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**Q4FY23 result review,
earnings and target
price revision**

Capital Goods

Target price: Rs698

Earnings revision

(%)	FY24E	FY25E
Sales	↑ 2.4	↑ 6.3
EBITDA	↑ 4.1	↑ 7.4
PAT	↑ 3.2	↑ 5.6

Target price revision

Rs698 from Rs663

Shareholding Pattern

	Sep '22	Dec '22	Mar '23
Promoters	62.4	62.4	62.4
Institutional investors	9.6	9.8	10.3
MFs and others	6.8	6.8	7.3
Insurance	0.1	0.2	0.1
FII	2.7	2.8	2.9
Others	28.0	27.8	27.3

Source: NSE

ESG disclosure score

Year	2021	2022	Chg
ESG score	26.2	36.6	10.4
Environment	0.9	0.9	0.0
Social	14.1	32.6	18.5
Governance	63.6	76.1	12.5

Note - Score ranges from 0 - 100 with a higher score indicating higher ESG disclosures.

Source: Bloomberg, I-sec research

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ISGEC Heavy Engineering

BUY

Maintain

Rs588

Good visibility on revenue amid margin improvement

ISGEC Heavy Engineering's (ISGEC) Q4FY23 standalone revenue increased 4% YoY to Rs14bn aided by EPC revenue growth of 8% YoY whereas manufacturing segment revenue declined 4% YoY. Improvement in the share of high-margin manufacturing business led to marginal improvement in EBITDA margin by 247bps YoY to 7.4%. We expect margins to see gradual improvement in the coming quarters with reduction in share of old and low-margin orders. Orderbook grew to Rs83.2bn led by order intake growth of 72% to Rs24.8bn. Management indicated enquiry pipeline remains robust in both domestic and international product-segments. Key sectors which are witnessing traction are - Oil & gas, Power (boilers), automobile, specialty chemical, steel and ethanol. Execution of biofuel plant in Cavite, Philippines, is on track and is expected to be operational by Aug'23. We revise our estimates for FY24E and FY25E factoring-in the better order outlook and improving margins. **Maintain BUY** on the stock with a revised target price of Rs698 (earlier: Rs663).

- **Improved execution in EPC; manufacturing performance lags:** During Q4FY23, EPC revenue grew 8% to Rs10.5bn, while manufacturing revenue declined 4% YoY to Rs4.4bn, resulting in an overall revenue growth of 4% YoY. Gross margin remained flat for the quarter, but expanded 190bps in FY23 on the back of favourable mix and softening commodity prices. We expect margin improvement to continue in the coming quarters
- **Improvement in performance of subsidiaries:** Consolidated revenue / EBITDA in Q4FY23 grew ~28% / 54% YoY to Rs20.4bn / Rs1.6bn respectively. This was led mainly by improved performance of the standalone business and Saraswati Sugar Mills Ltd. Eagle Press & Equipment subsidiary performance was weak. Hitachi Zosen reported annual revenue of Rs6bn for FY23 with a PAT margin of 25%. Going forward, management expects subsidiaries' performance to continue to improve owing to healthy orderbook and limited execution challenges.
- **Strong intake in Q4FY23 improves growth visibility:** Order inflow in Q4FY23 stood at Rs24.8bn vs Rs14.4 in Q4FY22, up 72% YoY. Overall orderbook stands at Rs83.2bn (1.8x TTM sales). Management has indicated strong demand across industries. Enquiry pipeline remains robust though decision-making from customer side is taking some time. ISGEC is preferring shorter-duration orders to reduce commodity price risks. Exports constitute ~10% of the total orderbook.
- **Maintain BUY:** With improving order inflow and better margins led by better job mix, we expect execution to pick up along with gradual improvement in profitability. Management guidance of double-digit revenue growth has also been factored into our estimates. **Maintain BUY with a revised target price of Rs698 (previously: Rs663).**

Market Cap	Rs43.3bn/US\$523mn	Year to Mar	FY22	FY23	FY24E	FY25E
Reuters/Bloomberg	ISGE.BO / IGSEC IN	Revenue (Rs mn)	44,445	46,519	53,279	61,271
Shares Outstanding (mn)	73.5	Rec. Net Income (Rs mn)	1,128	1,779	2,157	2,637
52-week Range (Rs)	589/423	EPS (Rs)	15.3	24.2	29.4	35.9
Free Float (%)	37.6	% Chg YoY	(48.3)	57.7	21.3	22.2
FII (%)	2.9	P/E (x)	38.3	24.3	20.0	16.4
Daily Volume (US\$/000)	455	CEPS (Rs)	24.2	32.8	38.0	44.7
Absolute Return 3m (%)	33.5	EV/E (x)	21.8	15.4	13.1	11.0
Absolute Return 12m (%)	19.7	Dividend Yield (%)	0.3	0.3	0.3	0.5
Sensex Return 3m (%)	7.2	RoCE (%)	6.4	8.9	9.8	10.6
Sensex Return 12m (%)	14.1	RoE (%)	6.5	9.5	10.5	11.6

Please refer to important disclosures at the end of this report

Outlook and valuation

Company has a strong orderbook of Rs83.2bn (1.8x TTM sales). Management has also indicated strong demand and healthy enquiries.

Factoring-in the improving order intake and margin outlook, we raise our earnings estimate for FY24E and FY25E by 3% and 6% respectively.

We value the standalone business at Rs646 (18x FY25E earnings), ISGEC Hitachi Zosen at Rs20 (13x FY25E earnings) and Saraswati Sugar Mills at Rs32 (8x FY25E earnings), arriving at a revised SoTP-based target price of **Rs698** (previously: Rs663). Maintain **BUY**.

Key risks: i) Further commodity price escalation (which might impact execution and margins), ii) higher-than-expected losses or any delays in commissioning of the Philippines plant.

Table 1: SoTP valuation

	Method	P/E Multiple	FY25E earnings	Value (Rs mn)	Holding (%)	Holding Value (Rs mn)	Per Share (Rs)
Standalone	FY25E P/E(x)	18	2,637	47,465	100	47,465	646
Saraswati Sugar	FY25E P/E(x)	8	296	2,366	100	2,366	32
ISGEC Hitachi Zosen	FY25E P/E(x)	13	220	2,863	51	1,460	20
Total						51,292	698

Source: I-Sec research

Table 2: Earnings revision (standalone)

Rs mn	FY24E			FY25E		
	Earlier	Revised	Change (%)	Earlier	Revised	Change (%)
Revenue	52,024	53,279	2.4	57,647	61,271	6.3
EBIDTA	3,433	3,573	4.1	3,980	4,273	7.4
PAT	2,091	2,157	3.2	2,497	2,637	5.6

Source: I-Sec research

Table 3: Quarterly financial highlights (standalone)

(Rs mn)	Q4FY23	Q4FY22	YoY(%)	Q3FY23	QoQ(%)	FY23	FY22	YoY(%)
Net Sales	14,197	13,631	4.2	10,983	29.3	46,519	44,445	4.7
EBITDA	1,057	678	55.8	746	41.7	2,995	2,091	43.3
Margin	7.4	5.0	247bps	6.8	65bps	6.4	4.7	173bps
Depreciation	163	168	(2.6)	158	3.2	631	654	(3.5)
Finance Cost	110	64	71.8	102	8.3	370	227	63.3
Other Income	58	26	118.2	49	18.5	350	260	34.4
PBT	841	473	77.8	534	57.3	2,344	1,471	59.4
Tax	220	121	82.0	136	61.2	639	342	86.5
Tax rate	26.1	25.5	60bps	25.5	63bps	27.2	23.3	396bps
Reported PAT	621	352	76.4	398	56.0	1,706	1,128	51.2
Adjusted PAT	621	352	76.4	398	56.0	1,706	1,128	51.2
Margin(%)	4.4	2.6	179bps	3.6	75bps	3.7	2.5	113bps
EPS (Rs)	8.5	4.8	76.4	5.4	56.0	23.2	15.3	51.2

Source: Company data, I-Sec research

Table 4: Segmental highlights (standalone)

Rs mn	Q4FY23	Q4FY22	YoY(%)	Q3FY23	QoQ(%)	FY23	FY22	YoY(%)
Segment Revenue								
Machinery & Equip.	4,406	4,603	-4.3	3,635	21.2	15,343	12,953	18.4
EPC	10,528	9,754	7.9	8,107	29.9	33,678	33,615	0.2
Total	14,938	14,376	3.9	11,802	26.6	49,088	46,591	5.4
Segmental EBIT								
Machinery & Equip.	584	422	38.6	312	87.1	1,357	1,123	20.8
EPC	446	129	245.9	325	37.0	1,430	635	125.0
EBIT margins (%)								
Machinery & Equip.	13.3	9.2	410bps	8.6	467bps	8.8	8.7	17bps
EPC	4.2	1.3	291bps	4.0	22bps	4.2	1.9	235bps

Source: Company data, I-Sec research

Table 5: Quarterly financial highlights (consolidated)

(Rs mn)	Q4FY23	Q4FY22	YoY(%)	Q3FY23	QoQ(%)	FY23	FY22	YoY(%)
Net Sales	20,427	15,962	28.0	15,971	27.9	63,982	54,993	16.3
EBITDA	1,644	1,065	54.3	1,278	28.7	4,537	3,113	45.7
Margin	8.0	6.7	137bps	8.0	5bps	7.1	5.7	143bps
Depreciation	268	274	(2.3)	262	2.2	1,043	1,014	2.9
Finance Cost	175	318	(45.0)	174	0.3	730	652	12.0
Other Income	57	11	400.0	9	520.9	127	132	(4.3)
PBT	1,258	484	159.8	850	47.9	2,891	1,581	82.9
Tax	333	116	187.1	204	62.8	850	508	67.4
Tax rate	26.4	23.9	252bps	24.0	242bps	29.4	32.1	-272bps
Reported PAT	861	377	128.5	629	36.8	2,034	1,137	78.9
Adjusted PAT	861	377	128.5	629	36.8	2,034	1,137	78.9
Margin(%)	4.2	2.4	185bps	3.9	27bps	3.2	2.1	111bps
EPS (Rs)	11.7	5.1	128.5	8.6	36.8	28	15.5	

Source: Company data, I-Sec research

Table 6: Segmental highlights (consolidated)

Rs mn	Q4FY23	Q4FY22	YoY(%)	Q3FY23	QoQ(%)	FY23	FY22	YoY(%)
Segment Revenue								
Machinery & Equip.	8,352	5,693	46.7	5,575	49.8	22,907	16,982	34.9
EPC	10,884	7,885	38.0	7,876	38.2	33,919	34,012	(0.3)
Sugar	1,524	2,074	-26.5	3,239	-53.0	8,986	6,723	33.7
Total	21,284	16,215	31.3	17,311	23.0	58,071	58,181	(0.2)
Segmental EBIT								
Machinery & Equip.	676	489	38.2	285	137.3	1,587	1,167	36.0
EPC	412	312	32.3	361	14.2	1,479	995	48.7
Sugar	281	187	50.1	270	4.0	948	689	37.6
EBIT margins (%)								
Machinery & Equip.	8.1	8.6	-50bps	5.1	299bps	6.9	6.9	6bps
EPC	3.8	4.0	-17bps	4.6	-80bps	4.4	2.9	144bps
Sugar	18.5	9.0	942bps	8.3	1011bps	10.6	10.3	30bps

Source: Company data, I-Sec research

Table 7: Financial assumptions (standalone)

Rs mn	FY21	FY22	FY23	FY24E	FY25E
Segment Revenue					
Manufacturing of machinery & equipment	11,369	12,953	15,343	17,491	19,590
YoY Growth (%)	-8.6	13.9	18.4	14.0	12.0
Engineering, procurement and construction	34,024	33,615	33,678	36,373	40,010
YoY Growth (%)	-12.7	-1.2	0.2	8.0	10.0
Total	45,392	46,591	49,088	53,864	59,600
EBIT					
Manufacturing of machinery & Equipment	1,373	1,123	1,357	1,662	1,959
Engineering, procurement & construction	1,702	635	1,430	1,580	1,859
Unallocated	-43	-80	-96	-106	-116
Total EBIT	3,033	1,678	2,690	3,136	3,701
EBIT margin (%)					
Manufacturing of machinery & Equipment	12.1	8.7	8.8	9.5	10.0
Engineering, procurement & construction	5.0	1.9	4.2	4.3	4.6
Total	7.0	3.8	5.8	6.1	6.5

Source: Company data, I-Sec research

Concall highlights

- **Philippines project:** Construction of biofuel and diesel oil plant in Philippines is on track and is expected to be ready by Jul'23, be operational by Aug'23 and run on full capacity by Nov'23.
 - Philippines government is providing support for ethanol production. There is a 10% blending requirement for ethanol, which is currently 5%, hence demand is likely to increase.
 - In the Philippines, price of ethanol is fixed by a government body, National Bioethanol Board. They revise the price of ethanol every 15 days. The price is set keeping in accounting for the cost of the feed stock which is a pass through.
 - Management expects Rs6bn revenue annually from this plant once it starts operations with an approximate 25% of operating margins.
- Margins in FY24 are likely to be better than FY23 margins because: 1) old orders (which had seen commodity price increases) are close to completion, and 2) projects that were earlier getting stretched are close to completion
- Even though the company might prefer variable price contracts, it cannot avoid fixed price contracts because they are a part of the market. Orders from PSU companies (which account for 40-45% of the total orders) have a price variation clause that gets passed on only up to 50-60%. Additionally, to reduce the risk of commodity price inflation, the company is trying to take projects with shorter durations.
- Company is witnessing strong enquiries; however, these enquiries are taking a lot of time to convert into orders due to delayed decision-making (which could be due to banks being careful while extending loans).
- Receivables has increased in FY23 due to significant number of milestone payments in some large orders, which are expected to decrease in FY24 as execution improves.
- Management is confident of demand for capital goods with increasing enquiries from the private sector instead of majority from PSUs earlier. On the international front, the company is seeing increasing interest and enquiries though decision-making is delayed.
- **FGD** enquiries are expected from state projects and project costing has improved.
- Company will be investing Rs650mn through internal accruals in the sugar business in FY24.
- **Railways:** ISGEC supplies coach building and coach repairing facilities/factories to railway companies.
- ISGEC is observing growth across market segments including steel, cement, refineries, oil & gas, defence, etc.
- **Hitachi Zosen's** FY23 revenue stood at ~Rs6bn and profit for the year was ~Rs120mn

Price chart

Source: Bloomberg

Financial summary (standalone)

Table 8: Profit and Loss statement

(Rs mn, year ending March 31)

	FY22	FY23	FY24E	FY25E
Total Income	44,445	46,519	53,279	61,271
Operating Expenses	42,354	43,524	49,706	56,998
EBITDA	2,091	2,995	3,573	4,273
% margins	4.7	6.4	6.7	7.0
Depreciation & Amortisation	654	631	638	645
EBIT	1,437	2,364	2,935	3,628
Gross Interest	227	370	397	439
Other Income	260	350	304	336
PBT before exceptionals	1,471	2,344	2,842	3,525
Add: Extraordinaries/ Exceptionals	-	-	-	-
Add: Share in associates	-	-	-	-
PBT	1,471	2,344	2,842	3,525
Less: Taxes	342	565	685	888
Less: Minority Interests	-	-	-	-
Net Income (Reported)	1,128	1,779	2,157	2,637
Adjusted Net Income	1,128	1,779	2,157	2,637

Source: Company data, I-Sec research

Table 9: Balance sheet

(Rs mn, year ending March 31)

	FY22	FY23	FY24E	FY25E
Assets				
Total Current Assets	39,437	44,687	50,830	58,574
of which cash & cash eqv.	1,970	1,528	1,508	1,853
Total Current Liabilities & Provisions	27,040	29,611	33,377	38,334
Net Current Assets	10,428	13,548	15,945	18,387
Investments	917	1,127	1,127	1,127
Other Non-Current Assets	4,025	2,970	3,042	3,117
Net Fixed Assets	4,830	4,752	4,813	4,868
Goodwill	-	-	-	-
Total Assets	22,169	23,925	26,435	29,352
Liabilities				
Borrowings	4,337	4,468	4,968	5,468
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	17,759	19,384	21,394	23,810
Net Worth	17,832	19,457	21,467	23,884
Total Liabilities	22,169	23,925	26,435	29,352

Source: Company data, I-Sec research

Table 10: Cashflow statement

(Rs mn, year ending March 31)

	FY22	FY23	FY24E	FY25E
Operating Cashflow	1,659	2,354	2,889	3,385
Working Capital Changes	(2,065)	(2,804)	(2,743)	(2,850)
Capital Commitments	(571)	(553)	(700)	(700)
Free Cashflow	(977)	(1,003)	(554)	(165)
Cashflow from Investing	(1,356)	2,292	232	261
Activities				
Issue of Share Capital	(0)	-	-	-
Buyback of shares	(0)	-	-	-
Inc (Dec) in Borrowings	2,348	131	500	500
Interest paid	(227)	(370)	(397)	(439)
Dividend paid	(147)	(147)	(147)	(221)
Extraordinary Items/Others	684	(1,344)	345	408
Chg. in Cash & Bank balance	326	(441)	(21)	345

Source: Company data, I-Sec research

Table 11: Key ratios

(Year ending March 31)

	FY22	FY23	FY24E	FY25E
Per Share Data (in Rs)				
Diluted adjusted EPS	15.3	24.2	29.4	35.9
Recurring Cash EPS	24.2	32.8	38.0	44.7
Dividend per share (DPS)	2.0	2.0	2.0	3.0
Book Value per share (BV)	242.6	264.7	292.1	324.9
Growth Ratios (%)				
Operating Income	3.1	4.7	14.5	15.0
EBITDA	(38.4)	43.3	19.3	19.6
Recurring Net Income	(48.3)	57.7	21.3	22.2
Diluted adjusted EPS	(48.3)	57.7	21.3	22.2
Diluted Recurring CEPS	(37.7)	35.3	16.0	17.4
Valuation Ratios				
P/E	38.3	24.3	20.0	16.4
P/CEPS	24.3	17.9	15.5	13.2
P/BV	2.4	2.2	2.0	1.8
EV / EBITDA	21.8	15.4	13.1	11.0
EV / Operating Income	1.0	1.0	0.9	0.8
EV / Op. FCF (pre -Capex)	(112.4)	(102.6)	320.6	87.6
Operating Ratios				
Raw Material/Sales (%)	75.0	71.5	71.0	71.8
SG&A/Sales (%)	13.1	14.6	15.5	15.1
Other Income / PBT (%)	17.7	14.9	10.7	9.5
Effective Tax Rate (%)	23.3	24.1	24.1	25.2
NWC / Total Assets (%)	26.7	29.7	31.2	31.8
Inventory Turnover (days)	45.3	50.3	49.3	49.3
Receivables (days)	187.2	218.8	213.8	213.8
Payables (days)	105.3	111.6	111.6	111.6
Net D/E Ratio (x)	0.1	0.2	0.2	0.2
Return/Profitability Ratios (%)				
Recurring Net Income Margins	2.5	3.8	4.0	4.3
RoCE	6.4	8.9	9.8	10.6
RoNW	6.5	9.5	10.5	11.6
Dividend Payout Ratio	13.0	8.3	6.8	8.4
Dividend Yield (%)	0.3	0.3	0.3	0.5
EBITDA Margins	4.7	6.4	6.7	7.0

Source: Company data, I-Sec research

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