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Q1FY22 result review  
and earnings revision

## Capital Goods

Target price: Rs869

### Earnings revision

(%)	FY22E	FY23E
Sales	↓ 0.0	↓ 0.0
EBITDA	↓ 3.8	↓ 4.5
PAT	↓ 4.6	↓ 5.2

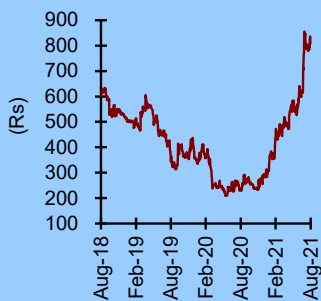
### Target price revision

Rs869 from Rs914

	Dec '20	Mar '21	Jun '21
Promoters	62.4	62.4	62.4
Institutional investors	9.3	8.9	9.2
MFs and others	7.9	6.8	6.9
Insurance	0.0	0.1	0.2
FIs	1.4	2.0	2.1
Others	28.3	28.7	28.4

Source: NSE

### Price chart



# ISGEC Heavy Engineering

**BUY**

**Maintained**

**Cost pressure impacts margins; muted execution** **Rs709**

ISGEC Heavy Engineering (ISGEC) has reported lower-than-expected revenue at Rs8.1bn vs our estimate of Rs11.5bn in Q1FY22. EBIDTA margin dropped 340bps YoY to 4.4%, impacted by higher cost overheads. The management is confident of recovery in margins and normalisation of the same. Order intake has been strong with Rs2.4bn of consol and Rs2.1bn of standalone order intake with current consol orderbook of Rs79.2bn. Factoring in near term margin stress, we marginally cut standalone earnings by 5% (each) for FY21E and FY22E. Given strong order intake and growth outlook, we maintain our BUY rating on the stock with revised SoTP-based target price of Rs869 (earlier: Rs914).

- **Cost pressure impacts margins:** Q1FY22 standalone revenue grew 6% YoY to Rs8.1bn led by 13% YoY growth in EPC at Rs6.7bn, while products revenue declined 25% YoY to Rs1.7bn. Product margins improved 200 bps YoY to 10.6% and EPC margins dropped 360bps YoY to 1% resulting in standalone EBIDTA margin decline of 340bps YoY to 4.4%. Impacted by lower margins, standalone PAT dipped 53% YoY to Rs137mn.
- **Strong order intake provides growth visibility:** Standalone order intake stood at Rs2.1bn vs Rs4bn in Q1FY21 and consol order intake stood at Rs2.4bn vs Rs6bn in Q1FY21. The overall orderbook stands at a record high of Rs79.2bn (1.8x TTM sales), oil & gas, pharma, chemicals, metals and sugar are the major segments in which the company booked orders. The order outlook is promising and we believe this provides strong growth visibility.
- **Philippines plant to be completed:** ISGEC has decided to complete the pending work with an overseas loan of ~US\$25mn. Post the commencement of operations, the company will seek an opportunity to sell (current environment is favourable to ethanol distillery segment) the plant. The company's overall exposure in the Philippines entity currently stands at US\$38mn and it is confident of coming out of this successfully with no loss.
- **Maintain BUY:** Despite the challenging environment and higher mix of EPC work, the liquidity situation is under control. We believe it will be able to come out of the Philippines asset with no major impact, but this continues to be an overhang on the valuation. We value the stock at a standalone target P/E multiple of 20x at Rs821 per share, ISGEC Hitachi Zosen at Rs21 per share (25x FY23E earnings) and the sugar subsidiary at Rs27 per share (5x FY23E earnings). Maintain **BUY** with a revised SoTP-based target price of Rs869 (previously: Rs914).

Market Cap	Rs52.1bn/US\$702mn	<b>Year to Mar</b>	<b>FY20</b>	<b>FY21</b>	<b>FY22E</b>	<b>FY23E</b>
Reuters/Bloomberg	ISGE.BO / IGSEC IN	Revenue (Rs bn)	48,937	43,099	52,079	57,611
Shares Outstanding (mn)	73.5	Rec. Net Income (Rs bn)	1,531	2,186	2,505	3,018
52-week Range (Rs)	855/230	EPS (Rs)	20.8	29.7	34.1	41.0
Free Float (%)	37.6	% Chg YoY	19.3	42.8	14.6	20.5
FII (%)	2.1	P/E (x)	34.1	23.9	20.9	17.3
Daily Volume (US\$/'000)	1,995	CEPS (Rs)	30.8	38.9	43.2	49.7
Absolute Return 3m (%)	27.5	EV/E (x)	19.2	15.4	12.3	10.1
Absolute Return 12m (%)	198.2	Dividend Yield (%)	0.3	0.4	0.4	0.4
Sensex Return 3m (%)	13.3	RoCE (%)	10.2	12.9	13.5	14.3
Sensex Return 12m (%)	44.5	RoE (%)	10.9	13.9	14.0	14.8

Please refer to important disclosures at the end of this report

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## Outlook and valuation

Orderbook as of June 2021 stood at ~Rs79bn, providing growth visibility. The order pipeline too looks promising. We believe execution should gather pace in near to medium term. Public spending on infrastructure, emission norms, private sector capex, and railway projects are major growth drivers. We maintain our **BUY** rating on the stock with a revised SoTP-based target price of Rs869.

We value the standalone business at Rs821 (20x FY23E earnings), ISGEC Hitachi Zosen at Rs21 (25x FY23E earnings) and Saraswati Sugar Mills at Rs27 (5x FY23E earnings), arriving at an SoTP-based target price of Rs869.

**Table 1: SoTP valuation**

	Method	P/E Multiple	Sep'22E earnings	Value (Rs mn)	Holding (%)	Holding Value (Rs mn)	Per Share (Rs)
Standalone	FY23E PER(x)	20	3,018	60,356	100	60,356	821
Saraswati Sugar	FY23E PER(x)	5	403	2,016	100	2,016	27
ISGEC Hitachi Zosen	FY23E PER(x)	25	120	2,992	51	1,526	21
<b>Total</b>						<b>63,898</b>	<b>869</b>

Source: I-Sec research

**Table 2: Earnings revision (Standalone)**

Rs mn	FY22E			FY23E		
	Earlier	Revised	YoY (%)	Earlier	Revised	YoY (%)
Revenue	52,079	52,079	-	57,611	57,611	-
EBITDA	4,187	4,026	(3.8)	4,921	4,700	(4.5)
PAT	2,625	2,505	(4.6)	3,183	3,018	(5.2)

Source: I-Sec research

**Table 3: Quarterly financial highlights (standalone)**

(Rs mn)	Q1FY21	Q1FY22	YoY(%)	4QFY21	QoQ(%)	Isec Est	Var(%)	FY20	FY21	YoY(%)
<b>Net Sales</b>	7,652	8,111	6.0	13,211	(38.6)	11,750	(31.0)	<b>48,937</b>	<b>43,099</b>	<b>(11.9)</b>
EBITDA	600	358	(40.4)	974	(63.3)	958	(62.7)	2,785	3,398	22.0
Margin	7.8	4.4	-344bps	7.4	-296bps	8.1	-374bps	5.7	7.9	219bps
Depreciation	176	156	(11.3)	166	(5.7)	166	(6.0)	737	678	(8.0)
Finance Cost	55	38	(29.9)	87	(55.9)	50	(23.6)	159	228	43.4
Other Income	16	25	50.6	207	(88.1)	25	(1.2)	186	356	91.7
<b>PBT</b>	386	188	(51.4)	929	(79.8)	767	(75.5)	<b>2,075</b>	<b>2,849</b>	<b>37.3</b>
Tax	96	51	(46.4)	192	(73.2)	192	(73.2)	544	663	21.9
<i>Tax rate</i>	24.8	27.3	253bps	20.6	669bps	25.0		26.2	23.3	-293bps
<b>Reported PAT</b>	291	137	(53.0)	737	(81.5)	575	(76.2)	<b>1,531</b>	<b>2,186</b>	<b>42.8</b>
Adjusted PAT	291	137	(53.0)	737	(81.5)	575	(76.2)	1,531	2,186	42.8
Margin(%)	3.8	1.7	-211bps	5.6	-390bps	-	168bps	3.1	5.1	194bps
<b>EPS (Rs)</b>	4.0	1.9	(53.0)	10.0	(81.5)	7.8		<b>20.8</b>	<b>29.7</b>	

Source: Company data, I-Sec research

**Table 4: Segmental highlights (standalone)**

Rs mn	Q1FY21	Q1FY22	YoY(%)	4QFY21	QoQ(%)	Isec Est	Var(%)	FY20	FY21	YoY(%)
<b>Segment Revenue</b>										
Machinery & Equip.	2,259	1,687	-25.3	3,890	-56.6	2,800	(39.7)	9,659	7,479	-22.6
EPC	5,959	6,748	13.3	9,797	-31.1	9,500	(29.0)	28,061	24,226	-13.7
<b>Total</b>	<b>8,224</b>	<b>8,445</b>	<b>2.7</b>	<b>13,685</b>	<b>-38.3</b>	<b>12,300</b>	<b>(31.3)</b>	<b>37,723</b>	<b>31,719</b>	<b>-15.9</b>
<b>Segmental EBIT</b>										
Machinery & Equip.	193	179	-7.0	543	-66.9	264	(31.9)	920	831	-9.7
EPC	274	68	-75.2	440	-84.5	571	(88.1)	1,051	1,263	20.2
<b>EBIT margins (%)</b>										
Machinery & Equip.	8.5	10.6	209bps	14.0	-332bps	9.4	122bps	9.5	11.1	158bps
EPC	4.6	1.0	-359bps	4.5	-348bps	6.0	-500bps	3.7	5.2	147bps

Source: Company data, I-Sec research

**Table 5: Quarterly financial highlights (consolidated)**

(Rs mn)	Q1FY21	Q1FY22	YoY(%)	Q4FY21	QoQ(%)	FY20	FY21	YoY(%)
<b>Net Sales</b>	10,708	11,283	5.4	16,177	(30.3)	58,518	54,256	(7.3)
EBITDA	923	481	(47.8)	1,216	(60.4)	2,979	4,550	52.7
Margin	8.6	4.3	-435bps	7.5	-325bps	5.1	8.4	330bps
Depreciation	270	239	(11.7)	216	10.3	967	1,008	4.2
Finance Cost	129	112	(12.8)	142	(21.1)	411	502	22.1
Other Income	40	51	27.5	68	(24.0)	620	488	(21.3)
<b>PBT</b>	<b>565</b>	<b>182</b>	<b>(67.7)</b>	<b>926</b>	<b>(80.3)</b>	<b>2,220</b>	<b>3,527</b>	<b>58.9</b>
Tax	183	91	(50.5)	227	(60.0)	724	1,683	132.7
<i>Tax rate</i>	32.4	49.7	1727bps	24.5	2521bps	32.6	47.7	1514bps
<b>Reported PAT</b>	<b>418</b>	<b>137</b>	<b>(67.3)</b>	<b>655</b>	<b>(79.1)</b>	<b>1,545</b>	<b>2,499</b>	<b>61.8</b>
Adjusted PAT	418	137	(67.3)	655	(79.1)	1,545	2,499	61.8
Margin(%)	3.9	1.2	-269bps	4.0	-284bps	2.6	4.6	197bps
<b>EPS (Rs)</b>	<b>5.7</b>	<b>1.9</b>	<b>(67.5)</b>	<b>8.9</b>	<b>(79.2)</b>	<b>20.4</b>	<b>34.0</b>	

Source: Company data, I-Sec research

**Table 6: Segmental highlights (consolidated)**

Rs mn	Q1FY21	Q1FY22	YoY(%)	Q4FY21	QoQ(%)	FY20	FY21	YoY(%)
<b>Segment Revenue</b>								
Machinery & Equip.	3,413	3,359	-1.6	5,593	-39.9	16,122	15,628	-3.1
EPC	6,018	6,861	14.0	10,000	-31.4	39,290	34,577	-12.0
Sugar	1,871	1,536	-17.9	2,239	-31.4	5,545	7,856	41.7
<b>Total</b>	<b>11,358</b>	<b>11,746</b>	<b>3.4</b>	<b>17,784</b>	<b>-34.0</b>	<b>60,999</b>	<b>58,181</b>	<b>-4.6</b>
<b>Segmental EBIT</b>								
Machinery & Equip.								
EPC	214	169	-20.9	755	-77.6	898	1,645	83.2
Sugar	285	99	-65.4	468	-78.9	1,516	1,724	13.7
	218	116	-46.9	126	-8.2	483	1,026	112.4
<b>EBIT margins (%)</b>								
Machinery & Equip.								
EPC	6.3	5.0	-123bps	13.5	-847bps	5.6	10.5	496bps
Sugar	4.7	1.4	-330bps	4.7	-324bps	3.9	5.0	113bps

Source: Company data, I-Sec research

**Table 7: Financial assumptions (standalone)**

Rs mn	FY19	FY20	FY21	FY22E	FY23E
<b>Segment Revenue</b>					
Manufacturing of machinery & equipment	12,026	12,434	11,369	13,074	14,643
<i>YoY Growth (%)</i>	12.7	3.4	-8.6	15.0	12.0
Engineering, procurement and construction	32,214	38,974	34,024	40,148	44,163
<i>YoY Growth (%)</i>	87.2	21.0	-12.7	18.0	10.0
<b>Total</b>	<b>44,241</b>	<b>51,408</b>	<b>45,392</b>	<b>53,222</b>	<b>58,805</b>
<b>EBIT</b>					
Manufacturing of machinery & Equipment	1,317	904	1,373	1,569	1,757
Engineering, procurement & construction	1,166	1,504	1,702	1,927	2,429
Unallocated	75	-80	-43	-47	-52
<b>Total EBIT</b>	<b>2,558</b>	<b>2,329</b>	<b>3,033</b>	<b>3,449</b>	<b>4,135</b>
<b>EBIT margin (%)</b>					
Manufacturing of machinery & Equipment	11.0	7.3	12.1	12.0	12.0
Engineering, procurement & construction	3.6	3.9	5.0	4.8	5.5
<b>Total</b>	<b>6.2</b>	<b>4.8</b>	<b>7.0</b>	<b>6.6</b>	<b>7.2</b>

Source: Company data, I-Sec research

## Financial summary (standalone)

Table 8: Profit &amp; loss statement

(Rs mn, year ending March 31)

	FY20	FY21	FY22E	FY23E
<b>Total Income</b>	<b>48,937</b>	<b>43,099</b>	<b>52,079</b>	<b>57,611</b>
<b>Operating Expenses</b>	<b>46,152</b>	<b>39,701</b>	<b>48,053</b>	<b>52,910</b>
<b>EBITDA</b>	<b>2,785</b>	<b>3,398</b>	<b>4,026</b>	<b>4,700</b>
% margins	5.7	7.9	7.7	8.2
Depreciation & Amortisation	737	678	668	637
<b>EBIT</b>	<b>2,048</b>	<b>2,720</b>	<b>3,358</b>	<b>4,063</b>
Gross Interest	159	228	205	215
Other Income	186	356	196	186
<b>PBT before exceptionals</b>	<b>2,075</b>	<b>2,849</b>	<b>3,349</b>	<b>4,035</b>
Add: Extraordinary/Exceptionals	-	-	-	-
Add: Share in associates	-	-	-	-
<b>PBT</b>	<b>2,075</b>	<b>2,849</b>	<b>3,349</b>	<b>4,035</b>
Less: Taxes	544	663	844	1,017
Less: Minority Interests	-	-	-	-
<b>Net Income (Reported)</b>	<b>1,531</b>	<b>2,186</b>	<b>2,505</b>	<b>3,018</b>
<b>Adjusted Net Income</b>	<b>1,531</b>	<b>2,186</b>	<b>2,505</b>	<b>3,018</b>

Source: Company data, I-Sec research

Table 9: Balance sheet

(Rs mn, year ending March 31)

	FY20	FY21	FY22E	FY23E
<b>Assets</b>				
Total Current Assets	35,880	38,970	46,702	53,272
of which cash & cash eqv.	2,176	1,644	4,636	6,738
Total Current Liabilities & Provisions	26,218	29,392	34,630	38,226
<b>Net Current Assets</b>	<b>7,487</b>	<b>7,934</b>	<b>7,436</b>	<b>8,308</b>
Investments	1,693	1,693	1,710	1,727
Other Non-Current Assets	1,497	2,298	2,340	2,383
<b>Net Fixed Assets</b>	<b>5,263</b>	<b>4,913</b>	<b>4,644</b>	<b>4,407</b>
Goodwill	-	-	-	-
<b>Total Assets</b>	<b>18,115</b>	<b>18,482</b>	<b>20,766</b>	<b>23,563</b>
<b>Liabilities</b>				
Borrowings	3,410	1,736	1,736	1,736
Deferred Tax Liability	-	-	-	-
Minority Interest	-	-	-	-
Equity Share Capital	74	74	74	74
Face Value per share (Rs)	1.00	1.00	1.00	1.00
Reserves & Surplus	14,632	16,672	18,957	21,754
<b>Net Worth</b>	<b>14,705</b>	<b>16,746</b>	<b>19,030</b>	<b>21,828</b>
<b>Total Liabilities</b>	<b>18,115</b>	<b>18,482</b>	<b>20,766</b>	<b>23,563</b>

Source: Company data, I-Sec research

Table 10: Cashflow statement

(Rs mn, year ending March 31)

	FY20	FY21	FY22E	FY23E
<b>Operating Cashflow</b>	<b>2,213</b>	<b>2,687</b>	<b>3,182</b>	<b>3,684</b>
Working Capital Changes	(2,729)	(836)	(99)	(1,240)
Capital Commitments	(813)	(328)	(400)	(400)
<b>Free Cashflow</b>	<b>(1,329)</b>	<b>1,523</b>	<b>2,683</b>	<b>2,043</b>
<b>Cashflow from Investing Activities</b>	<b>1,011</b>	<b>(10)</b>	<b>129</b>	<b>117</b>
Issue of Share Capital	-	-	-	-
Buyback of shares	-	-	-	-
Inc (Dec) in Borrowings	2,663	(1,674)	-	-
Interest paid	(159)	(228)	(205)	(215)
Dividend paid	(147)	(221)	(221)	(221)
<b>Extraordinary Items/Others</b>	<b>(2,339)</b>	<b>77</b>	<b>606</b>	<b>377</b>
<b>Chg. in Cash &amp; Bank balance</b>	<b>(300)</b>	<b>(532)</b>	<b>2,992</b>	<b>2,102</b>

Source: Company data, I-Sec research

Table 11: Key ratios

(Year ending March 31)

	FY20	FY21	FY22E	FY23E
<b>Per Share Data (in Rs.)</b>				
Diluted adjusted EPS	20.8	29.7	34.1	41.0
Recurring Cash EPS	30.8	38.9	43.2	49.7
Dividend per share (DPS)	2.0	3.0	3.0	3.0
Book Value per share (BV)	200.0	227.7	258.8	296.9
<b>Growth Ratios (%)</b>				
Operating Income	18.5	(11.9)	20.8	10.6
EBITDA	12.5	22.0	18.5	16.7
Recurring Net Income	19.3	42.8	14.6	20.5
Diluted adjusted EPS	19.3	42.8	14.6	20.5
Diluted Recurring CEPS	16.8	26.3	10.8	15.2
<b>Valuation Ratios</b>				
P/E	34.1	23.9	20.9	17.3
P/CEPS	23.0	18.3	16.5	14.3
P/BV	3.6	3.1	2.7	2.4
EV / EBITDA	19.2	15.4	12.3	10.1
EV / Operating Income	1.1	1.2	0.9	0.8
EV / Op. FCF (pre -Capex)	(28.5)	28.3	16.0	19.3
<b>Operating Ratios</b>				
Raw Material/Sales (%)	72.8	73.5	73.0	73.0
SG&A/Sales (%)	15.1	12.2	13.4	13.0
Other Income / PBT (%)	9.0	12.5	5.8	4.6
Effective Tax Rate (%)	26.2	23.3	25.2	25.2
NWC / Total Assets (%)	22.5	22.6	19.7	19.7
Inventory Turnover (days)	38.1	40.3	40.0	40.0
Receivables (days)	148.5	199.8	180.0	180.0
Payables (days)	96.9	133.4	122.0	122.0
Net D/E Ratio (x)	0.1	0.0	(0.2)	(0.2)
<b>Return/Profitability Ratios (%)</b>				
Recurring Net Income Margins	3.1	5.1	4.8	5.2
RoCE	10.2	12.9	13.5	14.3
RoNW	10.9	13.9	14.0	14.8
Dividend Payout Ratio	9.6	10.1	8.8	7.3
Dividend Yield (%)	0.3	0.4	0.4	0.4
EBITDA Margins	5.7	7.9	7.7	8.2

Source: Company data, I-Sec research

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BUY: >15% return; ADD: 5% to 15% return; HOLD: Negative 5% to Positive 5% return; REDUCE: Negative 5% to Negative 15% return; SELL: < negative 15% return

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