
Punjab Tractors Ltd. (PTL)

Price: Rs.163 (8th July 2002)

Reason: Divestment of PSIDC stake.

Recommendation: **BUY**

In the mid of June 2002 the Punjab State Industrial Development Corporation (PSIDC) cleared the proposal to sell its stake in PTL. We expect PSIDC to receive very competitive bids for its 23.5% stake in Punjab Tractors. Many companies such as M&M, Escorts, New Holland would be interested in taking up the 23.5% stake in the company but the price tag for acquisition would be substantially higher. According to press reports PSIDC is looking for around Rs.300 cr for its 23.5% stake in the company. This works out to Rs.210 per share. We feel this price to be on the lower side and expect the bidding to take place above Rs.250.

Why we expect any bidder to pay a higher price to takeover PTL?

- For MNCs such as New Holland who have just 2-3% market share it will be a big opportunity for them to grab 20% of the tractor market with the acquisition. Indian domestic companies would be bidding with twin objective in mind. First, the takeover of PTL will widen the market share of the acquirer by a huge margin. Secondly, Indian competitors would see to it that PTL does not go cheap into the hands of MNCs.
- The capital investment by New Holland for 35,000 units capacity has been around Rs.500 cr. That works to capital cost per tractor of around Rs.140,000. Punjab Tractors Gross Fixed Asset (GFA) as at the end of FY01 was Rs.262 cr, which works to GFA per tractor of Rs.44,000. New Holland's investment would also include cost of setting up distribution network and other costs. Even then their investment cost per tractor is substantially higher than that of PTL.
- PTL is the second largest tractor manufacturer in the country with 18% market share. Around 60% of the company's volumes comes from the 30-40 hp segment.
- PTL has a wide product portfolio consisting of nearly 50 variants in the different HP segment.
- A near debt free company. Borrowings is only for short term working capital requirements.
- PTL has the highest operating profit margins of around 18% amongst all the tractor manufacturers. The earnings before interest and tax (EBIT) margin of PTL in FY02 was 21% as compared to the industry leader M&M's 6% in the same period. EBIT per tractor in case of PTL works to around Rs.46,000 as compared to Rs.14,400 of M&M.
- PTL has a vast distribution network spread across the main markets for tractors. In the last two years the company has added 100 dealers taking its network to 350.

One more aspect to be considered by any potential strategic partner would be the investments of PTL in three group companies, Swaraj Engines Ltd. (33%), Swaraj Mazda Ltd. (29%) & Swaraj Automotives Ltd. (24%). We have not considered Swaraj Automotives in our valuation because it is not listed and its size is also very small as compared to the other two group companies. After carefully examining the takeover code we expect the acquirer of PTL to come out with an open offer for 20% in Swaraj Engines Ltd. and Swaraj Mazda Ltd. This will be because of the management change. However in case of Swaraj Engines and Swaraj Mazda the open offer price would be based on the average of last 6 months high & low price preceding the stake sale in PTL.

The total cost for acquiring 20% stake in Swaraj Engines and Swaraj Mazda would be around Rs.31 cr. The combined Market Cap of PTL's holding in Swaraj Engines and Swaraj Mazda at current prices works to Rs.60 cr.

Dated: 9th July 2002



Outlook for FY03 & FY04

We are not very positive on the company's outlook for FY03. Company's tractor sales volume is expected to fall by 17% in FY03. Operating margins of the company would come under pressure in FY03. We expect PTL's operating margins to dip by more than 200 basis points from 18.8% in FY02 to 16.5% in FY03. We expect the company's Net profit to fall by 27% in FY03 to Rs.73 cr. A minor recovery should come in FY04 where we expect company's revenues to rise by 9%. Earnings in FY04 should increase by 15% to Rs.84 cr. Our EPS for FY04 works to Rs.14.

In the mid of June 2002 the Punjab State Industrial Development Corporation (PSIDC) cleared the proposal to sell its stake in PTL. We expect PSIDC to receive very competitive bids for its 23.5% stake in Punjab Tractors. Many companies such as M&M, Escorts, New Holland would be interested in taking up the 23.5% stake in the company but the price tag for acquisition would be substantially higher. According to press reports PSIDC is looking for around Rs.300 cr for its 23.5% stake in the company. This works out to Rs.210 per share. We feel this price to be on the lower side and expect the bidding to take place above Rs.250.

PTL : Financial summary

(Rs. in cr)	FY01	FY02	% chg	FY03 F	% chg	FY04 F	% chg
Tractors Sales Vol. (units)	45712	40100	-12	33283	-17	35280	6
Net Sales	964.5	885.5	-8	767.9	-13	835.2	9
Op.profit	185.8	168.5	-9	126.7	-25	135.0	7
OPM	19.3%	19.0%	--	16.5%	--	15.7%	--
Interest	-0.1	11.5	--	13.0	13	6.0	-54
Depreciation	17.0	17.9	5	18.9	6	20.0	6
Other income	2.0	3.9	92	6.5	67	9.1	40
Extra-ordinary	3.1	0.0	--	0.0	--	0.0	--
PBT	168.0	143.0	-15	101.3	-29	118.0	16
Prov. For Tax	55.5	42.0	-24	27.9	-34	33.6	19
PAT	112.5	101.0	-10	73.4	-27	84.4	15
EPS (Rs.)	18.5	16.6	-10	12.1	-27	13.9	15

Source: Company data & Karvy estimates

Valuation

At the start of calendar year 2002 the stock used to trade between Rs.150 to Rs.170 levels. After poor Q4 results and falling sales volume in the first two months of FY03 the stock touched a low of Rs.130 and since then it has bounced back to above Rs.160 levels on the PSIDC divestment news. We have used four parameters (P/E ratio, EV/EBIDTA, M.Cap/Sales & Price/Book Value) to arrive at the fair price of the stock after the open offer. Based on 12x PE multiple, EV/EBIDTA of 6x, M.Cap/Sales ratio of 1x and Price-to-Book value of 2x our post open offer fair price target comes to Rs.140.

For calculating the absolute returns we have factored in dividend per share of Rs.7.5 for FY02 (Rs.8/- in FY01). The absolute returns after taking into consideration the dividend appears to be very attractive. Returns taking into account post open offer price of Rs.147 (Rs.140+ Rs.7.5 div.) works to 8% (@ Rs.250), 12% (@ Rs.275) and 16% (@Rs.300). In case the strategic partner buys out UTI & LIC stake @ Rs.230 then returns would be 17% (@ Rs.250), 24% (@ Rs.275) and 30% (@ Rs.300). Investors looking for minimum risk and satisfied with a low return of 10% with a time frame of four to six months can invest in the stock at current price.

Dated: 9th July 2002



Year	Avg. price (Rs.)	Net Sales (Rs.cr)	Net Profit (Rs.cr)	EPS (Rs.)	Book Value (Rs.)	Equity Cap. (Rs.cr)	**EV (Rs.cr)	Mkt Cap (Rs.cr)	EBIDTA (Rs.cr)	M.cap /Sales (x)	PE ratio (x)	Price /BV (x)	EV / EBITDA (x)
March													
FY98	224	802	97	15.9	113	20.2	412	454	132	0.6	14	2.0	3.1
FY99	274	981	126	20.7	147	20.2	513	555	177	0.6	13	1.9	2.9
FY2000	394	1017	133	21.9	184	20.2	800	798	195	0.8	18	2.1	4.1
FY2001	212	965	112	18.5	71	60.8	1294	1288	186	1.3	11	3.0	7.0
FY2002	173	886	101	16.6	79	60.8	1201	1049	167	1.2	10	2.2	7.2
FY2003 F	163	768	73	12.1	83	60.8	1014	990	127	1.3	13	2.0	8.0
FY2004 F	163	835	84	13.9	89	60.8	994	990	135	1.2	12	1.8	7.4
Median (FY98 to FY2002) :										0.9	13	2.2	4.9

Price target (based on FY03 estimated numbers)

Parameters	Potential Price (Rs.)
At 12x PE ratio	145
At 2x Price / Book Value	166
At 6x EV / EBIDTA	121
At 1x M.Cap / Sales	126
Average of above	140

To work out the total investment required to be made by any strategic partner who wants to buy PTL, we have taken three different price scenarios (i.e Rs.250, Rs.275 & Rs.300).

Amount required (in Rs. cr)	@ Rs. 250	@ Rs. 275	@ Rs. 300
for 23.5% stake of PSIDC (14274000 shares)	357	393	428
for 20% open offer	304	334	365
Total amount required for 43.5% stake :	661	727	793
If 28% stake of UTI & LIC is acquired @ Rs.230 (17254232 shares)	397	397	397
Total amt. Required including UTI & LIC stake (around 72%)	1057	1124	1190
Average (High & Low) of 26 weeks of Swaraj Engines.	250	250	250
Open offer of Swaraj Engines (20% or 827988 shares)	21	21	21
Average (High & Low) of 26 weeks of Swaraj Mazda	50	50	50
Open offer of Swaraj Engines (20% or 2097400 shares)	10	10	10
Total amt. required for open offer of Swaraj Eng. & Swaraj Mazda	31	31	31
Market value of PTL's holding in Swaraj Eng. (CMP: Rs.250)	34	34	34
Market value of PTL's holding in Swaraj Mazda (CMP: Rs.85)	26	26	26
Total Mkt Values of PTL's holding in Swaraj Eng. & Swaraj Mazda	60	60	60

Return calculation under different scenarios	@ Rs. 250	@ Rs. 275	@ Rs. 300
Without UTI & LIC stake			
Acceptance ratio	26%	26%	26%
CMP	163	163	163
Post buy back price expectation	140	140	140
Example: Investment If one buys 100 shares @ Rs.163	16300	16300	16300
Amount realised from 26 shares that will be accepted by Co.	6500	7150	7800
Amount realised from selling 74 shares @ Rs.140 (post buy back)	10360	10360	10360
Total amount realised from selling the total 100 shares	16860	17510	18160
Add: Dividend on 100 shares expected to be @ Rs.7.5 per share	750	750	750
Hence amount realised (including dividend income) works to:	17610	18260	18910
Absolute returns	8%	12%	16%

Dated: 9th July 2002



In case The Strategic Partner buys UTI & LIC stake @Rs.230

Acceptance ratio	40%	40%	40%
CMP	163	163	163
Post buy back price expectation	140	140	140
Example: Investment If one buys 100 shares @ Rs.163	16300	16300	16300
Amount realised from 40 shares that will be accepted by Co.	10000	11000	12000
Amount realised from selling 60 shares @ Rs.140 (post buy back)	8400	8400	8400
Total amount realised from selling the total 100 shares	18400	19400	20400
Add: Dividend on 100 shares expected to be @ Rs.7.5 per share	750	750	750
Hence amount realised (including dividend income) works to:	19150	20150	21150
Absolute returns	17%	24%	30%

Karvy Stock Broking Limited

131, Andheri Industrial Estate, Off Veera Desai Road, Andheri (W), Mumbai – 400 053. India.
Voice: (91-22) 695 0205, 693 6346/7.

Disclaimer :

The information and views presented in this report are prepared by Karvy Stock Broking Limited. The information contained herein is based on our analysis and up on sources that we consider reliable. We, however, do not vouch for the accuracy or the completeness thereof. This material is for personal information and we are not responsible for any loss incurred based upon it.

The investments discussed or recommended in this report may not be suitable for all investors. Investors must make their own investment decisions based on their specific investment objectives and financial position and using such independent advice, as they believe necessary. While acting upon any information or analysis mentioned in this report, investors may please note that neither Karvy nor Karvy Stock Broking nor any person connected with any associated companies of Karvy accepts any liability arising from the use of this information and views mentioned in this document.

The author, directors and other employees of Karvy and its affiliates may hold long or short positions in the above-mentioned companies from time to time. Every employee of Karvy and its associated companies are required to disclose their individual stock holdings and details of trades, if any, that they undertake. The team rendering corporate analysis and investment recommendations are restricted in purchasing/selling of shares or other securities till such a time this recommendation has either been displayed or has been forwarded to clients of Karvy. All employees are further restricted to place orders only through Karvy Stock Broking Ltd s