

November 8, 2022

High growth but valuations cap upside...

About the stock: Elgi Equipments (Elgi) manufactures a wide range of air compressors (~92% of revenue) and automotive equipment (~8%).

- 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 ~50% in FY22)

Q2FY23 Results: Elgi reported decent Q2FY23 results, positively surprising with higher EBITDA margin of 15.2%.

- Consolidated revenues came in at ₹ 738.7 crore, up 13.3% YoY
- EBITDA margins came in at 15.2% in Q2FY23 (above our estimates of 12.3%), thanks to price hikes taken by company
- Consequently, PAT was at ₹ 71.9 crore, up 39.4% YoY

What should investors do? Elgi's share price has grown by ~4.5x over the past six years (from ~₹ 65 in March 2016 to ~₹ 370 levels in February 2022).

- We remain long term positive on the stock but rich valuations cap upside. Hence, we maintain **HOLD** rating

Target Price and Valuation: We value Elgi at ₹ 520 i.e. 50x P/E on average EPS for FY24E and FY25E

Key triggers for future price performance:

- Going forward, accelerated growth in international markets, new products like disrupted AB series compressors, good traction in India business to drive long term incremental growth
- We expect revenue, EBITDA to grow at CAGR of 19%, 27%, respectively, in FY22-25E owing to various cost control initiatives improving margins
- Net debt free b/s, double-digit return ratios & strong cash generation

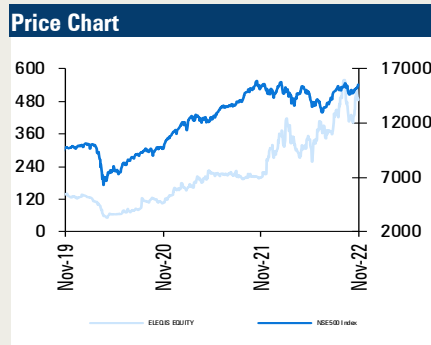
Alternate Stock Idea: We also like Grindwell Norton in our coverage.

- High margin value added products and solutions oriented approach to drive margin expansion (from ~16.7% in FY20 to 21.0% in FY24E)
- BUY with target price of ₹ 2460



Particulars	
Particular	Amount
Market Capitalization	₹ 15815 Crore
Total Debt (FY22)	₹ 326 Crore
Cash & Inv. (FY22)	₹ 122 Crore
EV (FY22)	₹ 16020 Crore
52 week H/L (₹)	464 / 191
Equity capital	₹ 31.7 Crore
Face value	₹ 1

Shareholding pattern					
(in %)	Dec-21	Mar-22	Jun-22	Sep-22	
Promoter	31.9	31.3	31.3	31.2	
FII	24.9	26.2	27.0	28.1	
DII	6.8	6.0	5.9	5.7	
Others	36.4	36.3	35.8	35.1	



Recent Events & Key risk

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

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Key Financial Summary

(₹ crore)	FY21	FY22	FY23E	5 Year CAGR (FY18-FY23)	FY24E	FY25E	2 year CAGR (FY23-25E)
Revenue	1,924.1	2,524.7	3,057.4	13.8%	3,607.8	4,257.2	18.0%
EBITDA	215.7	294.9	391.3	17.3%	505.1	604.5	24.3%
EBITDA Margin (%)	11.2	11.7	12.8		14.0	14.2	
Net Profit	102.5	181.0	226.8	18.5%	297.4	361.5	26.2%
EPS (₹)	3.2	5.7	7.2		9.4	11.4	
P/E (x)	154.3	87.4	69.7		53.2	43.7	
EV/EBITDA (x)	73.8	54.3	40.3		31.0	25.4	
RoCE (%)	11.7	18.9	19.0		21.4	22.0	
RoE (%)	11.8	18.7	19.8		21.3	21.1	
Growth		31.2	21.1		18.0	18.0	

Key takeaways of recent quarter....

Q2FY23 Results: Decent numbers

- Consolidated revenue grew 13.3% YoY to ₹ 738.7 crore vs. our estimate of ₹ 790 crore. Standalone revenue (domestic & direct exports compressor) grew 7.7% YoY to ₹ 448.5 crore (~61% of consolidated topline) amid good demand in domestic market and better exports. Despite challenges, the automotive (ATS) segment revenue grew 4.24% to ₹ 56 crore YoY
- EBITDA margins were strong at 15.2% in Q2FY23 (above our estimate of 12.3%) thanks to price hikes taken by the company. Consequently, absolute EBITDA grew 40.5% to ₹ 112.6 crore on a YoY basis (vs. above our estimates of ₹ 97.1 crore) with gross margins of 50% vs. 44.4% in Q2FY22
- PAT came in at ₹ 71.9 crore (above our estimate of ₹ 62.4), up 39.4% YoY aided by strong operational performance

Q2FY23 Earnings Conference Call highlights

- Elgi's standalone revenue (domestic & direct exports compressor) grew 7.7% YoY to ₹ 448.5 crore (~61% of consolidated top line). The compressor business in the domestic market was close to projected numbers. Business growth in Europe, North America and Brazil was strong. Middle East, Africa, Australia and South East Asian Countries are slowly recovering. The automotive business witnessed growth on the back of improvements in the Indian automotive sector. India business contributed to 40% revenue while rest of the world contributed 60%. The company saw volume growth of 8% in Q2FY23
- India business witnessed 8% volume growth on a high base as Q2FY22 saw high demand for compressors in oxygen segment. On a like-to-like basis, revenues (ex-demand for oxygen segment) would have been 18% YoY for Q2FY23. All sectors are showing traction in terms of orders and enquiries barring textile sector in the domestic market
- Elgi has managed to take price hikes across all products with all geographies. This has resulted in expansion in gross margin. Going ahead, the management alluded to the fact that price hikes taken were more than required and the same would see some correction in coming quarters
- For Q2FY23, the EBITDA miss compared to management expectation was on account of normalisation of fixed cost. Last year fixed cost was subdued (due to Covid) and should expect these to levels to continue, going forward
- The management expects European losses to get over by FY24 end. The same should start showing profitability by FY25 onwards
- To ensure product availability, the company has created huge inventory. As a consequence of that, the debt level has increased by ₹ 234 crore from March 2022. According to the management, it is well managed now, debt will come down in the next two to three months while cash flows are expected to start to improve, going forward
- The company is cautiously optimistic on moving towards its strategic business plan amid shades of recession being spoken about in Europe while such trends are not visible in North America. The domestic market may see minor ups and downs. However, overall, the company is on its way towards achieving its targets

Exhibit 1: Variance Analysis

	Q2FY23	Q2FY23E	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	Comments
Revenue	738.7	790.0	652.0	13.3	693.8	6.5	Standalone revenue grew 7.7% YoY
Other Income	14.7	10.0	17.3	-15.2	11.8	24.8	
Total Revenue	753.4	800.0	669.3	12.6	705.5	6.8	
Raw material cost	369.1	402.9	362.0	2.7	358.4	7.5	
Employee Expenses	137.1	160.0	117.0	17.2	141.6	-3.2	
Total Other expenses	119.9	130.0	92.9	29.1	115.6	3.8	
Operating Profit (EBITDA)	112.6	97.1	80.2	40.5	78.1	44.1	
EBITDA Margins	15.2	12.3	12.3	295 bps	11.3	398 bps	Gross margins improved significantly
Interest	5.1	2.8	2.8	83.0	2.8	82.8	
Depreciation	19.6	20.0	18.3	7.4	18.9	4.1	
Total Tax	32.1	21.9	25.5	26.3	21.8	47.4	
PAT	71.9	62.4	51.6	39.4	48.7	47.8	

	Q2FY23	Q2FY23E	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	
Revenue (Segment-wise)	738.7	790.0	652.0	13.3	693.8	6.5	
Air Compressors	683.0	610.0	599.2	14.0	646.2	5.7	Getting gradual traction in domestic business and decent incremental growth in international market
% of Sales	92%	92%	92%		93%		
Automotive Equipments	56.0	52.0	53.7	4.2	48.3	16.0	
% of Sales	8%	8%	8%		7%		
EBT Margin							
Air Compressors	57.3	75.0	39.5	45.2	71.6	-19.9	
EBT Margin	8.4%	12.3%	6.6%		11.1%		
% of EBT	89.7	94.1	86.0		93.7		
Automotive Equipments	6.6	4.7	6.4	2.8	4.8	37.2	
EBT Margin	11.8%	9.0%	12.0%		10.0%		
% of EBT	10.3	5.9	14.0		6.3		

Source: Company, ICICI Direct Research

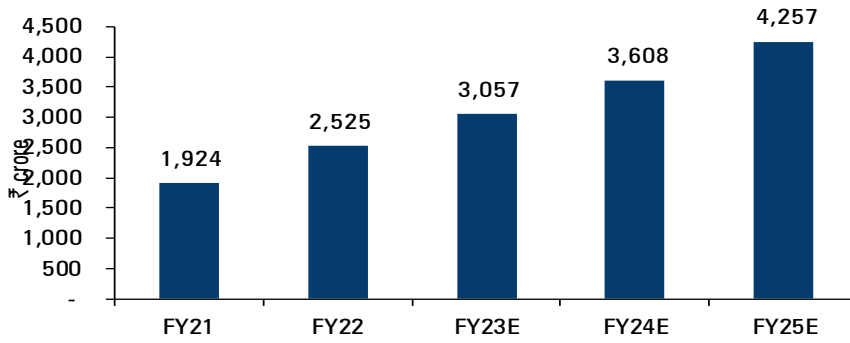
Exhibit 2: Change in estimates

₹ crore	FY23		FY24E		%	FY25E		%
	Old	New	Old	New	Change	Old	New	Change
Revenue	3,057.4	3,668.9	3,607.8	-	-1.7	-	4,257.2	-
EBITDA	391.3	495.3	505.1	-	2.0	-	604.5	-
EBITDA margin (%)	12.8	13.5	14.0	50 bps		-	14.2	-
PAT	226.8	288.9	297.4	-	3.0	-	361.5	-
EPS (₹)	7.2	9.1	9.4	3.1		-	11.4	-

Source: Company, ICICI Direct Research

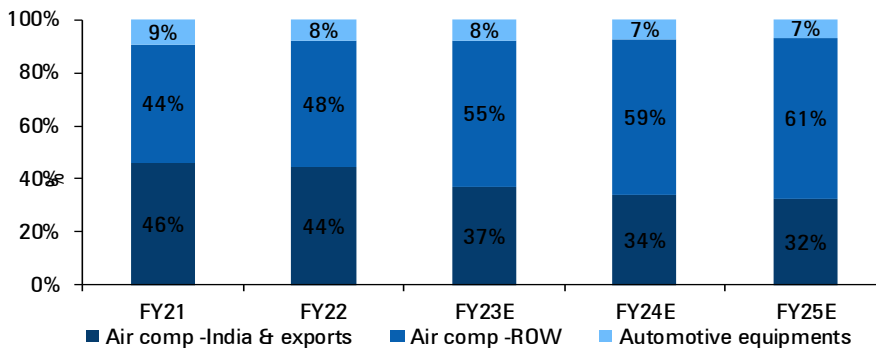
Financial story in charts

Exhibit 3: Revenue trend



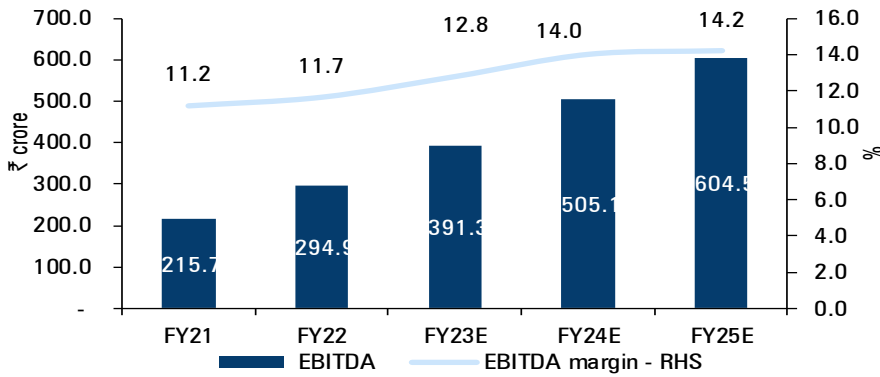
Source: Company, ICICI Direct Research

Exhibit 4: Revenue segmentation



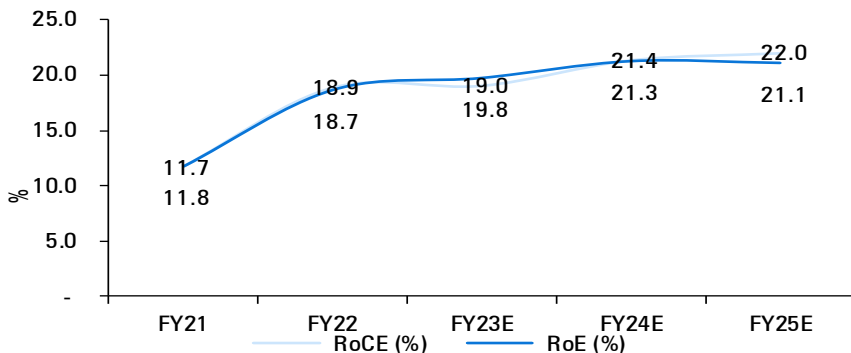
Source: Company, ICICI Direct Research

Exhibit 5: EBITDA and EBITDA margin trend



Source: Company, ICICI Direct Research

Exhibit 6: Return ratios to improve



Source: Company, ICICI Direct Research

Financial summary

Exhibit 7: Profit and loss statement				
	₹ crore			
(₹ Crore)	FY22	FY23E	FY24E	FY25E
Net Sales	2,524.7	3,057.4	3,607.8	4,257.2
Other Operating Income	-	-	-	-
Total Operating Income	2,524.7	3,057.4	3,607.8	4,257.2
% Growth	84.3	21.1	18.0	18.0
Other Income	55.0	24.5	24.5	24.5
Total Revenue	2,579.7	3,081.9	3,632.3	4,281.7
Growth (%)	86.6	19.5	17.9	17.9
Total Raw Material Costs	1,354.5	1,635.7	1,912.1	2,256.3
Employee Expenses	483.9	590.1	685.5	800.3
Other expenses	391.4	440.3	505.1	596.0
Total Operating Expense	2,229.8	2,666.1	3,102.7	3,652.6
EBITDA	294.9	391.3	505.1	604.5
Growth (%)	111.9	32.7	29.1	19.7
Interest	11.1	9.1	8.5	7.9
PBDT	338.7	406.7	521.1	621.1
Depreciation	74.5	97.8	115.4	127.7
PBT before Exceptional	264.2	308.9	405.6	493.4
Total Tax	84.6	83.4	109.5	133.2
PAT before MI	179.6	225.5	296.1	360.2
Minority Interest	-	-	-	-
PAT	181.0	226.8	297.4	361.5
Growth (%)	144.7	25.4	31.1	21.5
EPS*	5.7	7.2	9.4	11.4

Source: Company, ICICI Direct Research

Exhibit 8: Cash flow statement				
	₹ crore			
(₹ Crore)	FY22	FY23E	FY24E	FY25E
Profit after Tax	181.0	226.8	297.4	361.5
Depreciation	74.5	97.8	115.4	127.7
Interest	11.1	9.1	8.5	7.9
Cash Flow before WC changes	266.6	333.8	421.4	497.1
Changes in inventory	(140.4)	(61.4)	(48.6)	(106.7)
Changes in debtors	(72.2)	(72.6)	(196.8)	(75.1)
Changes in loans & Advances	3.1	(6.3)	(1.7)	(1.9)
Changes in other current assets	(32.3)	(8.0)	(25.3)	(29.9)
Net Increase in Current Assets	(241.6)	(148.3)	(272.4)	(213.7)
Changes in creditors	29.7	91.8	73.9	87.2
Changes in provisions	2.7	3.8	3.5	4.2
Net Increase in Current Liabilities	33.4	150.7	116.0	136.8
CF from operations	58.3	336.2	264.9	420.2
Changes in deferred tax assets	(7.5)	-	-	-
(Purchase)/Sale of Fixed Assets	(54.3)	(50.0)	(75.0)	(75.0)
CF from Investing	(62.1)	(50.0)	(75.0)	(75.0)
Dividend and Dividend Tax	(25.4)	(47.5)	(47.5)	(47.5)
CF from Financing	(136.5)	(79.4)	(76.0)	(75.4)
Net Cash flow	(140.3)	206.8	113.9	269.8
Opening Cash/Cash Equivalent	262.0	121.6	328.4	442.3
Closing Cash/ Cash Equivalent	121.6	328.4	442.3	712.1

Source: Company, ICICI Direct Research

Exhibit 9: Balance sheet				
	₹ crore			
(₹ Crore)	FY22	FY23E	FY24E	FY25E
Equity Capital	31.7	31.7	31.7	31.7
Reserve and Surplus	937.2	1,116.5	1,366.4	1,680.3
Total Shareholders funds	968.9	1,148.2	1,398.1	1,712.0
Minority Interest	-	-	-	-
Other Non Current Liabilities	48.4	48.4	48.4	48.4
Total Debt	326.2	303.4	283.4	263.4
Total Liabilities	1,363.7	1,520.1	1,750.0	2,044.0
Gross Block	922.2	977.2	1,052.2	1,127.2
Acc: Depreciation	355.9	453.8	569.2	696.9
Net Block	566.2	523.4	482.9	430.2
Capital WIP	5.0	-	-	-
Total Fixed Assets	571.2	523.4	482.9	430.2
Non Current Assets	63.0	63.0	63.0	63.0
Inventory	483.1	544.5	593.1	699.8
Debtors	471.9	544.5	741.3	816.4
Loans and Advances	2.9	9.2	10.8	12.8
Other Current Assets	132.7	140.6	166.0	195.8
Cash	121.6	328.4	442.3	712.1
Total Current Assets	1,212.1	1,567.1	1,953.4	2,436.9
Current Liabilities	318.7	410.4	484.3	571.5
Provisions	15.9	19.7	23.2	27.4
Net Current Assets	718.6	923.0	1,193.3	1,540.0
Total Assets	1,363.7	1,520.1	1,750.1	2,044.0

Source: Company, ICICI Direct Research

Exhibit 10: Key ratios				
	₹ crore			
	FY22	FY23E	FY24E	FY25E
Per Share Data				
EPS	5.7	7.2	9.4	11.4
BVS	30.6	36.2	44.1	54.0
Dividend per share	0.8	1.5	1.5	1.5
Dividend payout ratio	14.0	21.0	16.0	13.1
Operating Ratios				
EBITDA Margin	11.7	12.8	14.0	14.2
PAT Margin	7.2	7.4	8.2	8.5
Inventory days	69.8	65.0	60.0	60.0
Debtor days	68.2	65.0	75.0	70.0
Creditor days	46.1	49.0	49.0	49.0
Return Ratios				
RoE	18.7	19.8	21.3	21.1
RoCE	18.9	19.0	21.4	22.0
RoC	16.5	21.9	26.0	30.4
Valuation Ratios				
EV / EBITDA	54.3	40.3	31.0	25.4
P/E	87.4	69.7	53.2	43.7
EV / Net Sales	6.3	5.2	4.3	3.6
Sales / Equity	2.6	2.7	2.6	2.5
Market Cap / Sales	6.3	5.2	4.4	3.7
Price to Book Value	16.3	13.8	11.3	9.2
Turnover Ratios				
Asset turnover	1.7	1.8	1.9	1.9
Debtors Turnover Ratio	5.8	6.0	5.6	5.5
Creditors Turnover Ratio	8.3	8.4	8.1	8.1
Solvency Ratios				
Debt / Equity	0.3	0.3	0.2	0.2
Current Ratio	3.3	2.9	3.0	2.9
Quick Ratio	1.8	1.6	1.8	1.7

Source: Company, ICICI Direct Research

Exhibit 11: ICICI Direct coverage universe (Capital Goods)

Company	CMP			M Cap (₹ Cr)	EPS (₹)			P/E (x)			RoCE (%)			RoE (%)		
	(₹)	TP(₹)	Rating		FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
L&T (LARTOU)	2,015	2,355	Buy	282745	56.8	66.1	76.7	35.5	30.5	26.3	8.9	9.3	11.6	12.1	12.9	13.6
Siemens Ltd	2,943	3,660	Buy	104806	29.5	36.7	50.5	99.8	80.1	58.3	13.9	15.7	19.2	10.1	11.6	14.2
AIA Engineering (AIAENG)	2,709	3,011	Buy	25551	64.6	79.8	86.0	41.9	33.9	31.5	16.5	17.9	17.1	13.2	14.3	13.6
Thermax (THERMA)	2,345	2,405	Buy	27942	26.2	38.7	53.4	89.5	60.6	43.9	11.3	15.4	18.7	8.9	12.0	14.6
KEC International (KECIN)	435	542	Buy	11184	12.9	16.0	31.9	33.7	27.2	13.6	11.9	13.9	20.3	10.6	11.1	18.6
Greaves Cotton (GREAVE)	158	209	Buy	3641	0.7	3.5	3.6	222.5	44.7	44.1	2.5	9.4	10.7	1.3	6.7	7.7
Elgi Equipment (ELGEQU)	499	520	Hold	15814	7.2	9.4	11.4	69.7	53.2	43.7	19.0	21.4	22.0	19.8	21.3	21.1
Bharat Electronics (BHAELE)	110	135	Buy	80261	3.2	3.8	4.5	34.3	28.9	24.4	26.1	28.4	30.0	19.5	21.2	22.4
Cochin Shipyard (COCSHI)	596	445	Buy	7837	42.9	38.6	42.3	13.9	15.4	14.1	10.9	12.5	12.7	12.7	10.8	11.1
SKF (SKFIND)	4,512	5,215	Buy	22306	77.0	108.7	130.3	58.6	41.5	34.6	26.0	30.7	31.3	20.6	23.3	23.4
Timken India (TIMIND)	2,691	3,561	Buy	20241	43.5	61.3	71.2	61.9	43.9	37.8	25.3	36.2	42.0	19.7	27.9	32.2
NRB Bearing (NRBBEA)	181	220	Buy	1756	7.8	9.2	12.1	23.2	19.7	15.0	15.0	15.3	19.2	12.6	12.6	14.8
Action Construction (ACTCON)	333	365	Buy	3961	8.8	13.9	18.2	37.8	23.9	18.3	23.0	24.0	25.8	13.9	17.1	18.3
Data Patterns (DATPAT)	1408	1,555	Buy	7305	18.1	22.0	30.4	77.7	64.1	46.4	23.8	24.9	28.4	16.4	18.2	21.0
HAL (HINAER)	2,592	2,860	Buy	86657	151.9	130.9	143.1	17.1	19.8	18.1	27.4	30.6	30.8	26.3	23.2	23.4
ABB (ABB)	3,268	3,275	Buy	69252	25.5	38.9	43.7	128.3	84.1	74.8	45.0	49.2	64.9	11.2	13.0	17.6
Ador Welding (ADOWEL)	830	890	Buy	1129	33.2	37.5	49.3	25.0	22.1	16.8	19.9	23.8	26.8	13.6	17.1	19.3
Bharat Dynamics (BHADYN)	996	1,068	Buy	18255	27.3	33.0	42.7	30.4	25.2	19.5	24.6	24.7	27.9	17.3	17.7	20.0
Mazagon Dock (MAZDOC)	804	562	Buy	16216	30.3	31.2	40.1	27.4	26.6	20.7	20.0	18.1	20.9	16.1	14.6	16.6

Source: Company, ICICI Direct Research

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Buy: > 15%

Hold: -5% to 15%;

Reduce: -5% to -15%;

Sell: < -15%



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