

October 28, 2010

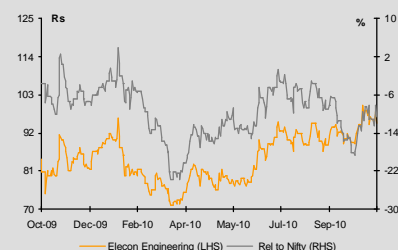
| | |
|--------------------------|----------------------|
| Reco | Previous Reco |
| Buy | Buy |
| CMP | Target Price |
| Rs 95 | Rs 121 |
| EPS change FY11E/12E (%) | NA |
| Target Price change (%) | NA |
| Nifty | 5,988 |
| Sensex | 19,941 |

Price Performance

| (%) | 1M | 3M | 6M | 12M |
|---------------|----|-----|----|------|
| Absolute | 5 | 7 | 19 | 5 |
| Rel. to Nifty | 5 | (4) | 5 | (15) |

Source: Bloomberg

Relative Price Chart



Source: Bloomberg

Stock Details

| | |
|-----------------------------|-------------------|
| Sector | Material Handling |
| Bloomberg | ELCN@IN |
| Equity Capital (Rs mn) | 186 |
| Face Value(Rs) | 2 |
| No of shares o/s (mn) | 93 |
| 52 Week H/L | 104/70 |
| Market Cap (Rs bn/USD mn) | 9/202 |
| Daily Avg Volume (No of sh) | 502828 |
| Daily Avg Turnover (US\$m) | 1.1 |

Shareholding Pattern (%)

| | S'10 | J'10 | M'10 |
|--------------|------|------|------|
| Promoters | 45.7 | 45.7 | 45.7 |
| FII/NRI | 4.1 | 3.3 | 3.1 |
| Institutions | 13.8 | 13.0 | 12.8 |
| Private Corp | 7.3 | 7.4 | 7.4 |
| Public | 29.1 | 30.6 | 31.1 |

Source: Capitaline

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- **EEL performance ahead of estimates – revenue growth 10% yoy to Rs2.8 bn, EBITDA up 8% yoy to Rs400 mn and APAT growth of 32% yoy to Rs142 mn**
- **Order book declined marginally to Rs15.0 bn – led by lower order inflows at Rs2.1 bn (MHE – Rs0.7 bn and TE – Rs1.3 bn)**
- **Acquired standardized gears & gearboxes business of David Brown Gear System for Rs1.3bn—earnings neutral in near-term**
- **Trading at attractive valuations of 13.8X FY11E and 10.1X FY12E earnings. Maintain our Buy rating**

Strong performance – Net profit growth at 32% yoy

Elecon Engineering (EEL) reported strong performance in Q2FY11 with 32% yoy growth in net profits – above estimates. Strong performance was led by traction in high-margin transmission segment and decline in interest costs. Key highlights are (1) 10.1% yoy growth in revenues – led by Transmission Equipment (TE) division (up 33% yoy to Rs1.3 bn) whereas Material Handling Equipment (MHE) division declined marginally by 3% yoy to Rs1.6 bn (due to low order-book cover) (2) Stable EBITDA margins at 14.2% with EBITDA growth at 8.4% yoy to Rs400 mn and (3) Sharp decline in interest costs by 20.4% yoy to Rs107 mn.

Order book at Rs15.0 bn, Order inflows subdued at Rs2.1 bn

After a strong Q1FY11, EEL witnessed lower order inflows at Rs2.1 bn in Q2FY11. This was due to delays and postponements in finalization of orders leading to lower orders in the MHE division - merely Rs0.7 bn (Vs Rs4.1 bn in Q1FY11). Order inflows in the TE division were healthy at Rs1.3 bn. Consequently, order book declined marginally on qoq basis to Rs15.0 bn (including Rs3.2 bn Bramhani Steel order – on hold).

Acquires standard gears & gearboxes business of David Brown

EEL acquired the standardized gears and gearboxes business in Sweden (with manufacturing facility), USA and UK of David Brown Gear Systems in Oct'10 – the foreclosure of acquisition is expected in Nov'10. EEL has made the acquisitions through its 100% subsidiary (step-down) Elecon USA Transmission Ltd. for a total value of Rs1.3 bn (GBP 18.4 mn) – to be financed through internal accruals (20-22%) and debt (78-80%). The acquired business has revenues of Rs1.6-1.8 bn in FY09 and PAT margins of 6-8%. The acquisition provides geographical diversification, access to new customer base, complementary products and outsourcing opportunities. Based on back-of-envelope calculation, acquisition would be earnings neutral in near-term.

Attractive valuations; Maintain 'BUY' rating

We believe that the tide has turned for EEL and expect EEL to witness sharp recovery in earnings in FY10-12E period after witnessing earnings decline during FY08-10 period. We believe that EEL will benefit from expected revival in industrial capex in ensuing quarters and record strong earnings growth. We maintain earnings forecasts of Rs6.9/Share and Rs9.4/Share for FY11E and FY12E. We maintain our Buy rating.

Financial Snapshot

Rs Mn

| YE-Mar | Net Sales | EBITDA (Core) | EBITDA (%) | APAT | EPS (Rs) | EPS %Chg | ROE (%) | P/E | EV/EBITDA | P/BV |
|--------|-----------|---------------|------------|------|----------|----------|---------|------|-----------|------|
| FY09 | 9,551 | 1,724 | 18.1 | 613 | 6.6 | -7.4 | 24.0 | 14.4 | 8.2 | 3.2 |
| FY10 | 10,464 | 1,540 | 14.7 | 500 | 5.4 | -18.5 | 16.6 | 17.6 | 8.9 | 2.7 |
| FY11E | 11,609 | 1,751 | 15.1 | 641 | 6.9 | 28.2 | 18.2 | 13.8 | 7.7 | 2.3 |
| FY12E | 14,165 | 2,134 | 15.1 | 875 | 9.4 | 36.5 | 21.2 | 10.1 | 6.5 | 2.0 |

Quarterly Results

| Rs mn | Q2FY10 | Q3FY10 | Q4FY10 | Q1FY11 | Q2FY11 | YoY (%) | QoQ (%) | YTD'11 | YTD'10 | Gr (%) |
|------------------------------------|---------------|---------------|---------------|---------------|---------------|-------------|-------------|---------------|---------------|-------------|
| Revenue | 2,551 | 2,512 | 3,324 | 2,472 | 2,809 | 10.1 | 13.6 | 5,281 | 4,696 | 12.5 |
| Expenditure | 2,182 | 2,126 | 2,858 | 2,099 | 2,409 | 10.4 | 14.8 | 4,509 | 3,968 | 13.6 |
| Consumption of RM as % of sales | 1,801 70.6 | 1,713 68.2 | 2,346 70.6 | 1,692 68.5 | 1,874 66.7 | 4.0 | 10.8 | 3,566 67.5 | 3,225 68.7 | 10.6 |
| Employee Cost as % of sales | 119 4.7 | 131 5.2 | 97 2.9 | 120 4.8 | 156 5.6 | 31.6 | 30.7 | 276 5.2 | 208 4.4 | 32.7 |
| Other expenditure as % of sales | 262 10.3 | 282 11.2 | 416 12.5 | 288 11.6 | 379 13.5 | 44.5 | 31.7 | 667 12.6 | 534 11.4 | 24.9 |
| EBITDA | 369 | 387 | 466 | 372 | 400 | 8.4 | 7.4 | 772 | 728 | 6.0 |
| Depreciation | 78 | 83 | 95 | 89 | 98 | 25.1 | 9.4 | 187 | 153 | 22.2 |
| EBIT | 291 | 304 | 371 | 283 | 302 | 3.9 | 6.7 | 585 | 575 | 1.7 |
| Other Income | 6 | 3 | 5 | 7 | 4 | -35.3 | -42.7 | 11 | -6 | -296.0 |
| Interest | 134 | 113 | 117 | 98 | 107 | -20.4 | 8.3 | 205 | 278 | -26.3 |
| PBT | 163 | 193 | 259 | 192 | 199 | 22.5 | 4.1 | 391 | 292 | 34.1 |
| Total Tax | 55 | 72 | 70 | 58 | 57 | 4.1 | -1.6 | 116 | 99 | 17.1 |
| Adjusted PAT | 108 | 121 | 188 | 133 | 142 | 31.9 | 6.6 | 275 | 193 | 42.8 |
| Extra ordinary items | 0 | 77 | 82 | 0 | 0 | NA | NA | 0 | 0 | #DIV/0! |
| Reported PAT | 108 | 198 | 271 | 133 | 142 | 31.9 | 6.6 | 275 | 193 | 42.8 |
| Adjusted EPS | 1.2 | 1.3 | 2.0 | 1.4 | 1.5 | 31.9 | 6.6 | 3.0 | 2.1 | 42.8 |

| Margins (%) | | | | | | (bps) | (bps) | | | | (bps) |
|--------------------|------|------|------|------|------|-------|-------|------|------|-----|-------|
| EBIDTA | 14.5 | 15.4 | 14.0 | 15.1 | 14.2 | -20 | -80 | 14.6 | 15.5 | 360 | |
| EBIT | 11.4 | 12.1 | 11.2 | 11.5 | 10.8 | -60 | -70 | 11.1 | 12.3 | 420 | |
| EBT | 6.4 | 7.7 | 7.8 | 7.7 | 7.1 | 70 | -70 | 7.4 | 6.2 | 340 | |
| PAT | 4.2 | 4.8 | 5.7 | 5.4 | 5.1 | 80 | -30 | 5.2 | 4.1 | 180 | |
| Effective Tax rate | 33.9 | 37.4 | 27.2 | 30.5 | 28.8 | -510 | -170 | 29.6 | 33.9 | 610 | |

Segmental Performance

| Rs mn | Q2FY10 | Q3FY10 | Q4FY10 | Q1FY11 | Q2FY11 | YoY (%) | QoQ (%) | YTD'11 | YTD'10 | Gr (%) |
|-----------------------------|--------------|--------------|--------------|--------------|--------------|--------------|-------------|--------------|--------------|--------------|
| Segment Revenues | | | | | | | | | | |
| Material Handling Equipment | 1,659 | 1,498 | 2,100 | 1,498 | 1,610 | -3.0 | 7.5 | 3,108 | 2,950 | 5.3 |
| Transmission Equipment | 943 | 1,052 | 1,358 | 1,010 | 1,251 | 32.7 | 23.8 | 2,261 | 1,849 | 22.3 |
| Less: Intersegment | 51 | 52 | 167 | 48 | 0 | - | - | 0 | 0 | - |
| Total | 2,551 | 2,499 | 3,291 | 2,460 | 2,860 | 12.1 | 16.3 | 5,321 | 4,674 | 13.8 |
| Segment Results | | | | | | | | | | |
| Material Handling Equipment | 189 | 181 | 272 | 192 | 204 | 8.4 | 6.7 | 396 | 347 | 14.2 |
| Transmission Equipment | 157 | 173 | 215 | 153 | 181 | 14.9 | 18.3 | 334 | 303 | 10.1 |
| Total | 346 | 354 | 487 | 344 | 385 | 11.3 | 11.9 | 730 | 650 | 12.3 |
| Add- Unall Income / (Exp) | -49 | 30 | -28 | -54 | -79 | - | - | -134 | -80 | - |
| Less- Interest Exp | 134 | 113 | 117 | 98 | 107 | -20.4 | 8.3 | 205 | 278 | -26.3 |
| PBT | 163 | 271 | 341 | 192 | 200 | 22.5 | 4.2 | 391 | 292 | 34.2 |
| Segment Cap Employed | | | | | | | | | | |
| Material Handling Equipment | 5,174 | 4,946 | 4,780 | 4,985 | 5,041 | -2.6 | 1.1 | 5,041 | 5,174 | -2.6 |
| Transmission Equipment | 3,946 | 3,966 | 4,016 | 3,919 | 4,043 | 2.5 | 3.2 | 4,043 | 3,946 | 2.5 |
| Total | 9,120 | 8,912 | 8,797 | 8,904 | 9,084 | (0.4) | 2.0 | 9,084 | 9,120 | (0.4) |
| Segment Margins (%) | | | | | | | | | | |
| Material Handling Equipment | 11.4 | 12.1 | 12.9 | 12.8 | 12.7 | 130 | -10 | 12.7 | 11.8 | 100 |
| Transmission Equipment | 16.7 | 16.5 | 15.8 | 15.1 | 14.5 | -220 | -70 | 14.8 | 16.4 | -160 |
| Average | 13.3 | 13.9 | 14.1 | 13.7 | 13.5 | 20 | -30 | 13.6 | 13.5 | 10 |

Order Backlog details

| Rs mn | Q2FY10 | Q3FY10 | Q4FY10 | Q1FY11 | Q2FY11 | YoY (%) | QoQ (%) |
|-----------------------------|---------------|---------------|---------------|---------------|---------------|------------|--------------|
| Order Backlog | | | | | | | |
| Material Handling Equipment | 11,770 | 11,050 | 9,970 | 12,530 | 11,660 | -0.9 | -6.9 |
| Transmission Equipment | 2,470 | 2,570 | 2,460 | 3,290 | 3,350 | 35.6 | 1.8 |
| Total | 14,240 | 13,620 | 12,430 | 15,820 | 15,010 | 5.4 | -5.1 |
| Order Inflows | | | | | | | |
| Material Handling Equipment | 739 | 778 | 1,020 | 4,058 | 740 | 0.1 | -81.8 |
| Transmission Equipment | 1,183 | 1,152 | 1,248 | 1,840 | 1,311 | 10.8 | -28.8 |
| Total | 1,922 | 1,931 | 2,268 | 5,898 | 2,050 | 6.7 | -65.2 |

Key Consolidated Financials

Income Statement

| Y/E, Mar (Rs. mn) | FY09 | FY10 | FY11E | FY12E |
|-------------------------------|--------------|---------------|---------------|---------------|
| Net Sales | 9,551 | 10,464 | 11,609 | 14,165 |
| <i>Growth (%)</i> | 15.6 | 9.6 | 10.9 | 22.0 |
| Expenditure | 7,826 | 8,924 | 9,857 | 12,031 |
| Materials Consumed | 5,944 | 6,982 | 7,665 | 9,367 |
| Employee Cost | 439 | 436 | 524 | 689 |
| Manufacturing Exp | 653 | 614 | 683 | 823 |
| Other Exp | 790 | 892 | 986 | 1,153 |
| EBITDA | 1,724 | 1,540 | 1,751 | 2,134 |
| <i>Growth (%)</i> | 24.5 | -10.7 | 13.7 | 21.8 |
| EBITDA margin (%) | 18.1 | 14.7 | 15.1 | 15.1 |
| Depreciation | 221 | 331 | 350 | 381 |
| EBIT | 1,503 | 1,209 | 1,402 | 1,753 |
| EBIT margin (%) | 15.7 | 11.6 | 12.1 | 12.4 |
| Other Income | -99 | 41 | 32 | 32 |
| Interest expenses | 484 | 509 | 472 | 472 |
| PBT | 920 | 741 | 962 | 1,313 |
| Tax | 306 | 241 | 321 | 438 |
| <i>Effective tax rate (%)</i> | 33.3 | 32.6 | 33.4 | 33.4 |
| Adjusted PAT | 613 | 500 | 641 | 875 |
| <i>Growth (%)</i> | -7.4 | -18.5 | 28.2 | 36.5 |
| Net Margin (%) | 6.4 | 4.8 | 5.5 | 6.2 |
| E/O items | -63.7 | 161.7 | 0.0 | 0.0 |
| Reported PAT | 550 | 662 | 641 | 875 |
| <i>Growth (%)</i> | -18.2 | 20.4 | -3.2 | 36.5 |

Cash Flow

| Y/E, Mar (Rs. mn) | FY09 | FY10 | FY11E | FY12E |
|------------------------------|--------------|---------------|--------------|-------------|
| PBT | 1,368 | 748 | 962 | 1,313 |
| Depreciation | 221 | 331 | 350 | 381 |
| Interest Provided | 484 | 509 | 472 | 472 |
| Other Non-Cash items | -481 | -19 | 0 | 0 |
| Chg in working cap | -566 | 339 | -248 | -870 |
| Tax paid | -259 | -180 | -321 | -438 |
| Operating Cashflow | 767 | 1,729 | 1,215 | 858 |
| Capital expenditure | -1,400 | -841 | -500 | -500 |
| Free Cash Flow | -633 | 888 | 715 | 358 |
| Other income | 0 | 0 | 0 | 0 |
| Investments | -14 | 212 | 0 | 0 |
| Investing Cashflow | -14 | 212 | 0 | 0 |
| Equity Capital Raised | 0 | 0 | 0 | 0 |
| Loans Taken / (Repaid) | 1,828 | -705 | 0 | 0 |
| Interest Paid | -484 | -509 | -472 | -472 |
| Dividend paid (incl tax) | -162 | -161 | -139 | -139 |
| Income from investments | 0 | 0 | 0 | 0 |
| Others | 0 | 0 | 0 | 0 |
| Financing Cashflow | 1,183 | -1,375 | -612 | -612 |
| Net chg in cash | 535 | -276 | 103 | -254 |
| Opening cash position | 75 | 611 | 388 | 491 |
| Closing cash position | 611 | 334 | 491 | 238 |

Balance Sheet

| Y/E, Mar (Rs. mn) | FY09 | FY10 | FY11E | FY12E |
|-------------------------------|---------------|--------------|---------------|---------------|
| Equity share capital | 186 | 186 | 186 | 186 |
| Reserves & surplus | 2,568 | 3,075 | 3,577 | 4,312 |
| Net worth | 2,754 | 3,261 | 3,763 | 4,498 |
| Secured Loans | 5,236 | 3,329 | 3,329 | 3,329 |
| Unsecured Loans | 685 | 1,887 | 1,887 | 1,887 |
| Loan Funds | 5,921 | 5,216 | 5,216 | 5,216 |
| Net deferred tax liability | -328 | -403 | -403 | -403 |
| Total Liabilities | 8,347 | 8,074 | 8,576 | 9,311 |
| Gross Block | 4,277 | 5,094 | 5,594 | 6,094 |
| Less: Depreciation | 1,448 | 1,651 | 2,000 | 2,381 |
| Net block | 2,829 | 3,443 | 3,594 | 3,713 |
| Capital work in progress | 281 | 179 | 179 | 179 |
| Investment | 109 | 57 | 57 | 57 |
| Current Assets | 10,085 | 9,263 | 10,391 | 12,197 |
| Inventories | 4,007 | 3,152 | 3,494 | 4,263 |
| Sundry debtors | 4,717 | 5,176 | 5,859 | 7,149 |
| Cash & bank balance | 611 | 388 | 491 | 238 |
| Loans & advances | 749 | 547 | 547 | 547 |
| Other current assets | 0 | 0 | 0 | 0 |
| Current lia & Prov | 4,318 | 4,088 | 4,865 | 6,054 |
| Current liabilities | 4,087 | 3,868 | 4,645 | 5,835 |
| Provisions | 231 | 220 | 220 | 220 |
| Net current assets | 5,767 | 5,174 | 5,526 | 6,142 |
| Misc. exp | 17 | 26 | 26 | 26 |
| Total Assets | 9,003 | 8,879 | 9,381 | 10,116 |

Key Ratios

| Y/E, Mar | FY09 | FY10 | FY11E | FY12E |
|----------------------------|-------|-------|-------|-------|
| Profitability (%) | | | | |
| EBITDA Margin | 18.1 | 14.7 | 15.1 | 15.1 |
| Net Margin | 6.4 | 4.8 | 5.5 | 6.2 |
| ROCE | 19.2 | 13.5 | 15.4 | 18.0 |
| ROE | 24.0 | 16.6 | 18.2 | 21.2 |
| RoIC | 20.5 | 16.2 | 17.9 | 19.8 |
| Per Share Data (Rs) | | | | |
| EPS | 6.6 | 5.4 | 6.9 | 9.4 |
| CEPS | 9.0 | 9.0 | 10.7 | 13.5 |
| BVPS | 29.7 | 35.1 | 40.5 | 48.4 |
| DPS | 1.5 | 1.5 | 1.5 | 1.5 |
| Valuations (x) | | | | |
| PER | 14.4 | 17.6 | 13.8 | 10.1 |
| P/CEPS | 10.6 | 10.6 | 8.9 | 7.0 |
| P/BV | 3.2 | 2.7 | 2.3 | 2.0 |
| EV / Sales | 1.5 | 1.3 | 1.2 | 1.0 |
| EV / EBITDA | 8.2 | 8.9 | 7.7 | 6.5 |
| Dividend Yield (%) | 1.6 | 1.6 | 1.6 | 1.6 |
| Gearing Ratio (x) | | | | |
| Net Debt/ Equity | 1.9 | 1.5 | 1.2 | 1.1 |
| Net Debt/EBITDA | 3.0 | 3.1 | 2.7 | 2.3 |
| Working Cap Cycle (days) | 198.0 | 190.8 | 168.2 | 150.3 |

Recommendation History: Elecon Engineering – ELCN IN

| Date | Reports | Reco | CMP | Target |
|------------|---|--------------|-----|--------|
| 02/08/2010 | Elecon Engineering Q1FY11 Result Update | Hold | 93 | 96 |
| 13/05/2010 | Elecon Engineering Q4FY10 Result Update | Hold | 82 | 86 |
| 02/02/2010 | Elecon Engineering Q3FY10 Result Update | Under Review | 83 | 81 |
| 04/11/2009 | Elecon Engineering Q2FY10 Result Update | Under Review | 75 | 81 |

Recent Research Reports

| Date | Reports | Reco | CMP | Target |
|------------|---|------------|-----|--------|
| 27/10/2010 | TRF Q2FY11 Result Update | Accumulate | 689 | 754 |
| 24/09/2010 | ECI Strategy | - | - | - |
| 17/08/2010 | McNally Bharat Q1FY11 Result Update | Buy | 285 | 400 |

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