

July 30, 2010

## REDUCE

Price	Target Price
<b>Rs 67</b>	<b>Rs60</b>
<b>Sensex</b>	<b>17,868</b>

### Price Performance

(%)	1M	3M	6M	12M
Absolute	(18)	(27)	(26)	(22)
Rel. to Sensex	(21)	(29)	(32)	(34)

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	109/67
Market Cap (Rs bn/USD mn)	4/86
Daily Avg Volume (No of sh)	298009
Daily Avg Turnover (US\$m)	0.5

### Shareholding Pattern (%)

	J'10	M'10	D'09
Promoters	36.7	36.7	33.4
FII/NRI	7.5	9.5	9.2
Institutions	14.3	16.6	17.4
Private Corp	21.7	18.4	19.8
Public	19.7	18.7	20.2

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## Huge cost overruns; Maintain negative view

- Emco reported its worst ever quarter with huge cost overruns in its projects business – our sense is that cost over-runs are across the projects (including 765kv PGCIL order)
- Almost 60% of 765kv order (Rs5.5bn) still unexecuted, cost over-runs likely to continue through FY11E, with P.V.C. built in most of orders, miscalculations in quantity of input needed
- Transformer business also affected due to (1) rescheduling of deliveries from customer side, (2) competition impacting margins by 4-5% minimum and (3) payment delays
- Give benefit of doubt to management, assume positive numbers from Q2FY11 onwards, still reduction in earnings estimates by 97%/50% for FY11/12E; Maintain Reduce.

### Big negative surprise led by cost overruns

Revenues decline by 38% to Rs1.2bn, EBITDA loss of Rs256mn and net loss of Rs260mn - a big negative surprise. We believe that Emco has been aggressively bidding for transmission line towers and turnkey projects in T&D in the higher range (especially 765kv orders from PGCIL). We had highlighted earlier also that there could be a risk of very low margins in these contracts. But the reality seems to be worse. This we believe is the impact of huge cost overruns in these contracts. Though the company in its concall did not provide details but we believe that the cost overruns are likely to continue through FY11E. This is because 765kv order (45% of current project order book of Rs7.3bn) is still 60% unexecuted, likely to be executed in next three four quarters.

### Give benefit of doubt to mgmt still have to cut earnings by 97%/50%

The management in the concall has guided for a better overall FY11E (starting Q2FY11) with (1) 90% of the order book (Rs12bn) to be executed in FY11E and (2) positive numbers at the bottom line (starting Q2FY11E). Though we are not fully convinced but we give benefit of doubt to the management. We have assumed (1) revenue growth of 18% in FY11E/12E and (2) EBITDA margins of 8% in balance 9mFY11E and FY12E. Still, we have to cut our earnings by 97%/50% to Rs0.2/4.7 for FY11E/12E.

### Problems multiply - WC cycle increase; net debt increase by Rs1.7bn in just one qtr; maintain reduce with revised target of Rs60

Emco had net debt of Rs800mn at the end of FY10 which has increased to Rs2.5bn at the end of Q1FY11; a huge increase for a company with revenue of Rs1.2bn in the qtr. We believe Emco is grappling with multiple problems (1) payment delays (choice of wrong orders/customers), (2) inventory built up due to rescheduling of deliveries (choice of wrong orders/customers), (3) competition across its businesses (entering into right business at the wrong time - projects) and (4) wrong estimation of quantitative requirements of a project while bidding (talent crunch). Thus, we maintain our reduce rating on the stock with a revised price target of Rs60/share, 0.6x FY12E book value (Rs82 - earlier). On the CMP of Rs67, the stock is trading at 0.7x FY12E book value.

### Financial Snapshot

Rs Mn

YE-	Net	EBITDA			EPS	EPS	RoE	EV/		
Mar	Sales	(Core)	(%)	APAT	(Rs)	% chg	(%)	P/E	EBITDA	P/BV
FY09	9,963	1,375	13.8	524	8.9	(19.1)	13.1	7.5	4.7	0.9
FY10	9,786	1,102	11.3	355	5.4	(38.8)	26.7	3.3	4.7	0.7
FY11E	11,575	580	5.0	14	0.2	(96.1)	0.2	312.2	12.5	0.7
FY12E	13,749	1,097	8.0	309	4.7	2,109.3	5.2	14.1	7.7	0.7

Rs mn	Q1FY10	Q2FY10	Q3FY10	Q4FY10	Q1FY11	YoY (%)	QoQ (%)
<b>Revenue</b>	<b>1,926</b>	<b>2,014</b>	<b>2,081</b>	<b>3,764</b>	<b>1,188</b>	<b>-38.3</b>	<b>-68.4</b>
<b>Expenditure</b>	<b>-1,674</b>	<b>-1,754</b>	<b>-1,815</b>	<b>-3,441</b>	<b>-1,444</b>	<b>-13.8</b>	<b>-58.0</b>
as % of sales	-86.9%	-87.1%	-87.2%	-91.4%	-121.5%		
Consumption of RM	-1,437	-1,428	-1,537	-3,045	-1,109	-22.8	-63.6
as % of sales	-74.6%	-70.9%	-73.9%	-80.9%	-93.4%		
Power and Fuel	0	0	0	0	0		
as % of sales	0	0	0	0	0		
Other Mfg Expenses	0	0	0	0	0		
as % of sales	0	0	0	0	0		
Employee Cost	-99	-149	-117	-170	-156	57.6	-8.0
as % of sales	-5.1%	-7.4%	-5.6%	-4.5%	-13.1%		
Other expenditure	-138	-177	-161	-226	-179	29.4	-20.8
as % of sales	-7.2%	-8.8%	-7.7%	-6.0%	-15.1%		
<b>EBITDA</b>	<b>252</b>	<b>260</b>	<b>266</b>	<b>323</b>	<b>-256</b>	<b>-201.8</b>	<b>-179.2</b>
Depreciation	-44	-44	-46	-45	-46	6.6	3.3
<b>EBIT</b>	<b>208</b>	<b>216</b>	<b>220</b>	<b>278</b>	<b>-302</b>	<b>-245.4</b>	<b>-208.7</b>
Other Income	0	0	0	0	0		
Interest	-86	-75	-75	-125	-91	5.2	-27.7
<b>PBT</b>	<b>122</b>	<b>141</b>	<b>145</b>	<b>153</b>	<b>-393</b>	<b>-422.7</b>	<b>-357.4</b>
Tax	-41	-48	-44	-74	133	-421.8	-280.2
<b>Adjusted PAT</b>	<b>81</b>	<b>94</b>	<b>101</b>	<b>79</b>	<b>-261</b>	<b>-423.1</b>	<b>-428.9</b>
Extra ordinary items	0	985	0	-1	0		
<b>Reported PAT</b>	<b>81</b>	<b>1079</b>	<b>101</b>	<b>78</b>	<b>-261</b>	<b>-423.1</b>	<b>-434.5</b>
(Profit)/loss from JV's/Ass/MI	0	0	0	0	0		
<b>PAT after MI</b>	<b>81</b>	<b>1079</b>	<b>101</b>	<b>78</b>	<b>-261</b>	<b>-423.1</b>	<b>-434.5</b>
Reported EPS	1.2	16.6	1.5	1.2	-4.0	-423.1	-434.5

Margins (%)						(bps)	(bps)
EBIDTA	13.1	12.9	12.8	8.6	-21.5	-3461	-3013
EBIT	10.8	10.7	10.6	7.4	-25.5	-3625	-3284
EBT	6.3	70.2	6.9	4.0	-33.1	-3941	-3711
PAT	4.2	4.7	4.8	2.1	-21.9	-2612	-2404
Effective Tax rate	33.8	23.7	30.5	48.6	33.7	-10	-1485

## Financials

## Income Statement

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
<b>Net Sales</b>	<b>9,963</b>	<b>9,786</b>	<b>11,575</b>	<b>13,749</b>
Growth (%)	5.5	-1.8	18.3	18.8
<b>Expenditure</b>	<b>8,587</b>	<b>8,684</b>	<b>10,995</b>	<b>12,652</b>
Raw Materials	7,386	7,448	9,458	10,919
Construction Exp	519	510	603	648
Employee Cost	419	534	625	722
Other Exp	264	192	309	364
<b>EBITDA</b>	<b>1,375</b>	<b>1,102</b>	<b>580</b>	<b>1,097</b>
Growth (%)	6.9	-19.9	-47.4	89.2
<b>EBITDA margin (%)</b>	<b>13.8</b>	<b>11.3</b>	<b>5.0</b>	<b>8.0</b>
Depreciation	164	179	201	211
<b>EBIT</b>	<b>1,212</b>	<b>923</b>	<b>379</b>	<b>886</b>
<b>EBIT margin (%)</b>	<b>12.2</b>	<b>9.4</b>	<b>3.3</b>	<b>6.4</b>
Other Income	0	7	10	10
Interest expenses	415	368	368	428
<b>PBT</b>	<b>797</b>	<b>561</b>	<b>21</b>	<b>468</b>
Tax	273	206	7	159
Effective tax rate (%)	34.3	13.4	34.0	34.0
<b>Adjusted PAT</b>	<b>524</b>	<b>355</b>	<b>14</b>	<b>309</b>
(Profit)/loss from JV's/Ass/MI	0	0	0	0
<b>Adjusted PAT after MI</b>	<b>524</b>	<b>355</b>	<b>14</b>	<b>309</b>
Growth (%)	-19.1	-32.2	-96.1	2109.3
<b>Net Margin (%)</b>	<b>5.3</b>	<b>3.6</b>	<b>0.1</b>	<b>2.2</b>
E/O items	-1	984	0	0
<b>Reported PAT</b>	<b>523</b>	<b>1,339</b>	<b>14</b>	<b>309</b>
Growth (%)	-18.8	156.1	-99.0	2109.3

## Cash Flow

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
<b>PBT (Ex-Other income)</b>	<b>795</b>	<b>1,538</b>	<b>11</b>	<b>458</b>
Depreciation	164	179	201	211
Interest Provided	415	368	368	428
Other Non-Cash items	0	0	0	0
Chg in working cap	-984	15	-1,993	-1,448
Tax paid	-273	-203	9	-137
<b>Operating Cashflow</b>	<b>117</b>	<b>1,897</b>	<b>-1,404</b>	<b>-489</b>
Capital expenditure	-394	-270	-300	-300
<b>Free Cash Flow</b>	<b>-276</b>	<b>1,627</b>	<b>-1,704</b>	<b>-789</b>
Other income	0	7	10	10
Investments	-110	122	0	0
<b>Investing Cashflow</b>	<b>-503</b>	<b>-141</b>	<b>-290</b>	<b>-290</b>
Equity Capital Raised	0	13	0	0
Loans Taken / (Repaid)	673	-1,196	1,000	0
Interest Paid	-415	-368	-368	-428
Dividend paid (incl tax)	-82	-88	-2	-46
Income from investments	51	363	-12	-16
Others	0	0	0	0
<b>Financing Cashflow</b>	<b>227</b>	<b>-1,276</b>	<b>618</b>	<b>-490</b>
<b>Net chg in cash</b>	<b>-159</b>	<b>480</b>	<b>-1,076</b>	<b>-1,269</b>
Opening cash position	1,445	1,286	1,766	702
<b>Closing cash position</b>	<b>1,287</b>	<b>1,766</b>	<b>691</b>	<b>-567</b>

## Balance Sheet

Y/E, Mar (Rs. mn)	FY09	FY10	FY11E	FY12E
Equity share capital	118	131	131	131
Reserves & surplus	4,082	5,696	5,707	5,962
<b>Net worth</b>	<b>4,200</b>	<b>5,827</b>	<b>5,838</b>	<b>6,093</b>
<b>Minority Interest</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
Secured Loans	3,757	2,561	3,561	3,561
Unsecured Loans	0	0	0	0
<b>Loan Funds</b>	<b>3,757</b>	<b>2,561</b>	<b>3,561</b>	<b>3,561</b>
Net deferred tax liability	200	200	200	200
<b>Total Liabilities</b>	<b>8,157</b>	<b>8,587</b>	<b>9,599</b>	<b>9,854</b>
Gross Block	2,633	2,948	3,274	3,565
Less: Depreciation	807	986	1,187	1,398
<b>Net block</b>	<b>1,826</b>	<b>1,961</b>	<b>2,087</b>	<b>2,167</b>
Capital work in progress	234	190	164	172
<b>Investment</b>	<b>122</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Current Assets</b>	<b>10,190</b>	<b>9,986</b>	<b>12,256</b>	<b>13,166</b>
Inventories	1,756	1,530	2,419	2,874
Sundry debtors	4,700	4,770	6,552	7,783
Cash & bank balance	1,286	1,766	702	-559
Loans & advances	2,447	1,920	2,583	3,068
Other current assets	0	0	0	0
<b>Current lia &amp; Prov</b>	<b>4,215</b>	<b>3,550</b>	<b>4,907</b>	<b>5,651</b>
Current liabilities	4,119	3,450	4,791	5,513
Provisions	96	100	116	138
<b>Net current assets</b>	<b>5,975</b>	<b>6,436</b>	<b>7,349</b>	<b>7,514</b>
Misc. exp & Def. Assets	0	0	0	0
<b>Total Assets</b>	<b>8,157</b>	<b>8,587</b>	<b>9,599</b>	<b>9,853</b>

## Key Ratios

Y/E, Mar	FY09	FY10	FY11E	FY12E
<b>Profitability (%)</b>				
EBITDA Margin	13.8	11.3	5.0	8.0
Net Margin	5.3	3.6	0.1	2.2
ROCE	15.9	11.0	4.2	9.1
ROE	13.1	26.7	0.2	5.2
RoIC	13.0	11.8	3.2	6.1
<b>Per Share Data (Rs)</b>				
EPS	8.9	5.4	0.2	4.7
CEPS	11.4	9.8	2.2	6.9
BVPS	71.4	89.4	89.6	93.5
DPS	1.4	1.4	0.0	0.7
<b>Valuations (x)</b>				
PER	7.5	3.3	312.2	14.1
P/CEPS	5.9	6.8	29.8	9.7
P/BV	0.9	0.7	0.7	0.7
EV / Sales	0.6	0.5	0.6	0.6
EV / EBITDA	4.7	4.7	12.5	7.7
Dividend Yield (%)	2.1	2.0	0.0	1.1
<b>Gearing Ratio (x)</b>				
Net Debt/ Equity	0.6	0.1	0.5	0.7
Net Debt/EBIDTA	1.8	0.7	4.9	3.8
Working Cap Cycle (days)	172	174	210	214

**Recommendation History: Emco Ltd. – EMCO IN**

Date	Reports	Reco	CMP	Target
31.05.2010	<a href="#">Emco Q4FY10 Result Update</a>	Reduce	78	82
28.01.2010	<a href="#">Emco Q3FY10 Result Update</a>	Reduce	91	82
30.10.2009	<a href="#">Emco Q2FY10 Result Update</a>	Reduce	83	82
01.06.2009	<a href="#">Emco Q4FY09 Result Update</a>	Sell	95	27

**Recent Research Reports**

Date	Reports	Reco	CMP	Target
26.07.2010	<a href="#">NTPC Q1FY11 Result Update</a>	Accumulate	202	220
23.07.2010	<a href="#">Bharat Bijlee Q1FY11 Result Update</a>	Accumulate	1,260	1,350
14.07.2010	<a href="#">Sintex Industries Q1FY11 Concall Update</a>	Hold	330	325
13.07.2010	<a href="#">Sintex Industries Q1FY11 Result Update</a>	Hold	325	325

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