

Sector: Engineering

Market cap (mn)	Rs3,635/US\$81
52-week range	Rs844/301
Shares in issue (mn)	7.9
6-mon avg daily vol (no of shares)	24,175
6-mon avg daily vol (mn)	Rs11.1/US\$0.3
Bloomberg	EMCO IN
Reuters	EMCO.BO
BSE Sensex	9966
Website:	www.emcoindia.com

Shareholding Pattern (%)

Promoters	38.3
FI/MF	18.2
FII	18.0
Public	12.7
Others	12.8

(As of 31 March 2006)

Price Performance (%)

	1M	3M	12M
Absolute	(25.2)	(36.1)	30.5
Relative*	(16.3)	(27.4)	(10.4)

* To the BSE Sensex

Relative Performance



(As of 20 June 2006)

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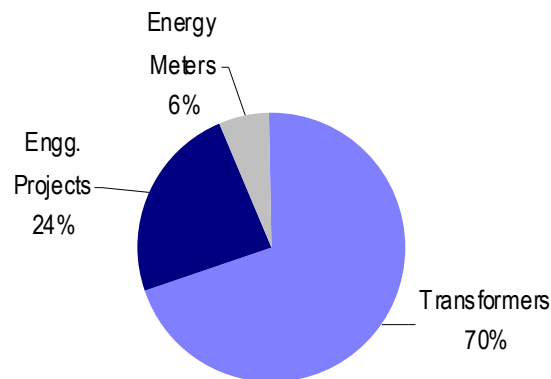
Outlook remains positive

EMCO posted stronger than expected topline growth of 122% in 4Q FY06 to Rs1.7bn, however receivables write-off to the extent of Rs62mn during the quarter depressed the margins and profits substantially. The company has still managed to do well this fiscal, doubling its EPS to Rs24.

Overall, the business environment continues to remain buoyant with strong demand growth expected for transformers on back of huge power capacity additions. The management is confident of maintaining momentum during FY07 by growing its topline by 50% and doubling its earnings.

We expect the company to report earnings of Rs45 and Rs61.5 for FY07 and FY08 respectively. We believe that at a PE of 9x FY07E and 7x FY08E, valuations are quite attractive. However its plans of entering the power generation space (which is capital intensive and offers low returns) can result in equity dilution and could be detrimental to cash flows in the near future.

Exhibit 1: FY06 revenue break-up



Source: Company Data.

Exhibit 2: Key financials

(Rs mn)

Y/E March	FY05	FY06E	FY07E	FY08E
Total Income	2,359	4,054	5,817	7,595
Operating Profit	308	458	743	972
OPM (%)	13.0	11.3	12.8	12.8
Adjusted PAT	96	191	383	523
Diluted EPS (Rs)	12.6	24.0	45.1	61.5
EPS Growth (%)	77.8	91.2	87.5	36.3
RONW (%)	13.1	14.1	21.8	23.6
ROCE (%)	12.9	16.1	23.7	27.9
PE (x)	36.6	19.1	10.2	7.5
PEG (x)	0.5	0.2	0.1	0.2
EVI/EBIDTA (x)	17.1	14.4	8.9	7.1

Source: Company, ASK-Raymond James. Note: Valuations as of 20 June 2006.

Highlights

- **Topline soars in last quarter:** EMCO reported a 122% YoY growth in revenues to Rs1.7 bn in 4QFY06, leading to a 72% YoY growth for FY06 to Rs4.05 bn. This strong topline performance was driven by the large part of project execution getting reflected during the quarter. The demand for transformers also continued to be buoyant on account of massive investments in the power generation space.
- **Profits impacted by write-off:** During the quarter, the company has written off debts to the tune of Rs62 mn (outstanding for the past few years), which resulted in fall in margins to 9% and 11.3% for 4Q FY06 and FY06 respectively. However, the management believes that the same is non-recurring in nature and the operating margins are sustainable at around 13% levels going forward. The company's PAT doubled in FY06 to Rs191 mn.
- **Increasing transformer capacity to meet demand:** In FY06, the company produced and sold around 7900 MVA of transformers. EMCO's capacity utilisation has risen to around 79% from 70% in FY05. Given the strong demand outlook for the transformer business, the company plans to increase its capacity in FY07 by 50% to 15,000 MVA. This is expected to be further ramped up to around 20,000 MVA by 2009.
- **Demand for energy meters to pick up:** The energy meters segment has not been performing well as it faces tough competition from the unorganized segment on account of low entry barrier and lack of quality consciousness by customers. However, the management is confident of strong growth in this segment going forward, given the APDRP directive of metering of power at all stages to reduce T&D losses. To tap these opportunities, the company has developed high end automated and prepaid meters. For FY07, we believe that the division can report revenues of Rs450 mn from Rs250mn in FY06.
- **Switchgear business to commence in FY08:** EMCO will be setting up a switchgear facility during the year at an investment of close to Rs200 mn. The operations of this division will commence by end FY07. The company expects this business to generate revenues of Rs300 mn in FY08. Additionally, EMCO's value addition to a substation project will increase to 50% from 35% earlier.
- **Moving into power generation space:** EMCO, through an SPV, will be setting up a 135 MW coal based power plant in Maharashtra. The investment required for the project will be close to Rs5.5 bn, funded in debt-equity ratio of 70:30. While the various elements of this project are on the drawing board, we believe the crucial aspect here will be the funding of EMCO's equity contribution of Rs1.8 bn.
- **Strong order book to drive revenue growth:** The company's currently sitting on strong order book of around Rs4 bn, and have bid for another Rs4.2 bn orders which are in finalisation stage. The management indicated that the order flow is likely to be strong in the near to medium-term for all the segments. As a result, we expect the company to end FY07 with a turnover of Rs5.8 bn, implying a growth of 43% YoY. For FY08, we expect the company to clock revenue growth of 31% YoY to Rs7.6 bn.

- **Low incremental capex:** Going forward, EMCO will be requiring minimal capex to the tune of around Rs300 mn in FY07 primarily on increasing transformer capacity and for setting up the new switchgear facility. Low incremental capex will aid in improving their return ratios as well as improve the overall cash generation.
- **Attractive valuations:** We expect the company to report earnings of Rs45 and Rs61.5 for FY07 and FY08 respectively. We believe that at a PE of 9x FY07E and 7x FY08E, valuations are quite attractive. However its plans of entering the power generation space (which is capital intensive and offers low returns) can result in equity dilution and could be detrimental to cash flows in the near future.

Exhibit 3: Results review**(Rs mn)**

Y/E March	4Q			Full year		
	FY06	FY05	% Var	FY06E	FY05	% var
Sales turnover	1,698	765	122	4,054	2,359	72
Total Exp. (a+b+c)	1,546	681	127	3,596	2,052	75
Raw material cost	1,328	561	137	3,068	1,696	81
Staff cost	55	30	83	136	95	43
Other exp.	163	90	81	392	260	51
Operating profit	152	84	81	458	308	49
Interest	32	28	15	118	136	(13)
Depreciation	15	11	40	57	52	8
PBT before other income	105	45	131	284	120	137
Other Income	0	0		0	1	(83)
PBT	105	45	131	284	121	135
Prov for tax	60	14	325	93	25	280
Effective tax rate (%)	57.6	31.3		32.8	20.3	
Adjusted PAT	44	31	43	191	96	99
Adjusted EPS (Rs)	5.6	3.9		24.0	12.1	
Reported PAT	44	31	43	191	96	99
Key Ratios (% to Sales)						
Raw material cost	78.2	73.3		75.7	71.9	
Operating profit	9.0	11.0		11.3	13.0	
Net profit	2.6	4.1		4.7	4.1	

Source: Company data, ASK Raymond James.

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