

CMP	Target	Rating
Rs. 145	Rs. 170	Buy

Elgi Equipments (ELEQ), a key manufacturer of air compressors with a **market share of ~22% in India**. Elgi's total revenues grew at a healthy CAGR of 20% in the past 5 years, but witnessed **muted growth in the domestic market over the past three years (2% CAGR in FY11-FY14)** on the back of weak demand environment. **EBITDA margins has been under strain due to increased competition, lack of operating leverage in domestic markets and losses in international subsidiaries**. **ELEQ is looking at increasing the contribution of high margin after sales service and shift sourcing for its international operations to low cost destinations (India and China) to improve its overall operating margins**. Increasing growth momentum primarily by **increasing focus on international markets (>15% y-o-y growth expected)**, **expanding product range and strengthening sales traction in new products (oil-free screw compressors)** are the key focus areas. We expect growth in the domestic market to witness a gradual recovery from FY17E as demand from key end-user industries – mining and construction is expected to recover. **In-house foundry in the newly commissioned facility would possibly result in better operating margins in this cycle.**

While the **industrial capex is unlikely to pick-up in FY16E in our view**, we see Elgi's growth prospects would be more back-ended from a three-year perspective. Notably, Elgi witnessed a sharp uptick in FY09-FY11 (27% revenue CAGR and EBITDA CAGR of 38%). Considering the **turnaround in the international subsidiaries, strong product portfolio, no major capex and the company's efforts to increase after sales service**, we are **directionally positive on the stock**. We believe ELGI has strong product portfolio to compete against the global players with "MAKE FOR INDIA" approach

- **Domestic markets to witness gradual recovery** – Revenues in the **domestic segment has remained flat over the past 3 years on the back of prolonged weakness in the water-well segment and subdued industrial segment growth**. A pick up in capex activity in key end-user segments – mining and construction should revive demand for compressors. **We believe demand recovery in the domestic market to begin from FY17E translating to ~18% CAGR in FY15-FY17E.**
- **Focus on high margin after-sales service** – Revenue **contribution from their high margin after sales services is currently ~26% in the domestic business and ranges between ~10% across various geographies**. ELEQ is aiming at increasing this further (especially international markets) to improve overall margins.
- **Turnaround in Pattons and Belair to revive international margins** – Sales in Pattons (US based compressor distributor acquired by Elgi in Nov'12) has contracted sharply after key executives were poached by its competitor. While the case against Atlas Copco has been awarded in favor of ELEQ by the US court, Patton's EBITDA has been impacted in FY15. **Recruitment of new professionals in 2HFY15 should stabilize the operations**. Similarly, Belair (France) is also progressing better after strengthening both the management and marketing team. Turnaround in these two entities should improve international margins going forward
- **Major capex completed, sufficient capacity to accommodate growth in the medium term** – ELEQ has **commissioned the new 'air-end' and foundry facilities which are currently operating at a capacity utilization of ~60-65%**. The current facility with global standards can comfortably accommodate strong revenue growth over the next 2-3 years.

Financial summary (Consolidated)

Year	Revenues (Rs. mn)	EBITDA (Rs. mn)	PAT (Rs. mn)	EPS (Rs.)	P/E(x)	RoE (%)
FY14	13,504	1,013	455	2.9	50.5	10.2
FY15E	13,194	947	525	3.3	43.8	10.7
FY16E	15,173	1,375	840	5.3	27.4	15.8
FY17E	18,208	1,869	1,224	7.7	18.8	21.1

Initiating Coverage

Date	Mar 24, 2015
Market Data	
SENSEX	28470
Nifty	8635
Bloomberg	ELEQ IN
Shares o/s	158mn
Market Cap	Rs. 22.9bn
52-wk High-Low	Rs. 175-94
3m Avg. Daily Vol	Rs. 12mn
Index member	BSE500
Latest shareholding (%)	
Promoters	31.9
Institutions	25.6
Public	42.5

Stock performance (%)

	1m	3m	12m
ELEQ	-4%	-2%	44%
Sensex	-3%	4%	30%
CG Index	-1%	12%	49%

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Corporate Factsheet	
Company Background	Elgi Equipments was established in 1960 as a service station equipment and reciprocating compressor manufacturing company. Over the years Elgi has emerged as a leading manufacturer of diverse range of air compressors and automotive servicing equipments in India. Elgi has two manufacturing locations in Coimbatore, with 352,000 sq ft of built up factory area.
Presence	It caters majorly to the Indian market and is actively expanding internationally to different countries including Australia, Brazil, China, countries in Europe and the US.
Management depth	Mr. Jairam Varadaraj (MD) Mr. Jairam joined Elgi in 1992 as the Deputy Managing Director and took over as Managing Director in 1994. Previously, he has worked in the US as a research assistant to study computerized marketing simulation as well as researched on euro-bond markets. He has also conducted detailed research studies on the international financial markets, euro currency markets, joint venture, corporate strategy and technology transfers in the US
Business	Elgi Equipments is engaged in the manufacturing of bore well, reciprocating, centrifugal and screw compressors. It also manufactures automotive garage equipment that includes lifting equipment, body shop equipment, wheel servicing equipment etc.
Corporate Structure	As on March FY14, Elgi had two Indian, eleven foreign subsidiaries and one Joint Venture (JV)
Revenue Model	Compressors (87% of FY14 Revenue), Automotive equipments (9% of FY14 Revenue) and others (4% of FY14 Revenue)
Capacity	It has 2 manufacturing plants in Coimbatore with a capacity of 32500 compressors per annum
Key Clientele	Compressors – Diverse client base across various industries including, water well, mining, textile, pharmaceuticals & railways Automotive equipments – Automobile garage/ service stations
Key Success Factors	Diverse product range and strong after sales service has led to Elgi secure a loyal customer base in the domestic market and expand internationally
Credit Rating	Long Term: AA, Short Term: A1+
Corporate Bankers	State Bank of India, Central Bank of India
Auditors	M/s RJC Associates

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Particulars	4QFY13	1QFY14	2QFY14	3QFY14	4QFY14	1QFY15	2QFY15	3QFY15
Net Sales	3,656	3,476	3,181	3,248	3,513	3,219	3,184	3,189
Raw material consumed	2,142	2,019	1,897	1,832	2,051	1,806	1,746	1,826
Employee Costs	546	587	559	609	573	613	604	650
Other Costs	670	542	531	591	721	587	566	588
Cost of Goods Sold	3,358	3,148	2,987	3,032	3,345	3,006	2,916	3,063
EBITDA	298	328	194	216	169	213	268	126
% of Sales	8.2%	9.4%	6.1%	6.7%	4.8%	6.6%	8.4%	3.9%
Depreciation	57	54	67	68	74	68	77	103
Other Income	73	32	59	38	48	54	23	277
EBIT	314	307	186	187	143	199	213	300
Interest	28	27	25	29	16	35	32	44
PBT	286	280	161	158	127	164	181	257
Total Tax	84	103	81	43	42	35	43	94
PAT	202	177	79	115	84	130	138	163
PAT Margin	5.5%	5.1%	2.5%	3.5%	2.4%	4.0%	4.3%	5.1%
ETR %	29.3%	36.8%	50.7%	26.9%	33.4%	21.1%	23.9%	36.5%
EPS	1.3	1.1	0.5	0.7	0.5	0.8	0.9	1.0

Revenue growth has been muted over the past two years due to weak sales in both industrial and water well segments in the domestic market

EBITDA margin continues to remain weak due to muted margins/losses in the international subsidiaries

Other income of Rs. 277mn in 3QFY15 includes Rs. 220mn received from Atlas Copco related to a litigation in the US.

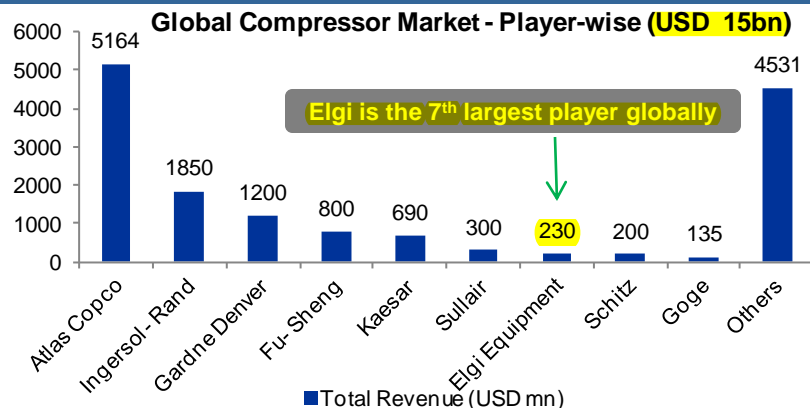
Earnings growth was subdued over the past two years

Compressor market

Business Overview – Global Markets – **Atlas Copco is the clear leader, Elgi has increased intl. presence**

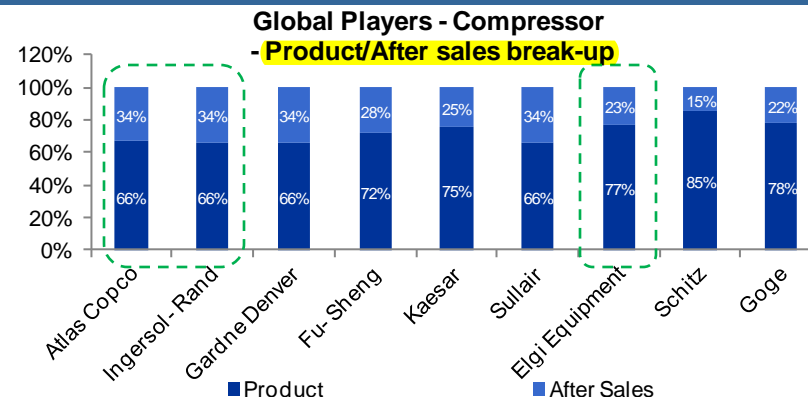
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Global compressor market – Player-wise



Source: Industry, Spark Capital Research

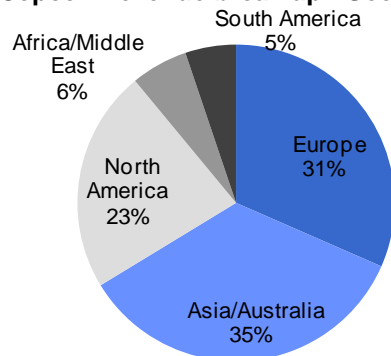
Market leaders **Atlas Copco and Ingersoll Rand have higher after-sales share**



Source: Industry, Spark Capital Research

Atlas Copco global has diversified presence across the globe

Atlas Copco - Revenue break-up - Geography-wise



Source: Atlas Copco Global, Spark Capital Research

ELEQ has significant intl. presence mainly through acquisitions

Country/Region	FY14 Revenue (Rs. mn)	% of Consolidated Revenue	Comments
US	1882	13.9%	Through acquisition of Pattons' in 2012
Italy	1462	10.8%	Through acquisition of Rotair in 2012
France	581	4.3%	Through acquisition of Beliar in 2010
Gulf	377	2.8%	
Brazil	257	1.9%	
China	201	1.5%	
Australia	40	0.3%	
Indonesia	4	0.0%	
Total	4804	35.6%	

Source: Industry, Spark Capital Research

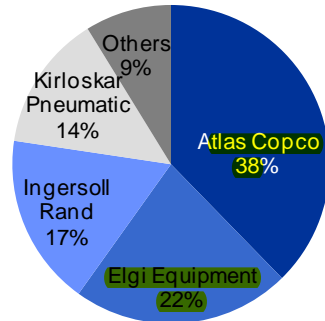
Compressor market

Business Overview – Domestic Market – Oligopolistic market, witnessing near term weakness

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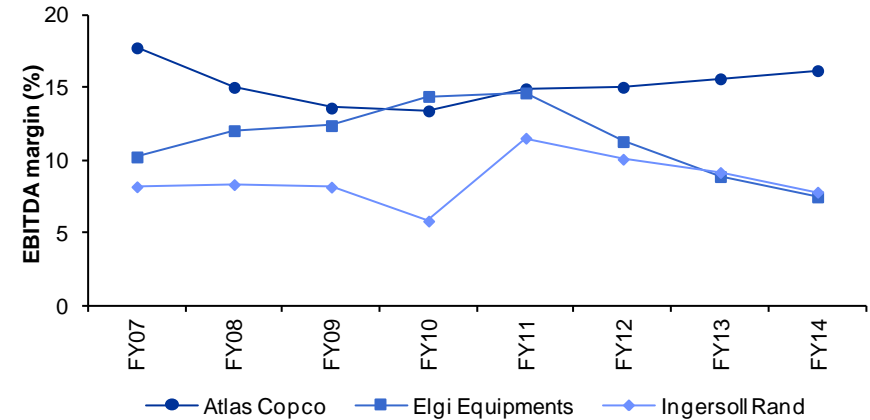
Indian compressor industry is an oligopolistic market, Elgi is the No.2 player

FY14 India Compressor Market
- Player-wise - Rs. 30bn



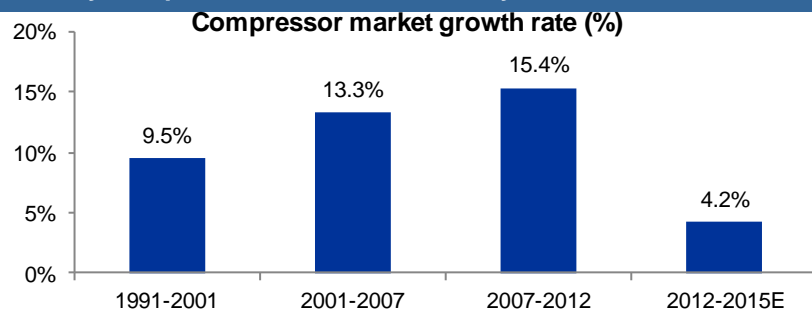
Source: Industry, Spark Capital Research

Atlas Copco has better margins due to higher after sales service



Source: Company, Spark Capital Research

Historically compressor market has been cyclical in nature

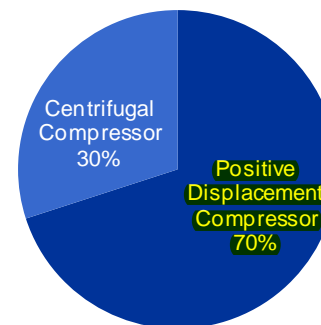


ELEQ has grown at a CAGR of 11.8% and 16.0% in '01-'07 and '07-'12 respectively. We believe overall domestic compressor market growth to pick up in '15-'20 and expect ELEQ to sustain/gain market share during the period through introduction of new products and better after sales service

Source: Industry, Spark Capital Research

Compressor market – Product-wise break-up; Elgi has been into positive displacement compressors. It is currently foraying into centrifugal compressors

Compressors - Product wise break-up (%)



Positive Displacement Compressor

- Piston Type
- Rotary -Screw
- Vane Compressor

Negative Displacement Compressor

- Centrifugal Compressor (large rating >500 HP, used widely in Oil & Gas, Fertilizer industries)

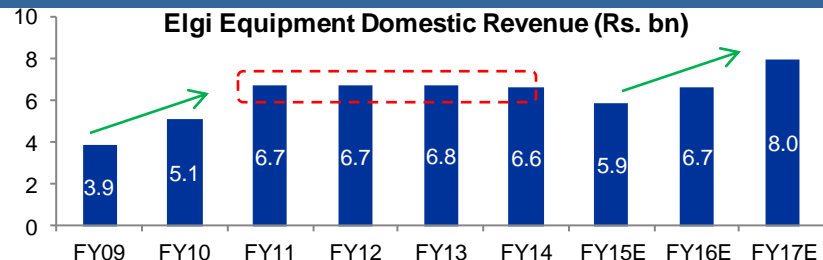
Source: Industry, Spark Capital Research

Elgi Equipments

Domestic Business – Subdued demand environment prevailing; **industrial, mining recovery to drive growth in the medium term**

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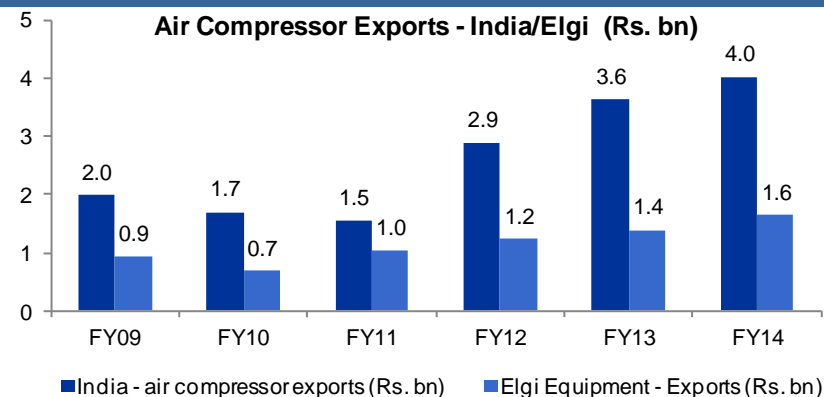
Growth in the domestic market has been subdued due to weak macro



ELEQ has witnessed >30% CAGR growth in FY09-FY11 in the domestic business on the back of strong traction from construction and mining industries. Muted activity in these two segments and sharp fall in cyclical water well business has impacted growth for ELEQ for the past 3-4 years. We expect recovery in construction and mining activities to drive growth going forward

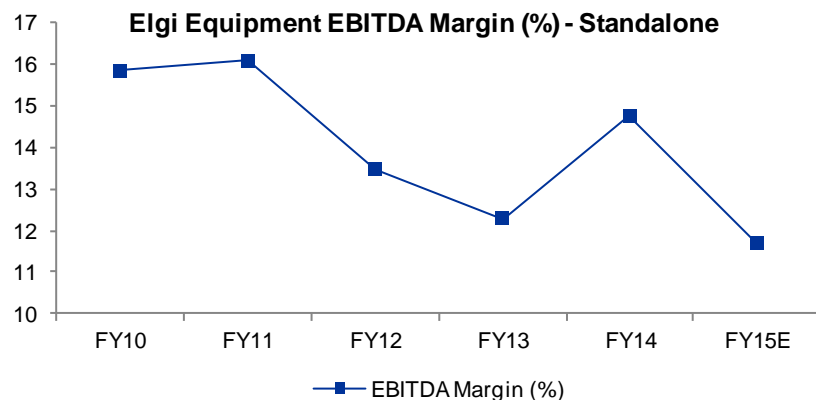
Source: Company, Spark Capital Research

Exports has compensated for domestic weakness, Elgi contributed to ~40% of India's air compressor exports



Source: Company, Spark Capital Research

Margins on a declining trend due to shift in product mix (lower high margin water well business), lack of operating leverage



Source: Company, Spark Capital Research

End –user sectors witnessing signs of recovery

Application Industry	Current demand Scenario	Growth traction/Outlook
Construction	Weak	Pick-up in road/building construction activity
Mining	Weak	Improved demand from marble, granite mining, etc
Water Well	Very weak	Pick-up in demand from agriculture. Partly linked to monsoon/water table.
Industrial	Improving	Textile, pharma, food processing industries is witnessing improved traction. However recovery in core industries cement and steel is absent
Railways	Improving	Increase in railway budgetary allocation from Rs. 260bn in FY14 to Rs. 290bn in FY15

Source: Industry, Spark Capital Research

Elgi Equipments

International – Turnaround in Bellair, Patton's to lead international margin recovery

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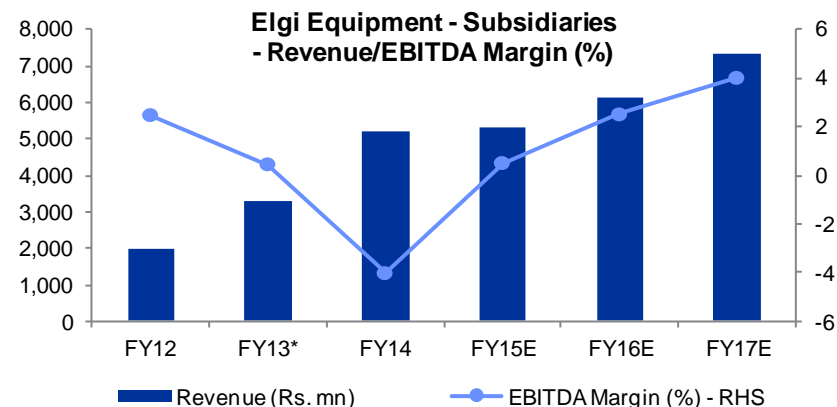
ATS Elgi	FY11	FY12	FY13	FY14
Revenue from operations	1,146	1,320	1,467	1,255
Profit before Tax	130	169	178	108
Provision for Taxation	46	51	55	30
Profit after Tax	83	119	123	79
PAT Margin (%)	7.3%	9.0%	8.4%	6.3%

SAS Belair	FY11	FY12	FY13	FY14
Revenue from operations	407	499	451	581
Profit before Tax	(4)	(87)	(94)	(198)
Provision for Taxation	-	-	-	-
Profit after Tax	(4)	(87)	(94)	(198)
PAT Margin (%)	-1.1%	-17.4%	-20.8%	-34.1%

Patton's	FY13	FY14
Revenue from operations	631	1,700
Profit before Tax	57	(190)
Provision for Taxation	15	(98)
Profit after Tax	42	(92)
PAT Margin (%)	6.7%	-5.4%

Rotair Spa	FY13	FY14
Revenue from operations	649	1,462
Profit before Tax	26	73
Provision for Taxation	6	29
Profit after Tax	20	44
PAT Margin (%)	3.0%	3.0%

Margins at subsidiary level is expected to improve



Source: Company, Spark Capital Research, * - Includes Rotair and Patton's acquisition

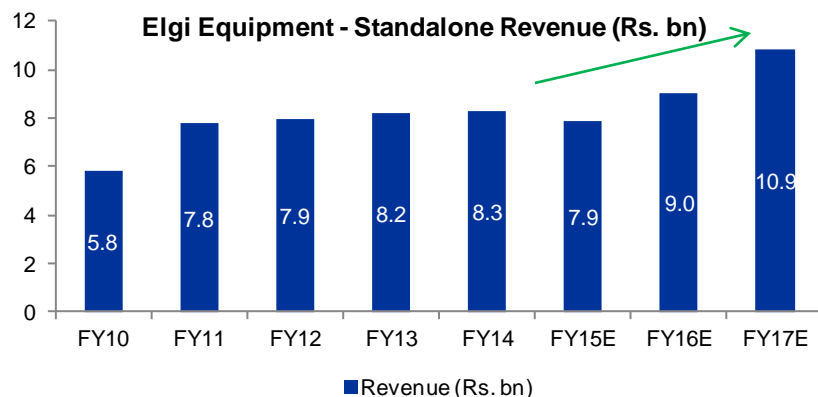
- **Patton's** - Sales in Pattons (US based compressor distributor acquired by Elgi in Nov'12) has contracted sharply after key executives were poached by the competitor. While the case against Atlas Copco has been awarded in favour of ELEQ by the US court, Patton's EBITDA has been impacted. Recruitment of new professionals and strengthening of marketing team should stabilize the operations going forward
- **Belair** - Elgi acquired France based company Belair in 2010 for EUR 0.7mn. Belair's business was impacted on the back of changes in the top management. Operations are expected to have stabilized currently and in is the process of turning around.
- **Rotair** - Elgi acquired Rotair, an Italy based manufacturer of portable compressor in 2012. Strong growth in FY14 and is expected to have maintain growth momentum in FY15 also
- **ATS Elgi** - It is a manufacturer of automobile garage servicing equipments. A pick-up in the automobile industry is expected to drive growth in this business

Elgi Equipments

Financial Analysis

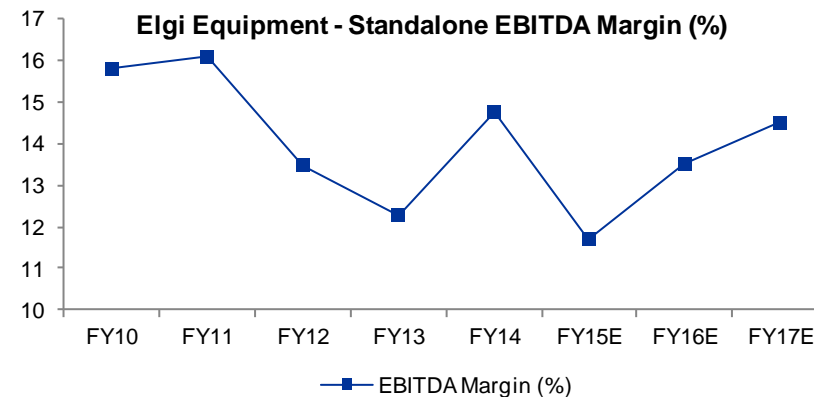
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Expect growth momentum to pick up over the next two years



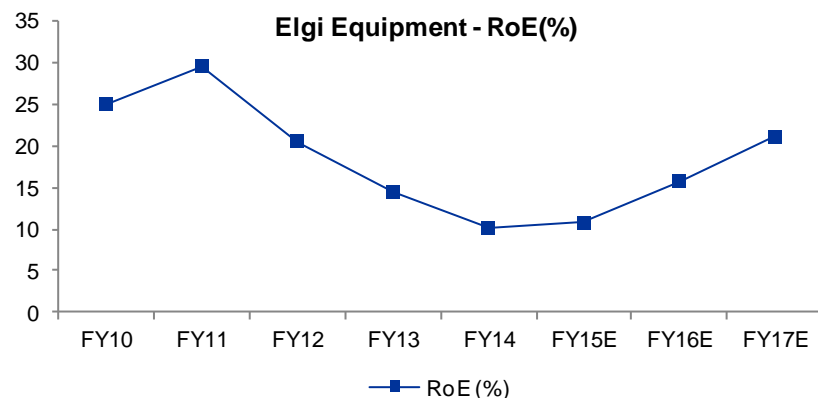
Source: Company, Spark Capital Research

Margins set to improve as after-sales & product mix improves



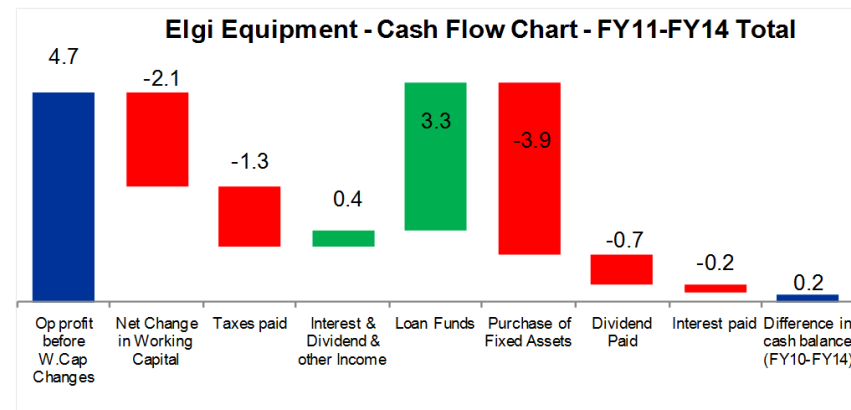
Source: Company, Spark Capital Research

Expect RoE to bounce back to ~20% by FY17E



Source: Company, Spark Capital Research

Sizeable portion of the cashflow used for capex and acquisition



Source: Company, Spark Capital Research,

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Abridged Financial Statements (Consolidated)

Rs. mn	FY14	FY15E	FY16E	FY17E
Profit & Loss				
Revenues	13,504	13,194	15,173	18,208
EBITDA	1,013	947	1,375	1,869
Other Income	91	177	198	220
Depreciation	262	281	319	364
EBIT	842	844	1,253	1,725
Interest	117	160	140	140
PBT	725	684	1,113	1,585
PAT	455	525	840	1,224
Balance Sheet				
Net Worth	4,636	5,138	5,528	6,095
Deferred Tax	(2)	114	114	114
Total debt	3,701	3,600	3,400	3,600
Total Networth and liabilities	8,335	8,852	9,042	9,809
Gross Fixed assets	5,772	6,772	7,372	7,972
Net fixed assets	3,911	4,630	4,910	5,146
CWIP	862	0	0	0
Investments	149	149	149	149
Inventories	2,527	2,458	2,491	2,990
Sundry Debtors	2,427	3,779	3,890	4,371
Cash and bank balances	688	1,074	1,206	1,321
Loans and advances	1,080	0	0	0
Current liabilities	3,308	3,238	3,605	4,168
Net current assets	3,414	4,074	3,983	4,514
Total assets	8,335	8,852	9,042	9,809
Cash Flows				
Cash flow s from Operations	974	809	1,522	1,312
Cash flow s from Investing	(1,222)	(139)	(600)	(600)
Cash flow s from Financing	204	(553)	(717)	(438)

Key metrics

	FY14	FY15E	FY16E	FY17E
Growth ratios				
Sales	18.0%	-2.3%	15.0%	20.0%
EBITDA	-0.5%	-6.4%	45.1%	35.9%
PAT	-24.3%	15.3%	60.0%	45.7%
Margin ratios				
EBITDA	7.5%	7.2%	9.1%	10.3%
PAT	3.4%	4.0%	5.5%	6.7%
Performance ratios				
RoE	10.2%	10.7%	15.8%	21.1%
RoCE	6.7%	7.5%	10.6%	14.1%
RoA	4.4%	4.8%	7.5%	10.2%
Fixed asset turnover (x)	2.3	1.9	2.1	2.3
Total asset turnover (x)	1.1	1.1	1.2	1.3
Financial stability ratios				
Net Debt to Equity (x)	0.6	0.5	0.4	0.4
Current ratio (x)	2.0	2.3	2.1	2.1
Inventory and debtor days	157	173	154	148
Creditor days	68	68	68	68
Working capital days	89	105	86	80
Interest cover (x)	7.2	5.3	9.0	12.3
Valuation metrics				
Fully Diluted Shares (mn)	158.5	158.5	158.5	158.5
Market cap (Rs.mn)	22,983	22,983	22,983	22,983
EPS (Rs.)	2.9	3.3	5.3	7.7
P/E (x)	50.5	43.8	27.4	18.8
EV (Rs.mn)	25,996	25,509	25,177	25,261
EV/ EBITDA (x)	25.7	26.9	18.3	13.5
BV/ share (Rs.)	29.3	32.4	34.9	38.5
Price to BV (x)	5.0	4.5	4.2	3.8

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Piston Compressor



Capacity

1 to 50 HP

Application

- Automotive garages
- Wood working
- Small & medium fabrication units
- Pneumatic tools

Screw Compressor



15 to 325 HP

- Cement
- Textile
- Paper & Pulp
- Automotive
- Steel Making

Oil free screw Compressor



120 to 410 HP

- Food and beverages
- Textiles
- Air Separation

Portable Compressor



30 to 100 HP

- Quarry
- Industrial Air
- Construction and breaker
- Water well

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