space, healthy balance sheet and improving profitability are some of the strong positives for the company. With the ramp up in production capacity and acquisition of ABC bearing, the company is well placed and equipped to tap the demand in the sectors of railways and commercial vehicles. Further with IRIS certification, company is well poised to cater to European rail. On the basis of peer comparison, company is trading at 2.6 times of its Price to Book as against industry average of 4.3 times. At CMP of Rs883, the stock is trading at 58.3x FY18E earnings. Betting on the anticipated growth in the industry and opportunities which Timken serves, we initiate a BUY on the stock with a target price of Rs1200 with a 12 months perspective.

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