

Emco

Q3 slumps but outlook remains healthy.

Emco's third-quarter results are below estimates on all counts. The topline was flat YoY at Rs 2.1bn, 15% below our forecast due to sluggish execution in the projects division. The EBITDA margin contracted 50bps YoY and while the company managed to show a 23% increase in net profit to Rs 101mn (owing to reduced borrowing costs), it missed our target of Rs 123mn. On the positive side, Emco's order book remains healthy at Rs 15bn (1.4x FY10E sales). We expect project execution to gather momentum in the coming quarters. We maintain our Buy rating on the stock.

Flat sales growth: EMCO has reported a topline of Rs 2.1bn for Q3FY10, which is flat YoY and 15% below our estimate on account of slow execution in the projects division. Revenues from this division slipped 17% YoY to Rs 708mn. The transformer business, however, reported strong growth of 19% YoY to Rs 1.3bn, led by a 24% increase in segmental volumes to 2,800mva. On the other hand, the meters division registered a sharp volume decline of 60% YoY to Rs 42mn.

EBITDA margin dips 50bps: Operating profit for the quarter decreased 4% YoY to Rs 266mn, with a margin contraction of 52bps to 12.8% as the margins in the projects division slipped. The transformer, meter and project businesses recorded margins of 16% (versus 15.5% in Q3FY09), 11% (18%) and 9% (10%) respectively. Emco's raw material cost to sales ratio increased to 73.9% in Q3FY10, up 220bps YoY.

PAT up 23%: PAT increased 23% YoY to Rs 101mn in spite of a 15% increase in depreciation, as interest cost declined 33% to Rs 78mn. A favourable interest rate environment saw borrowing costs decline YoY.

Steady order position: As at the end of Q3FY10, Emco's order book stood at Rs 15bn (1.4x FY10E sales). The projects segment contributed 66% of the order book (~11,000mva), transformers 32% and meters 2%.

Estimates pared; maintain Buy: The stock is trading at 8.8 and 7x FY11E and FY12E earnings respectively. We have downgraded our FY10 and FY11 estimates by ~15% and 11% respectively to factor in the weak quarterly performance. Our target price, however, remains unchanged at Rs 106 as we have lowered our target multiple for the stock to 8x and rolled forward our valuations to FY12. We maintain a Buy rating on Emco.

Financial highlights

(Rs mn)	FY09	FY10E	FY11E	FY12E
Revenue	9,963	9,956	12,170	15,015
Growth (%)	5.5	(0.1)	22.2	23.4
Adj net income	532	518	680	864
Growth (%)	(17.8)	(2.8)	31.3	27.1
FDEPS (Rs)	9.0	8.0	10.4	13.2
Growth (%)	(18.3)	(11.7)	30.7	27.1

Profitability and return ratios

(%)	FY09	FY10E	FY11E	FY12E
EBITDA margin	11.6	10.2	10.2	10.2
EBIT margin	10.9	9.4	9.4	9.5
Adj PAT margin	3.4	5.0	5.1	5.2
ROE	22.3	30.8	29.0	26.9
ROIC	22.6	22.6	23.4	23.0
ROCE	16.7	23.2	22.8	22.2

What's New? Target Rating Estimates

CMP	TARGET	RATING	RISK
Rs 91	Rs 106	BUY	HIGH

BSE	NSE	BLOOMBERG
504008	EMCO	EMCO IN

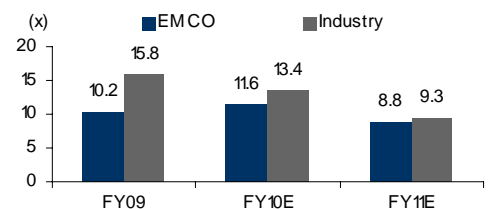
Company data

Market cap (Rs mn / US\$ mn)	5,428/117
Outstanding equity shares (mn)	59
Free float (%)	66.6
Dividend yield (%)	1.5
52-week high/low (Rs)	109 / 23
2-month average daily volume	455,466

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
EMCO	91	0.8	(0.4)	2.0
BSE Cap Gds	12,961	(7.5)	(1.5)	2.4
Sensex	16,307	(6.1)	0.1	6.4

P/E comparison



Valuation matrix

(x)	FY09	FY10E	FY11E	FY12E
P/E @ CMP	10.2	11.6	8.8	7.0
P/E @ Target	11.7	13.3	10.2	8.0
EV/EBITDA @ CMP	6.1	6.6	5.4	4.4





Result highlights

Fig 1 - Actual vs estimated performance

(Rs mn)	Actual	Estimate	% Variance
Net sales	2,081	2,460	(15.4)
EBITDA	266	320	(16.8)
EBITDA Margin (%)	12.8	13.0	(21bps)
Adj net income	101	123	(17.9)
FDEPS (Rs)	1.7	2.1	(17.9)

Source: RHH

Sales below estimates due to slower execution in projects segment

Fig 2 - Quarterly performance

(Rs mn)	Q3FY10	Q3FY09	% Chg YoY	Q2FY10	% Chg QoQ
Net sales	2,081	2,079	0.1	2,014	3.3
Expenditure	1,754	2,000	(12.3)	1,674	4.8
EBITDA	266	277	(3.8)	260	2.3
Other income	3	-	-	3	-
Interest	78	116	(32.7)	78	(0.2)
Depreciation	46	40	15.3	44	4.0
PBT	145	121	19.6	141	2.7
Tax	44	39	11.9	48	(7.3)
PAT	101	82	23.3	94	7.7
EBITDA margin (%)	12.8	13.3	(52bps)	12.9	(13bps)
EPS (Rs)	1.7	1.4	23.3	1.6	7.7

Source: Company, RHH

33% YoY decline in interest cost aided PAT growth

Fig 3 - Revised estimates

Key parameters (Rs mn)	FY10E			FY11E		
	Old	New	% Chg	Old	New	% Chg
Revenue	11,230	9,956	(11.3)	13,893	12,170	(12.4)
EBITDA margin (%)	13.0	13.0	0bps	12.9	12.9	0bps
Net profit	1,460	1,294	(11.3)	1,792	1,570	(12.4)
FDEPS (Rs)	607	518	(14.7)	768	680	(11.5)

Source: RHH

Estimates cut to factor in poor Q3 performance



Standalone financials

Profit and Loss statement

Y/E March (Rs mn)	FY09	FY10E	FY11E	FY12E
Revenues	9,963	9,956	12,170	15,015
Growth (%)	5.5	(0.1)	22.2	23.4
EBITDA	1,383	1,294	1,570	1,937
Growth (%)	7.0	(6.4)	21.3	23.4
Depreciation & amortisation	164	177	187	197
EBIT	1,220	1,118	1,383	1,740
Growth (%)	2.1	(8.4)	23.8	25.8
Interest	415	377	413	493
Other income	2	35	48	47
EBT	806	775	1,018	1,293
Income taxes	273	258	338	430
Effective tax rate (%)	33.8	33.3	33.2	33.2
Extraordinary items	-	980	-	-
Min into / inc from associates	-	-	-	-
Reported net income	533	1,498	680	864
Adjustments	1	980	-	-
Adjusted net income	532	518	680	864
Growth (%)	(17.8)	(2.8)	31.3	27.1
Shares outstanding (mn)	58.6	65.1	65.1	65.1
FDEPS (Rs) (adj)	9.0	8.0	10.4	13.2
Growth (%)	(18.3)	(11.7)	30.7	27.1
DPS (Rs)	1.4	3.0	1.0	2.0

Cash flow statement

Y/E March (Rs mn)	FY09	FY10E	FY11E	FY12E
Net income + Depreciation	697	1,674	866	1,061
Non-cash adjustments	14	(924)	(54)	52
Changes in working capital	(1,574)	(910)	(1,187)	(1,525)
Cash flow from operations	(863)	(160)	(375)	(412)
Capital expenditure	(950)	(200)	(200)	(200)
Change in investments	-	980	-	-
Other investing cash flow	(5)	(5)	80	-
Cash flow from investing	(955)	775	(120)	(200)
Issue of equity	(215)	351	-	65
Issue/repay debt	467	(215)	865	597
Dividends paid	(71)	(57)	(183)	(74)
Other financing cash flow	-	-	-	-
Change in cash & cash eq	(1,636)	695	187	(24)
Closing cash & cash eq	478	1,173	1,360	1,336

Economic Value Added (EVA) analysis

Y/E March	FY09	FY10E	FY11E	FY12E
WACC (%)	14.3	14.1	13.6	13.8
ROIC (%)	13.5	9.8	10.7	11.7
Invested capital (Rs mn)	7,149	8,050	9,214	10,698
EVA (Rs mn)	(54)	(349)	(272)	(227)
EVA spread (%)	(0.8)	(4.3)	(3.0)	(2.1)

Balance sheet

Y/E March (Rs mn)	FY09	FY10E	FY11E	FY12E
Cash and cash eq	478	1,173	1,360	1,336
Accounts receivable	4,981	4,978	6,085	7,507
Inventories	1,799	2,766	3,381	4,171
Other current assets	1,245	1,245	1,521	1,877
Investments	134	134	134	134
Gross fixed assets	3,335	3,535	3,735	3,935
Net fixed assets	2,583	2,606	2,619	2,622
CWIP	50	50	50	50
Intangible assets	5	0	-	-
Deferred tax assets, net	(50)	(78)	(113)	(158)
Other assets	-	-	-	-
Total assets	11,225	12,874	15,037	17,539
Accounts payable	-	-	-	-
Other current liabilities	3,598	3,651	4,462	5,505
Provisions	93	220	100	112
Debt funds	3,537	3,322	4,187	4,785
Other liabilities	-	-	-	-
Equity capital	117	130	130	195
Reserves & surplus	3,880	5,550	6,153	6,891
Shareholder's funds	3,997	5,681	6,284	7,087
Total liabilities	11,225	12,874	15,037	17,539
BVPS (Rs)	70.2	89.2	98.5	111.8

Financial ratios

Y/E March	FY09	FY10E	FY11E	FY12E
Profitability & Return ratios (%)				
EBITDA margin	13.9	13.0	12.9	12.9
EBIT margin	12.2	11.2	11.4	11.6
Net profit margin	5.3	5.2	5.6	5.8
ROE	13.7	10.7	11.4	12.9
ROCE	11.1	9.5	10.0	10.9
Working Capital & Liquidity ratios				
Receivables (days)	169	183	166	165
Inventory (days)	78	110	121	121
Payables (days)	130	132	132	132
Current ratio (x)	2.4	2.8	2.8	2.7
Quick ratio (x)	1.4	1.4	1.4	1.4
Turnover & Leverage ratios (x)				
Gross asset turnover	3.5	2.9	3.3	3.9
Total asset turnover	0.9	0.8	0.9	0.9
Interest coverage ratio	2.9	3.0	3.3	3.5
Adjusted debt/equity	0.9	0.6	0.7	0.7
Valuation ratios (x)				
EV/Sales	0.9	0.9	0.7	0.6
EV/EBITDA	6.1	6.6	5.4	4.4
P/E	10.2	11.6	8.8	7.0
P/BV	1.3	1.0	0.9	0.8



Quarterly trend

Particulars	Q3FY09	Q4FY09	Q1FY10	Q2FY10	Q3FY10
Revenue (Rs mn)	2,079	3,743	1,926	2,014	2,081
YoY growth (%)	(14.6)	9.4	5.1	(12.7)	0.1
QoQ growth (%)	(9.8)	80.0	(48.5)	4.6	3.3
EBITDA (Rs mn)	277	561	252	260	266
EBITDA margin (%)	13.3	15.0	13.1	12.9	12.8
Adj net income (Rs mn)	82	238	81	94	101
YoY growth (%)	(45.8)	(17.4)	(19.4)	(17.0)	23.3
QoQ growth (%)	(27.5)	190.4	(65.9)	15.7	7.7

DuPont analysis

(%)	FY08	FY09	FY10E	FY11E	FY12E
Tax burden (Net income/PBT)	68.0	66.0	66.7	66.8	66.8
Interest burden (PBT/EBIT)	79.7	66.1	69.4	73.6	74.3
EBIT margin (EBIT/Revenues)	12.6	12.2	11.2	11.4	11.6
Asset turnover (Revenues/Avg TA)	102.5	91.4	82.6	87.2	92.2
Leverage (Avg TA/Avg equitiy)	264.3	274.0	249.0	233.3	243.6
Return on equity	18.6	13.4	10.7	11.4	12.9

Company profile

Emco is the third largest manufacturer of transformers in India and a leading player in electronic energy meters and turnkey electrical projects up to 400kV. Its business is divided into three segments: transformers, meters and projects, with an installed capacity of 20,000mva. Transformers contribute ~65% to total revenue. The projects division contributes ~30% to revenue, wherein Emco undertakes transmission projects up to 400kV along with substation projects.

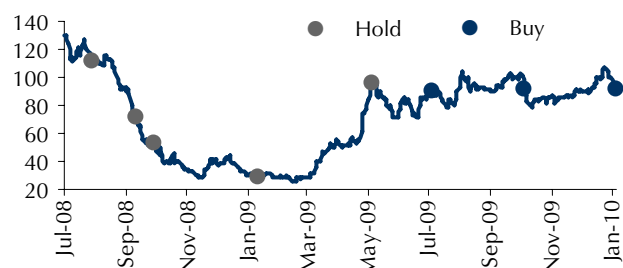
Shareholding pattern

(%)	Jun-09	Sep-09	Dec-09
Promoters	33.4	33.4	33.4
FIIIs	4.7	5.3	9.2
Banks & FIIs	15.0	13.0	17.4
Public	46.9	48.3	40.0

Recommendation history

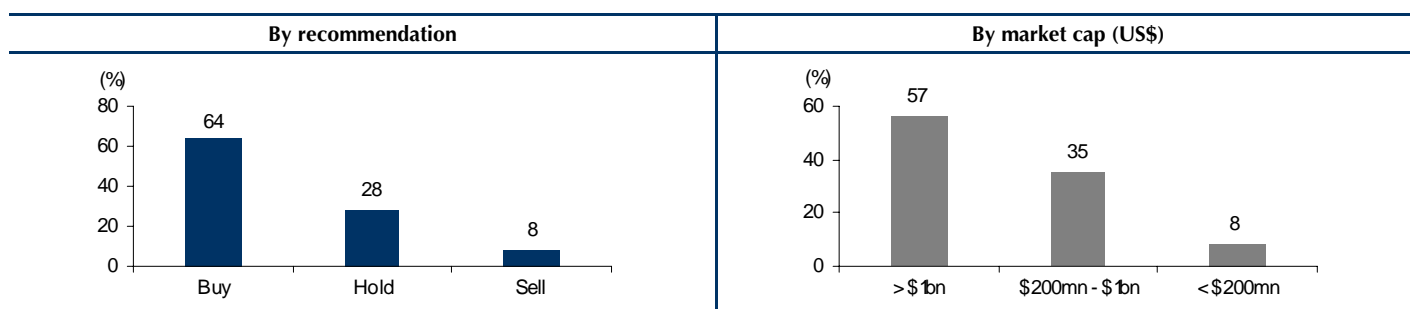
Date	Event	Reco price	Tgt price	Reco
21-Aug-08	RHH Compendium	112	129	Hold
6-Oct-08	Quarterly Preview	71	103	Hold
23-Oct-08	Results Review	53	63	Hold
2-Feb-09	Results Review	30	35	Hold
29-May-09	Results Review	96	95	Hold
28-Jul-09	Results Review	91	110	Buy
29-Oct-09	Results Review	92	106	Buy
28-Jan-10	Results Review	91	106	Buy

Stock performance





Coverage Profile



Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and -5%
Sell	Less than -5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

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