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September 25, 2012

Disa India

Delisting effort to revisit

Disa India (Disa), an 86.5% subsidiary of Disa Holding AG, is a market leader in manufacturing modern foundry equipment with a 70% market share in India. As per the June 2010 amendment of Securities Contract (Regulations) Act, all listed companies should have a minimum of 25% public shareholding by June 2013. Since the promoters' stake in Disa is at 86.5%, we believe that the company may opt for delisting rather than diluting its stake considering the company has tried delisting in the past. If the delisting doesn't get through, still the stock is trading at an attractive valuation of 12.8x its CY2013E EPS, owing to the company's collaboration with Wheelabrator's technologies, continuous expansion and improving order book. **We initiate coverage on the stock, with a Buy recommendation and a target price of ₹3,353.**

Potential delisting candidate: The amendment of Securities Contract Act in June 2010 mandates all listed companies to have a minimum 25% public shareholding by June 2013. We believe, Disa being a multinational company (MNC)'s subsidiary, with the global company holding an 86.5% stake, may opt for delisting since it has a history of delisting effort in CY2007.

Business scenario upbeat: Disa's continuous capacity expansion complementing its improving order book would be a major growth driver. Moreover, the company's collaboration with Wheelabrator's technologies would not only provide access to new target markets, but also improve profitability by reducing cost per part.

Strong balance sheet: We expect Disa to post a modest 14.8% and 15.6% CAGR in its revenue and profit, respectively, over CY2011-13E. Disa's debt free position and cash reserves indicate its strength in situation of worsening economic environment. At the current market price of ₹2,678, the stock is trading at a PE of 12.8x for CY2013E earnings, which we believe is attractive for an MNC. **We initiate coverage on the stock with a target price of ₹3,353 based on a target PE of 16.0x for CY2013E.**

Key Financials

Y/E December (₹ cr)	CY2010	CY2011	CY2012E	CY2013E
Net Sales	108	154	176	203
% chg	*51.0*	*43.1*	*14.6*	*15.0*
Net Profit	15	23	28	32
% chg	*14.0*	*14.7*	*15.6*	*15.6*
EBITDA (%)	19.6	20.7	22.7	22.6
EPS (₹)	**100.1**	**150.1**	**182.4**	**209.6**
P/E (x)	26.8	17.8	14.7	12.8
P/BV (x)	7.3	9.4	7.6	6.0
RoE (%)	27.1	52.5	51.8	47.0
RoCE (%)	39.8	59.8	75.6	69.5
EV/Sales (x)	3.3	2.2	2.0	1.7
EV/EBITDA (x)	17.0	10.8	9.0	7.5

Source: Company, Angel Research

BUY

CMP	₹2,678
Target Price	₹3,353
Investment Period	12 Months

Stock Info	
Sector	Capital Goods
Market Cap (Rs cr)	404
Net Debt	(17)
Beta	0.4
52 Week High / Low	3,944 / 1,401
Avg. Daily Volume	483
Face Value (Rs)	10
BSE Sensex	18,694
Nifty	5,674
Reuters Code	DISA.BO
Bloomberg Code	BMD IN

Shareholding Pattern (%)	
Promoters	86.5
MF / Banks / Indian Fls	0.0
FII / NRIs / OCBs	1.1
Indian Public / Others	12.4

Abs. (%)	3m	1yr	3yr
Sensex	10.7	16.5	12.0
Disa	4.2	80.8	62.3

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Investment Rationale

Potential delisting candidate

Historical delisting effort to revisit

In June 2010, the government amended the Securities Contract (Regulations) Act rules, according to which all listed companies should have a minimum of 25% public shareholding by June 2013.

The promoters (Disa Holding A/S) had made a delisting offer in April 2007 to acquire up to 3,88,554 shares representing 25.73% stake in the company. The delisting offer was rejected by the management due to high discovered price of ₹2,960 per share.

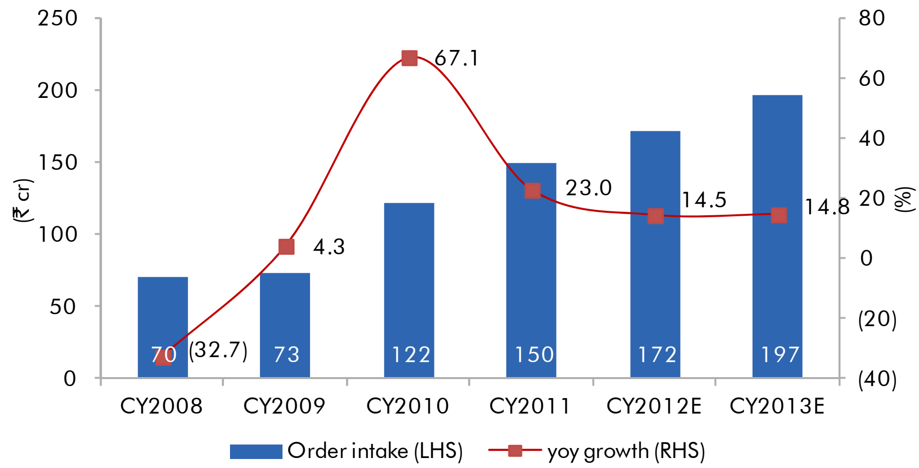
In December 2008, Hamlet Holding II ApS along with Disa Holding II A/S, Disa Holding A/S and DISA Holding AG, announced an open offer for acquisition of upto 3,02,041 shares representing 20% of the paid-up equity share capital of Disa India at a price of ₹1,657 per share. 1,84,485 shares were acquired in the offer representing 12.22% of the total share capital amounting to ₹30.6cr. These shares were held in the escrow account since the Securities and Exchange Board of India (SEBI) contested the open offer price calculation. SEBI lost the case in Securities Appellate Tribunal (SAT) and appealed to the Supreme Court. The Supreme Court gave Disa's promoters permission to transfer the shares even though the case is still going on, since the company gave an undertaking to abide by the Supreme Court's decision, whatever it might be. The promoters now officially hold 86.5%. Hence, in order to comply with the amended Securities Contract (Regulations) Act the company may opt for delisting rather than diluting its stake.

Business scenario upbeat

Continuous expansion, improving order inflow and Wheelabrator collaboration- indicators of improving business scenario

Disa has been continuously expanding its manufacturing facilities at Tumkur and Hosakote plants. The company is now planning its third unit near Bangalore. We expect these expansion plans to facilitate revenue growth going forward. Moreover, improving order intake which has more than doubled over CY2008-11 from ₹70cr in CY2008 to ₹150 in CY2011, would monetize in future.

Exhibit 1: Order intake



Source: Company, Angel Research

With the global merger of Wheelabrator group with Disa group in CY2009, Disa would now get access to Wheelabrator's surface preparation technology leading to focus on new target markets, ie automotive and steel processing industries. The automotive industry accounts for ~30% of the Indian foundry industry, thus facilitating the company's revenue growth. Moreover, a blend of the two technologies would result in lower cost per part for the company, thus resulting in better profitability.

Strong balance sheet will aid long term sustainability

Debt free position to shield against economic instability

Disa is a debt free company with cash reserves of ₹60cr for CY2011 and ROCE and ROE of 59.8% and 52.5% respectively. Thus, the interest rate volatility would not have any direct impact on the company. In view of the recent economic instability, the company's strategy of being cash rich could serve as a savior if the economy weakens further.

Financials

Exhibit 2: Key Assumptions

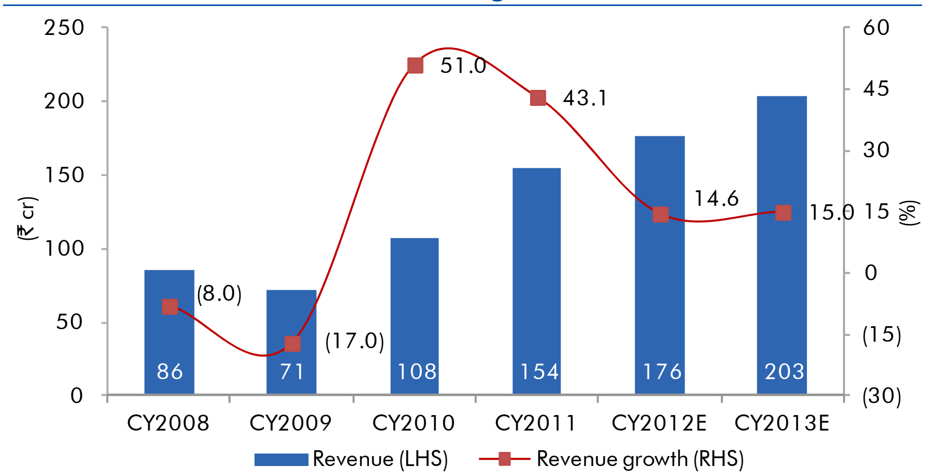
(%)	CY2012E	CY2013E
Growth in Foundry business	14.5	14.8
Growth in Air business	15.0	16.0

Source: Angel Research

Capacity expansion & better order intake to support revenue growth

We expect the company to post a CAGR of 14.8% over CY2011-13E in its revenue inspite of a decline in investment cycle. This growth would primarily be led by improving order intake which witnessed a 28.9% CAGR over CY2008-11 and is expected to grow at 14.6% over CY2011-13E. Moreover, continuous expansion projects undertaken by the company would support growth.

Exhibit 3: Revenue to witness a stable growth

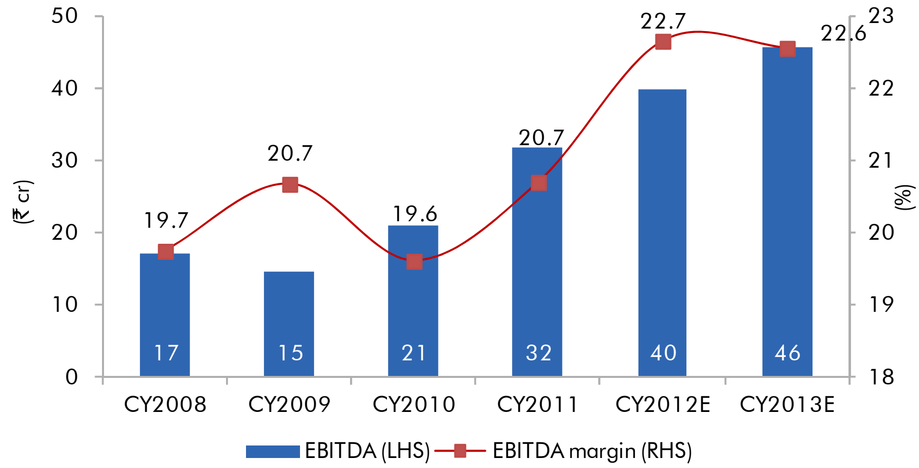


Source: Company, Angel Research

Technology collaboration benefits EBITDA margin

Disa reported relatively better EBITDA margin for 1HCY2012 as compared to previous year on account of decline in net raw material cost as percentage of sales. This was due to benefits arising from collaboration with Wheelabrator's surface preparation technology. We expect the trend to continue going forward; we expect the EBITDA margin to expand by 187bp yoy to 22.7% in CY2012E. The EBITDA margin is expected to stabilize at similar levels going forward.

Exhibit 4: EBITDA margin to stabilize at higher levels

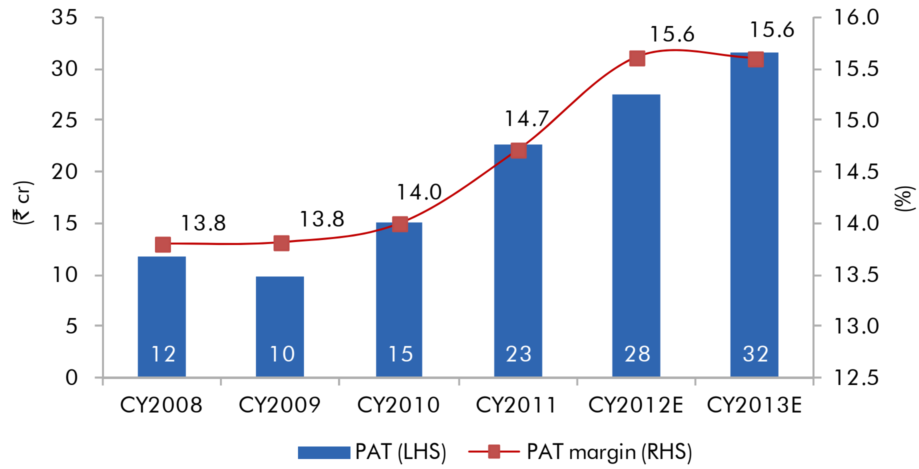


Source: Company, Angel Research

Net profit on an uptrend

Modest revenue growth and improving EBITDA margin is expected to lead to better profit going forward. We expect the company to post an 18.2% CAGR in net profit over CY2011-13E to ₹32cr in CY2013E.

Exhibit 5: PAT margin to inch higher

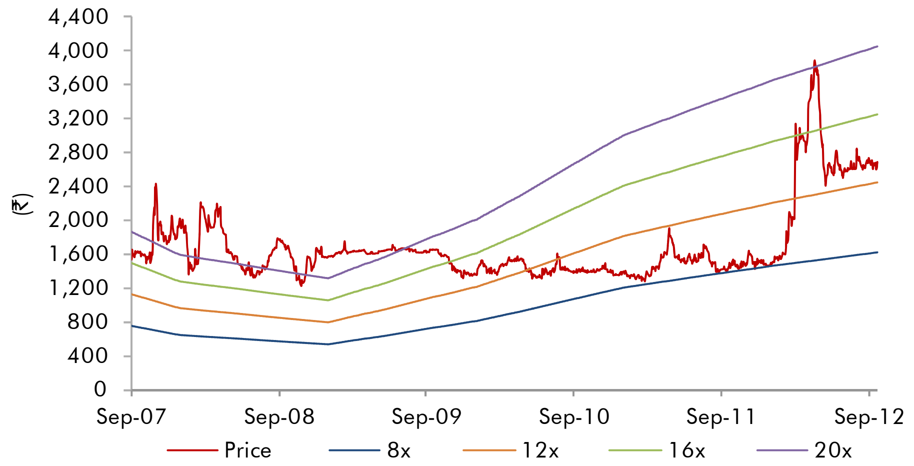


Source: Company, Angel Research

Outlook and Valuation

Disa has posted a stupendous performance on the top-line and bottom-line front over CY2009-11 with a CAGR of 47.0% and 51.6% in revenue and profit, respectively. We expect the growth to be modest at 14.8% CAGR over CY2011-13E to ₹203cr due to a slowdown in the investment cycle. However, the EBITDA margin is expected to expand by 186bp over CY2011-13E owing to benefits arising from the collaboration with Wheelabrator's technology. Thus, the net profit is expected to grow at 18.2% CAGR over CY2011-13E to ₹32cr in CY2013E. Moreover, higher promoter stake in the company at 86.5% makes it a potential delisting candidate to ensure compliance with the amended Securities Contract (Regulations) Act, which mandates a minimum of 25% public shareholding by June 2013. The stock is currently trading at a PE of 12.8x it CY2013E earnings and P/B of 6.0x for CY2013E. **We initiate coverage on Disa with a Buy rating and target price of ₹3,353 based on a target PE of 16.0x for CY2013E.**

Exhibit 6: One-year forward PE band



Source: Company, Angel Research

Relative Valuation

Amongst MNC capital goods players, Disa has a better operating margin and ROE profile than most other players. However, it is trading at an expensive valuation in terms of EV/sales, due to delisting expectations.

Exhibit 7: Relative Valuation

	Sales (₹ cr)	OPM (%)	PAT (₹ cr)	EPS (₹)	ROE (%)	P/E (x)	P/BV (x)	EV/EBITDA (x)	EV/Sales (x)
Disa	**158**	**22.0**	**25**	**162.3**	**51.1**	**16.5**	**8.4**	**11.2**	**2.5**
Vesuvius	565	16.3	52	25.6	16.1	13.0	2.1	7.1	1.2
Esab	534	12.1	38	24.5	100.0	18.3	18.3	9.8	1.2
Honda Siel	510	9.7	34	33.5	12.8	15.4	2.0	7.9	0.8
Igarashi	284	16.8	18	9.0	14.0	8.4	1.2	4.0	0.7
GMM	202	8.2	9	6.4	9.1	15.4	1.4	6.4	0.5

Source: Company, Angel Research (Note: Above numbers are for TTM ended June 2012)

Key concerns

Unstable economic scenario to impact growth prospects

In view of the current economic condition where we are witnessing declining GDP, increasing inflation, and policy paralysis and with a wavering political scenario underway, India's investment cycle is undergoing a slowdown. Since the foundry industry is directly dependent on the country's investment cycle, failure in revival of the economy will impact the growth of the company.

Hurdles in delisting

- **Preferences given to public shareholders:** The special resolution, which requires public shareholders' approval, mandates votes cast in favour of the proposal to be at least two times the number of votes cast against it.
- **Minimum number of equity shares to be acquired:** As per SEBI guidelines, an offer would be successful if post offer, the shareholding of the promoter reaches higher of a) 90% shares of the total issued shares; or b) the aggregate percentage of pre-offer promoter shareholding plus 50% of the offer size.

Company Background

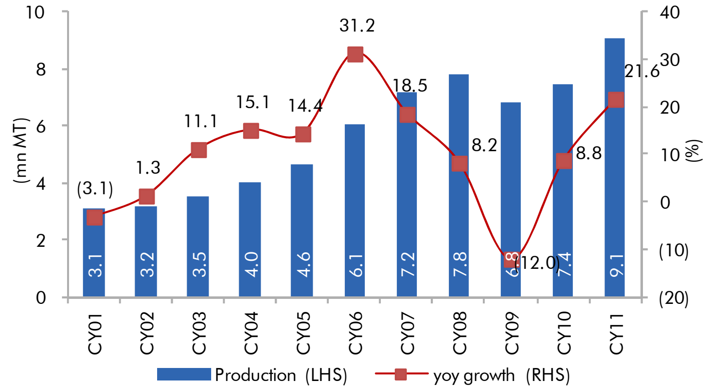
Disa India, an 86.5% subsidiary of Disa Holding AG, is a market leader in the manufacturing of modern foundry equipment with a market share of 70% in India. It supplies complete foundry systems by integrating the moulding machines and sand mixers with proper combination of sand plant equipment, surface treatment machines, environmental control systems and conveying systems. The company has two manufacturing plants in Karnataka, one in Hosakote and other in Tumkur.

Collaboration of Disa's moulding technology and Wheelabrator's surface preparation technology in CY2011 has led to lowering of lifecycle cost per part along with access to new target markets.

Industry

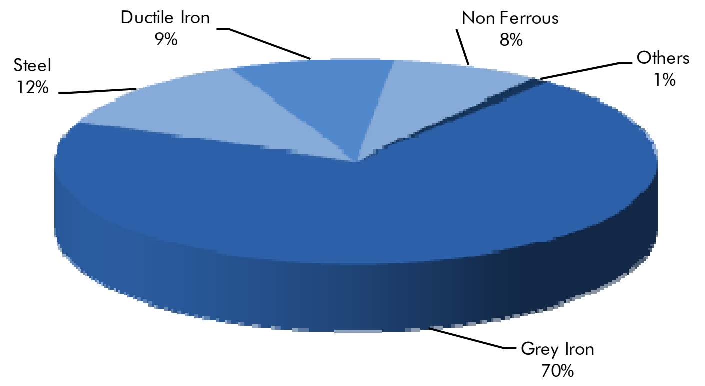
The Indian foundry industry is the second largest producer of casting with a production of ~9.1mnMT of various grades of castings as per International standards. The various types of castings which are produced are ferrous, non ferrous, aluminium alloy, graded cast iron, ductile iron, steel etc for application in automobiles; railways; pumps compressors and valves; diesel engines; cement/electrical/textile machinery; aero, sanitary pipes & fittings etc and castings for special applications. Grey iron castings constitute ~70% of total castings produced.

Exhibit 8: Production of castings in India



Source: Foundry informatics centre, Angel Research

Exhibit 9: Product mix



Source: Foundry informatics centre, Angel Research

There are more than 5,000 foundry units in India. The majority (nearly 80%) of the foundry units in India fall under the category of small-scale industry. The foundry industry in India has geographical clustering; the five major clusters are in Belgaum, Batala/Jalandhar, Coimbatore, Kolhapur and Rajkot.

Profit & Loss Statement

Y/E December (₹ cr)	CY2009	CY2010	CY2011	CY2012E	CY2013E
Gross sales	77	117	168	192	221
Less: Excise duty	5	10	14	16	18
Net Sales	**71**	**108**	**154**	**176**	**203**
% chg	*14.3*	*30.1*	*46.0*	*10.8*	*14.4*
Net Raw Materials	37	59	86	92	106
Power & Fuel costs	0	1	1	1	1
Personnel	10	13	18	22	25
Other expenses	10	14	17	22	25
Total Expenditure	57	87	122	136	157
EBITDA	**15**	**21**	**32**	**40**	**46**
% chg	*(13.1)*	*43.2*	*51.0*	*25.4*	*14.5*
(% of Net Sales)	*20.7*	*19.6*	*20.7*	*22.7*	*22.6*
Depreciation	2	2	2	3	4
EBIT	**13**	**19**	**30**	**37**	**42**
% chg	*(16.5)*	*51.5*	*53.8*	*23.3*	*14.9*
(% of Net Sales)	*17.9*	*17.9*	*19.3*	*20.8*	*20.7*
Interest & other charges	0	0	0	0	0
Other Income	3	4	5	6	7
(% of sales)	*4.0*	*3.9*	*3.4*	*3.4*	*3.4*
PBT	**15**	**23**	**35**	**42**	**49**
% chg	*21.4*	*21.6*	*22.6*	*24.0*	*24.0*
Tax	5	8	12	15	17
(% of PBT)	*35.5*	*35.2*	*34.7*	*35.0*	*35.0*
PAT (reported)	**10**	**15**	**23**	**28**	**32**
Extraordinary (Exp)/Inc.	0	0	0	0	0
ADJ. PAT	**10**	**15**	**23**	**28**	**32**
% chg	*(16.9)*	*53.0*	*50.4*	*21.5*	*14.9*
(% of Net Sales)	*13.8*	*14.0*	*14.7*	*15.6*	*15.6*
Basic EPS (₹)	**65.3**	**100.1**	**150.1**	**182.4**	**209.6**
Fully Diluted EPS (₹)	**65.3**	**100.1**	**150.1**	**182.4**	**209.6**
% chg	*(17.6)*	*53.2*	*50.0*	*21.5*	*14.9*

Balance Sheet

Y/E December (₹ cr)	CY2009	CY2010	CY2011	CY2012E	CY2013E
SOURCES OF FUNDS					
Equity Share Capital	2	2	2	2	2
Reserves& Surplus	39	54	42	52	66
Shareholders Funds	**40**	**56**	**43**	**53**	**67**
Total Loans	1	-	-	-	-
Deferred Tax Liability (Net)	0	0	0	0	0
Total Liabilities	**41**	**56**	**43**	**53**	**68**
APPLICATION OF FUNDS					
Gross Block	34	35	42	50	55
Less: Acc. Depreciation	21	23	25	28	32
Net Block	**12**	**12**	**17**	**22**	**23**
Capital Work-in-Progress	-	1	3	2	1
Investments	-	-	-	-	-
Long term Loans & adv	-	-	-	3	3
Current Assets	**53**	**85**	**109**	**98**	**123**
Cash	33	47	60	44	61
Loans & Advances	4	7	12	12	14
Inventory	11	18	29	29	32
Debtors	5	13	8	12	14
Other current assets	-	-	-	1	1
Current liabilities	24	42	86	72	82
Net Current Assets	**29**	**43**	**23**	**27**	**40**
Mis. Exp. not written off	-	-	-	-	-
Total Assets	**41**	**56**	**43**	**53**	**68**

Cash Flow Statement

Y/E December (₹ cr)	CY2009	CY2010	CY2011	CY2012E	CY2013E
Profit before tax	15	23	35	42	49
Depreciation	2	2	2	3	4
Change in Working Capital	5	(0)	33	(19)	4
Other income	(3)	(4)	(5)	(6)	(7)
Direct taxes paid	(5)	(8)	(12)	(15)	(17)
Others	(3)	2	(35)	-	-
Cash Flow from Operations	11	14	18	5	32
(Inc.)/Dec. in Fixed Assets	(1)	(2)	(9)	(7)	(4)
(Inc.)/Dec. in Investments	-	-	-	-	-
(Inc.)/Dec. in L.T.Loans & advances	-	-	-	(3)	-
Other income	3	4	5	6	7
Others	(1)	(2)	(0)	-	-
Cash Flow from Investing	1	(1)	(4)	(4)	3
Issue of Equity	-	-	-	-	-
Inc./(Dec.) in loans	(3)	(1)	-	-	-
Dividend Paid (Incl. Tax)	-	-	(35)	(18)	(18)
Others	3	0	35	-	-
Cash Flow from Financing	(0)	(0)	(0)	(18)	(18)
Inc./(Dec.) in Cash	12	14	13	(16)	17
Opening Cash balances	21	33	47	60	44
Closing Cash balances	33	47	60	44	61

Key Ratios

Y/E December	CY2009	CY2010	CY2011	CY2012E	CY2013E
Valuation Ratio (x)					
P/E (on FDEPS)	41.0	26.8	17.8	14.7	12.8
P/CEPS	41.0	26.8	17.8	14.7	12.8
P/BV	10.0	7.3	9.4	7.6	6.0
Dividend yield (%)	-	-	7.5	3.7	3.7
EV/Sales	5.2	3.3	2.2	2.0	1.7
EV/EBITDA	25.2	17.0	10.8	9.0	7.5
EV / Total Assets	9.0	6.4	7.9	6.7	5.1
Per Share Data (₹)					
EPS (Basic)	65.3	100.1	150.1	182.4	209.6
EPS (fully diluted)	65.3	100.1	150.1	182.4	209.6
Cash EPS	78.5	112.0	164.6	204.7	234.1
DPS	-	-	200.0	100.0	100.0
Book Value	268.1	368.1	285.8	352.1	445.5
Dupont Analysis					
EBIT margin	17.9	17.9	19.3	20.8	20.7
Tax retention ratio	0.6	0.6	0.7	0.7	0.7
Asset turnover (x)	1.9	2.2	3.1	3.6	3.4
ROIC (Post-tax)	21.6	25.8	39.1	49.1	45.2
Cost of Debt (Post Tax)	9.5	44.1	-	-	-
Leverage (x)	(0.7)	(0.8)	(1.1)	(1.1)	(0.9)
Operating ROE	49.5	87.7	78.1	98.2	90.4
Returns (%)					
ROCE (Pre-tax)	33.5	39.8	59.8	75.6	69.5
Angel ROIC (Pre-tax)	116.3	226.2	-	-	570.0
ROE	24.3	27.1	52.5	51.8	47.0
Turnover ratios (x)					
Asset Turnover (Gross Block)	2.1	3.2	4.0	3.8	3.8
Inventory / Sales (days)	83	49	56	60	55
Receivables (days)	22	31	25	25	25
Payables (days)	175	140	191	191	191
WC cycle (ex-cash) (days)	(9)	(13)	(48)	(56)	(34)
Solvency ratios (x)					
Net debt to equity	(0.8)	(0.8)	(1.4)	(0.8)	(0.9)
Net debt to EBITDA	(2.2)	(2.2)	(1.9)	(1.1)	(1.3)
Interest Coverage (EBIT / Interest)	38.6	113.6	129.1	138.9	138.8

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Disclosure of Interest Statement	Disa India
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹ 1 lakh for Angel, its Group companies and Directors

Ratings (Returns):	*Buy (> 15%)*	*Accumulate (5% to 15%)*	*Neutral (-5 to 5%)*
	Reduce (-5% to 15%)	Sell (< -15%)	

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