

May 31, 2010

REDUCE

Price Rs 78	Target Price Rs 82
Sensex	16,863

Price Performance

(%)	1M	3M	6M	12M
Absolute	(16)	(3)	(5)	(19)
Rel. to Sensex	(14)	(6)	(7)	(32)

Source: Bloomberg

Stock Details

Sector	Transformer
Reuters	EMCO.BO
Bloomberg	EMCO@IN
Equity Capital (Rs mn)	115
Face Value(Rs)	2
No of shares o/s (mn)	57
52 Week H/L	109/68
Market Cap (Rs bn/USD mn)	4/86
Daily Avg Volume (No of sh)	412971
Daily Avg Turnover (US\$m)	0.8

Shareholding Pattern (%)

	M'10	D'09	S'09
Promoters	36.7	33.4	33.4
FII/NRI	9.5	9.2	6.3
Institutions	16.6	17.4	13.0
Private Corp	18.4	19.8	24.5
Public	18.7	20.2	22.8

Source: Capitaline

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Negative margin in projects, maintain 'REDUCE'

Emco's net profit of Rs78mn (-67% yoy) was way below estimates mainly due to negative EBITDA margins (-2.5%) in the projects business. We believe Emco has bid aggressively in the projects business especially for 765KV order from PGCIL. This has led to dismal performance in Q4FY10, since part of the orders were executed in the quarter. The overall revenues were flat yoy to Rs3.8bn with transformers declining by 9% and projects segment reported growth of 26% yoy. The EBITDA margins stood at 8.6% (down 640 bps yoy) and absolute EBITDA declined by 42% yoy. We expect pressure on margins going forward for at least 3-4 quarters on the back of (1) low margin project orders still under execution, (2) high base of EBITDA margins (15.5% in FY10) in the transformer business and (3) project business likely to garner higher share of revenues putting pressure on blended margins. For FY10, Emco has reported standalone adjusted earnings of Rs5.4/Share (loss of Rs58mn or 0.9/Share in subsidiaries in FY10). We reduce our FY11E standalone estimates by 34% to Rs7.3/Share & introduce FY12E earnings of Rs9.4/Share. We have not considered any contribution from coal trading in our numbers. At CMP of Rs78, the stock is trading at 10.7x FY11E earnings, 4.8x FY11E EBITDA and 0.8x FY11E Book Value (ROE of 8% in FY11E). On the back of (1) pressure on realizations and margins, (2) very high working capital cycle (175 days), (3) declining and low order book (Rs12bn) visibility of 1x and (4) low ROE - we maintain 'REDUCE' rating on the stock with target price unchanged of Rs82/Share.

Negative margins in the projects business

Though the projects business revenues grew by 26% yoy in Q4FY10, hinting at pick up in execution but the negative EBITDA margins of -2.5% in the segment had impacted Q4FY10 performance of Emco. We believe Emco has been bidding aggressively in the projects business especially for 765KV order from PGCIL. This has led to dismal performance in Q4FY10, since part of the order was executed in the quarter.

In the transformer business, inspite of realization decline to Rs0.38mn/MVA (-38% yoy), revenues just declined by 9% to Rs2.15bn, thanks to 57% yoy volume growth to 5700MVA. The overall EBITDA margins stood at 8.6% (down 640 bps yoy) and absolute EBITDA declined by 42% yoy. The higher effective tax rate (49%) led to net profit decline of 67% to Rs78mn, way below expectations.

Expect pressure on margins to continue

The current order book stands at Rs12.0bn (projects - Rs7.9bn, transformers - Rs2.2bn, meters - Rs0.30bn). This is a decline of 22% compared with order book at the end of FY09. Also the order inflows declined by 56% in FY10, suggesting that there is a definite slowdown. Thus, we expect pressure on margins in the new orders as the impact of competition kicks in. Further, the margins are likely to be under pressure on the back of (1) low margin project orders still under execution, (2) high base of EBITDA margins (15.5% in FY10) in the transformer business and (3) project business likely to garner higher share of revenues putting pressure on blended margins.

Financial Snapshot

Rs Mn

YE-Mar	Net Sales	EBITDA (Core)	EBITDA (%)	APAT	AEPS (Rs)	EV/ EBITDA	P/BV	Div Yld (%)	RoE (%)	P/E
FY2009	9,963	1,383	13.9	523	8.9	4.2	1.0	1.8	12.8	8.8
FY2010P	9,786	1,102	11.3	354	5.4	5.3	0.9	1.7	6.9	14.4
FY2011E	11,575	1,217	10.5	474	7.3	4.8	0.8	1.4	7.9	10.7
FY2012E	13,749	1,441	10.5	615	9.4	4.1	0.8	1.8	9.5	8.3

Reduce FY11E estimates; maintain 'REDUCE'

For FY10, Emco has reported standalone adjusted earnings of Rs5.4/Share (loss of Rs58mn or 0.9/Share in subsidiaries in FY10). We reduce our FY11E estimates by 34% to Rs7.3/Share & introduce FY12E earnings of Rs9.4/Share. In FY11E and FY12E respectively, we have factored - (1) transformer volume growth of 14% & 15% and EBITDA margins of 14%, (2) projects revenue growth of 25% & 20% and EBITDA margins of 5.0% & 5.5%. We have not considered any contribution from coal trading in our numbers. At CMP of Rs78, the stock is trading at 10.7x FY11E earnings, 4.8x FY11E EBITDA and 0.8x FY11E Book Value (ROE of 8% in FY11E). On the back of (1) pressure on realizations and margins, (2) very high working capital cycle (175 days), (3) declining and low order book (Rs12bn) visibility of 1x and (4) low ROE - we maintain 'REDUCE' rating on the stock with target price unchanged of Rs82/Share.

	Q1FY10	Q2FY10	Q3FY10	Q4FY10	FY10
Sales Break Up					
Transformers	1310	1370	1124	2150	5953
Projects	539	564	853	1560	3516
Meters	77	81	104	50	312
Order Book Break Up					
Transformers	5418	5440	4950	4000	4000
Projects	9482	10240	9675	7909	7909
Meters	151	320	375	325	325

Key Quarterly Financials

	Q4 10	Q4 09	YoY	Q3 10	QoQ
Net Sales	3764	3743	1%	2081	81%
Raw Materials	2621	2331	12%	1598	64%
Stock Adjustment	424	499		-61	
Employee Cost	170	103	64%	117	45%
Other Expenses	226	249	-9%	161	40%
EBIDTA	323	561	-42%	266	22%
<i>EBITDA Margins</i>	<i>8.6%</i>	<i>15.0%</i>	<i>-640</i>	<i>12.8%</i>	<i>-419</i>
Depreciation	45	48	-6%	46	-3%
EBIT (Core Business)	278	513	-46%	220	27%
Income From Investments	0	0		3	
Income From Other Sources	0	0		0	
EBIT	278	513	-46%	222	25%
Interest Expense	126	139		78	
Extra Ordinary Expense	1	1		0	
Extra Ordinary Income	0	0		0	
PBT	151	373	-59%	145	5%
Current Tax	74	137	-46%	44	67%
Deferred Tax	0	0		0	
Reported Profit	78	235	-67%	101	-22%
Tax adj. E/O Item	0	0		0	
Adjusted Profit	78	235	-67%	101	-22%
Reported Earnings	1.2	4.0	-70%	1.5	-22%
Adjusted Earnings	1.2	4.0	-70%	1.5	-22%

Key Financials**Income Statement**

Y/E, Mar (Rs. m)	FY09	FY10P	FY11E	FY12E
Net Sales	9,963	9,786	11,575	13,749
Raw Materials	7,630	7,396	8,821	10,575
Stock Adjustments	(244)	52	-	-
Employee Expenses	411	534	625	722
Power, Oil & Fuel	38	37	44	52
Selling & Admn. Expenses	457	449	531	562
Other Mfg Expenses	24	24	28	33
Repairs & Maintenance	23	26	29	32
Other Expenses	241	166	280	333
Total Expenditure	8,579	8,684	10,358	12,308
EBITDA / Operating Profit	1,383	1,102	1,217	1,441
Depreciation	164	179	201	211
EBIT (Core business)	1,220	923	1,016	1,230
Income from investments	0	7	10	10
Income from Other Sources	-	-	-	-
EBIT incl. Other Income	1,220	929	1,026	1,240
Interest Expense	415	368	308	308
Extra ordinary Items	(1)	984	-	-
PBT	803	1,545	718	932
Current Tax	273	206	244	317
Deferred Tax	-	-	-	-
FBT	8	-	-	-
PAT	523	1,339	474	615
Tax Adj. EO Items	-	985	-	-
Adjusted PAT	523	354	474	615

Cash Flow Statement

Y/E, Mar (Rs. m)	FY09	FY10P	FY11E	FY12E
PAT	523	1339	474	615
Depreciation & amortization	164	179	201	211
Deferred tax	0	0	0	0
Change in Working Cap	984	(18)	827	1,031
Operating Cash Flow	(298)	1,536	(152)	(205)
Capex	502	148	300	300
Free Cash Flow	(799)	1,388	(452)	(505)
Equity Capital	196	196	0	0
Loans	478	(1,000)	-	-
Dividend	82	103	83	108
Others	(50)	0	0	0
Net Change in Cash	(159)	480	(535)	(613)
Opening cash & equivalent	1,445	1286	1766	1231
Closing cash & equivalent	1,286	1766	1231	618

Balance Sheet

Y/E, Mar (Rs. m)	FY09	FY10P	FY11E	FY12E
Equity Share Capital	118	131	131	131
Reserves	4,082	5,696	6,087	6,594
Share Warrants	196	0	0	0
Net worth	4,396	5,827	6,217	6,724
Long term Loans	1,095	500	500	500
Short Term Loans	2,466	2,061	2,061	2,061
Loan Funds	3,561	2,561	2,561	2,561
Minority Interest	-	-	-	-
Total Liabilities	7,957	8,388	8,778	9,286
Gross Block	2,633	2,948	3,274	3,565
Less: Depreciation	807	986	1,187	1,398
Net Block	1,826	1,961	2,087	2,167
Capital Work in Progress	234	190	164	172
Goodwill	-	-	-	-
Investments	122	(0)	(0)	(0)
Current Assets	10,190	9,986	11,358	12,648
Inventories	1,756	1,530	1,943	2,309
Debtors	4,700	4,770	5,600	6,653
Cash & Bank	1,286	1,766	1,231	618
Loans & advances	2,447	1,920	2,583	3,068
Current Liabilities & Prov.	4,215	3,550	4,630	5,501
Net Current Assets	5,975	6,436	6,728	7,146
Miscellaneous Expenditure	-	-	-	-
Deferred Tax	(200)	(200)	(200)	(200)
Total Assets	7,957	8,388	8,778	9,286

Key Ratios

Y/E, Mar (Rs. m)	FY09	FY10P	FY11E	FY12E
Profitability (%)				
EBITDA Margin	13.9	11.3	10.5	10.5
Adj. PAT Margin	5.2	3.6	4.1	4.5
ROCE	10.9	7.2	7.9	9.1
ROE	12.8	6.9	7.9	9.5
Per Share Data (Rs)				
Adj. EPS	8.9	5.4	7.3	9.4
Adj. CEPS	11.7	8.2	10.4	12.7
BVPS	74.7	89.4	95.4	103.2
DPS	1.4	1.4	1.1	1.4
Valuations (X)				
PER	8.8	14.4	10.7	8.3
CPER	6.7	9.5	7.5	6.2
P/BV	1.0	0.9	0.8	0.8
EV / Sales	0.6	0.6	0.5	0.4
EV / EBITDA	4.2	5.3	4.8	4.1
Dividend Yield (%)	1.8	1.7	1.4	1.8
Turnover Days (x)				
Working Capital Cycle	154	175	160	160
Debtors Cycle	163	177	177	177
Inventory Cycle	57	61	61	61
Gearing Ratios				
Net Debt / Equity	0.5	0.1	0.2	0.3
Total Debt to Equity	0.8	0.4	0.4	0.4

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