

Awaiting Details, Retain 'Under Review'

February 2, 2010

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Price	Target Price
Rs83	Rs81

Sensex	16,356
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Price Performance

(%)	1M	3M	6M	12M
Absolute	(4)	(2)	5	129
Rel. to Sensex	1	(4)	1	29

Source: Capitaline

Stock Details

Sector	Material Handling
Reuters	ELCN.BO
Bloomberg	ELCN@IN
Equity Capital (Rs mn)	186
Face Value(Rs)	2
No of shares o/s (mn)	93
52 Week H/L	111/24
Market Cap (Rs bn/USD mn)	8/165
Daily Avg Volume (No of sh)	795698
Daily Avg Turnover (US\$m)	1.5

Shareholding Pattern (%)

	D'09	S'09	J'09
Promoters	45.7	45.7	45.7
FII/NRI	3.8	3.9	3.7
Institutions	12.3	13.4	15.9
Private Corp	7.2	6.9	6.1
Public	31.0	30.1	28.5

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Elecon Engineering (EEL) Q3FY10 performance was below estimates – indicating the impact of low order backlog and high exposure to Process Industries - which is yet to report meaningful traction. The headline numbers for Q3FY10 performance are (1) revenues grew below expectations at 2.3% yoy to Rs2512 mn (2) operating profits declined 13.4% yoy to Rs387 mn and (3) net profits declined by 4% yoy to Rs121 mn. At segment level, performance was below expectation - (1) Material Handling (MHE) division reported muted revenue growth at 4.3% yoy to Rs1498 mn (2) Transmission Equipment (TE) division declined 2% yoy to Rs1052 mn. Order backlog declined for the fifth straight quarter to Rs13.6 bn and visibility deteriorated to 1.3X FY10E revenues

We continue to maintain our positive bias on the MHE division with its high dependence on 'Power' vertical and expect EEL to witness strong order inflows in ensuing quarters. We maintain our earnings estimates of Rs7.1/Share and Rs9.1/Share for FY10E and FY11E respectively. Though, current valuations at 8.2X FY11E earnings are attractive – there is impending corporate and group restructuring whose impact cannot be ascertained. We retain our 'Under Review' rating and wait until clarity emerges on the corporate restructuring and subsequent impact on earnings estimates.

Below estimates – Revenues up 2% yoy, Net profit down 4% yoy

EEL's Q3FY10 performance was below estimates – indicating the impact of low order backlog and high exposure to Process Industries, which is yet to report meaningful traction. The headline numbers for Q3FY10 performance are (1) revenues grew below expectations at 2.3% yoy to Rs2512 mn – due to muted performance in MHE (+4.3% yoy) and TE division (-1.7% yoy) (2) 280 bps yoy decline in operating margins to 17.4% - attributed to high raw material costs (3) Operating profits declined 13.4% yoy to Rs387 mn – below expectation and (4) Net profits fell 3.7% yoy to Rs121 mn – below expectation.

MHE division – Muted revenue growth at 4% yoy

MHE division was saddled with 58% yoy decline in order inflows and 6% qoq decline in order backlog – despite high exposure to the Power sector. MHE reported muted revenue growth at 4.3% yoy to Rs1498 mn - below our estimates. The book to bill ratio declined to 1.7X FY10E MHE revenues - lowest in the past 2 years. Segment EBIT grew 11.7% yoy to Rs181 mn led by 80 bps yoy expansion in EBIT margins – yet remain below estimates. We believe that, traction in order inflows and revenue booking will remain critical to achieve FY11E estimates.

TE division – Revenues decline 2% yoy, but up 12% qoq

Led by sustained pick up in order inflows (up 16.5% yoy), TE division's performance improved sequentially in Q3FY10. However, order inflows remained under pressure on qoq basis – down 2.5% qoq. TE division revenues declined 1.7% yoy to Rs1052 mn (up 11.6% qoq). Segment EBIT declined 7.7% yoy to Rs173 mn led by 110 bps yoy drop in EBIT margins to 16.5%.

Financial Snapshot:

Rs Mn

	Net Sales	EBITDA (Core)	EBITDA (%)	APAT	AEPS (Rs)	EV/ EBITDA	P/BV	Div Yld (%)	RoE (%)	P/E
FY08	8,264	1,385	16.8	663	7.1	7.9	2.9	2.0	31.2	10.5
FY09	9,551	1,764	18.5	613	6.6	7.0	2.5	2.0	24.0	11.4
FY10E	10,612	1,768	16.7	661	7.1	6.9	2.1	2.0	21.9	10.5
FY11E	12,461	2,065	16.6	842	9.1	6.1	1.8	2.0	23.2	8.2

Order backlog at Rs13.6 bn – visibility deteriorates to 1.3X revenues

EEL's order backlog declined for the fifth straight quarter to Rs13.6 bn – continues to disappoint on order inflow front. EEL failed to show noteworthy traction in order inflows despite high exposure to power sector (at 70%) and Rs40 bn order bid pipeline at end of H1FY10. Infact, order inflows in MHE division declined 58% yoy to Rs7.8 bn. On the contrary, TE division, despite its exposure to Process industries has maintained its order inflows at the pre-crisis level – up 16% yoy to Rs1.2 bn. The current order backlog of Rs13.6 bn renders low visibility at 1.3X FY10E revenues.

Retain the stock 'Under Review'

We continue to maintain our positive bias on the MHE division with its high dependence on 'Power' vertical and expect EEL to witness strong order inflows in ensuing quarters. We maintain our earnings estimates of Rs7.1/Share and Rs9.1/Share for FY10E and FY11E respectively. Though, current valuations at 8.2X FY11E earnings are attractive – there is impending corporate and group restructuring whose impact cannot be ascertained. We retain our 'Under Review' rating and wait until clarity emerges on the corporate restructuring and subsequent impact on earnings estimates.

Corporate restructuring on the anvil, await granular details

EEL has embarked upon a corporate restructuring plan covering Elecon Group - with specific emphasis on (1) elimination of cross-holdings, create simple holding structure, (2) consolidate promoter holding and enhance share-holder value (3) increase financial flexibility and reduce leverage on books and (4) increase group level synergies. At this stage, we are unable to determine the impact of restructuring on interest of minority shareholders- shall wait for granular details and review our rating thereafter.

Key Financials

YE Mar (Rs Million)	Q3FY10	Q3FY09	YoY Gr(%)	Q2FY10	QoQ Gr(%)
Net Sales	2,512	2,457	2.3	2,551	-1.5
Expenses	2,126	2,010	5.8	2,182	-2.6
Raw Materials	1,713	1,554	10.2	1,801	-4.9
% Of Sales	68.2	63.3	-	70.6	-
Other expenditure	282	324	-12.9	262	7.5
% Of Sales	11.2	13.2	-	10.3	-
Employee Cost	131	132	-1.1	119	10.0
% Of Sales	5.2	5.4	-	4.7	-
Operating Profit	387	447	-13.4	369	4.9
Operating Margin (%)	15.4	18.2	-280 bps	14.5	90 bps
Other Income	3	(67)	-104.2	6	-55.0
Interest	113	141	-19.8	134	-15.4
Depreciation	83	56	47.8	78	6.3
Profit Before Tax	193	183	5.7	163	18.6
Tax	72	57	26.5	55	30.9
Reported Net Profit	121	126	-3.7	108	12.3
Net Margin (%)	4.8	5.1	-30 bps	4.2	60 bps
Adjusted Net Profit	77	-	NA	-	NA
Earnings	198	126	57.9	108	84.1

Segment Results

YE Mar (Rs Million)	Q3FY10	Q3FY09	YoY Gr(%)	Q2FY10	QoQ Gr(%)
Segment Revenues					
Material Handling Equipment	1,498	1,437	4.3	1,659	-9.7
Transmission Equipment	1,052	1,071	-1.7	943	11.6
Less- Inter-segment Revenue	52	52	0.6	51	2.5
Net Revenues	2,499	2,457	1.7	2,551	-2.0

Segment Results

Material Handling Equipment	181	162	11.7	189	-4.1
Transmission Equipment	173	188	-7.7	157	10.1
Total	354	350	1.3	346	2.3
Less- Interest Expense	113	142	-20.0	134	-15.4
Less- Unallocated Exp / (Inc)	(30)	33	-191.0	49	-160.5
PBT	271	175	54.6	163	66.1

Segment Margins

Material Handling Equipment	12.1	11.3	80 bps	11.4	70 bps
Transmission Equipment	16.5	17.5	-110 bps	16.7	-20 bps
Total	13.9	13.9	-10 bps	13.3	60 bps

Order Book Details

(Rs Million)	Q3FY10	Q3FY09	YoY Gr(%)	Q2FY10	QoQ Gr(%)
Order Backlog Details					
Material Handling Equipment	11,050	15,700	-29.6	11,770	-6.1
Transmission Equipment	2,570	2,420	6.2	2,470	4.0
Total Order Book	13,620	18,120	-24.8	14,240	-4.4

Key Financials

Income Statement

Y/E, Mar (Rs. mn)	FY08	FY09	FY10E	FY11E
Net Sales	8,264	9,551	10,612	12,461
<i>Growth</i>	14.7	15.6	11.1	17.4
Expenses	6,879	7,826	8,856	10,407
<i>Growth</i>	14.5	13.8	13.2	17.5
Raw Materials	5,301	5,944	6,732	7,905
% Of Sales	64.1	62.2	63.4	63.4
Employee Cost	344	439	525	660
% Of Sales	4.2	4.6	4.9	5.3
Manufacturing Exps	496	653	724	845
% Of Sales	6.0	6.8	6.8	6.8
Administration Exps	330	327	360	396
% Of Sales	4.0	3.4	3.4	3.2
Selling & Distribn Exps	408	463	514	600
% Of Sales	4.9	4.8	4.8	4.8
EBIDTA	1,385	1,724	1,756	2,054
<i>Growth (%)</i>	15.5	24.5	1.9	17.0
<i>EBIDTA Margin (%)</i>	16.8	18.1	16.6	16.5
Other Income	8	-99	95	95
Depreciation	142	221	253	278
Interest	274	484	590	590
PBT	977	920	1,008	1,280
Tax	315	306	336	427
Adjusted PAT	663	613	672	854
<i>Growth</i>	20.4	-7.4	9.6	27.0
<i>Net Margin (%)</i>	8.0	6.4	6.3	6.8
E/O Item	9	-64	0	0
Reported PAT	672	550	672	854

Cash Flow Statement

Y/E, Mar (Rs. mn)	FY08	FY09	FY10E	FY11E
Pre-Tax Profit	1,263	1,368	1,008	1,280
Depreciation	142	221	253	278
Other Non-cash	-274	-481	0	0
Chg in Working Capital	-1,259	-566	-174	-835
Tax Paid	-324	-259	-336	-427
Operating Cash Flow	-452	283	750	297
Capital Expenditure	-805	-1,400	-600	-500
Free Cash Flow	-1,257	-1,117	150	-203
Investments	-5	-14	0	0
Equity Capital	5	0	0	0
Loans	1,259	1,828	0	0
Dividend	-54	-162	-139	-139
Others	0	0	1	2
Net Change in Cash	-52	535	11	-342
Opening Cash Position	128	75	611	622
Closing Cash Position	75	611	622	280

Balance Sheet

Y/E, Mar (Rs. mn)	FY08	FY09	FY10E	FY11E
Equity Share Capital	186	186	186	186
Reserves	2,182	2,568	3,101	3,815
Networth	2,367	2,754	3,287	4,001
Secured Loans	3,209	5,236	5,236	5,236
Unsecured Loans	884	685	685	685
Loan Funds	4,093	5,921	5,921	5,921
Capital Employed	6,460	8,675	9,208	9,922
Gross Block	3,006	4,277	4,877	5,377
Less: Depreciation	1,234	1,448	1,701	1,979
Net Block	1,772	2,829	3,177	3,398
Capital Work In Progress	159	281	281	281
Investments	95	109	109	109
Current Assets	8,096	10,085	10,357	11,580
Inventories	2,526	4,007	3,630	4,262
Debtors	4,923	4,717	5,356	6,289
Cash & Bank	75	611	622	280
Loans & Advances	572	749	749	749
Current Liabilities & Prov	3,500	4,318	4,404	5,135
Net Current Assets	4,596	5,767	5,952	6,445
Miscellaneous Expenditure	10	17	17	17
Deferred Tax	-171	-328	-328	-328
Capital Deployed	6,460	8,675	9,208	9,922

Ratios

Y/E, Mar (Rs. mn)	FY08	FY09	FY10E	FY11E
Profitability (%)				
EBITDA Margin	16.8	18.1	16.6	16.5
Net Margin	8.0	6.4	6.3	6.8
ROCE	22.4	18.5	17.9	19.6
ROE	31.2	24.0	22.3	23.4
Per Share Data (Rs)				
EPS	7.1	6.6	7.2	9.2
CEPS	8.8	8.6	9.1	11.2
BVPS	25.5	29.7	35.4	43.1
DVPS	1.5	1.5	1.5	1.5
Valuations Ratios (X)				
PER	11.5	12.5	11.4	8.9
CPER	9.4	9.5	9.1	7.3
P/BV	3.2	2.8	2.3	1.9
EV/Sales	1.4	1.4	1.2	1.1
EV/EBIDTA	8.4	7.5	7.4	6.5
Dividend Yield (%)	1.8	1.8	1.8	1.8
Turnover (Days)				
Debtor T/o	194	184	184	184
Inventory T/o	93	125	125	125
Gearing Ratio (X)				
Net Debt / Equity	1.7	1.9	1.6	1.4
Total Debt / Equity	1.7	2.1	1.8	1.5

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