

## A favorable juxtaposition of strong demand prospects and robust capacity step-up

We remain positive on Timken India (TMKN) as we believe it is amongst the best plays in the bearings space given its leadership in tapered roller bearings, with exposure to the right end-markets – specifically railways, exports (to parent) and CVs, which we believe poises TMKN for exponential growth. This would be enabled by TMKN's capacity doubling capex (already underway), underpinned by empirically, best in industry asset turns and capital efficiency ratios; we believe that the new facility would reach sizeable utilisation by FY17 end; and that the management would have to plan for further expansion as early as mid-FY17

**Railways (~25% of revenue; in expected to be major growth engine; TMKN is the market leader in all its target sub-segments):** TMKN would benefit from the continued addition of new wagons by the Rlwys, (additions continue to significantly lag replacement requirements). Also, the implementation of DFC (for which TMKN is a tech. partner) is expected to boost demand for advanced bearings, positively impacting accruals. TMKN is expected to be the supplier of choice to GE and Alstom - who have won orders of ~\$ 6bn, cumulatively, to supply locomotives to the Rlwys - given the ties of the parent with GE and with Alstom being an existing customer. Increasing localization efforts by Indian Metro Rail Corps., along with potential orders from Alstom India (an existing customer in same segment) for supplies to the upcoming Metrorail in Sydney, is a huge plus

**Exports (35% of revenue, to benefit from cost competitiveness coupled with strong engineering edge):** Exports have grown at a 30% CAGR in the last four years, and we expect CAGR of 22% over FY15-FY17. We see the parent increase sourcing from the TMKN, leveraging on its strong engineering capabilities, which gives an edge over mfg. in China. This would be enabled by the plans to enhance capacities

**Steep recovery in CVs (~20% of sales):** Steep pick-up in CV volumes bodes well for TMKN as it is a leading supplier of axle bearings, with a significant opportunity for improvement in content per vehicle with better mix of multi-axle vehicles (> 25MT accounts for >40% of volumes now vs. 27% in FY11). Expect this segment to record a 25% CAGR from FY15-FY17 on the back of continued recovery in the CV segment and the expected positive growth from tractors in FY17

**Traded bearings:** The traded bearings segment is expected to grow strongly especially with a pick up in the economy; TMKN plans to manufacture these bearings locally, which would not only improve competitiveness and profitability, but also open up opportunities for exports

**Financials:** Expect overall revenue CAGR of 22% over two years through FY17, with Rlwys and exports expected to record a CAGR of 25% and 22% respectively, with margins expected at 15.4% and 16.7% for FY15 and FY16 on the back of the favorable revenue mix. Among peer companies (SKF India and FAG), Timken is the best in terms of capital efficiency (RoACE of 25.6% in FY17E v/s SKF : ~12% and FAG: ~15%). **Maintain BUY, TP of Rs.660 at 30x FY17E EPS**

### Company Update

Date	Nov 18, 2015
Market Data	
SENSEX	25864
Nifty	7838
Bloomberg	TMKN IN
Shares o/s	68mn
Market Cap	Rs. 38bn
52-wk High-Low	Rs. 669-442
3m Avg. Daily Vol	Rs. 15mn
Index member	BSEMDCAP
Latest shareholding (%)	
Promoters	75.0
Institutions	11.0
Public	14.0

### Stock Performance (%)

	1m	3m	12m
Timken	-7%	-3%	24%
Sensex	-5%	-7%	-8%
BSE Auto	0%	-5%	-3%

### Financial Summary

Year	Revenues (Rs. mn)	EBITDA (Rs. mn)	EBITDA Margin	Adj. PAT (Rs. mn)	Adj. EPS (Rs.)	P/E(x)	EV/EBITDA(x)
FY15	9,349	1,396	14.9%	807	11.9	47.3	27.2
FY16E	10,922	1,677	15.4%	1,003	14.8	38.0	22.6
FY17E	14,044	2,345	16.7%	1,492	21.9	25.6	16.1

## Key points underpinning TMKN's growth drivers

Railways  
(~25% of revenue)

### Freight segment:

- TMKN has ~60% market share in the freight sub-segment and is expected to continue to benefit from addition of new wagons for rail freight. Currently ~12,000 wagons are being annually by the Railways against a requirement of ~30,000 wagons. We expect ~15,000 wagons to be added every year for the next five years.
- Also, when the DFC becomes operational, requirement of wagons with higher axle load, higher avg. speeds and higher load capacity would be mandatory, which would result in higher average realisation per wagon for TMKN, which is the tech partner for the DFC.
- **Though SKF India has recently been chosen as one of the suppliers for the freight sub-segment, we do not expect steep competition in the next two years, owing to TMKN's first mover advantage. In the first two years, we do not expect SKF India to have more than 10% share of business in this segment.**  
Also, even in the event of SKF India achieving ~20% share in the next three years, we do not see an impact on TMKN as the overall size of the market is also expected to grow significantly.

### Locomotives segment:

- **General Electric has won a \$2.6bn order** to supply 1,000 diesel locomotives to the Railways, and would set up a mfg. facility in Bihar and maintenance units in Punjab and Gujarat. **We expect Timken India to be a large supplier given its parents' relationships with GE**
- **Alstom has won a ~\$3.0bn order** to supply 800 electric locomotives to the Railways and would set up the facility in Bihar. **TMKN is already a large supplier to Alstom in India** for the metro rail coaches (Kochi metro), hence we expect it to also cater to a large part of Alstom's bearings requirement for the locomotives.

### Metro Rail segment:

- TMKN is amongst the largest bearing supplier for Metro rail coaches with supplies to both Alstom and Rotterdam. Currently, though majority of the bearings are imported from the parent, **TMKN has seen an uptick in local sourcing - supplies for the Kochi Metro (Alstom) are from TMKN.**
- **Alstom India has won an order to export coaches to Sydney Metro – given that TMKN has supplied to Alstom India for Kochi Metro, we believe it will remain a large supplier to Alstom India for the export order as well.**
- With heavy focus on localising – Delhi Metro Rail Corporation (DMRC) have achieved 90% localisation, **(DMRC has a cap of 25% on imported components) and such initiatives across the states for metro projects, the opportunity for TMKN would significantly increase** over the next few years as the pipeline for metro projects in the country is large.

### Passenger Rail segment:

- TMKN is not a large supplier to the passenger rail coaches as these still use cylindrical and spherical roller bearings and not tapered roller bearings. Only high speed trains (Rajdhani/Shatabdi) currently use taper roller bearings for which TMKN is a large supplier.
- With Railways focussed on increasing the number of high speed trains, we expect TMKN to see higher opportunity in this segment.

## Key points underpinning TMKN's growth drivers

### Exports (~35% of revenue)

- We believe exports will continue to see a steep growth primarily from increased sourcing by the parent company. In general we see increased focus from American companies such as Wabco, Cummins, Ingersoll Rand to increase sourcing from their Indian subsidiaries; we believe this is not just on account of lower cost of manufacturing but also due to superior engineering capabilities.
- **We believe that TMKN will benefit from the parent's focus on outsourcing from India vis a vis. from China. This we believe is borne out by the significant capex that TMKN is undertaking and further visibility of capacity addition required beyond this round of capex.**

### Traded Bearings

- FY15 saw strong growth in TMKN's traded bearing revenues, primarily driven by focus on new end-markets such as wind energy, paper/pulp, cement and cranes. The company continues to focus on these end-markets and we expect growth to remain buoyant as these are new markets for the company and these markets will see a steep growth with a pick-up in the economy.
- **Currently TMKN imports cylindrical and spherical roller bearings for the non-mobile (industrial) applications. We believe the company would look to start manufacturing these bearings locally, this would significantly improve competitive ability, profitability and open up export opportunity for these bearings**
- Timken India in FY15 also saw a steep improvement in gross margin for traded bearings (27% compared to 15.8% in CY14 for SKF and 22.3% CY14 for FAG)

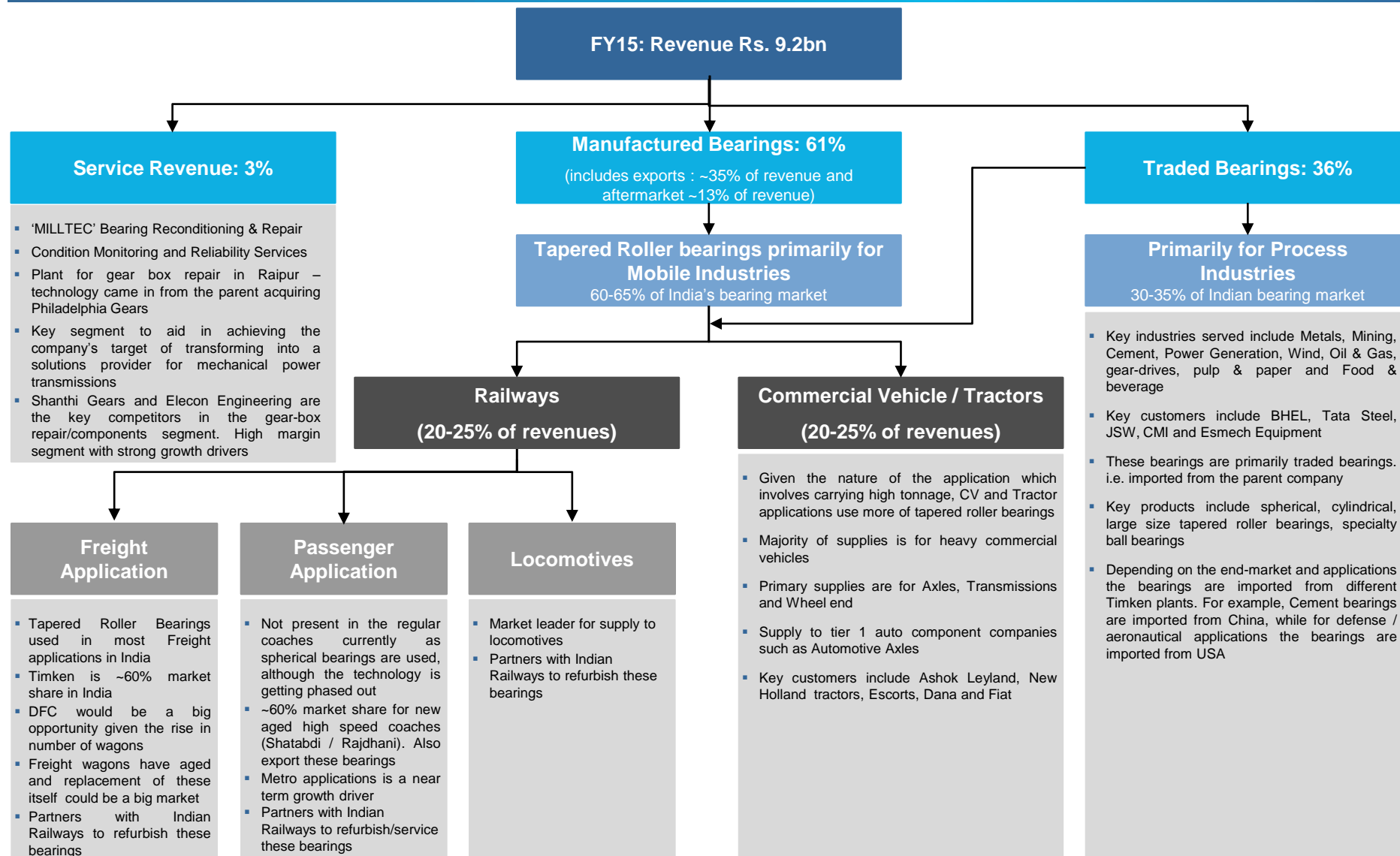
### Gears

- Parent company is having a focus on increasing its product portfolio by providing adjacent products. Timken India has set up its new facility in Raipur for gears box repairs. The technology is from the parent's acquisition of 'Philadelphia-Gear' in 2011
- Our channel checks suggest that Timken is the only company in India which has capabilities to service and manufacture high speed gears for industrial use. Most other companies such as Shanti gears, Elecon engineering are only into low speed gears. While the segment continues to be significantly small for the company, over a longer term it is expected to be a sizeable business

### CVs

- Steep pick-up in CV volumes bodes well for Timken as it is a leading supplier of axle bearings to the industry. Moreover, we see a significant opportunity for improvement in content per vehicle with the improvement in mix towards multi-axle vehicles (> 25MT accounts for >40% of volumes now vs. 27% in FY11).
- **TMKN is a 100% supplier to Ashok Leyland (through Automotive axles) and ~40% supplier to VECV. The company supplies pinion bearings for few platforms to Tata Motors. Apart from CVs, the company supplies bearings to tractors (~45% share with M&M, Escorts, John Deere, New Holland**

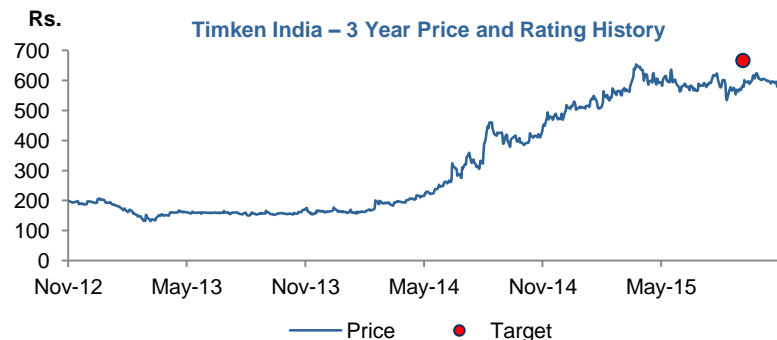
CMP	Target	Rating
Rs. 561	Rs. 660	BUY



## Financial Summary

**CMP**
**Rs. 561**
**Target**
**Rs. 660**
**Rating**
**BUY**

Abridged Financial Statements					Key metrics				
Rs. mn	FY14	FY15	FY16E	FY17E		FY14	FY15	FY16E	FY17E
<b>Profit &amp; Loss</b>					<b>Growth ratios</b>				
Revenues	7,201	9,349	10,922	14,044	Revenues	4.6%	29.8%	16.8%	28.6%
Manufacturing & Other Expenses	6,486	7,953	9,245	11,698	EBITDA	-2.6%	95.1%	20.1%	39.8%
EBITDA	716	1,396	1,677	2,345	PAT	1.2%	80.3%	24.3%	48.7%
Depreciation	158	168	206	231	<b>Margins</b>				
EBIT	558	1,229	1,471	2,114	EBITDA	9.9%	14.9%	15.4%	16.7%
Net Interest Exp / (inc)	9	6	6	6	EBIT	7.7%	13.1%	13.5%	15.1%
Profit Before Tax	657	1,223	1,475	2,194	PAT	6.2%	8.6%	9.2%	10.6%
Tax	209	416	472	702	<b>Leverage &amp; WC ratios</b>				
Adj. Net Profit	447	807	1,003	1,492	Current ratio (x)	2.9	2.8	2.4	2.5
<b>Balance Sheet (Rs. mn)</b>					Debtor days (Sales)	76	68	65	69
Shareholders Equity	3,823	4,384	5,060	6,142	Inventory days (Sales)	70	66	65	68
Loan funds	32	25	25	25	Creditor days (Sales)	38	34	38	38
<b>Sources of Funds</b>					<b>Performance &amp; turnover ratios</b>				
Net block	965	1,069	1,613	1,881	RoACE	10.4%	19.6%	21.1%	25.6%
Capital WIP	256	268	268	268	RoAE	12.4%	19.7%	21.2%	26.6%
Current assets, loans & advances	3,498	4,311	4,847	6,185	Total asset turnover (x)	1.3	1.5	1.6	1.8
Current liabilities & provisions	1,141	1,444	1,849	2,373	Fixed asset turnover (x)	2.7	3.2	3.2	3.5
Net Current Assets	2,356	2,867	2,998	3,812	<b>Valuation metrics</b>				
<b>Application of funds</b>					Current price (Rs.)	561			
<b>Cash Flows (Rs. mn)</b>					Shares outstanding (mn)	68	68	68	68
Cash flows from operations	457	447	1,103	794	Market capitalisation (Rs. mn)	38,142	38,142	38,142	38,142
Capex	(307)	(264)	(750)	(500)	Enterprise value (Rs. mn)	37,973	37,930	37,823	37,857
Free Cash Flow	150	183	353	294	EV/EBIDTA (x)	53.1	27.2	22.6	16.1
Cash flows from investments	(300)	(256)	(750)	(500)	Adj. Per-share earnings (Rs.)	6.6	11.9	14.8	21.9
Cash flows from financing	(159)	(257)	(246)	(328)	Price-earnings multiple (x)	85.2	47.3	38.0	25.6
Closing Cash and Cash Equivalents	201	237	344	310	Dividend yield (%)	1.2%	0.5%	0.7%	0.9%



Report Date	Price	Target	Reco.
16/Sep/15	564	666	Buy

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<b>SELL</b>	Stock expected to fall >10% over a 1-year horizon

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CMP

Rs. 561

Target

Rs. 660

Rating

BUY

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