

EMCO Ltd.

Rs 59

KRChoksey
wealth enhancement solutions


On the verge of rebound

BUY

Company Profile:

Emco Ltd. is the 3rd largest manufacturer of transformers in India and a leading player in electronic energy meter, turn key electrical substation and transmission lines of up to 765 KV. It specializes in application transformers like rectifiers, furnace and locomotive with wide product line ranging from 11 KV to 400 KV. Company has acquired a 37.4 % stake in an Indonesian coal mine PT Bism with the proven reserves of 105 million tones. In addition, It is also making a foray into power business with 1800 MW of thermal power capacity under various stages of planning and implementation.

Investment Rationale :

EMCO is in a transformation phase: Company reported a positive EBITDA after a gap of two quarters. It registered a margin of 14% in transformer segment back from 8% in Q2FY11. Going forward; we believe that transformer segment is going to witness a turnaround, even in face of intensifying competition, as a Capex of approximately Rs 640,000 crore in T&D sector over the next 5-6 years will ensure the optimum capacity utilisation for major players like EMCO. Company became EBITDA positive in project business during the quarter even as commodity prices continued to rise sharply. Going forward, we believe that EMCO will be able to secure a pie in PGCIL transmission line orders as it has a prior experience for the same.

Planning a foray into 765 KV segment: Company has again reiterated during the concall that it is actively scouting for a joint venture partner to make a foray in 765 KV segment transformers. It is also planning to venture into high voltage switchgears. We believe that next phase of growth will come from higher voltage segment as lower voltage class has largely become commoditised.

Indonesian coal mines to boost profitability: Company is currently producing 40,000 MT from its Indonesian coal mines and during the concall it has reiterated that it will be to sell 150,000 MT during FY11. Going forward, we believe that coal is going to be a precious commodity for Indian power utilities as production ramp up from CIL is not going to keep pace with the demand growth. Sharp spike in coal prices on account of floods in Australia and strong demand from China and India augurs well for the company. We expect EMCO to ramp up the production to 1 million tonnes by FY12, giving a sharp boost to company's profitability.

Valuation and View:

EMCO has returned back to profitability and we believe the worst is over for the company. The strong investment pipeline in the T&D space and commencement of production from its Indonesian coal mines ensures revenue visibility for the next 5-6 years. We have valued the company on SOTP basis and arrived at a target price of Rs 97 which is 64% upside to the current market price. Currently the stock is trading at a P/E of 5.8x FY12E EPS.

Key Financials:

Rs In Cr.

Particulars	FY09	FY10	FY11E	FY12E
Sales	996.3	978.6	1071.0	1234.6
EBITDA	150.5	117.0	28.9	162.8
PAT	53.3	41.2	-38.6	63.5
EPS	8.6	6.7	-6.2	10.2
P/E	6.9	9.0	N.M	5.8
P/B	0.8	0.6	0.7	0.6
EV/EBITDA	4.3	5.6	22.6	4.0
OPM%	15.1%	12.0%	2.7%	13.2%
NPM%	5.4%	4.2%	-3.6%	5.1%
ROE%	12.2%	7.1%	-7.1%	10.5%
ROCE%	14.2%	10.2%	1.9%	12.4%

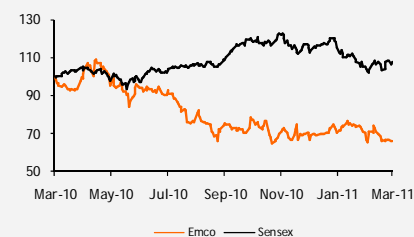
Source : KRChoksey Research

Price Outlook : Rs 97

Market Data	Mar 9 th , 2010
Shares outs (Cr)	6.51
Equity Cap (Rs Cr)	13.02
Mkt Cap (Rs Cr)	383
52 Wk H/L (Rs)	99/55
Avg Vol (1yr avg)	322,265
Face Value (Rs)	2
Bloomberg Code	EMCO IN

Market Info:

SENSEX	18,470
NIFTY	5,531

Price Performance**Share Holding pattern (%)**

Particulars	Dec - 10	Sep - 10	Chg
Promoters	39.85	36.73	3.12
Institutions	7.48	11.48	-4.00
FII	3.04	3.40	-0.36
Public	49.63	48.39	1.24
Total	100.00	100.00	

Analyst :

Atul Karwa
atul.karwa@krchoksey.com
 ☎ 91-22-6696 5555

www.krchoksey.com

☎ 91-22-6696 5555
 ☎ 91-22-6691 9569

Indonesian coal mine to be a key valuation trigger

Company has started production from its Indonesian coal mines in Q1FY11 and is currently producing 40,000 tonnes / month. It expects to sell around 150,000 tonnes and 1,000,000 tonnes in FY11 and FY12 respectively.

We believe that it is going to be a key valuation trigger as its coal mines mature in to full fledged production by FY12 and FY13. Company is well placed to benefit of rising demand from Power sector in India as its coal has a calorific value of 5,200-5,300 Kcal/ Kg, fit for consumption in thermal power plants.

We have valued the Indonesian coal mines of the company having a reserve of 105 million tones on the EV/Reserve basis. Indonesian coal mines having a calorific value of 5100-5500 Kcal/kg with no mining history are valued at 1.5-2.0 x reserve. We have done a sensitivity analysis with 1x, 1.5x and 2x being the worst case, base case and best case, respectively.

Particulars	Worst Case	Base Case	Best Case
Reserve Extractable(million tonnes)	78.8	78.8	78.8
EV/Reserve (\$/ton)	1.0	1.5	2.0
Exchange Rate (Rs /\$)	45.8	45.8	45.8
Enterprise Value (Crore)	360.5	540.8	721.0
Less: Expected Debt	48.0	48.0	48.0
Value (Crore)	312.5	492.8	673.0
% Stake of EMCO	37.4	37.4	37.4
EMCO Stake Value	116.7	184.0	251.4
No. of Shares Out	6.5	6.5	6.5
Fair Value (Rs)	18.0	28.3	38.7

Note: We have assumed that 75% of the mine is extractable

Source: KRChoksey Research

EMCO stands to be a key beneficiary of increased capex

Industry's top line and profitability has been marred in last 2 years by economic slowdown, excess capacity and import from China and Korea. However, we believe that industry is going to witness a turnaround in FY12. Key demand drivers will be PGCIL capex for 12th five year plan, capex by the SEBs and revival in industrial capex cycle. As for import threat from China and Korea, there is a clear policy shift towards preference to local manufactures, evident by PGCIL making it mandatory to have 50% local manufacturing content, a qualification to bid for 765 KV transformers. Emco is likely to benefit from the higher capex and the policy shift.

PGCIL: 12th Plan Transmission capacity addition plans	
Transmission Lines(Ckm)	54,000-66,000
600 KV/800KV HVDC	4,000-6,000
765 KV AC	25,000-30,000
400 KV AC	25,000-30,000
New substations (Nos.)	75-90
765/400 KV	25-30
400/200/132 KV	50-60
1200/400 KV	1-2
Transformation capacity(MVA)	130,000-150,000
765/400KV	90,000-100,000
400/200/132 KV	40,000-50,000

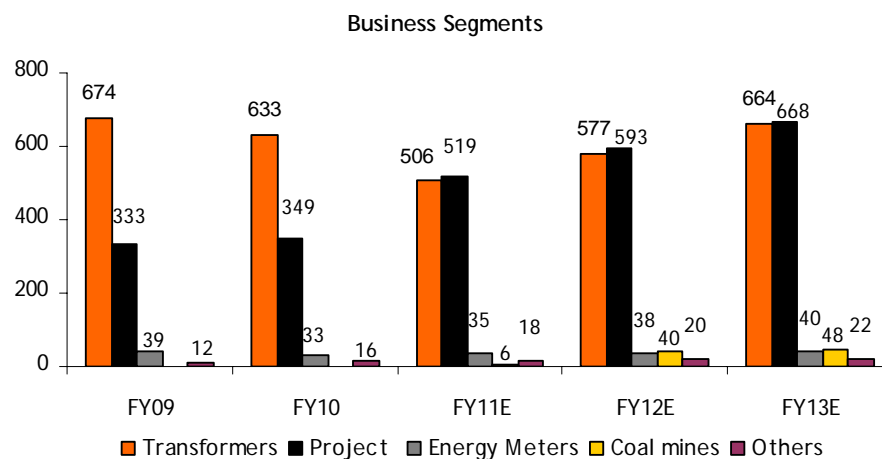
Source: PGCIL, KRChoksey Research

Q3FY11 Result Highlights

- Sales grew by 46% YoY to ₹ 303.7 crore, largely driven by improved execution in the project business. Sales mix is Projects (64%), Transformer (34%) and Meters (2%)
- EBITDA margins declined sharply by 480 bps YoY on account of steep rise in commodity prices and company's exposure to fixed price contracts.
- PAT declined by a whopping 45.6% YoY driven down by a sharp rise in Interest cost (48.2 % YoY).
- EMCO received orders to the tune of ₹ 250 crore during the quarter and current order book stands at ₹ 910 Crore. Composition of order book is Projects (67%), Transformers (31 %) and Meters (2%).
- Company reported a positive EBITDA (₹ 24.2) after registering losses in last 2 quarters. Margins in Transformer, Projects and Meters segment were 14%, 4% and 3%, respectively.
- EMCO received order enquiries of around ₹ 6,000 crore during the quarter after a lull in first 2 quarters.

Particulars	Q3FY11	Q2FY11	QoQ	Q3FY10	YoY	Remarks
Net sales	303.7	290.2	4.7%	208.1	46.0%	Driven by the improved execution in Project business
Other Operating Income	0.0	0.0	NA	0.0	NA	
Total Operating Income	303.7	290.2	4.7%	208.1	46.0%	
Expenditure :	279.5	317.6	-12.0%	181.5	54.0%	
(Inc)/Dec in stock	4.7	-1.9	-347.6%	-6.1	-177.5%	
Raw Material Cost	240.0	280.4	-14.4%	159.8	50.1%	Propelled by the steep rise in commodity prices
Employee Cost	11.8	14.8	-20.8%	11.7	0.4%	
Other Expenditure	23.1	24.4	-5.2%	16.1	43.5%	
EBITDA	24.2	-27.4	-188.3%	26.6	-8.9%	
Depreciation	4.5	4.6	-1.3%	4.6	-2.3%	
EBIT	19.7	-32.0	-161.6%	22.0	-10.3%	
Interest Expense	11.5	11.2	2.8%	7.8	48.2%	On account of rise in interest rates
Other Income	0.1	0.0	169.0%	0.3	-53.3%	
PBT	8.3	-43.1	-119.2%	14.5	-42.7%	
Tax	2.8	-14.5	-119.5%	4.4	-35.9%	
PAT	5.5	-28.6	-119.1%	10.0	-45.6%	
EPS	0.8	-4.6	-118.2%	1.7	-50.9%	
Operating Margin	8.0%	-9.4%	1,741 bps	12.8%	-480 bps	Marred by the sharp rise in commodity prices and cost over runs
Net profit margin	1.8%	-9.9%	1,165 bps	4.8%	-303 bps	Declined in line with EBITDA margins and rising interest rates

Segmental revenue:



Source: Capitaline, KRChoksey Research

**Technicals**

Last Price	58.60
14 day EMA	60.80
50 day EMA	63.45
C 200 day EMA	67.70

The stock is moving downwards. The support for the stock exists at around 56 levels. The MACD indicator for the stock is moving downwards in negative zone. Investors can buy the stock at declines.

**Disclaimer :**

This publication has been prepared solely for information purpose and does not constitute a solicitation to any person to buy or sell a security. While the information contained therein has been obtained from sources believed to be reliable, investors are advised to satisfy themselves before making any investments. Kisan Ratilal Choksey Shares & Sec Pvt Ltd., does not bear any responsibility for the authentication of the information contained in the reports and consequently, is not liable for any decisions taken based on the same. Further, KRC Research Reports only provide information updates and analysis. All opinion for buying and selling are available to investors when they are registered clients of KRC Investment Advisory Services. As a matter of practice, KRC refrains from publishing any individual names with its reports. As per SEBI requirements it is stated that, Kisan Ratilal Choksey Shares & Sec Pvt Ltd., and/or individuals thereof may have positions in securities referred herein and may make purchases or sale thereof while this report is in circulation.



Kisan Ratilal Choksey Shares and Securities Pvt. Ltd.
1102, Stock Exchange Tower, Dalal Street, Mumbai 400 001.
Head-Off Phone : 91-22-66535000 Fax : 66338060
Branch-Off Phone : 91-22-66965555 Fax : 66919576

Members: BSE & NSE
www.krchoksey.com