



Veljan Denison Ltd (BSE Scrip Code – 505232)

A pioneer hydraulics and pneumatics company in India !!

Alpha/Alpha Plus stock recommendation for Feb'12 (Date of Release – 29th Feb'12)

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Veljan Denison Ltd – An Introduction

Veljan Denison – The pioneers in the field of Fluid Power



Veljan is a pioneer Hydraulics and Pneumatics company in India and a leader in its own right.

The Company is promoted by Sri. V C Janardan Rao who had earlier set up M/s. Veljan Hydrair Limited in 1966. Recognising Sri. Rao's achievements and that of Veljan, M/s Abex Corporation, USA through its Denison Division, selected Sri. Rao and Veljan as the Indian promoter from amongst several others, to setup the new venture of Denison Hydraulics India Limited (now Veljan Denison Ltd) to manufacture High Pressure Hydraulic Components and Systems.

Veljan Denison Limited has been in the business of manufacturing highly Engineered Fluid Power Components, Products and Systems since inception. Over time, the Company has expanded its product range by successfully engineering products catering to the increased demands of various industry segments and applications. The company has its three manufacturing plants near Hyderabad. These plants are equipped with state-of-the-art production and test facilities and supported by a 500 – strong skilled workforce.

VDL manufactures hydraulic vane pumps, motors, valves, and power systems. The company's manufacturing unit at Hyderabad has capacity to manufacture 150,000 hydraulic components per annum.

Veljan Denison – Investment Snapshot (As on February 29, 2012)

Recommendation :- BUY

Accumulation Range :- 340 – 360

Portfolio Allocation :- 3%

Profit Booking strategy – Refer Alpha/Alpha

Plus weekly for regular updates

Current Market Price – Rs. 343.00

BSE Scrip Code – 505232

Bloomberg Code – VELJ:IN

Market Cap (INR Crores) – Rs 77 crores

Total Equity Shares [Mn] – 2.25

Face Value – Rs. 10

52 Week High / Low – Rs. 499.97/Rs. 235.57

Promoter's Holding – 76.40%

Veljan Denison- Key Fundamentals

Market Cap (Rs Cr.):	77	Latest Div. (%):	75.00
EPS - TTM (Rs):	76.82	Div. Yield (%):	2.18
P/E Ratio (x):	4.48	Book Value / sh. (Rs) :	249.55
Face Value (Rs):	10.00	P/B Ratio (x):	1.38

Veljan Denison- Comparative Analysis

	Today	1 Month	3 Months	1 Year	3 Years
Veljan Denison Ltd.	0.55%	6.2%	3.32%	48.21%	157.13%
BSE Smallcap	2.77%	5.02%	13.65%	12.47%	119.5%
CNX NIFTY JUNIOR	3.56%	5.93%	14.75%	0.13%	161.11%

Veljan Denison – Key Investment highlights

Bright outlook for Fluid Power Industry in India – India is one of the fastest growing markets for hydraulic components like valves, cylinders, accumulators, pumps, hydraulic hoses, filters, etc.

The market for fluid power in India is very buoyant and is poised to grow further. The new growth will be fuelled largely by the budget focus on infrastructure and power, and by India's emergent status as a low cost manufacturing base.

Strong outperformance over peers – Veljan manufactures a wide range of Hydraulic and Pneumatic products. Besides, it develops complex and highly technical products in comparison to companies like Yuken India and thus commands a premium for its products and therefore much higher margins in comparison to all its peers.

Low leverage and very high promoter holding - We like companies that are able to maintain a good growth rate without leveraging their balance sheet. Veljan's debt to equity ratio stands at 0.26. The other good point about Veljan is high Promoter holding at 76% (they have initiated steps to bring it below 75%), thus aligning their interest in line with that of minority shareholders.

In a sweet spot – We find Veljan in a very sweet spot where they have been generating good cash flows from operations (almost in line with earnings) and have been able to deploy capital at very good returns.

Very attractive valuations – Veljan has been consistently growing at a rate of 23%+ for the last many years. Despite an envious track record, the stock is still available at 1.18 times FY 12 (E) book value, 4.8 times FY 12 (E) earnings and 2.88 times EV/EBITDA.

Veljan Denison Ltd – Business Overview

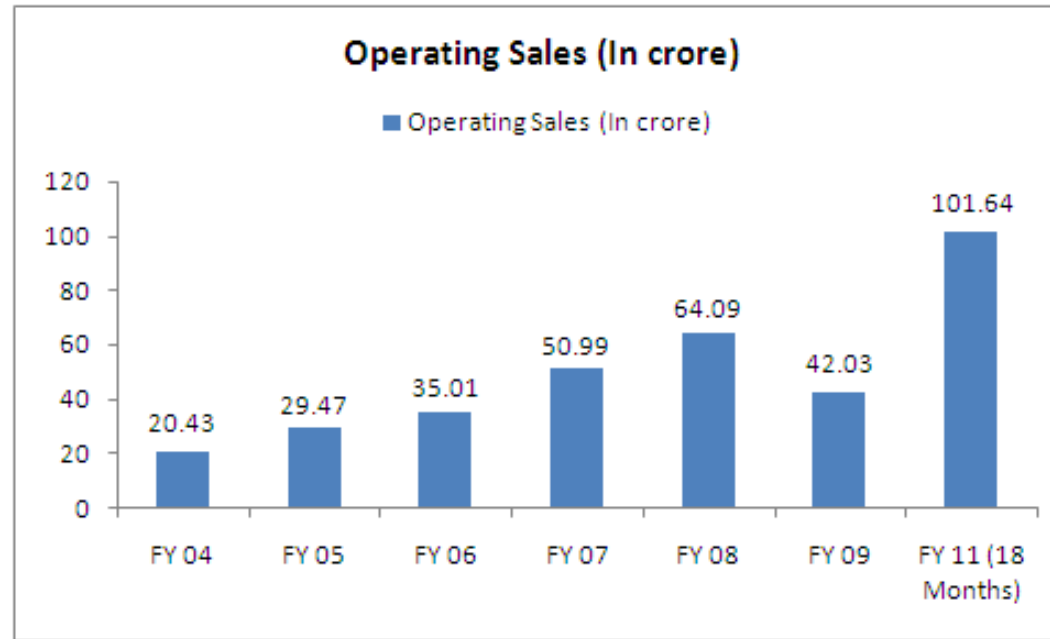
- Wide range of Hydraulic & Pneumatic products
- Veljan – Revenue streams
- Margins Overview
- Sales realization – Peer comparison
- Efficient capacity build up and utilization
- Related party transactions – Sales to Veljan Hydrair Ltd
- Veljan’s competitors – How have they been performing?

Wide range of Hydraulic and Pneumatic products



HR
(Mill Duty Design)

Veljan – Revenue streams



- Veljan operates in only 1 segment i.e. Hydraulic and Pneumatic products.
- As can be observed above, during the last 7 years the company's sales have grown at the rate of 23% annualized.
- The company's performance was excellent till 2008 as also the investment cycle in India was in its full flow. Post 2008, the growth's been slow on account of both global and India centric factors.
- We believe that we are probably at the trough of the investment cycle and the same should pick up (in both the infrastructure and manufacturing segment) going forward, which will be a big boost for the fluid power industry and Veljan Denison in particular.

Margins Overview

Veljan Denison Ltd - Margins Overview								
	9M FY 12	FY 11	FY 09	FY 08	FY 07	FY 06	FY 05	FY 04
Gross Margins (%)	70.55%	70.10%	65.24%	69.43%	71.77%	68.32%	72.54%	70.77%
Operating Profit Margins (%)	32.35%	31.93%	28.55%	27.16%	33.08%	29.16%	27.82%	27.80%
Net Profit Margins (%)	17.25%	16.61%	11.02%	13.22%	18.03%	16.53%	15.07%	14.13%

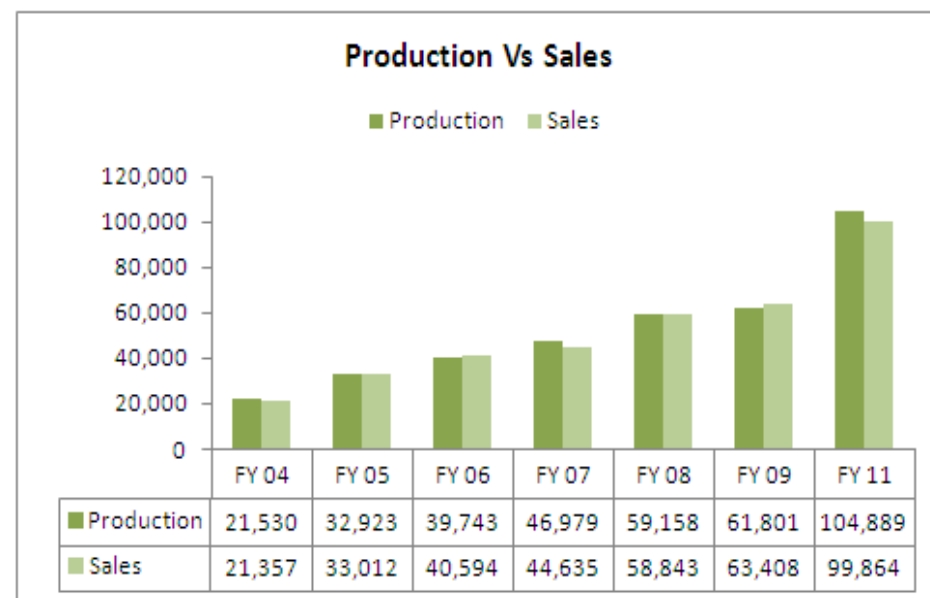
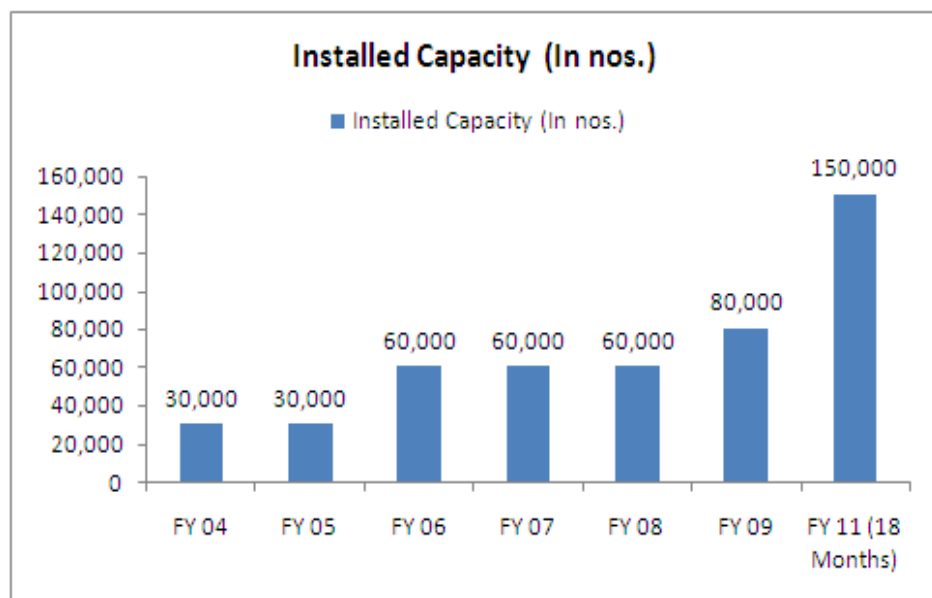
- In the above illustration, we have covered the Gross Margins, operating profit margins and the net profit margins of the company for the last 7 years.
- It's good to note throughout the above period, the company has been able to maintain its Gross margins in the range of 69-71% (2008-09 was an exception across the board). Thus, company has been able to pass on any increase in cost of goods sold over the period, to its clients.
- Besides, one can also notice a gradual improvement in operating profit margins of the company from 27-28% to 31-32% at the moment. Looking at the above margins, one may confuse the company for a software giant, however we must mention here that margins being commanded by the company are very high in comparison to its peers.

Sales Realization – Peer Comparison

Sales Realization - Peer Comparison						
	FY 11	FY 10	FY 09	FY 08	FY 07	FY 06
Veljan Denison	10,709	#	6,986	11,608	12,248	9,227
Yuken India	4,373	4,632	3,860	4,728	4,762	4,748
Rexroth	*	5,697	6,812	6,116	6,377	6,621
* - Data Not available						
# - Company changed its accounting year from Oct-Sep to Apr-Mar						

- While trying to find out the reason for high margins of Veljan Denison in comparison to its peers, we had a talk with a few dealers of the hydraulic products of different companies.
- The basic reason cited by all the dealers is as following: **Veljan develops complex and highly technical products in comparison to companies like Yuken India and thus commands a premium for its products and therefore the margins are higher.**
- As per the dealers, the higher the complexity of the product, the better the pricing power with the company.
- In the above illustration, we have depicted the average Sales realization of Yuken India and Bosch Rexroth in comparison to Veljan Denison. As can be noted, the average sales realization of Veljan Denison is approx. 80-100% higher than its peers.

Efficient capacity build up and utilization



Veljan Denison - Capacity Utilization							
	FY 11	FY 09	FY 08	FY 07	FY 06	FY 05	FY 04
Production Capacity	150000	80000	60000	60000	60000	30000	30000
Sales	99864	63408	58843	44635	40594	33012	21357
Capacity Utilization	66.58%	79.26%	98.07%	74.39%	67.66%	110.04%	71.19%

- In case of Veljan Denison, the management has been quick to respond to capacity expansion requirement. As soon as the capacity utilization approached 100% mark, the company expanded its capacity sufficiently.
- At current rate of capacity utilization of 67%, we believe there won't be any hindrance to growth for at least next two years on account of capacity constraints.

Related party transactions – Sales to Veljan Hydrair Ltd

	FY 11	FY 09	FY 08	FY 07	FY 06	FY 05
Operating Sales	101.64	42.03	64.09	50.99	35.01	29.47
Sales to Veljan Hydrair Ltd.	50.06	20.15	35.93	28.85	19.09	14.35
% of Sales to Veljan Hydrair Ltd.	49.25%	47.94%	56.06%	56.58%	54.53%	48.69%
Note: Veljan Hydrair Ltd is a company promoted by the management of Veljan Denison						

	FY 11	FY 09	FY 08	FY 07	FY 06	FY 05	FY 04
Total Sundry debtors	39.09	15.29	22.80	20.26	13.02	9.60	8.51
Due from Vejan Hydrair	18.58	4.78	11.21	11.39	7.16	4.58	4.55
% of sundry debts due from Vejan Hydrair	47.53%	31.26%	49.17%	56.22%	54.99%	47.71%	53.47%

- In the previous slides, we discussed the good points about the company. However any investment idea is not 100% perfect and in case of Veljan Denison we would like to bring to your notice the related party transactions of the company.
- Veljan Hydrair Ltd is a company promoted by the management of Veljan Denison. As can be observed from the above illustration, 50% of Veljan Denison sales are made to Vejan Hydrair Ltd.
- We believe, had Veljan Denison been selling directly to the end customers, it could probably have earned higher margins through higher sales realization. On the flip side, its good to note that Veljan Hydrair is marginally better (than other clients of Veljan Denison) in terms of payments for the goods purchased.

Vejan's Competitors – How have they been performing?

Bosch Rexroth – P&L (Curr. Rs. In crore)

Particulars	Dec-10	Dec-09	Dec-08	Dec-07	Dec-06	Dec-05
INCOME :						
Sales Turnover	506.18	370.78	356.64	285.49	240.45	208.47
Excise Duty	19.07	12.85	19.36	20.08	21.64	22.16
Net Sales	487.11	357.93	337.28	265.41	218.81	186.31
Other Income	8.38	10.66	6.84	7.25	4.76	3.07
Stock Adjustments	26.39	-5.48	8.76	5.75	1.02	1.96
Total Income	521.88	363.11	352.88	278.41	224.59	191.34
EXPENDITURE :						
Raw Materials	366.02	235.02	227.92	181.25	144.84	120.03
Power & Fuel Cost	2.71	2.25	2.34	1.52	1.30	1.21
Employee Cost	40.23	29.04	27.98	20.86	15.41	12.45
Other Manufacturing Expenses	17.33	13.70	13.70	9.21	7.37	5.56
Selling and Administration Expenses	27.97	20.00	21.83	14.15	12.77	9.97
Miscellaneous Expenses	14.32	16.96	17.32	3.84	6.95	3.77
Less: Pre-operative Expenses Capitalised	0.00	0.27	0.00	0.00	0.00	0.25
Total Expenditure	468.58	316.70	311.09	230.83	188.64	152.74
Operating Profit	53.30	46.41	41.79	47.58	35.95	38.60
Interest	12.18	8.19	6.02	4.22	3.17	2.54
Gross Profit	41.12	38.22	35.77	43.36	32.78	36.06
Depreciation	9.70	6.64	5.49	4.23	3.42	2.74
Profit Before Tax	31.42	31.58	30.28	39.13	29.36	33.32

Yuken India – P&L (Curr. Rs. In crore)

Particulars	Mar-11	Mar-10	Mar-09	Mar-08	Mar-07	Mar-06
INCOME :						
Sales Turnover	164.51	123.93	109.05	119.37	98.99	81.89
Excise Duty	15.36	9.71	12.11	16.14	14.16	11.73
Net Sales	149.15	114.22	96.94	103.23	84.83	70.16
Other Income	1.89	2.10	2.14	2.28	1.44	1.10
Stock Adjustments	1.86	0.24	-0.29	0.11	0.57	-0.04
Total Income	152.70	116.56	98.79	105.62	86.84	71.22
EXPENDITURE :						
Raw Materials	75.43	53.87	44.51	55.61	46.72	38.01
Power & Fuel Cost	2.78	1.81	1.65	1.58	1.28	1.07
Employee Cost	20.04	15.27	15.75	14.51	12.17	10.42
Other Manufacturing Expenses	15.63	14.67	13.54	3.95	3.85	2.93
Selling and Administration Expenses	15.57	12.00	11.08	10.60	9.43	8.55
Miscellaneous Expenses	3.17	2.67	3.81	4.52	1.73	1.67
Less: Pre-operative Expenses Capitalised	0.00	0.00	0.00	0.00	0.00	0.00
Total Expenditure	132.62	100.29	90.34	90.77	75.18	62.65
Operating Profit	20.08	16.27	8.45	14.85	11.66	8.57
Interest	2.90	3.38	4.50	3.18	2.83	2.58
Gross Profit	17.18	12.89	3.95	11.67	8.83	5.99
Depreciation	2.52	2.52	2.44	2.07	1.84	1.82
Profit Before Tax	14.66	10.37	1.51	9.60	6.99	4.17

- In the above two illustrations (Source: India Infoline) we have depicted the annual performance of the two major competitors of Veljan Denison: Bosch Rexroth and Yuken India.
- An important point that stands out from the performance of the two companies is the fact that Fluid power industry (organized) as a whole has been registering a good growth of 20%+ YoY for the last few years. Operationally, Velian Denison has been performing exceptionally well over its peers.

Management Quality

- Promoter's Profile
- Shareholding Pattern
- Low dividend payout and high return on shareholders funds
- Managements' remuneration – Performance linked incentives

Promoters Profile

A brief view on the profile of V.C. Janardan Rao and Mr. V. G. Srinivas

V. C. Janardan Rao – Promoter & Executive Chairman

Mr. V. C. Janardan Rao is Executive Chairman of the Board of Veljan Denison Ltd. He is a qualified and experienced Engineer with specialization in the area of Fluid Power. He is one of the First Directors of the Company.

He has been all along involved with the R & D wing of the company comprising of qualified and experienced Engineers and Technicians in the field of Design, Development and Manufacture of Fluid Power products. He has B.SC.(Engg)., degree and has 37 Years of Experience in Veljan Denison Limited and Promoter / Director of Veljan Hydrair Ltd., and Veljan Investments Ltd.

V. G. Srinivas – Promoter & Managing Director

Mr. V.G. Srinivas, Managing Director, is B.E. M.Sc by qualification and S/o. Shri V C Janardan Rao, Chairman of the Company. On completion of his Masters Degree from the Bath University, U.K. he worked in the Company in various departments and was also assisting Sri V C Janardan Rao, former Chairman and Managing Director in the discharge of his duties. He worked as Production Manager from 1st January, 1993 and was appointed as Executive Director on 26th September 1994. He was appointed as Managing Director on 1st March 1998 and is in charge of day-to-day operations of the Company.



V.C.Janardan Rao

Shareholding pattern

Veljan Denison Ltd - Shareholding Pattern	Dec'11	Sep'11	Mar'11	Sep'10	Jun'10
Promoter & Promoter Group	76.40%	73.10%	73.10%	73.10%	73.10%
Indian					
Foreign					
Public	23.60%	26.90%	26.90%	26.90%	26.90%
Institutions					
FII					
DII					
Non-Institutions	23.60%	26.90%	26.90%	26.90%	26.90%
Bodies Corporate	0.32%	0.45%	0.37%	0.44%	0.42%
Custodians					
Total No. of Shares	2,250,000	1,800,000	1,800,000	1,800,000	1,800,000

- The promoters of the company have since long been holding 73% equity stake in the company.
- From Mar'05 to Dec'07, they increased their holding in the company from 58.66% to 73.10% (a good move that aligned their interest further in line with that of minority shareholders)
- On account of Rights issue offered by the company to the existing shareholders, the shareholding of the Promoters has increased beyond 75%. As per the statement issued by the promoters, they have taken steps to bring down their holding to 75%.
- Besides 76% holding of the Promoters, another 10% is held by Vejan's Joint Venture partners Incentive Fastighet AB. Thus, with 87% equity being held by Promoter and JV partners, the stock is highly illiquid.

Low dividend payout & high return on shareholders funds

Return on Shareholders Funds							
	FY 11	FY 09	FY 08	FY 07	FY 06	FY 05	FY 04
Shareholder's Funds	55.70	40.3	36.63	29.17	21.01	15.82	11.88
PAT	16.97	4.71	8.51	9.22	5.80	4.45	2.92
ROAE	35.35%	12.24%	25.86%	36.74%	31.49%	32.12%	

Dividends Declared				
Announcement Date	Effective Date	Dividend Type	Dividend %	Amount (in crore)
30/7/2011	22/8/2011	Final	75%	1.35
31/5/2010	24/6/2010	Final	50%	0.90
3/3/2009	25/3/2009	Final	50%	0.90
3/3/2008	24/3/2008	Final	50%	0.90
2/2/2007	2/3/2007	Final	30%	0.54
30/1/2006	20/2/2006	Final	25%	0.45
30/1/2005	18/3/2005	Final	21%	0.378
3/2/2004	19/3/2004	Final	21%	0.378
1/2/2003	20/3/2003	Final	21%	0.378

- Veljan has a long standing dividend history, though the dividend payout's been low.
- However, one should be more than happy with the low dividend payout policy of the company as they have been consistently generating 25%+ return on shareholders funds.

Management's Remuneration – Performance linked incentives

Management's Remuneration - Rs. In Lakhs							
	FY 11 (18 Months)	FY 09	FY 08	FY 07	FY 06	FY 05	FY 04
MDs Salary	26.17	17.45	16.65	15.25	14.40	14.40	12.60
MDs Commission (2%)	54.13	15.80	30.39	31.61	18.47	15.21	6.29
Provident Fund	3.14	2.09	1.96	1.82	1.72	1.72	1.51
Perquisites	15.24	9.39	9.5	7.02	5.76	5.76	5.03
Commission to Other Directors (1%)	27.06	8.94	15.19	16.25	9.23	7.60	5.09
Total	125.76	53.68	73.71	71.52	50.47	45.56	30.99

- From the above illustration its good to note that company follows a policy of performance linked incentives for both the Managing Director and the Independent Directors of the company.
- In cases where the fixed salary constitutes a large sum of the Management's remuneration, the incentive to perform is missing in general.
- The other good point about the above remuneration policy is that Independent Directors are awarded commission based on the performance of the company, thus ensuring their active participation rather than sitting as lame ducks on the board of the company.

Industry Overview

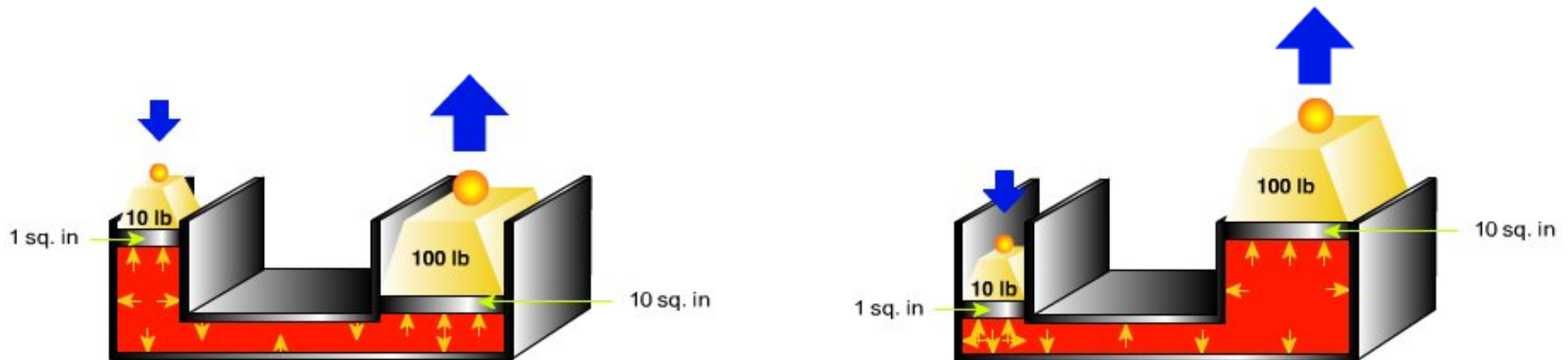
- Fluid Power – An introduction
- Applications of Fluid Power
- Fluid power industry – The Indian scenario
- Some important data points
- What do industry experts believe?

Fluid Power – An introduction

Fluid power is energy transmitted and controlled by means of a pressurized fluid, either liquid or gas. The term fluid power applies to both hydraulics and pneumatics. Hydraulics uses pressurized liquid, for example, oil or water; pneumatics uses compressed air or other neutral gases. Fluid power can be effectively combined with other technologies through the use of sensors, transducers and microprocessors.

How Fluid Power works

Pascal's Law expresses the central concept of fluid power: "Pressure exerted by a confined fluid acts undiminished equally in all directions."



An input force of 10 pounds (44.8 N) on 1-square-inch piston develops a pressure of 10 pounds per square inch (psi) throughout the container. This pressure will allow a 10-square-inch piston to support a 100-pound (444.8 N) weight. The forces are proportional to the piston areas.

Fluid Power – Applications

Electro Hydraulics	Electro Pneumatics	Pneumatics Automation
Concrete Saw	Multiple welding machine	Assembly
Airframe Tester	Paint Spray system	Broaching
Missile pump test	Pneumatic torquer for engine bolts	Clamping
Hitch control for tractor	Well-digger brake	Drilling
Plastic injection molding	Stapler test	Facing
Jackknife car loader	Tension control of a paper web	Loading
Flight simulator	Component inserter	

Coming to the applications, about 60% of fluid power caters to the mobile machinery and equipment, whereas 40% is the share of industrial/stationary equipment and machinery.

In the mobile category, fluid power is used to transport, excavate and lift materials as well as control or power mobile equipment. End use industries include construction, agriculture, marine and the military. Fluid power is also used for both commercial and military aircraft, spacecraft and related support equipment. Applications include landing gear, brakes, flight controls, motor controls and cargo loading equipment.

In the industrial/stationary category, fluid power is used to provide power transmission and motion control for the machines of industry.

Today, no aspect of human life is untouched by developments in fluid power technology: huge infrastructure projects, entertainment parks, and even the business of making movies, everything involves using the power of hydraulics and pneumatics.

Fluid Power Industry – The Indian scenario

As the Indian industry rebounds into the growth trajectory, the demand for hydraulic and pneumatic power is increasing by leaps and bounds. This is because fluid power finds applications in all the industries where automation is used. Fluid power is one of the fastest growing segments in Indian manufacturing.

Demand Drivers

Fluid power sits at a very important juncture in the manufacturing ecology. There is a lot of automation and conversion into more sophisticated manufacturing methods which is fuelling the demand for hydraulic and pneumatic products.

The other fact is that India is becoming an attractive destination for manufacturing and outsourcing by major global OEMs in strategic sectors like plant machinery and machine tools.

Apart from transport and energy, the new demand is being fuelled by automotives and machine tools. The automotive market is growing at a faster than the economy with a lot of global auto majors making India their global manufacturing hub. At the moment only 15% of the machine tools needed to make autos are produced in India and the balance are imported. The emerging trend here is that local demand for Indian machine tools is increasing dramatically because of their cost advantage. The main drive & components for these machine tools are fluid power products.

Besides, the boom in Infrastructure projects translates into demand for construction and other kinds of equipments which use a lot of hydraulics. The same holds true for the energy sector where demand will be fuelled by machinery for coal mining and material handling which are mostly powered by hydraulics.

Some important data points

Indian industry overview

The fluid power industry has grown tremendously in the last couple of years in India.

- Growth rate of the fluid power industry is typically twice that of GDP growth in any economy.
- The size of the fluid power market in India was about Rs 2011 crore in 2007-08

Veljan Denison commands a decent market share in the organized sector

Both domestic and the foreign manufacturers (through their JVs) are supplying products in Indian Market

- As at Mar'10, the fluid power market in India had grown to Rs 2880 crore from 2000 crore in 2008.
- Thus, the industry recorded a growth of 20% YoY.

Experts in the field of hydraulics are predicting an accelerated growth in the Asian infrastructure market; the Indian fluid power industry is predicted to have a huge growth potential in this region.

Indian Fluid power market size is estimated to be Rs 3300-3700 crore at the moment.

- Hydraulics account for more than 2,500 crore.
- Pneumatic account for Rs 400-500 crore
- Electro Hydraulics account for a further Rs 300-350 crore.
- Rest is accounted for by accessories and systems.
- Caters to Mobile (60%) and Industrial/Stationary (40%)

India is one of the fastest growing markets for hydraulic components like valves, cylinders, accumulators, pumps, hydraulic hoses, filters, etc. Most foreign MNCs in fluid power are already present in India, with some of them here for a long time.

The market for fluid power in India is very buoyant and is poised to grow further. The new growth will be fuelled largely by the budget focus on infrastructure and power, and by India's emergent status as a low cost manufacturing base.

What do industry experts believe?

The automation market in India is estimated to be 1/10th of China's. If India has to become one of the leading economies in the world based on manufacturing, it will have to attain higher technological standards and higher level of automation in manufacturing.

Heads of leading companies connected with the fluid power industry — M Seethapathy Rao, chairman and managing director, Hycom Engineering (India) Pvt Ltd; Martin Voglsanger, country unit head & managing director, Bosch Rexroth (India) Ltd; R Joshi, managing director, Festo Controls Pvt Ltd; Andreas Gruchow, member of the board, Deutsche Messe AG and Sudhir Patil, managing director, Hannover Milano Fairs India Pvt Ltd — met to answer this question and draw a roadmap for the future. The discussion was moderated by G V Gururaj, senior general manager - marketing, Dynamatic Technologies Ltd.

GV Gururaj: Could you give us a brief description of the fluid power industry, its market potential and growth rate in India?

M Seethapathy Rao: The fluid power industry covers all aspects of pneumatics and hydraulics and it is increasingly getting into areas of automation. It is a branch of mechanical engineering plus a bit of electrical and electronics put in. It is one of the fastest growing segments of Indian industry.

The growth rate of this industry in India is typically about twice that of growth of economy at large.

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Reasons are three-fold. As the economy grows, this industry grows in consonance with that. Then there is a lot of automation and conversion into more sophisticated manufacturing methods so that increases the rate. Three, one of the interesting things happening in this industry is that India is becoming an attractive destination for manufacturing and outsourcing of some of the products. So these three aspects together are creating a situation where this industry growth is twice the GDP growth in India.

Gururaj: What do you feel about the current trend in the industry and what are the issues it faces?

Rao: We are at a bit of crossroads. We are growing very rapidly in traditional products and applications of this industry. The industry is becoming more sophisticated and the Indian industry is getting integrated with the world markets. That's going to be the major change as I see in the next few years. Our rate of growth will continue to be very good.

Martin Voglsanger: I think we can bring it down to a simple example: the automotive market in India is growing at a faster pace than the economy. A lot of foreign automotive producers are setting up plants. There is a very big demand to manufacture the sub parts of the car. At the moment only 15% approximately of the machine tools needed for the industries are produced in India and balance are imported. The future trend is that this number of the Indian machine tool manufacturers will increase dramatically. Why will it increase? Because of the cost advantage of raw materials in India for machine tools, reasonable engineering and labour costs, and saving of import duties. The main drive and components for these machine tools are fluid power products. This is just one example, where we see production of more cars in the country based on the end user demand, more machines are needed for this, and that these machines are produced increasingly locally.

Contd..

Gururaj: I agree with you on the growth in the machine tool industry and I think the other market segments like infrastructure, civil engineering, steel and energy sector, etc are also growing.

Voglsanger: Yes, when we see major growth drivers in India for fluid power and automation, I would say it is power, automotive, infrastructure and steel. When we look at infrastructure, it is all over India, we have new modernised airports coming up, we have river projects connecting all over India, and in infrastructure the main part is building new roads and highways and all these infrastructure projects require machines. You need earth moving equipment and the main part, which drives these machines, is hydraulics. New industries like renewable wind energy are coming up, but the main source of our power will be thermal and hydel. In thermal power, only for transportation of the coal and getting it out, a huge market potential is in mining and material handling. Again here, to get the products from the mines and transport you need these machines using hydraulics.

R Joshi: In daily life, the moment you open your eyes, any object you find around you and this is really very interesting, any object be it water bottle or drinking glass, the newspapers, it is made using fluid power. For example, pen manufacturing, leather processing in tannery, gluing and stitching of shoes, fabrics manufacturing and testing is done using fluid power.

Now comes the point why its importance is increasing: You can say India has high potential for fluid power because we are growing. The biggest challenge is manpower and this is where we need to go back to the basic education system. Fluid power needs to be part of the educational system, not as an elective subject. Everyone has heard of mechatronics; it is partly mechanical, partly fluid power, electronics and/or a combination of all these technologies. Mechatronics will play an important role in technology upgradation in industrial automation. Fluid power industries are doing their bit under the banner of Fluid Power Society of India.

Veljan Dension Ltd – Financials

Annual Performance

PROFIT AND LOSS - VELJAN DENISON LTD (Curr: Rs in Cr.)								
	9M FY 12	FY 11 (18 Months)	FY 2009	FY 2008	FY 2007	FY 2006	FY 2005	FY 2004
INCOME:								
Operating Sales	61.87	101.64	42.03	64.09	50.99	35.01	29.47	20.43
Other income	0.68	0.55	0.70	0.29	0.14	0.07	0.05	0.24
Total Income	62.55	102.19	42.73	64.38	51.13	35.08	29.52	20.67
EXPENDITURE:								
Cost of Goods sold	18.22	30.39	14.69	19.59	14.39	11.09	8.09	5.97
Employees Remuneration & Benefits	4.70	7.01	3.62	4.38	3.20	2.42	1.88	1.77
Other Manufacturing expenses	10.95	18.96	7.18	14.54	10.00	6.51	6.93	3.65
Selling and Administrative Expenses	8.63	12.80	4.61	8.17	6.51	4.77	4.36	3.35
Total Expenditure	42.52	69.18	30.03	46.68	34.12	24.79	21.27	14.75
Operating Profit	20.02	33.01	12.70	17.70	17.01	10.29	8.25	5.92
Interest	1.29	2.32	1.71	1.44	0.68	0.58	0.39	0.46
Depreciation	2.46	4.93	2.63	1.82	1.22	0.95	0.72	0.68
Profit Before Tax	16.27	25.75	8.37	14.43	15.08	8.73	7.14	4.78
Provision for taxation	5.48	8.78	3.65	5.91	5.86	2.92	2.69	1.85
Net Profit	10.79	16.97	4.71	8.51	9.22	5.80	4.45	2.92

- As already indicated in the previous slides, the company has reported good all round performance over the years, though sales slowed down during 2009 and 2010.
- Since the lows of 2009, the sales growth has picked up again.
- For the nine months ending Dec'11 the company has already recorded a sales turnover of Rs 62.55 crore and net profit of Rs 10.79 crore.
- March ending quarter is the best quarter for the company. We expect Veljan to close the year with a turnover of Rs 95 crore and a net profit of Rs 15-16 crore.

Quarterly Performance

QUARTERLY RESULTS - VELJAN DENISON LTD [Curr: Rs. In Cr.]									
	Dec'11	Dec'10	VAR [%]	Sep'11	Sep'10	VAR [%]	Jun'11	Jun'10	VAR [%]
Sales & Services	25.94	17.93	44.67%	23.05	15.00	53.67%	12.87	10.50	22.57%
Other income	0.43	0.13	230.77%	0.02	0.14	-85.71%	0.23	0.03	666.67%
Total Income	26.37	18.06	46.01%	23.07	15.14	52.38%	13.10	10.53	24.41%
Total Expenditure	16.76	12.11	38.40%	16.83	10.39	61.98%	8.93	7.39	20.84%
PBIDT	9.61	5.95	61.51%	6.24	4.75	31.37%	4.17	3.14	32.80%
Interest	0.49	0.39	25.64%	0.52	0.36	44.44%	0.28	0.36	-22.22%
Depreciation	0.82	0.75	9.33%	0.82	0.75	9.33%	0.82	0.75	9.33%
Tax	2.78	1.73	60.69%	1.63	1.23	32.52%	1.14	0.79	44.30%
Profit After Tax	5.53	3.08	79.55%	3.22	2.41	33.61%	1.93	1.24	55.65%

- As can be observed from the above illustration, Veljan has performed extremely well for the three quarters ending Dec'11.
- Last year, in the Mar'11 quarter the company recorded phenomenal performance with a sales turnover of Rs 30.59 crore and a net profit of Rs 6.60 crore. On account of high base effect, we would be happy even if the company is able to maintain Mar'11 turnover for Mar'12 quarter.
- We derive our optimism from the fact that March quarter sales are in general higher than December quarter sales by more than 10%. Thus on the basis of FY 12 (E) earnings of Rs 16 crore, Veljan Denison is quoting at a PE of 4.8.

Sustainable Cash Flows

CASH FLOW FROM OPERATIONS - VELJAN DENISON LTD (Curr: Rs in Cr.)							
	FY 11 (18 Months)	FY 2009	FY 2008	FY 2007	FY 2006	FY 2005	FY 2004
Cash Flow from Operating Activities:							
Net Profit Before Taxation & extraordinary item	25.76	8.37	14.43	15.08	8.73	7.14	4.78
Depreciation	4.93	2.63	1.82	1.22	0.96	0.72	0.68
Interest Expense	2.32	1.70	1.44	0.68	0.58	0.39	0.46
Interest Income	-0.11	-0.13	-0.16	-0.02	-0.03	-0.02	-0.22
Tools and Jigs, Fixtures & Patterns Written off	0.13	0.10	0.10	0.09	0.09	0.04	0
Operating Cash flow before working capital changes	33.04	12.68	17.64	17.00	10.33	8.28	5.69
Adjustments For:							
Inventories	-2.08	3.39	-4.17	-2.60	0.14	-2.53	-0.83
Trade Receivables	-23.79	7.50	-2.54	-7.24	-3.50	-1.13	-2.07
Other Receivables	1.21	-1.76	-1.91	-1.83	-0.58	-0.47	-0.46
Trade Payable	4.76	-2.86	1.07	3.96	1.49	1.14	0.42
Interest Paid	-2.32	-1.95	-1.29	-0.66	-0.56	-0.38	-0.47
Income Tax Paid	-7.19	-4.14	-5.34	-4.11	-2.68	-2.01	-1.53
Net cash flow from Operating Activities	3.63	12.85	3.46	4.52	4.64	2.90	0.77

- Veljan Denison has consistently been generating positive cash flows from operations, thus enabling it to maintain low leverage.
- The cash flows of the company are slightly strained by the fact that receivable days of the company have been high.
- We consider taxes paid as an important metric and for Veljan Denison the average tax rate for the last 5 years is 32.47%. The same lends immense comfort regarding the accounting practices of the company.

Balance Sheet

BALANCE SHEET - VEJAN DENISON LTD (Curr: Rs in Cr.)							
	FY 11 (18 Months)	FY 2009	FY 2008	FY 2007	FY 2006	FY 2005	FY 2004
SOURCES OF FUNDS:							
Share Capital	1.80	1.80	1.80	1.80	1.80	1.80	1.80
Reserves and Surplus	53.90	38.50	34.83	27.37	19.21	14.02	10.08
Total Shareholders Funds	55.70	40.30	36.63	29.17	21.01	15.82	11.88
Secured Loans	14.73	13.25	18.93	9.32	4.18	3.65	3.47
Deferred Tax Liability	3.89	3.75	2.84	2.04	1.44	1.32	0.97
Total	74.32	57.30	58.42	40.54	26.63	20.79	16.32
APPLICATION OF FUNDS:							
Net Block	34.12	32.23	25.94	17.80	12.45	9.19	7.41
Investments	0.001	0.001	0.001	0.001	0.001	0.001	0.001
Current Assets, Loans and Advances							
Inventories	11.21	9.26	12.76	8.69	6.18	6.32	3.79
Sundry Debtors	39.09	15.29	22.80	20.26	13.02	9.60	8.51
Cash & Bank Balances	2.11	1.77	1.28	2.58	1.75	0.53	0.36
Loans & Advances	6.89	10.85	12.24	6.63	9.19	8.54	2.03
Total Current Assets	59.31	37.18	49.08	38.17	30.14	24.99	14.70
Less: Current Liabilities & Provisions							
Current Liabilities	14.83	9.96	13.33	12.07	7.64	6.06	4.86
Provisions	4.27	2.15	3.28	3.35	8.32	7.33	0.93
Total Current Liabilities	19.11	12.11	16.61	15.43	15.96	13.39	5.79
Net Current Assets	40.20	25.07	32.47	22.73	14.18	11.60	8.91

- Though company has achieved 23% annualized sales growth over the last 6 years, there wasn't any equity dilution nor substantial debt funding by the company.
- In fact company has repaid much of its debt since 2008.
- The capacity expansion executed by the company is very much evident from the four fold increase in the net block of the company.
- The working capital management has been excellent with working capital as a % of sales remaining more or less same over the years.

Concerns

Concerns

- The investment cycle in India has slowed down, though the signs are evident of imminent pick-up. In case the investment cycle does not pick up, the growth of Veljan Denison will remain subdued.
- Increasing competition from exports, may impact the company's market share and volumes.
- Veljan is already commanding huge margins in comparison to its peers. We don't expect much improvement in margins from here on, while there are obvious downside risks to the margins of the company. In case the margins of the company deteriorate from here on, we may encounter a situation of improving sales with stagnant profits.

Conclusion

Price chart



- Over the last 2 years, there's been some strong accumulation in the range of Rs 250-300
- We believe that Rs 300 will act as a very strong support for the stock and it is unlikely to fall below the same, unless there's a major deterioration in the performance of the company or the market conditions.
- We suggest starting with 3% portfolio allocation in the range of Rs 340-360. We may suggest increasing allocation to 5% in case the stock falls below Rs 300 for reasons other than fundamental.

Katalyst Wealth – Alpha Portfolio



Katalyst Wealth Alpha Portfolio service is focused on helping individual investors/institutions beat market returns by a wide margin without taking large risks through in-depth research, analysis and follow up on the stock.

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