

Elecon Engineering

Rs 267

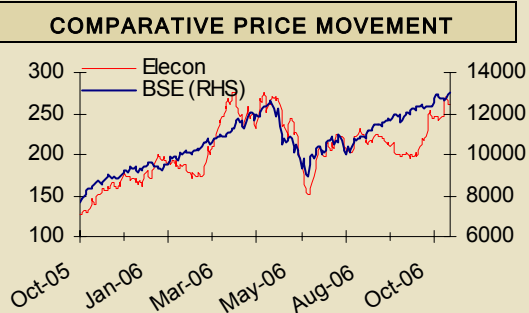
2nd Nov 2006

Firing all Cylinders

Reiterate Buy

SCRIP DETAILS	
Market Cap (Rs crores)	827.7
P/E (x) - FY08 (E)	10.3
Market Cap/Sales (x) - FY08 (E)	0.9
EV / EBIDTA (x) - FY08 (E)	6.3
Dividend (Rs)/ Yield (%)	1/0.4
Equity Capital (Rs crores)	6.2
Face Value (Rs)	2.0
52 Week High/Low (Rs)	288 / 115.6
Website: www.indo-tech.com	
NSE Code	ELECON
Sensex	13,033
Nifty	3767

(as on 30th June 2006)	
Promoters	42.5
FII's	6.4
Mutual Funds/ Banks/ FIs	14.3
Public	30.0
Others	6.8


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Elecon Engineering, a Gujarat-based company and a leading manufacturer of bulk material handling equipment (MHE) and industrial gear, has delivered excellent results for Q2FY07.

Stunning Performance

Net sales for Q2FY07 have jumped by 85%, to Rs 175.5 crores from Rs 94.7 crores in Q2FY06. PAT for the quarter was up by 182%, at Rs 16.3 crores from Rs 5.8 crores. For H1FY07, net sales were up 63%, at Rs 270 crores. Net profits were up 146%, from Rs 8.8 crores in H1FY06 to Rs 21.7 crores in H1FY07. EPS jumped significantly, to Rs 7.0 from Rs 2.8 for H1FY07.

MHE segment - a major Growth driver

Revenues from the MHE division constituted nearly 55% of the total revenues, as against 38% in Q2FY06. Robust infrastructure scenario and a strong order book in MHE resulted in a 178%-growth in segment revenues, from Rs 36 crores in Q2FY06 to Rs 100 crores in Q2FY07. Volume growth in MHE and better realisation led to more than four-fold increase in segment profits, from Rs 2.81 crores to Rs 13.1 crores. Margins were also up, from 7.8% to 13.1%. On the other hand, the gears segment reported a 38%-growth in revenues. Profits from this division were up 34%, from Rs 12.5 crores to Rs 16.8 crores.

Margin expansion, on the back of volume growth in MHE segment

For Q2FY07, operating margins were more than 300 bps, from 13.5% to 16.6%, on the back of volume growth in the MHE segment and better realisation. While raw material costs to sales were stagnant at 66%, there was reduction in other expenditure by 240 bps. The Management expects the margins to remain firm, on the back of increased volume from the MHE segment.

Strong order book provides earnings visibility

Currently, the Company has an unexecuted order book of Rs 678 crores, with majority being accounted by the MHE business (Rs 524 crores) and the balance being accounted by the gears business. Of the MHE order book, about 60-65% caters to the power sector and the balance being contributed by mining, cement, steel & aluminium sectors; on the other hand, the Industrial Gears order book is spread across the MHE, cement & sugar sectors. Further, to aid the earnings visibility, the Company has already floated tenders to the tune of Rs 550 crores, for which the orders are awaiting.

Buoyant investment climate to aid further growth

The country is, at present, witnessing huge investments in core infrastructure sectors like power, mining, coal, steel and cement. Industry majors have announced their ambitious plans to expand/ upgrade their facilities, while the capex by Coal India and the development of ports would present further opportunities for the MHE players. The Gears sector is benefiting from the robust growth in manufacturing. With this, the outlook remains extremely favourable and more so for Elecon, which is the market leader.

Capex plans to add to the momentum

The Company is planning to invest Rs 70 crores in the current fiscal and Rs 150 crores in FY08. Of the proposed amount, 65% would be allocated to the Gears division. The required amount would be raised, partly through term loan and the balance through internal accruals.

Forward integration into windmill manufacturing

The Company is now planning to widen its scale of operations in windmill manufacturing, with an estimated capex of Rs 40-50 crores, and this move comes as a logical step, since gearbox is the main component for windmills. Considering the future potential in windmill manufacturing, the Company has entered into a technical collaboration with M/s Turbowinds N.V., Belgium, for import of technology to manufacture wind-electric generators. The Company has already received a certificate for setting-up windmills of 600 KW, from C-WET (Centre for Wind Energy Technology). The Company expects to sell at least 50 windmills in FY08, which could contribute around Rs 50-100 crores to the topline.

Foray into fabrication of ship blocks

The Company is also planning to foray into fabrication of ship blocks, with a capex of Rs 10-15 crores. This is another rational step, since it has the necessary expertise and technology in place. The Company has signed an agreement with Pipavav Shipyards Ltd (PSL), wherein PSL would be concentrating on design and execution of the overall ship and Elecon would be doing the fabrication of ship blocks. Another advantage of this foray is that it is a relatively low-risk business with a low capex, since the work would be done at the site itself. Revenues from this segment are expected to be in the range of Rs 50-100 crores in FY08.

Inorganic growth to strengthen international presence

Elecon expects 25-30% of revenues from the Gears segment to come from exports by FY08. In order to achieve this, the Company is looking to acquire an overseas company in the gears segment, to increase its international presence. The feasibility study is currently going on.

Financials

(YE March 31)	Q2FY07	Q2FY06	Chg (%)	H1FY07	H1FY06	Chg (%)	FY07(E)	Chg (%)
Net Sales	175.5	94.7	85.3	270.0	165.4	63.3	692.0	56.4
Raw Mat. Consumed	115.9	62.2	86.1	177.5	108.6	63.5	460.1	53.8
Other expenses	23.6	15.0	57.2	37.1	25.2	47.1	90.2	39.8
Personnel	6.9	4.7	48.4	12.2	9.7	26.0	24.0	26.0
Total expenditure	146.4	81.9	78.7	226.8	143.5	58.1	574.3	50.0
Operating Profit	29.1	12.7	128.3	43.2	21.9	97.6	117.7	97.3
Other Income	1.8	1.1	67.3	2.7	1.4	91.6	3.0	-63.8
Interest	4.5	3.2	40.1	8.2	6.9	20.1	19.0	35.9
Gross Profit	26.3	10.6	149.2	37.7	16.4	129.3	101.7	88.4
Depreciation	2.9	2.4	22.5	5.6	4.7	19.2	13.5	43.2
PBT before Extraord. Expd	23.5	8.2	185.6	32.1	11.8	173.1	88.2	98.0
Extraordinary Expenditure	0.6	0.6	0.0	1.1	0.0	0.0	3.0	-15.6
PBT after Extraord. Expd	22.9	7.6	200.3	31.0	11.8	163.4	85.2	107.8
Prov. for Tax- Current	6.6	1.8	266.7	9.3	3.0	210.0	28.5	114.3
PAT	16.3	5.8	182.6	21.7	8.8	146.4	56.7	103.2
Equity Share capital	6.2	6.2		6.2	6.2		6.2	
EPS (Rs)	5.3	1.9	182.6	7.0	2.8	146.4	18.3	87.1
CEPS (Rs)	6.4	2.5	150.3	9.2	4.2	118.7	22.6	74.1
OPM (%)	16.6	13.5		16.0	13.2		17.0	
PBT (%)	13.4	8.7		11.9	7.1		12.7	
PAT (%)	9.3	6.1		8.0	5.3		8.2	

Segmental Revenue

(Rs crores)	Q2FY07	Q2FY06	Chg (%)	H1FY07	H1FY06	Chg (%)
MHE						
Revenue	100.8	36.0	178.4	157.2	62.8	150.3
PBIT	13.1	2.8	365.8	19.7	4.6	330.3
Segment Margins (%)	13.1	7.8		12.6	7.3	
% Of total sales	54.6	37.5		55.9	37.4	
Transmission Equipment						
Revenue	83.2	60.1	38.6	124.1	105.2	18.0
Results	16.8	12.5	34.4	25.1	21.8	15.0
Segment Margins (%)	20.2	20.8		20.2	20.7	
% Of total sales	45.4	62.6		44.1	62.6	

Valuation and Conclusion

The key to Elecon's success is the current boom in the infrastructure sector, which would see substantial inflow of funds from various corporate houses over the next 4-5 years. The Government thrust on 'Power for all' by 2012 acts as a positive stimulus for the Company, which derives more than 25% of the revenues from the power sector. Additionally, there are huge greenfield and brownfield expansion plans that have been announced by steel majors, which would give Elecon further impetus to its growth. At the current market price of Rs 267, the stock trades at 14.6x the FY07 earnings of Rs 18.3 and 10.3x the FY08 earnings of Rs 25.9. Considering the growth prospects, the strong order book, expansion plans and the buoyancy in the infrastructure sector, along with its foray into windmills and ship block fabrication, we reiterate a **BUY** at current levels, with a revised price target of Rs 350 (previous price target Rs 300, post split), an upside of 31% from the current levels, for a one-year horizon. (previous recommendation at Rs 212, post split)

WAY2WEALTH Research

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