

BUY
CMP: 42

BSE Code	504008
NSE Code	EMCO

Key Data

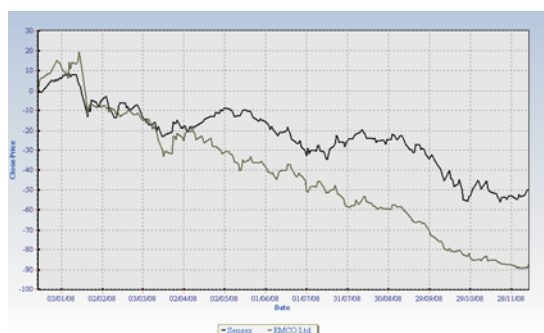
Sensex	10100
52 week H/L (Rs.)	28/330
Nov H/L (Rs.)	32/28
Market Cap (Rs cr)	246
Avg. daily volume (6m)	22898
Face Value	2

Source: Capitaline

Shareholding Pattern (%)

Promoters	33.86
Institution	26.28
Foreign holding	9.05
Non-promoter corporate holding	22.70
Public & Others	8.11

Source: Capitaline

One-Year Performance (Rel. to Sensex)


Source: Capitaline

Background and Business

EMCO, one of the leading solution providers in the power sector is amongst the largest manufactures of the transformers in the country. It controls about 13-14% of the market share and ranks third only after BHEL and Crompton Greaves. It is also the market leader in single phase electronic meter. EMCO is also one of the few approved supplier to the Indian Railways and has been supplying Trackage Transformers and Locomotive Transformers. It has involved it self over the years from being a product seller to a solution provider. It provides IT solution to companies in distribution and automatic meter reading in power distribution business. Company has formed a SPV to foray into power generation. It is in initial stage of setting up 540 MW, coal based power project in Nagpur. Company has also invested in wind farm for generating 10.5 Mw of power in Maharashtra.

Currently company has 45 manufacturing facility plant & more than 10 offices across the India.

Facility	Product Range
Transformer	
Thane (Power)	400MVA/66KV-315MVA/400KV
Jalgaon (Industrial)	10 MVA-50MVA/132 KV
Jalgaon (Distribution)	5KVA-5MVA/33KV
Meters	
Dadra & Thane	All types of Electronic Energy Meters
Towers	
Vadodara	Up to 45000MT/annum

EMCO export to more than 30 countries across the globe. It has been approved by large international EPC contractors. International division contributed around 16% of total revenue. Their strategic goal is to increase company's revenue to about 30% in next 2-3 years.

Capacity additions in power generation, Transmission and reforms in distribution expected to provide strong demand for transformers.

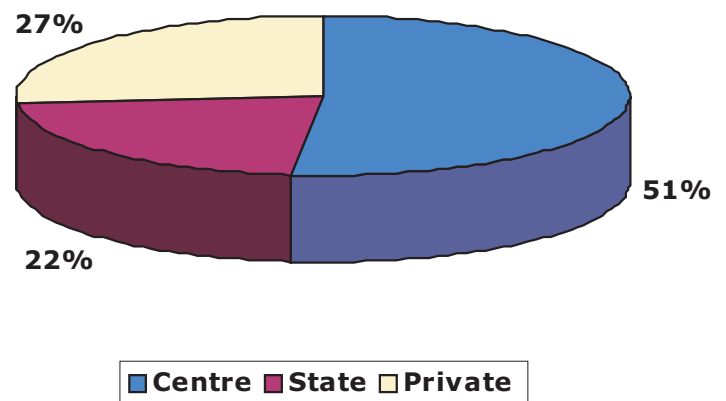
Investment Rationale

Power Sector: - Still long way to go

The government has set a goal to provide power to all people in India by FY12. The major initiative to achieve this goal was introduction of the Rural Electrification Scheme – Rajiv Gandhi Grameen Vidyutikaran Yojana (RGGVY). The scheme would be funded by Rural Electrification Corporation (REC) and Power Finance Corporation (PFC). This initiative will boost demand for distribution transformers as typically 15-20% of allocated fund for distribution and 10-15% of allocated funds in rural electrification go into transformers.

According to Mckinsey & Co if India has to fulfill its power requirement of 315 to 335 GW by 2017, India will require a generation capacity of 415 to 440 GW, after adjusting for plant availability and a modest 5 per cent spinning reserve. This implies a tripling of installed capacity from the current level of about 140 GW, which, in turn, translates into an annual addition of 20 to 40 GW. This is fivefold to tenfold the 4 GW per year that was achieved in the last 10 years.

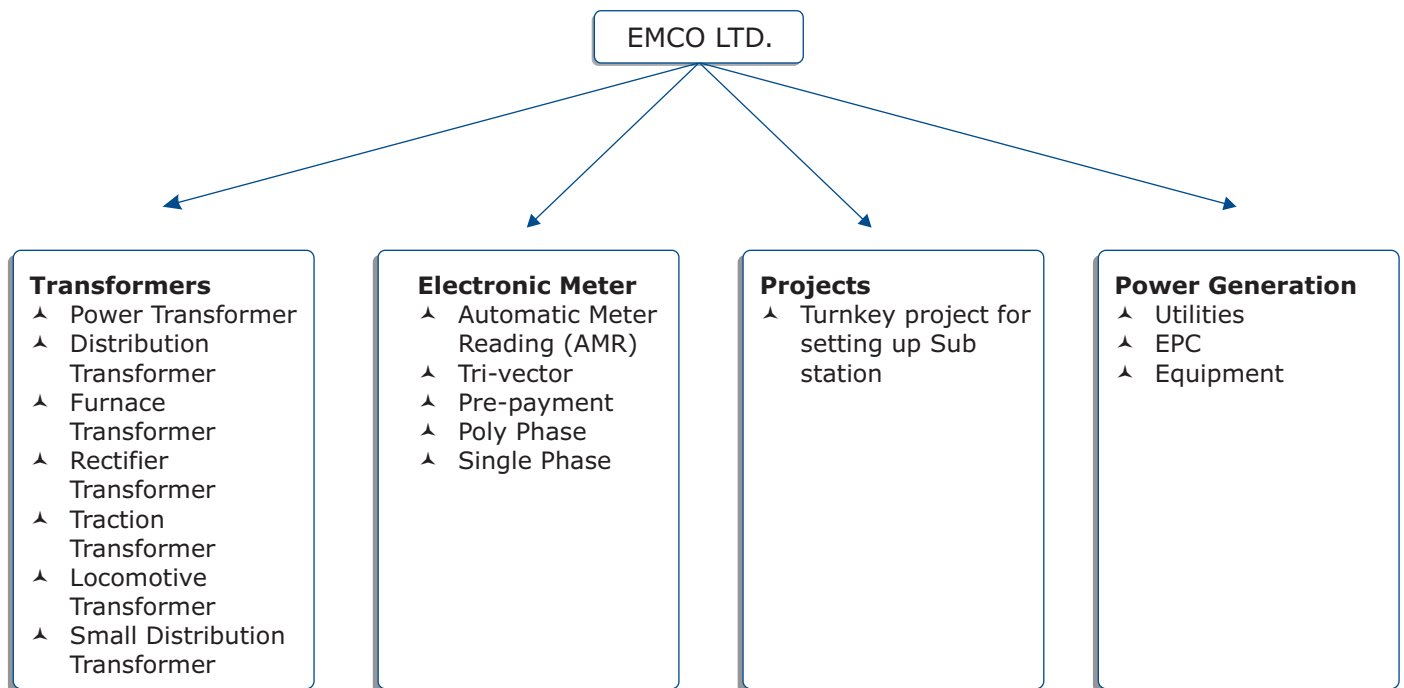
Investment in Power Generation in 11th plan



5-10% of the total outlay of PGCIL will go into power transformers.

National Grid to raise interregional power transmission capacity to 37000 MW by 2012.

PGCIL, the nodal agency for an interregional grid, is forming a national grid for interregional transfer of power to the extent of 37,000 MW by FY12, with an investment outlay of Rs. 700 bn , approximately 60-65% of it is still to be spend.



Emco achieves key milestones in its power project

Emco has achieved most of the key milestones in its 270MW (2 x 135) power project in Maharashtra. The company has completed the land acquisition for the project and has received allocation of water from the state government. The project has also received environmental clearance and the preliminary site work has already commenced. Emco has announced capex of Rs. 45 crore for power plant. Emco has not tied up the off-take from the power plant under a PPA and is proposing to retain the entire power generated for merchant sales in the open market. With all the major pre-development milestones achieved, we expect plant to be commissioned by September 2010.

Tie-up with Power yields results

Last year Emco had entered into a tie-up with a Japanese company 'Power', which executed its Rs130m pilot project in Ahmedabad for Torrent Power. The technology from Power offers solutions to increase the carrying capacity of a transmission line without erecting higher transmission towers.

Only a few Indian cities have underground electricity cables and most depend on above-ground transmission lines. This is a problem peculiar to Indian cities due to scarcity of land, which does not allow replacing existing towers with taller ones. Specially-designed conductors are used to enhance transmission capacity.

Total capex of around 10 USD million for JV

JV With Edison Power

Emco (51% stake in JV) had entered into a MoU with South Africa's Edison Power to manufacture will start with 2,000 MVA capacities in South Africa, with commercial production expected by Apr '09. At start, its focus would be on 20 MVA range and 33 kV class transformers. Emco plans to source larger transformers (220 kV and 400 kV class) from its Indian facilities. This tie in with its aim to increase exports to South African neighboring countries. The company plans to utilize 30% of its transformer manufacturing capacity to cater to export markets such as the Middle East, China and Africa. According to management, it intends to tap the US\$5.5bn transmission and distribution opportunities available in the African market.

Management expects 10-12% of margin going forward from project business

Meter Division

Growth lies a ahead

EMCO diversified into manufacturing electronic meters with an annual capacity of 1.2-1.3 million units per annum-one of the largest in Asia. It offers metering solution including Automatic Metering Reading, Single Phase meter, Poly Phase meter, prepaid meters, and Tri vector meters. Total order book from this division is Rs. 520 crore.

EMCO is qualified on the 765 KV in Transmission lines.

Transformer continues to dominate with 64% in revenue.

EMCO Ltd., manufacturers a wide arrange of power & distribution Oil filled transformers. It also has its presence in furnace, rectifier and loco transformer too. It is the third largest player in transformer industry after BHEL and Crompton Greaves with a market share of around 13-14%. It is amongst the largest players in the 132 KV and 220 KV range segment.

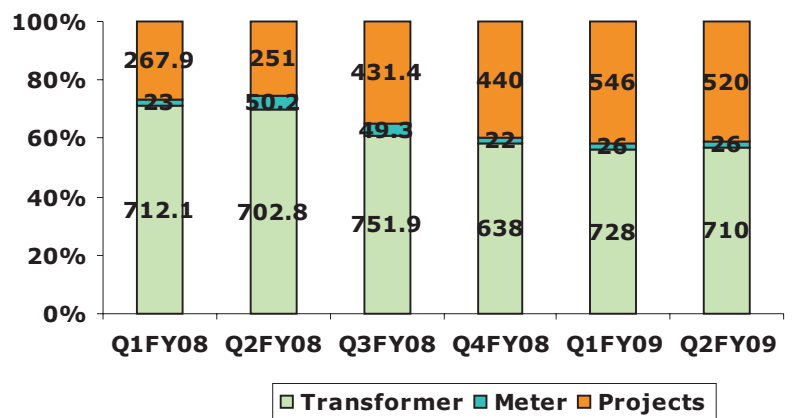
The transformer order backlog at end Sept was Rs7.1bn (12700 MVA), up 1.6% y-o-y. Growth was flat because the company had stopped bidding for APDRP & RGGVY Schemes, .

Management continues its stance of not bidding for distribution transformer contracts awarded under the APDRP and RGGVY schemes of the government due to concerns regarding customers not accepting delivery and poor profitability.

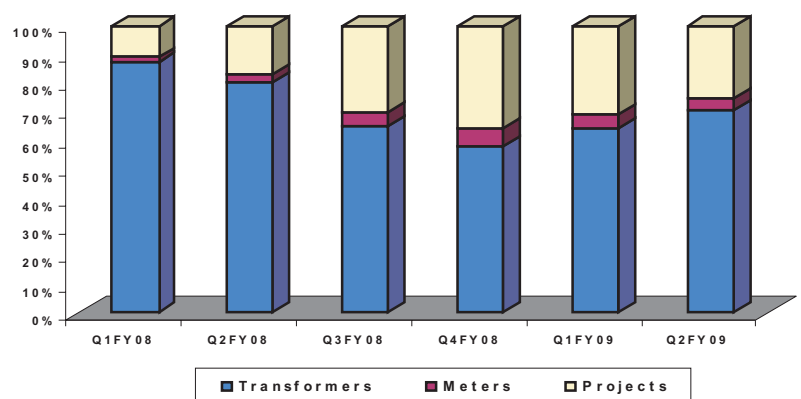
Product Portfolio

Product Portfolio	Range	Voltage	Application	Application
Power Transformer	Up to 315 MVA	Up to 400 KV	Generator, Interconnecting, System, Station Auxiliary, Unit Auxiliary	Generator, Interconnecting, System, Station Auxiliary, Unit Auxiliary
Distribution Transformer	Up to 315 MVA	400 KV	Industries, Substation and distribution	Introduces various type of single phase and three phase transformers from 10 KVA to 500 KVA
Furnace Transformers	Up to 63MVA	Up to 33KV	Arc/ Submerged/ Arc/ Laddle / Induction DC Furnace Transformers	EMCO is the market leader in this segment
Rectifier Transformer	Up to 160 KA DC	Up to 33KV	In various Plant like:- Chemicals, Alumina, Chloria, Graphite	EMCO enjoy maximum share in this market
Locomotive Transformer	Up to 7500 KVA	25KV	Railways-Single Phase	Approved by Indian Railways
Trackside Transformer	Up to 21.6 MVA	220KV	Railways:- Single / Three phase	Approved by Indian Railways
Small Distribution Transformer	10 KVA up to 500 KVA	Up to 33 KV	Single/three Phase for APDRP and HVDS Schemes	

Orderbacklog mix



Revenue Mix



Sources:- company data

Management expects 15-16% margin from Transformer business after shifting trends.

EMCO is shifting its trend from SEB's to focus towards industry business to improve its bottom line and better realization. As government entities had been delaying taking delivery of distribution transformers, Emco decided against bidding for some SEB transformer contracts. This resulted in almost flat growth in transformer order book. Currently, 70% of unexecuted contracts in the segment are from Government entities; the balance from industrial customers. Emco aims to have a balanced customer mix – 50% SEBs and 50% industrial customers.

Indonesia Coal Shipment Delayed due to some statutory clearances, it is expected soon

Emco acquires coal mine in Indonesia

During Q4FY08, Emco Overseas Pte Ltd. (EOPL), a 100% subsidiary of Emco has entered in to an arrangement to acquire a 37.35% stake in PT Bina Insan Sukes Mandiri (PT Bina), an Indonesian coal mining company. The coal mine, speared over an area of 5,000 hectares, has total reserves of 105mn tons, of which 70mn tons are measured and 35mn tons are inferred. The coal block is located on the banks of a river, which is expected to be used for transporting coal to the nearest jetty at sea for onward shipments. Simultaneously, EOPL has also entered in to an agreement to acquire a 37.35% stake in Rabaan (S) Pte. Ltd. (RSPL), Singapore based company, which has long term exclusive coal off-take arrangements with PT Bina. ***The total investment in acquiring the 37.35% stakes in the two companies is expected to be US\$18mn (US\$0.4/ton of reserves), of which, US\$14mn has already been invested so far.***

Risk Concerns

- ▲ Demand of transformers is directly dependent on the speed of the reforms undertaken by the government in the power sector. Since this is a politically sensitive issue, there could be delay in implementation, resulting in subdued growth opportunity.
- ▲ The company operates in working capital intensive industry with payment cycle being long.

Outlook and Financials

The government has targeted 78000 MW of generation capacity by 2012. For every 1 MW of generation capacity added requires addition of 7 MVA of transformation capacity in the system. The growth in infrastructure and housing in India will also generate further demand for power. The number of new malls, hotels and IT parks being developed will also result in large consumption of power. Almost one fourth of the total investment in power generation goes for transformers, which indicates that over the next five years, at least Rs 1 lakh crore should be spent on the transformer industry citing a huge opportunity.

Exports to countries where power reforms are underway i.e. Africa and Middle East provide growth opportunity. Also, huge industrial capex lined up in power intensive industries i.e. oil and gas, metals and cement act as a booster.

The Rs. 55bn Indian transformer industry will benefit from the strong demand expected from reforms in the power sector. Improved realizations and higher volumes will largely drive this growth. The government intends to add massive capacity to the generation side and create a National Grid for distribution of this power, both of which should boost demand for transformers. The funding issues for the same have been taken care by the World Bank (WB) and Asian Development Bank (ADB) and the annual demand of about 122,679MVA expected for the next five years.

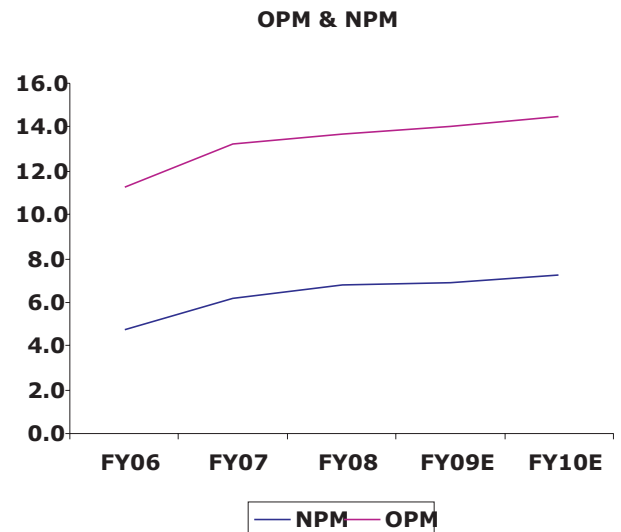
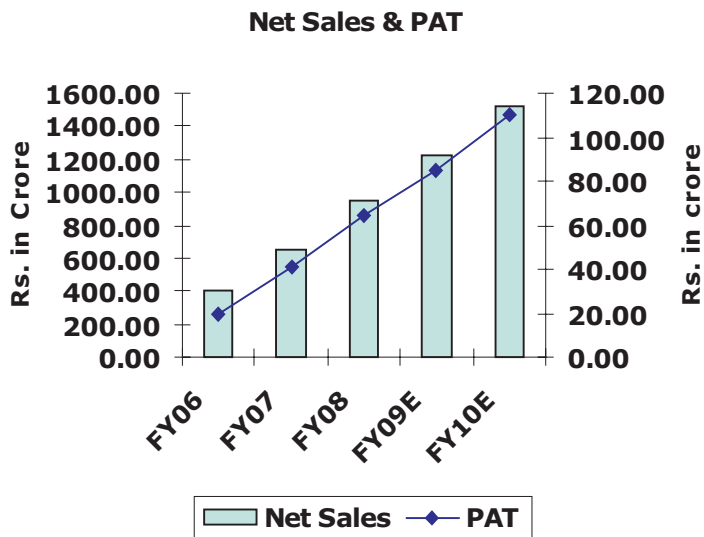
The key risk however remains that any slowdown in infrastructure spending and volatile prices of raw materials, mainly copper would adversely impact the transformer industry.

We remain positive on EMCO's electrical equipment and projects businesses and the three verticals in the power sector i.e., utilities, equipment, and EPC, it is likely to benefit significantly from the strong macro environment in the power sector. Also we view EMCO's entry into the South African market to be positive. While there would be a certain lead time before this business scales up, we believe geographic diversification increases the revenue visibility substantially for the company. EMCO is entering into coal trading business as it has recently acquired 37.35% stake in Indonesian mines. We expect this new business venture to substantially boost revenue going forward.

Company	Sales Fy08	NP	Capacity (MVA)	Orders	OB/ Sales
EMCO	944	64.36	20000	1300	1.38
IndoTech	189.68	39.02	7450	120	0.63
CGL	6832.3	406.7	18500	6000	0.88

As observed, EMCO enjoy 1.3X order book to sales ratio, which are best among its peers. EMCO has highest manufacturing capacity of around 20,000 MVA.

Stock had corrected more than 90% from its 52 week high and its is trading nearly 52 week low. At CMP, stock trades at 2.9x and 2.3x FY09 and FY10 earnings with an EPS of RS. 14.34 and 18.69 respectively. **We recommended BUY rating with the target of 68.**



(Sources:- Anagram Research)

Financial Performance Consolidated

Rs. In crore	FY06	FY07	FY08	FY09E	FY10E
Net Sales	405.37	655.89	944.25	1227.53	1522.13
Total Expenses	359.59	569.32	815.38	1055.67	1301.42
Operating Profit	45.78	86.57	128.87	171.85	220.71
Other Income	0.01	0.13	0.11	0.15	0.15
Interest	11.75	19.81	24.07	35.50	42.58
Depreciation	5.65	5.98	9.79	12.30	16.50
PBT	28.39	60.91	95.12	124.20	161.78
Tax	9.32	20.31	30.76	39.75	51.77
PAT	19.07	40.60	64.36	84.46	110.01
Equity	11.77	11.77	11.77	11.77	11.77
EPS	3.24	6.90	10.94	14.35	18.69
Margin (%)					
OPM	11.3	13.2	13.6	14.0	14.5
NPM	4.7	6.2	6.8	6.9	7.2

We expect Margin to increase on back of decline in Commodity prices & falling interest rate

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RATING INTERPRETATION

Buy Expected to appreciate more than 20% over a 12-month period

Accumulate Expected to appreciate up to 20% over a 12-month period

Hold Expected to remain in a narrow range

Avoid Expected to depreciate up to 10% over a 12-month period

Exit Expected to depreciate more than 10% over a 12-month period