

Elgi Equipments (ELGEQU)

CMP: ₹ 203

Target: ₹ 260 (28%)

Target Period: 12-18 months

August 5, 2021

BUY

Healthy growth, margins impacted amid challenges...

About the stock: Elgi Equipments (Elgi) manufactures a wide range of air compressors (~90% of revenue) and automotive equipment (~10%).

- Elgi is the second largest player in the Indian air compressor market (~22% market share) and among the top eight players globally
- Expansion in new international markets to drive long term incremental growth (rest of the world contributed ~40% in FY21)

Q1FY22 Results: Elgi reported decent Q1FY22 results amid challenges.

- Consolidated revenues came in at ₹ 489.4 crore, up 71% YoY on a low base
- EBITDA margins came in at 6.6% in Q1FY22 (below our estimates of 8.2%) primarily due higher commodity prices and supply chain disruptions
- Consequently, PAT at ₹ 12.4 crore (vs. net loss of ₹ 8.7 crore in Q1FY21)

What should investors do? Elgi's share price has grown by ~2.2x over the past five years (from ~₹ 65 in March 2016 to ~₹ 205 levels in March 2021).

- Considering strong growth outlook, better margins, we maintain BUY rating

Target Price and Valuation: We value Elgi at ₹ 260 i.e. 42x P/E on FY23E EPS

Key triggers for future price performance:

- Going forward, accelerated growth in International markets, new products like disrupted AB series compressors, traction in India business drive long term incremental growth
- We expect revenue, EBITDA to grow at CAGR of 18.6%, 28.7% respectively in FY21-FY23E owing to various cost control initiatives improving margins
- Net debt free b/s, double-digit return ratios & strong cash generation

Alternate Stock Idea: We also like Grindwell Norton in our coverage.

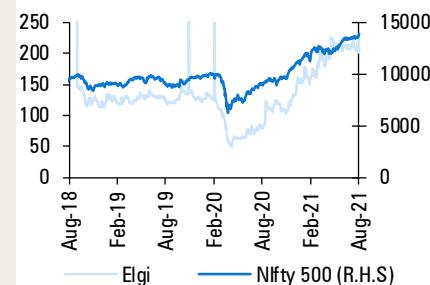
- High margin value added products and solutions oriented approach to drive margin expansion (from ~16.7% in FY20 to 20.6% in FY23E)
- BUY with target price of ₹ 1510



| Particulars | |
|-----------------------|--------------|
| Particular | Amount |
| Market Capitalization | ₹ 6433 Crore |
| Total Debt (FY21) | ₹ 370 Crore |
| Cash & Inv. (FY21) | ₹ 262 Crore |
| EV (FY21) | ₹ 6541 Crore |
| 52 week H/L (₹) | 244 / 79 |
| Equity capital | ₹ 31.7 Crore |
| Face value | ₹ 1 |

| Shareholding pattern | | | | |
|----------------------|--------|--------|--------|--------|
| (in %) | Sep-20 | Dec-20 | Mar-21 | Jun-21 |
| Promoter | 31.9 | 31.9 | 31.9 | 31.9 |
| FII | 21.9 | 22.1 | 23.0 | 23.0 |
| DII | 10.3 | 10.2 | 9.5 | 9.2 |
| Others | 35.9 | 35.8 | 35.6 | 35.9 |

Price Chart



Recent Events & Key risk

- Key risk: (i) Uncertainty in global markets, non-profitable or unwanted international expansions (ii) volatile commodity prices

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Key Financial Summary

| (₹ crore) | FY19 | FY20 | FY21 | 5 Year CAGR (FY16-FY21) | FY22E | FY23E | 2 year CAGR (FY21-23E) |
|-------------------|---------|---------|---------|-------------------------|---------|---------|------------------------|
| Revenue | 1,863.5 | 1,829.4 | 1,924.1 | 6.7% | 2,231.9 | 2,680.5 | 18.0% |
| EBITDA | 191.8 | 133.9 | 215.7 | 11.5% | 239.9 | 340.4 | 25.6% |
| EBITDA Margin (%) | 10.3 | 7.3 | 11.2 | | 10.8 | 12.7 | |
| Net Profit | 103.1 | 42.6 | 102.5 | 13.7% | 124.2 | 195.1 | 38.0% |
| EPS (₹) | 3.3 | 1.3 | 3.2 | | 3.9 | 6.2 | |
| P/E (x) | 62.4 | 151.1 | 62.8 | | 51.8 | 33.0 | |
| EV/EBITDA (x) | 34.0 | 50.3 | 30.3 | | 27.2 | 18.9 | |
| RoCE (%) | 13.8 | 6.5 | 11.7 | | 12.8 | 18.1 | |
| RoE (%) | 13.4 | 5.5 | 11.8 | | 13.9 | 18.7 | |
| Growth | | 1.81 | 5.2 | | 16.0 | 20.1 | |

Key takeaways of recent quarter....

Q1FY22 Results: Strong topline, margins impacted amid pandemic...

- Consolidated revenue grew 71.1% YoY to ₹ 489.4 crore vs. I-direct estimate of ₹ 378.5 crore. Standalone revenue (domestic & direct exports compressor) grew robust by 152.7% YoY to ₹ 301.4 crore (~62% of consolidated topline) amid low base led by better demand revival in domestic market and robust exports despite challenges while the international compressor business grew 9.6% to ₹ 161.5 crore, YoY (contributing ~33% of Elgi's consolidated topline), the automotive segment revenue grew 37.3% to ₹ 26.8 crore, YoY (~5.5% of firm's topline)
- EBITDA margins came in at 6.6% in Q1FY22 (below our estimates of 8.2%) primarily due higher commodity prices, input costs and supply chain disruptions despite better revenue booking amid pandemic. Consequently, absolute EBITDA grew 270% to ₹ 32.1 crore on a YoY basis (vs. our estimate of ₹ 31.1 crore) on a very low base
- Elgi's standalone air compressor (domestic & direct exports compressor) grew 152.7% YoY to ₹ 301.4 crore (~62% of consolidated topline). Pure domestic air compressor sales estimated to have grown at more than 60.7% YoY (contributing ~50% to overall air compressor sale). Elgi is on track in its strategy to optimise employee cost and raw material costs. Its disrupted AB series oil free compressor is gaining good traction in India and abroad as the economies gather pace worldwide. After-market (~20-25% to India topline) was impacted in Q1FY22 due to pandemic while continues to see strong traction across geographies. As on Q1FY22, consolidated debt has reduced marginally while working capital remains stable, cash position remains strong
- In Q1FY22, air compressor international sales (including exports from India) is estimated to have contributed ~50% to air compressor sales growing at 88.7% YoY amid low base. It continues to perform well in key international markets led by US, Europe while Australia, South East Asia and Gulf were impacted due to pandemic and expected to rebound gradually. Margins are expected to further improve due to ramp-up in international business, cost optimisation strategies to lead incremental revenue, future growth and positive operating leverage. The company aims to optimise material cost by ~2% over 12-18 months. Also, Elgi is on track in its strategic investment initiatives in Europe
- Going ahead, further traction in international market, new products like oil free compressors (AB series) would aid growth while India business has started seeing good traction and would further aid topline. Also, its strategy on cost reduction and focus on operating cash business would help deal with working capital, debt reduction and liquidity situation

Exhibit 1: Variance Analysis

| | Q1FY22 | Q1FY22E | Q1FY21 | YoY (%) | Q4FY21 | QoQ (%) | Comments |
|-------------------------------|--------|---------|--------|---------|--------|---------|--|
| Revenue | 489.4 | 378.5 | 286.1 | 71.1 | 610.6 | -19.8 | Standalone revenue grew 152.7% YoY on low base while international business grew by 9.6% YoY |
| Other Income | 11.9 | 5.8 | 5.7 | 107.2 | 5.8 | 105.8 | |
| Total Revenue | 501.3 | 384.3 | 291.9 | 71.8 | 616.4 | -18.7 | |
| Raw material cost | 263.0 | 203.1 | 148.5 | 44.5 | 333.6 | -27.1 | |
| Employee Expenses | 118.6 | 94.3 | 87.6 | 35.4 | 112.3 | 5.6 | People cost is expected to normalise at current |
| Total Other expenses | 75.6 | 50.0 | 41.3 | 83.1 | 85.5 | -11.5 | Measures to optimise operating costs, which is likely to normalise as percentage of sales |
| Operating Profit (EBITDA) | 32.1 | 31.1 | 8.7 | 270.0 | 79.2 | -59.4 | |
| EBITDA Margins | 6.6 | 8.2 | 3.0 | | 13.0 | | Margins impacted by higher commodity cost and supply chain disruptions |
| Interest | 2.9 | 3.2 | 3.7 | -21.2 | 3.2 | -8.1 | |
| Depreciation | 18.5 | 19.8 | 17.5 | 6.1 | 19.6 | -5.7 | |
| Total Tax | 10.6 | 3.9 | 2.0 | 433.9 | 19.4 | -45.3 | |
| PAT | 12.4 | 10.3 | -8.7 | -242.4 | 43.4 | -71.3 | |
| | Q1FY22 | Q1FY22E | Q1FY21 | YoY (%) | Q4FY21 | QoQ (%) | |
| Revenue (Segment-wise) | 489.4 | 378.5 | 286.1 | 71.1 | 610.6 | -19.8 | |
| Air Compressors | 462.9 | 345.0 | 266.6 | 73.6 | 560.1 | -17.4 | Positive surprise with gradual traction in domestic business and decent incremental growth in international market |
| % of Sales | 95% | 91% | 93% | | 92% | | |
| Automotive Equipments | 26.8 | 33.0 | 19.5 | 37.3 | 50.5 | -46.9 | Automotive space impacted by supply chain disruptions and pandemic lockdowns |
| % of Sales | 5% | 9% | 7% | | 8% | | |
| EBT Margin | | | | | | | |
| Air Compressors | 24.3 | 21.0 | -5.0 | -590.8 | 56.2 | -56.8 | |
| EBT Margin | 5.2% | 6.1% | -1.9% | | 10.0% | | |
| % of EBT | 107.6 | 105.0 | 73.5 | | 90.5 | | |

Source: Company, ICICI Direct Research

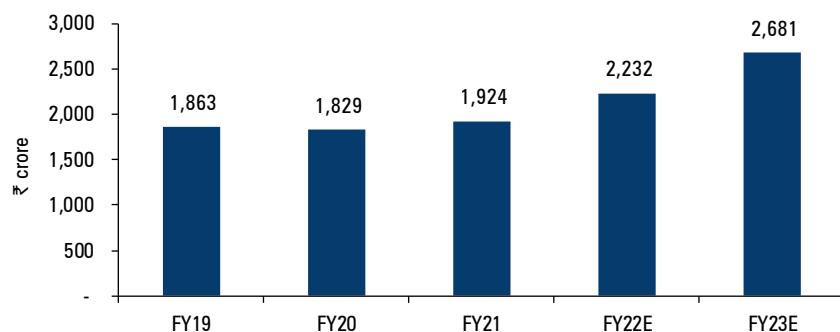
Exhibit 2: Change in estimates

| ₹ crore | FY20 | | FY21 | | FY22E | | % | FY23E | | % |
|-------------------|---------|---------|---------|---------|---------|---------|---------|---------|-----|---|
| | Old | New | Old | New | Change | Old | New | Change | Old | |
| Revenue | 1,829.4 | 1,924.1 | 2,241.5 | 2,231.9 | -0.4 | 2,712.2 | 2,680.5 | -1.2 | | |
| EBITDA | 133.9 | 215.7 | 255.5 | 239.9 | -6.1 | 355.3 | 340.4 | -4.2 | | |
| EBITDA margin (%) | 7.3 | 11.2 | 11.4 | 10.8 | -65 bps | 13.1 | 12.7 | -40 bps | | |
| PAT | 42.6 | 102.5 | 135.1 | 124.2 | -8.1 | 204.6 | 195.1 | -4.6 | | |
| EPS (₹) | 1.3 | 3.2 | 4.3 | 3.9 | -8.8 | 6.5 | 6.2 | -5.3 | | |

Source: Company, ICICI Direct Research

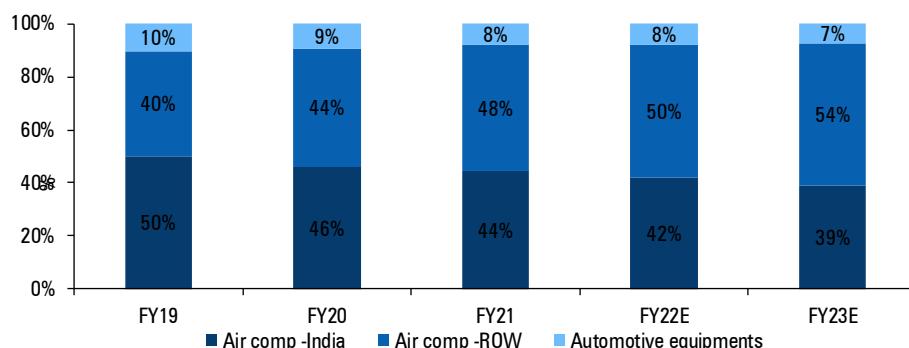
Financial story in charts

Exhibit 3: Revenue trend



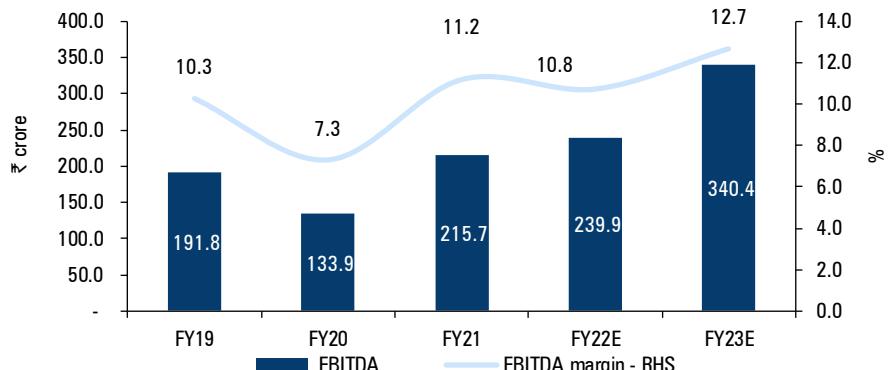
Source: Company, ICICI Direct Research

Exhibit 4: Revenue segmentation



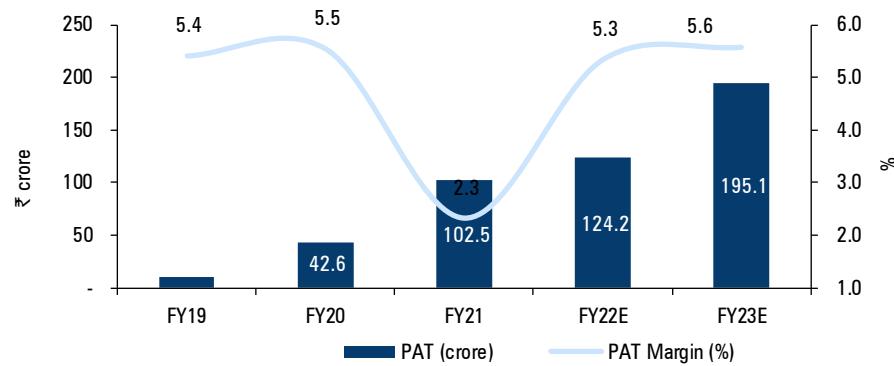
Source: Company, ICICI Direct Research

Exhibit 5: EBITDA and EBITDA margin trend



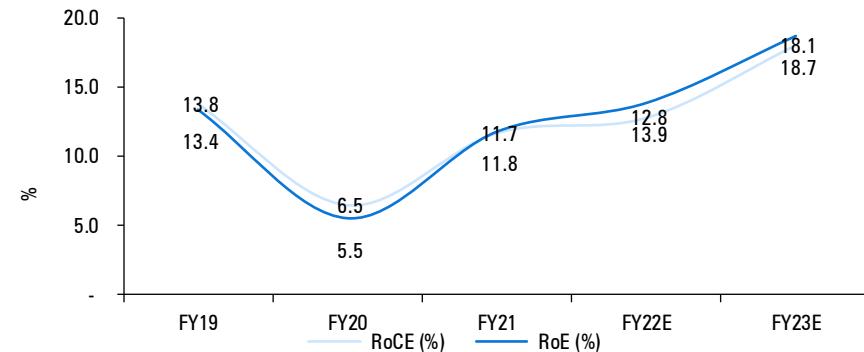
Source: Company, ICICI Direct Research

Exhibit 6: PAT and PAT margin trend



Source: Company, ICICI Direct Research

Exhibit 7: Return ratios to improve



Source: Company, ICICI Direct Research

Financial Summary

| Exhibit 8: Profit and loss statement (₹ crore) | | | | |
|--|----------------|----------------|----------------|----------------|
| (₹ Crore) | FY20 | FY21 | FY22E | FY23E |
| Net Sales | 1,829.4 | 1,924.1 | 2,231.9 | 2,680.5 |
| Other Operating Income | - | - | - | - |
| Total Operating Income | 1,829.4 | 1,924.1 | 2,231.9 | 2,680.5 |
| % Growth | 33.5 | 5.2 | 16.0 | 20.1 |
| Other Income | 15.2 | 23.5 | 21.5 | 24.5 |
| Total Revenue | 1,844.6 | 1,947.5 | 2,253.4 | 2,705.0 |
| Growth (%) | 33.5 | 5.6 | 15.7 | 20.0 |
| Total Raw Material Costs | 980.6 | 1,027.6 | 1,197.4 | 1,434.1 |
| Employee Expenses | 404.6 | 411.7 | 478.7 | 530.7 |
| Other expenses | 310.3 | 269.1 | 315.8 | 375.3 |
| Total Operating Expense | 1,695.5 | 1,708.4 | 1,992.0 | 2,340.1 |
| EBITDA | 133.9 | 215.7 | 239.9 | 340.4 |
| Growth (%) | (3.8) | 61.0 | 11.2 | 41.9 |
| Interest | 15.5 | 13.5 | 10.0 | 6.4 |
| PBDT | 133.6 | 225.7 | 251.4 | 358.6 |
| Depreciation | 65.2 | 74.3 | 79.7 | 85.8 |
| PBT before Exceptional | 68.3 | 151.4 | 171.7 | 272.8 |
| Total Tax | 27.0 | 50.3 | 48.9 | 79.1 |
| PAT before MI | 41.3 | 101.1 | 122.8 | 193.7 |
| Minority Interest | - | - | - | - |
| PAT | 42.6 | 102.5 | 124.2 | 195.1 |
| Growth (%) | (42.4) | 140.7 | 21.2 | 57.1 |
| EPS* | 1.3 | 3.2 | 3.9 | 6.2 |

Source: Company, ICICI Direct Research

| Exhibit 9: Cash Flow Statement (₹ crore) | | | | |
|--|----------------|---------------|----------------|---------------|
| (₹ Crore) | FY20 | FY21 | FY22E | FY23E |
| Profit after Tax | 42.6 | 102.5 | 124.2 | 195.1 |
| Depreciation | 65.2 | 74.3 | 79.7 | 85.8 |
| Interest | 15.5 | 13.5 | 10.0 | 6.4 |
| Cash Flow before WC changes | 123.4 | 190.3 | 213.9 | 287.2 |
| Changes in inventory | (64.7) | 0.7 | (30.3) | (45.6) |
| Changes in debtors | 20.2 | (53.0) | (34.4) | (43.2) |
| Changes in loans & Advances | 0.4 | 0.9 | (0.7) | (1.3) |
| Changes in other current assets | (52.7) | 13.6 | (4.5) | (18.4) |
| Net Increase in Current Assets | (96.9) | (37.8) | (69.9) | (108.5) |
| Changes in creditors | (37.9) | 80.1 | 35.2 | 35.8 |
| Changes in provisions | (1.0) | 1.1 | 1.6 | 2.4 |
| Net Increase in Current Liabilities | (61.0) | 117.0 | 57.4 | 47.3 |
| CF from operations | (34.5) | 269.5 | 201.4 | 226.0 |
| Changes in deferred tax assets | 8.8 | (15.7) | - | - |
| (Purchase)/Sale of Fixed Assets | (159.9) | (54.3) | (75.0) | (95.0) |
| CF from Investing | (126.5) | (58.0) | (75.0) | (95.0) |
| Dividend and Dividend Tax | (55.5) | (25.4) | (41.2) | (47.5) |
| CF from Financing | 136.5 | (35.2) | (144.0) | (83.9) |
| Net Cash flow | (24.5) | 176.3 | (17.6) | 47.0 |
| Opening Cash/Cash Equivalent | 110.2 | 85.7 | 262.0 | 244.4 |
| Closing Cash/ Cash Equivalent | 85.7 | 262.0 | 244.4 | 291.4 |

Source: Company, ICICI Direct Research

| Exhibit 10: Balance Sheet (₹ crore) | | | | |
|-------------------------------------|----------------|----------------|----------------|----------------|
| (₹ Crore) | FY20 | FY21 | FY22E | FY23E |
| Equity Capital | 15.8 | 31.7 | 31.7 | 31.7 |
| Reserve and Surplus | 753.1 | 838.2 | 864.7 | 1,012.2 |
| Total Shareholders funds | 769.0 | 869.9 | 896.3 | 1,043.9 |
| Minority Interest | - | - | - | - |
| Other Non Current Liabilities | 37.1 | 53.1 | 53.1 | 53.1 |
| Total Debt | 389.7 | 369.6 | 333.4 | 303.4 |
| Total Liabilities | 1,211.8 | 1,306.6 | 1,296.9 | 1,414.5 |
| Gross Block | 814.8 | 868.7 | 942.8 | 1,042.8 |
| Acc: Depreciation | 207.1 | 281.4 | 361.1 | 446.9 |
| Net Block | 607.6 | 587.3 | 581.7 | 595.9 |
| Capital WIP | 3.7 | 4.1 | 5.0 | - |
| Total Fixed Assets | 611.4 | 591.4 | 586.7 | 595.9 |
| Non Current Assets | 41.9 | 55.9 | 55.9 | 55.9 |
| Inventory | 343.4 | 342.7 | 373.0 | 418.6 |
| Debtors | 346.8 | 399.7 | 434.2 | 477.4 |
| Loans and Advances | 6.9 | 6.0 | 6.7 | 8.0 |
| Other Current Assets | 114.0 | 100.4 | 104.9 | 123.3 |
| Cash | 85.7 | 262.0 | 244.4 | 291.4 |
| Total Current Assets | 896.7 | 1,110.8 | 1,163.1 | 1,318.7 |
| Current Liabilities | 208.8 | 288.9 | 324.1 | 359.8 |
| Provisions | 12.2 | 13.2 | 14.9 | 17.3 |
| Net Current Assets | 553.6 | 650.7 | 645.6 | 754.0 |
| Total Assets | 1,211.8 | 1,306.6 | 1,297.0 | 1,414.5 |

Source: Company, ICICI Direct Research

| Exhibit 11: Key Ratios | | | | |
|--------------------------|-------|------|-------|-------|
| | FY20 | FY21 | FY22E | FY23E |
| Per Share Data | | | | |
| EPS | 1.3 | 3.2 | 3.9 | 6.2 |
| BVS | 24.3 | 27.5 | 28.3 | 32.9 |
| Dividend per share | 1.8 | 0.8 | 1.3 | 1.5 |
| Dividend payout ratio | 130.3 | 24.8 | 33.2 | 24.4 |
| Operating Ratios | | | | |
| EBITDA Margin | 7.3 | 11.2 | 10.8 | 12.7 |
| PAT Margin | 2.3 | 5.3 | 5.6 | 7.3 |
| Inventory days | 68.5 | 65.0 | 61.0 | 57.0 |
| Debtor days | 69.2 | 75.8 | 71.0 | 65.0 |
| Creditor days | 41.7 | 54.8 | 53.0 | 49.0 |
| Return Ratios | | | | |
| RoE | 5.5 | 11.8 | 13.9 | 18.7 |
| RoCE | 6.5 | 11.7 | 12.8 | 18.1 |
| RoIC | 5.7 | 12.4 | 13.7 | 20.3 |
| Valuation Ratios | | | | |
| EV / EBITDA | 50.3 | 30.3 | 27.2 | 18.9 |
| P/E | 151.1 | 62.8 | 51.8 | 33.0 |
| EV / Net Sales | 3.7 | 3.4 | 2.9 | 2.4 |
| Sales / Equity | 2.4 | 2.2 | 2.5 | 2.6 |
| Market Cap / Sales | 3.5 | 3.3 | 2.9 | 2.4 |
| Price to Book Value | 8.4 | 7.4 | 7.2 | 6.2 |
| Turnover Ratios | | | | |
| Asset turnover | 1.4 | 1.4 | 1.6 | 1.7 |
| Debtors Turnover Ratio | 5.1 | 5.2 | 5.4 | 5.9 |
| Creditors Turnover Ratio | 8.0 | 7.7 | 7.3 | 7.8 |
| Solvency Ratios | | | | |
| Debt / Equity | 0.5 | 0.4 | 0.4 | 0.3 |
| Current Ratio | 3.7 | 2.8 | 2.7 | 2.7 |
| Quick Ratio | 2.1 | 1.7 | 1.6 | 1.6 |

Source: Company, ICICI Direct Research

Exhibit 12: ICICI Direct coverage universe (Capital Goods)

| Company | CMP | | | M Cap | | | EPS (₹) | | | P/E (x) | | | RoCE (%) | | | RoE (%) | | |
|------------------------------|------|-------|--------|--------|------|-------|---------|-------|-------|---------|------|-------|----------|------|-------|---------|--|--|
| | (₹) | TP(₹) | Rating | (₹ Cr) | FY21 | FY22E | FY23E | FY21 | FY22E | FY23E | FY21 | FY22E | FY23E | FY21 | FY22E | FY23E | | |
| L&T (LARTOU) | 1623 | 1,870 | Buy | 227739 | 81.9 | 46.7 | 52.9 | 19.8 | 34.8 | 30.7 | 7.4 | 8.0 | 8.8 | 18.8 | 10.2 | 11.0 | | |
| AIA Engineering (AIAENG) | 1980 | 2,275 | Buy | 18675 | 60.0 | 58.7 | 71.0 | 33.0 | 33.7 | 27.9 | 16.5 | 15.1 | 16.7 | 13.3 | 12.2 | 13.3 | | |
| Thermax (THERMA) | 1386 | 1,685 | Buy | 16515 | 17.3 | 26.8 | 37.0 | 80.0 | 51.8 | 37.4 | 9.8 | 12.5 | 15.9 | 7.6 | 9.8 | 12.4 | | |
| Kalpataru Power(KALPOW) | 475 | 550 | Buy | 7349 | 41.3 | 33.9 | 42.0 | 11.5 | 14.0 | 11.3 | 15.9 | 16.6 | 17.6 | 12.7 | 11.5 | 12.7 | | |
| KEC International (KECIN) | 416 | 485 | Buy | 10695 | 21.5 | 23.3 | 32.2 | 19.4 | 17.8 | 12.9 | 19.4 | 18.3 | 20.9 | 16.5 | 15.9 | 18.3 | | |
| Greaves Cotton (GREAVE) | 158 | 210 | Buy | 3653 | 0.4 | 4.7 | 6.5 | 352.6 | 33.3 | 24.1 | 6.5 | 16.5 | 21.9 | 3.3 | 12.0 | 16.0 | | |
| Elgi Equipment (ELGEQU) | 203 | 260 | Buy | 6433 | 3.2 | 3.9 | 6.2 | 62.8 | 51.8 | 33.0 | 11.7 | 12.8 | 18.1 | 11.8 | 13.9 | 18.7 | | |
| Bharat Electronics (BHAEL) | 176 | 205 | Buy | 42884 | 8.5 | 9.5 | 10.8 | 20.8 | 18.5 | 16.3 | 27.1 | 26.7 | 27.7 | 19.1 | 19.7 | 20.5 | | |
| Cochin Shipyard (COCSHI) | 375 | 500 | Buy | 5089 | 46.4 | 44.0 | 55.6 | 8.1 | 8.5 | 6.7 | 14.4 | 15.2 | 16.0 | 15.3 | 13.0 | 14.7 | | |
| SKF (SKFIND) | 2815 | 3,300 | Buy | 14100 | 60.2 | 72.0 | 94.0 | 46.8 | 39.1 | 29.9 | 24.8 | 25.0 | 28.0 | 19.0 | 19.0 | 21.0 | | |
| Timken India (TIMIND) | 1490 | 1,235 | Hold | 11729 | 19.0 | 31.2 | 35.3 | 78.3 | 47.8 | 42.2 | 15.4 | 19.4 | 21.9 | 11.9 | 14.8 | 16.8 | | |
| NRB Bearing (NRBBEA) | 138 | 175 | Buy | 1466 | 5.6 | 8.0 | 9.8 | 24.6 | 17.3 | 14.1 | 11.8 | 15.8 | 17.2 | 10.4 | 13.1 | 14.1 | | |
| Action Construction (ACTCON) | 245 | 300 | Buy | 2894 | 7.1 | 9.4 | 13.7 | 34.5 | 26.1 | 17.9 | 26.9 | 25.8 | 30.7 | 15.3 | 17.1 | 20.3 | | |

Source: Company, ICICI Direct Research

RATING RATIONALE

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Buy: > 15%

Hold: -5% to 15%;

Reduce: -5% to -15%;

Sell: < -15%



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