

Elecon Engineering Company Ltd. **INR 81****All's in Order(s)****BUY**

Gateway to Prosperity

Nov 6, 2009

Company Background

Elecon Engineering Company Ltd (Elecon), is one of India's leading manufacturer of Power Transmission & Material Handling Equipment (MHE) with technology based products. It supplies its hi-tech equipment to major core sectors such as steel, fertilisers, cement, coal, lignite & iron ore mines, sugar, power stations & port mechanization in India & Abroad. Elecon is Asia's largest manufacturer of industrial gears & was the first Company in India to introduce modular design concept, case hardened & ground gear technology.

Investment Rationale**➔ Financial performance**

During Q2FY10, Elecon Net Sales stood at INR 2569 mn as against INR 2522 mn, while its Net Profit was at INR 108 mn against INR 160 mn. However decrease in PAT was due to slight increase in depreciation & interest expense during the quarter. However during the year till 30th September, orders of MHE stands at INR 1410 mn while Industrial Gears stands at INR 1980 mn.

➔ Market share plays a key role

Elecon is the market leader in industrial gears with a market share of 26% & is also having a positive presence in Material Handling Equipment. Even offering a wide range of products to various industries helps it, to reduce the risk of its business as poor performance from one of its segments can be fulfilled by other segment.

➔ Order books shows revenue visibility

The company has strong order book of INR 15490 mn, of which INR 13040 mn (84%) is from MHE, while the remaining INR 2450 mn (16%) is from Industrial Gears Segment. Elecon even expects that its wind mill division would able to generate revenue of INR 500 mn in the current fiscal, on the back of better orders & is also expecting to get some good orders from various players.

➔ Growing economy to help more

With the recession near to its end, various companies across different sectors have announced various expansion plans & also with the increasing thrust of the Government on the Indian Infra Sector. With the various expansion plans going on in sector like power, steel, coal, cement, ports etc. Elecon Engineering would be one of the major beneficiaries of these huge investment plans going on.

➔ Strong tie up for technology

In order to acquire expertise & technical know-how to design & manufacture gearboxes for the vertical rolling mill used in the cement & coal industries, Elecon has entered into an agreement with Renk, AG of Germany. It has also signed a technical collaboration agreement for availing the technology to design & manufacture the Lift Gear box with Haisung Industrial Company Ltd of Korea.

➔ Enhancing shareholder's value

The Company has initiated a corporate restructuring exercise with a view to explore various strategic options to consolidate businesses within the group companies, thus enhancing shareholders value, synergy realization & providing financial flexibility for raising further equity/debt to fund future growth plans.

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Info Codes

| | |
|-----------|-----------|
| Reuters | : ELCN.BO |
| Bloomberg | : ELCN@IN |
| NSE | : ELECON |
| BSE | : 505700 |

Market Data

| | |
|----------------------|------------|
| 52 Wk Range (INR) | : 111 / 24 |
| Shares in Issue (mn) | : 92.85 |
| Mkt. Cap (INR bn) | : 7.40 |
| BSE 2 Wk Avg Vol | : 282514 |

Share Holding Pattern (%)

| | |
|------------------|---------|
| Promoters | : 45.71 |
| MFs, FIs & Banks | : 13.29 |
| FIIIs | : 2.02 |
| Others | : 38.98 |

Investment Theme

Elecon is having market share of 26% in Industrial gears & a better presence in MHE segment & is having a wide experience in the related segments. It provides solution to various industries including steel, power, cement, ports, coal etc, thus reducing its business risk. The company expects to flow revenues from its wind mill segment soon & has even bagged better orders for it. The company plans to increase its revenue from exports & is targeting to achieve turnover of INR 1000 mn from it during the current fiscal & has formed 5 JV for marketing its products. Elecon has an ambitious target to grow at a rate of 20% during the Financial Year 2009-10.

Equipping the Core Sectors

Business Segments

➔ Material Handling Equipment (MHE)

Elecon supplies material handling equipment to core sectors such as steel, fertilizer, cement, coal in India & Abroad. The MHE division received ISO 9001 certification in 1999, which brought it international recognition. Product category under the material handling equipment includes trippers, wagon tippers & marshalling equipment, crushers, scrapers, cable reeling drum, wagon loader, roller screen, ship loader, conveyors, feeders, stackers & reclaimers, which are been used for tough duties. Elecon has a modern, well equipped MHE manufacturing plant spanning over 1,17,000 sq mts, in Gujarat. The company derives around 74% of this segment revenues from the power sector itself.

Industry Wise break up for FY09

| Segment | Sales (FY 09) | Order Book (Mar 09) |
|-----------|---------------|---------------------|
| Power | 73.7% | 22.4% |
| Cement | 10.9% | 1.5% |
| Steel | 8.5% | 58.5% |
| Mining | 4.2% | 0.4% |
| Wind Mill | 1.0% | NA |
| Port | 0.2% | 17.2% |
| Others | 1.6% | 0.1% |

(Source:Company)

Elecon’s MHE division has recently bagged a huge order of INR 3235 mn from Bramhani Industries & the total outstanding order bag as on date is worth INR 13040 mn, which the company expects to execute over the next 2 years. The company procures orders on the basis of project as well as the product, of which 70% of the current order book position is on the project basis & the remaining 30% on the product basis. Of the total order book of INR 15490 mn in its kit, more than INR 13040 mn is from the MHE division. However the order flow from last few quarters have been slowed down due to slowdown in the global economy & breaks on the expenditure from the Government side. With the recession near to its end it is expected with the increasing thrust of the Government on the Indian Infrastructure sector, company would be able to grab more orders from this upcoming opportunities.

➔ Gear Division

Elecon is the market leader in the transmission equipments segment which offers a wide range of products in this category. The major categories of gears manufactured are spiral bevel & helical gears, planetary gears, worm gears, couplings & gear boxes for specialized applications, which offer services to various industries like Steel, Marine, Mining, Cement, Fertilizers, Windmills, Sugar, Plastics, Rubber etc. The company has a market share of 26% in industrial gears & is acknowledged as one of the most modern in the gear industry. Most of Elecon's machinery is computerized numerically controlled (CNC) machines that ensure high degree of precision in design, manufacture & quality testing of gear components to DIN/AGMA specifications. Out of the total order book position of INR 15490 mn, industrial gears division accounts for INR 2450 mn, which is to be executed over the next 6 months. Of the current order book position, 55%-60% orders are for the standard gears & the rest for the customized gears. It has also bagged an order of INR 5.8 mn from the Naval department which will be executed within the current season.

Ambitious growth target of 20% in FY09-10.

Elecon, India’s largest Material Handling Equipments, Industrial Gears & Transmission Products manufacturer expects to grow by 20% with Sales Target of around INR 11.5 bn in the current fiscal. The company continues to enjoy a healthy order position by controlling cost & improving efficiency, with having total orders of INR 15490 mn. Export order booking & invoicing target for Gear Division during the year 2009-10 is expected to be around INR 900 mn & 500 mn respectively. To further enhance profitability & make on time deliveries, the company is taking several initiatives to meet the order book. By consistently upgrading the technology with flexible machining systems, quality control equipment, online computerized inventory control & execution programmes managed by using state of the art ERP software, the company has remained ahead of the competition in comparison of its competitors. Through its supplies highly sophisticated equipment, Elecon is now present in core sectors such as fertilizer, cement, coal/power generation, chemical, port mechanization, steel plant etc, in national & international markets. It looks well-placed with increasing investments in the infrastructure sectors, due to increasing thrust of the government, along with the key beneficiaries industries that are linked with the indian infra sector like power, cement, mining & steel.

Industry Wise break up for FY09

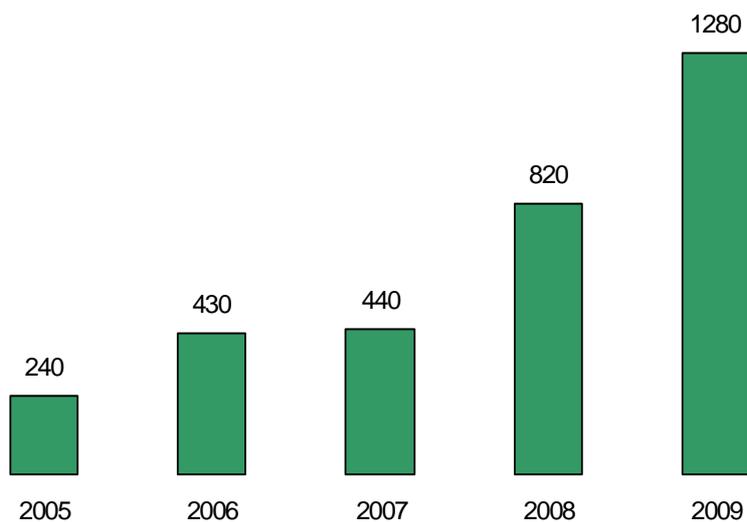
| Segment | Sales (FY 09) | Order Book (Mar 09) |
|-----------------------|---------------|---------------------|
| Material Handling | 22% | 23% |
| Cement | 12% | 11% |
| Sugar | 11% | 14% |
| Steel Conversion | 10% | 10% |
| Plastic & Rubber | 8% | 9% |
| Lift Gears | 8% | 7% |
| Sponge Iron | 5% | 4% |
| Marine | 5% | NA |
| Mining | 3% | 4% |
| Chemical & Fertilizer | 3% | 5% |
| Other | 13% | 13 |

(Source:Company)

➔ Wind Energy segment

The company has entered the high growth Wind Energy segment, where it manufactures & sells wind mills up to 600kw. Elecon currently manufactures only the windmill gearbox & out sources the remaining components required for the wind mill i.e. it manufactures only 10% & the rest 90% is outsourced. Elecon has also put a wind mill gear box plant, to manufacture wind mills gear box up to 1-2 mw. However, the company is in talks with a German client to which it has given the windmill gear box prototypes, which is undergoing testing. Once the design & prototype is approved, the client is likely to place orders for Elecon’s for the windmill gear boxes. In this segment, the company has a capex program of INR 650 mn in the current fiscal, while it has already capitalized capex of INR 1280 mn during the last FY. The entire capex would be funded through USD 10 mn ECB, where the company has already tied up for it.

Capex Infused



(Source: Company)

➔ Group Restructuring ongoing

Elecon has a complex group structure with many unlisted companies & complex holding structure, which has created minority shareholder issues. Accordingly, the management is in the process of creating a lean & transparent structure, which will address minority shareholder issues & increase transparency. The management is in the process of appointing advisors for the same and is trying to complete the process by the year end.

Its Key Orders

The demand for the material handling solution has always been high & is still on a rise, due to tremendous growth in the mining & power industry in India. More & more investments are expected to pool in, with the implementation of mega projects. An equal contribution in the growth of the MHE is from the power, steel, coal, ports and similar industries.

Some of its orders by value

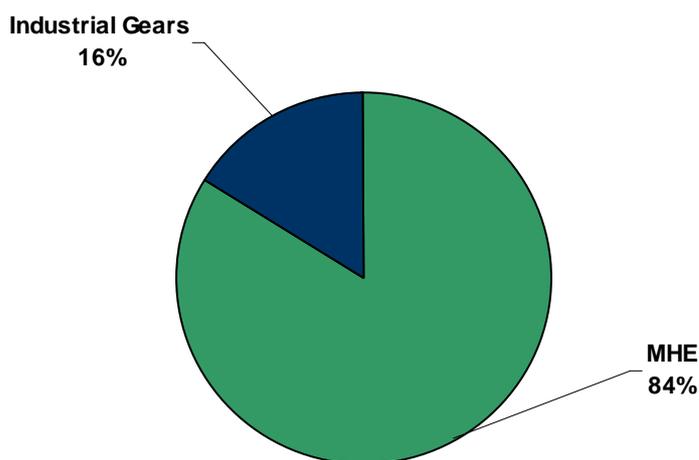
- ➔ Order worth INR 199.9 mn from ABG Cement, Mumbai for supply of Stacker & Reclamimers.
- ➔ Order worth INR 162.5 mn from Tecpro Systems Limited, Chennai for supply of Slewing & Luffing Stacker, Bucket Wheel type Reclaimer and Drive units for Utkal Alumina Project.
- ➔ Order worth INR 150 mn from Penna Cement Industries Limited, Hyderabad for supply of Wagon Tipplers.
- ➔ Order worth INR 120.5 mn from Tecpro Systems Limited, Chennai for supply of Reversible Bucket Wheel type Stacker cum Reclaimer with Hydraulic Drive, Drive Units, Spares for Reversible Bucket wheel type stacker cum Reclaimer with Hydraulic Drive, Spares for Drive Unit.
- ➔ Order worth INR 103 mn from BGR Energy Systems Ltd., Chennai for supply of Rotary Breaker, Ring Granulator, Roller Screen & Mandatory Spares for TNEB’s Mettur Thermal Power Station, 600 MW.
- ➔ Order worth INR 96 mn from POSCO Engineering & Construction Company Ltd, South Korea for the supply of Coal Crusher of Coal Preparation & Coke Handling Facility of No.5 Coke Plant Steel Works.

(To name a few)

➔ Strong order flows shows revenue visibility

The company has a strong order book of INR 15490 mn, of which INR 13040 mn (84.18%) is from MHE segment & the rest INR 2450 mn is from the Industrial Gears segment. Of the total orders, maximum orders are from steel division followed by cement, power & others. The average execution cycle for the Industrial Gears segment is 3-6 months whereas for the MHE segment it is 18-24 months. In the MHE segment, the company has bid for projects worth INR 30000-35000 mn, which are expected to be finalized in the second half of the current fiscal year.

Order Book position



(Source: Company)

➔ Alternate Energy division on track soon

The company has entered in to the high growth wind energy segment, where it manufactures & sells wind mills upto 600kw. The company expects that this division would be able to generate revenue around INR 500 mn in the current fiscal. It has recently bagged a 10 windmill contract worth INR 350-400 mn from Nigeria which it expects to execute in the current financial year, along with 2 wind mills orders.. Elecon has also put a wind mill gear box plant to manufacture wind mills gear box up to 1-2 mw. The company has recently signed an agreement with one of the companies to supply gearboxes with them. It expects to deliver the prototype by December 2009 & once approved will start the full commercial production for the same by March 2010.

Key Financials

| Year Ended Mar 31 st | FY 07 | FY 08 | FY 09 |
|---------------------------------|----------------|----------------|----------------|
| Revenue (INR mn) | 7513.4 | 8575.3 | 9846.1 |
| Rev. growth (%) | 61.64 | 14.13 | 14.82 |
| EBITDA (INR mn) | 1164.2 | 1405.1 | 1565.4 |
| Net profit (INR mn) | 548.9 | 672.0 | 549.7 |
| Shares outstanding (mn) | 30.9 | 92.85 | 92.85 |
| EPS (INR) | 17.8 | 7.2 | 5.9 |
| EPS growth (%) | (63.67) | (59.26) | (18.20) |
| P/E (x) | 7.3 | 26.1 | 5.3 |
| EV/ EBITDA | 36.8 | 127.9 | 21.9 |
| ROCE (%) | 25.44 | 22.02 | 12.92 |

Key Customers

MHE

Power

BHEL, NTPC, BGR Energy, Torrent power
AEC Limited

Steel

SAIL, JSW Steel Ltd, Sical Iron ore Terminals

Mining & Coal

DVC, Neyveli Lignite Corporation, NMDC

Cement

Gujarat Ambuja Cement, Panna Cement, Madras Cement

Others

Mcnally Bharat Engg co Ltd, Tecpro Systems Pvt Ltd

Industrial Gear

Power

NTPC, MSEB

Mining

NMDC, Neyveli Lignite Corporation

Defence

Indian Navy, Coast Guard

Lift Gears

Schindler India

Wind Mill

NEPC, Pioneer Wincon

Sugar

Bajaj Hindustan Ltd

Core Sectors MHE

ThyssenKrupp Elevator Pvt Ltd

Steel

Tata Steel, JSE Steel & SAIL

Sponge Iron

Jindal Steel & Power

Cement

ACC, Panna Cement, Ultra Tech

Chemical

RCF

Plastic

Rajoo Engineers, DGP Windsor

Financial Statements

Income Statement

(INR mn)

| Year end Mar 31 st | FY 07 | FY 08 | % Chg | FY 09 | % Chg |
|-------------------------------|--------|--------|--------|---------|---------|
| Operating Income | 8394.6 | 9503.8 | 13.21 | 10493.0 | 10.41 |
| Other Income | 82.3 | 98.0 | 19.08 | 95.8 | (2.24) |
| Change in Stocks | 97.1 | 470.9 | 384.96 | 1055.0 | 124.04 |
| Raw Material Con. | 4525.0 | 5457.9 | 20.62 | 6145.2 | 12.59 |
| Employee Exp. | 290.2 | 342.8 | 18.13 | 438.3 | 27.86 |
| Excise | 963.5 | 1026.5 | 6.54 | 742.7 | (27.65) |
| Other Exp. | 1631.1 | 1840.4 | 12.83 | 2752.2 | 49.54 |
| Operating Exp. | 7312.7 | 8196.7 | 12.09 | 9023.4 | 10.09 |
| Operating Profit | 1081.9 | 1307.1 | 20.82 | 1469.6 | 12.43 |
| Total Interest | 193.6 | 274.3 | 41.68 | 483.7 | 76.34 |
| Gross Profit | 970.6 | 1130.8 | 16.51 | 1081.7 | (4.34) |
| Net Dep. | 126.7 | 144.1 | 13.73 | 225.5 | 56.49 |
| Total Taxation | 295.0 | 314.7 | 6.68 | 306.5 | (2.61) |
| Net Profit/Loss | 548.9 | 672.0 | 22.43 | 549.7 | (18.20) |

4 Years Balance Sheets

(INR mn)

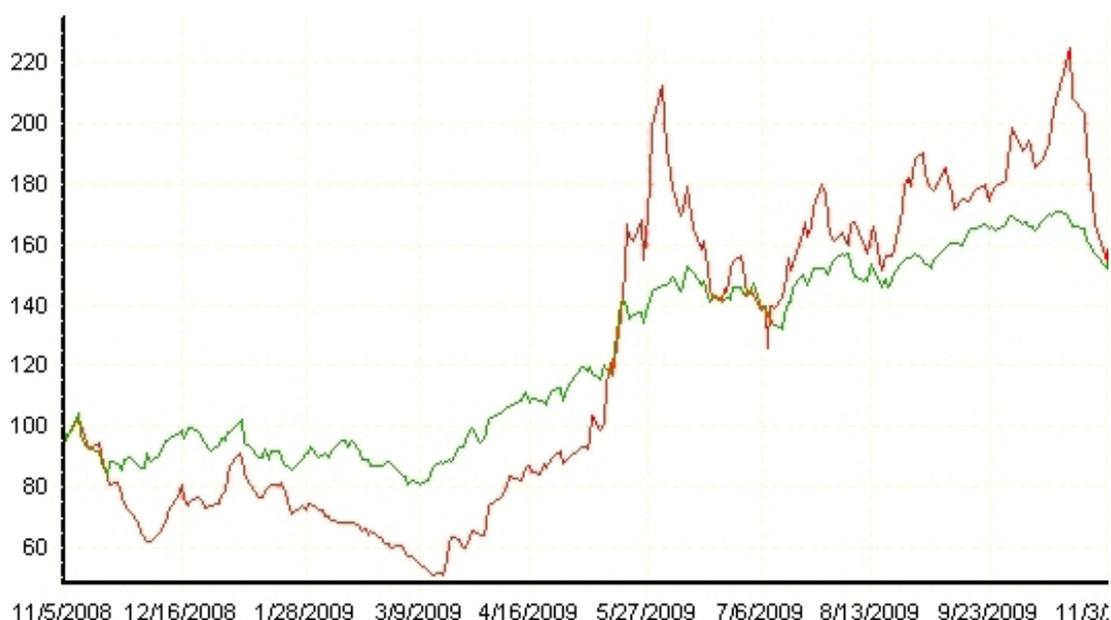
| Balance Sheet as on 31 st | Mar 2006 | Mar 2007 | Mar 2008 | Mar 2009 |
|--------------------------------------|---------------|---------------|---------------|---------------|
| SOURCES OF FUNDS | 3081.1 | 4712.9 | 6459.9 | 8674.6 |
| Equity Share capital | 57.1 | 61.8 | 185.7 | 185.7 |
| Share Application Money | 0.0 | 0.0 | 0.0 | 0.0 |
| Preference Share Capital | 0.0 | 0.0 | 0.0 | 0.0 |
| Reserves & Surplus | 969.7 | 1817.3 | 2181.5 | 2568.3 |
| Loan Funds | 1506.1 | 2672.9 | 3329.4 | 5236.0 |
| Unsecured Loans | 548.2 | 160.9 | 763.3 | 684.6 |
| USES OF FUNDS | 3081.1 | 4712.9 | 6459.9 | 8674.6 |
| Gross Block | 2027.2 | 2466.5 | 3005.6 | 4277.4 |
| Less : Revaluation Reserves | 0.0 | 0.0 | 0.0 | 0.0 |
| Less : Accumulated Depreciation | 1181.6 | 1243.8 | 1234.0 | 1448.3 |
| Net Block | 845.6 | 1222.7 | 1771.6 | 2829.1 |
| Capital Work in Progress | 106.6 | 44.7 | 159.2 | 281.1 |
| Investments | 62.9 | 80.3 | 94.5 | 108.7 |
| Current Assets | 4336.8 | 6101.2 | 8111.8 | 10086.4 |
| Less : Current Liabilities | 2293.8 | 2740.3 | 3686.9 | 4647.6 |
| Net Current Assets | 2043.0 | 3360.9 | 4424.9 | 5438.8 |
| Misc. Expenses not written | 23.0 | 4.3 | 9.7 | 16.9 |
| NOTE | | | | |
| Bk Val Unquoted Investments | 32.3 | 49.8 | 64 | 78.1 |
| Mkt Val. Quoted Investments | 342.9 | 536.7 | 589.1 | 294 |
| Contingent Liabilities | 508.7 | 205.7 | 1068.5 | 1098.2 |
| Dividend (%) | 50 | 75 | 75 | 75 |

Quarterly Income Sheets

(INR mn)

| Quarter Ended | Dec 08 | Mar 09 | Jun 09 | Sep 09 |
|-----------------------|--------|--------|--------|--------|
| Net Sales | 2466.6 | 2935.6 | 2144.8 | 2569.3 |
| Cost Of Sales | 1686.2 | 2057.2 | 1513.5 | 1919.9 |
| Operating Profit | 780.4 | 878.4 | 631.3 | 649.4 |
| Recurring Income | 0.0 | 0.0 | 0.0 | 0.0 |
| Adjusted PBDIT | 780.4 | 878.4 | 631.3 | 649.4 |
| Financial Expenses | 141.8 | 158.2 | 144.2 | 134.0 |
| Depreciation | 56.1 | 69.8 | 74.9 | 78.0 |
| Other Write Offs | 0.0 | 0.0 | 0.0 | 0.0 |
| Adjusted PBT | 582.5 | 650.4 | 412.2 | 437.4 |
| Tax Charges | 57.0 | 102.4 | 43.7 | 55.2 |
| Adjusted PAT | 525.5 | 548.0 | 368.5 | 382.2 |
| Non Recurring Items | 0.0 | 0.0 | 0.0 | 0.0 |
| Other Non Cash Adjust | 400.4 | 378.2 | 283.5 | 274.5 |
| Net Profit | 125.1 | 169.8 | 85.0 | 107.7 |

52 Week Index Relative Percentage Appreciation



Elecon with Sensex

Risks Associated

Slowdown in Economy

Growth in the MHE segment as well as the Industrial Gears segment is dependent on investment happening in the core sectors like power, steel, sugar, cement, etc. Hence any slowdown in investment will impact the demand for this segments & thus would impact company's financials.

Rising cost of raw materials

Iron & Steel, Pipes & Tubes etc are the basic raw materials used in the infra sector. Hence any increase in the cost of the raw materials would impact the margins of the companies engaged in this sector.

Breaks on expansion

Most of the companies engaged in this sector are totally dependent on the projects which are been undertaken from its valuable clients. Hence any deferrals from the client for execution of the project may affect the top line as well as the bottom line of the company.

In a Nutshell

Elecon Engineering Company Limited is a leading manufacturer of mission critical Material Handling Equipment and Power Transmission Solutions for Defence, Mining, Power, Steel, Plastic, Sugar & Cement amongst other sectors. With the increasing thrust of the government & high spending expected during the next few years, Elecon would be one of the key beneficiaries of the increased investment in sectors such as power, cement, mining & steel. Several Companies across sectors have announced expansion plans & there seems to be huge opportunity for Elecon Engineering, as the material handling equipment & the power transmission equipment which it manufactures, are utilized by these companies. The Company plans to increase its revenue from exports & is targeting to achieve an export turnover of close to INR 1000 mn in the current financial year & for this the company has formed five joint ventures (JVs) for marketing its products in line with this target. In order to acquire the required expertise & technical know-how to design and manufacture gearboxes for the vertical rolling mill used in the cement & coal industries, Elecon has entered into an agreement with Renk, AG of Germany.

Indira Group Offices

| | |
|-----------------------------------|---|
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Rating Interpretation

| | | | |
|-------------------|---|-------------------|---|
| Buy | : Expected to appreciate 20% or more over 12-months | Reduce | : Expected to depreciate up to 10% over 12-months |
| Accumulate | : Expected to appreciate up to 20% over 12-months | Sell | : Expected to depreciate 10% or more over 12-months |
| Trade Buy | : Expected to appreciate more than 10% over 45-days | Trade Sell | : Expected to depreciate more than 10% over 45-days |

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