



Long way to Go..

9th May, 2016

CMP: Rs. 63

Recommendation Not Rated

Stock Info

BSE Group	B
BSE Code	505700
NSE Symbol	ELECON
Bloomberg	ELCN IN
Reuters	ELCN.NS
BSE Sensex	25,522
NSE Nifty	7,819

Market Info

Market Capital	Rs 694 cr
Equity Capital	Rs 21.8 cr
Avg. Trading Vol	72,145
52 Wk High/ Low	Rs 97/42
Face Value	Rs 2

Shareholding Pattern (%) (Mar 2016)

Promoters	57.4
Domestic Institutions	8.5
Foreign Institutions	0.5
Public & Others	33.6

Price Vs Sensex Chart



Elecon Engineering Company, founded in 1951, is engaged in delivering power transmission solutions and material handling equipment. The company caters to the needs of various sectors like steel, fertilizers, cement, coal, lignite and iron ore mines, sugar, power stations and port mechanization in India and abroad. It has emerged as the largest gear manufacturing company in Asia.

This company manufactures sophisticated gears for each division; so far this company has 3 major Divisions:

Power Transmission solutions- This division of company design and manufactures worm gears, parallel shaft and right angle shaft, helical and spiral bevel helical gears, fluid, geared and flexible couplings and planetary gear boxes. These products are supplied to sectors such as sugar, cement, chemical, fertilizer, steel, plastic extrusion and rubber. The company has received ISO 9001:2000 certification for its quality management.

Material handling equipments- Under this, the company manufactures products such as belt conveyors, stacker-cum-reclaimers, pusher cars, idlers and pulleys, barrel type blender reclaimers, ship loaders and unloaders, stacker, bridge type bucket wheel reclaimers, crawler mounted bucket wheel excavators, wagon tippers and side arm chargers, crushers and feeders. This division caters the need of various industries such as steel, fertilizer; cement, coal; lignite and iron are mines, power stations and port mechanization in India and abroad.

Wind Power- Elecon manufactures wind turbines of 300 KW and 600 KW capacities at the unit located at **Vallabh Vidynagar in Gujarat**. The company has entered into technical collaboration with Turbo wind of Belgium with an aim to manufacture quality wind turbines.

We had participated in investor day which was conducted by Elecon Engineering on 29th April in Mumbai, Company illustrated about their recent merger with EPC along with future business Model, investments, Expansion plans, New ventures into other countries, Corporate Action & future revenue guidance. The highlights are as follows.

The merger of Elecon EPC into Elecon was necessitated as some of the advantages that management envisaged in the earlier demerger did not get into down to both the divisions. While management did see some momentum in the Transmission business, the material handling business was bogged down by tough industry and macroeconomic conditions. Company believe the merger of the EPC business back into the parent would deliver economies of scale and financial benefits that would benefit both the Company and the shareholders.

The merger with Elecon will enable smooth functioning of business verticals currently housed within Elecon EPC and would improve operational efficiencies within the verticals. India's EPC Industry is facing a slow down due to various reasons including delay in governmental clearances, environmental approvals and land acquisitions etc. The Company's strategy on moving away from EPC projects and focusing solely on the equipment's business would further cement the consolidation with Elecon which is being envisaged.

**Strategic Rationale:**

- The Scheme envisages amalgamation of Elecon EPC into Elecon, resulting in consolidation of the business in one entity and strengthening the position of the merged entity, by enabling it to harness and optimize the synergies of the two companies.
- The proposed amalgamation of Elecon EPC into Elecon is in line with the global trends to achieve size, scale, integration and greater financial strength and flexibility and in the interests of maximizing shareholder value.
- Elecon EPC and Elecon believe that the financial, managerial and technical resources, personnel capabilities, skills, expertise and technologies of Elecon EPC and Elecon pooled in the merged entity, will lead to increased competitive strength, cost reduction and efficiencies, productivity gains, and logistic advantages, thereby significantly contributing to future growth.

Highlights- Gear Business: Largest gear manufacturer in Asia, Company has most comprehensive range of industrial gears. There are two main segments of operation includes catalogue (standard) product and engineered (customized) product.

In Gear business, company revenue increased by 3.1% YoY to Rs 518.8 Crs from Rs 503.2 Crs. Compared to the previous year. Profit for company increased by 30% this year due to Improvement in gross margins as a result of technology initiatives.

Order book position: This year company had order bookings of Rs 1,025 out of total Rs 1,747 and Rs,722 are pending. On gear business company may get higher margin in future in the range of 20-22 percent by looking at stronger order book.

Recent initiatives:

- Developed a first of its kind 1500 MM size gear box for Cement industry.
- Reduction in manufacturing lead time due to innovation in worm shaft cylindrical grinding.
- Setup of a fully fledged training centre to train employees to match international standards.

Sales Mix – in Gear Segment.

Sectors	% Of sales
Material Handling	8
Cement	9
Sugar	7
Steel & Metal	7
Chemical	4
Marine	3
Plastic & Rubber	3
Crane	2
Mining	2
Power	28
Others	23



Target Industry Opportunity

Elecon engineering focused major industries like Power, sugar & Cement etc. and company is already in talks with counter parties to get contracts for these industries. Company also got an approval from Indian Navy for their new defence hybrid ships and we believe this contract will add company's top line by end of 2nd quarter for this fiscal year.

Power : Contributes over 28% to the business, One of the most wide product ranges and Government has already identified power as a core sector and anticipates \$350b investments in the next 10 years.

Cement: Contributes ~10% to the top line and company has started seeing traction in terms of enquiries. The Government plans to increase investment to the tune of US\$ 1 trillion and increase the industry's capacity to 150 MT

Sugar: Contributes ~7% to the business. The recent initiatives by Government are likely to revive fortunes of Sugar industry which is world's 2nd largest sugar producer at 28 million tons.

Steel: Contributed about 7% in fiscal 2016, likely to see uptick in the coming years. The Government has also reiterated commitment to support the steel industry to reach a production target of 300 Million Tonne Per Annum (MTPA) in 2025.

Marine: Recently received orders worth of INR 5b in the marine space. Ex-Defence, the Government also plans to investment INR 700b in 12 major ports in the next five years under 'Sagarmala' initiative

Chemicals: India is the third largest producer of chemicals in Asia and sixth by output, in the world. A large population, huge domestic market dependence on agriculture and strong export demand are the key growth drivers for the industry.

Gears Business- International

Radicon (David Brown) is a brand name known in Europe for over 70 years as an expert in high quality gears. Radicon and Benzlers deal - the company's first international acquisition in 2010 and it seems smooth way for globalising its offering.

In international business company's revenue decreased by 7.2% YoY to Rs 296.9 Crs from Rs 320 Crs. Compared to the previous year. ELECON experienced EBITDA margin of 7% this year, a significant improvement over the previous year. Company had restructured the business in order to ensure greater focus.

Order book position: This year company had total order bookings of Rs 23.1 out of Rs 83.1crs and Rs 60 crs are pending.

Recent Technology Initiatives:

- Developed new series of cooling tower gear boxes to cater to the power sector.
- Developing shaft mounted planetary gear boxes for sugar industry.
- Developed new series of EON/EOS to be more competitive in the market.



Material Handling (MHE) business

Elecon EPC Projects Ltd. so formed, is today, the 3rd largest Material Handling Equipment Company in India with in-house design, manufacturing, fabrication, component manufacturing and support services in a vertically integrated model.

In this segment company's revenue decreased by 7.8% YoY to Rs 479.5 Crs from Rs 520.1 Crs. Compared to the previous year. Business performance affected due to headwinds in economy leading to slower execution of projects at the client level.

The company bagged a second big order from the government worth Rs 225 crore for supply of marine gearboxes. With this order, from Garden Reach Ship builders & Engineers - a warship building company, the total order book of Elecon from the gearboxes business stands at around Rs 750 crore, According to the management The company had recently bagged another Rs 300-crore order from Mazgaon Dock. The order book of the Engineering, Procurement & Construction (EPC) business is currently at around Rs 900 crore, the gearboxes business contributes nearly 60 percent to total revenues of company and has EBITDA margins of over 20 percent, however, is concerned that the exports target might be missed due weakness in European markets.

Recent Technology Initiatives:

- New Equipment developed:
 - Stacker with "C" Frame design and 4200/4600 TPH capacity
 - High speed rollers
- Developed 3 Pile reclaimer for bulk material from pile to feed to conveyor
- Pipe conveyor of 7.5 km length , one of the longest conveyors in the world

Future outlook

As per a recent survey the global gear manufacturing market is expected to grow at a CAGR of 5.33% over the period 2014-19. One of the key factors contributing to this growth is the growth in emerging markets. Another study expects global gear demand to grow to US \$217 billion by 2018.

The engineering sector is a growing market. Current spending on engineering services is projected to increase to US \$1.1 trillion by 2020. Elecon total debt is round about Rs 600 odd crore. Out of which Rs 350 crore is Working capital. Company has been slowly and gradually reducing it over a period of time and believes that there is continuous exercise to further bring it down.

- ✓ Exemplary government support in union budget towards power, mining, and ports sectors.
- ✓ Government initiative of allowing private sector participation by opening up the defence sector to 26% FDI.
- ✓ Speedier project clearances along with declining interest rates should provide the much needed impetus to the sector.

**Growth outlook:**

Revenue outlook INR in cr	Gears		Material Handling		Benzlers & Radicon	
	2016	2019	2016	2019	2016	2019
	518	650	479	600	300	400
Margins	18-23%	25-28%	13-13%	13-19%	3-5%	8-10%

The Company is confident that the economic upturn could lead to a pipeline of opportunities that could be mined to register a strong growth in the fiscal 2017, with a sustainable business model with robust outlook based on economic growth and scale.



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Stock Rating Scale

	Absolute Return
Buy	> 20%
Accumulate	12% to 20%
Hold	5% to 12%
Neutral	-5% to 5%
Reduce	< -5%

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