

# Independent Equity Research

Enhancing investment decisions



In-depth analysis of the fundamentals and valuation

**Eimco Elecon (India)  
Limited**

## Explanation of CRISIL Fundamental and Valuation (CFV) matrix

The CFV Matrix (CRISIL Fundamental and Valuation Matrix) addresses the two important analysis of an investment making process – Analysis of Fundamentals (addressed through Fundamental Grade) and Analysis of Returns (Valuation Grade)

### Fundamental Grade

CRISIL's Fundamental Grade represents an overall assessment of the fundamentals of the company graded in relation to other listed equity securities in India. The grade facilitates easy comparison of fundamentals between companies, irrespective of the size or the industry they operate in. The grading factors in the following:

- Business Prospects: Business prospects factors in Industry prospects and company's future financial performance
- Management Evaluation: Factors such as track record of the management, strategy are taken into consideration
- Corporate Governance: Assessment of adequacy of corporate governance structure and disclosure norms

The grade is assigned on a five-point scale from grade 5 (indicating Excellent fundamentals) to grade 1 (Poor fundamentals)

CRISIL Fundamental Grade	Assessment
5/5	Excellent fundamentals
4/5	Superior fundamentals
3/5	Good fundamentals
2/5	Moderate fundamentals
1/5	Poor fundamentals

### Valuation Grade

CRISIL's Valuation Grade represents an assessment of the potential value in the company stock for an equity investor over a 12 month period. The grade is assigned on a five-point scale from grade 5 (indicating strong upside from the current market price (CMP)) to grade 1 (strong downside from the CMP).

CRISIL Valuation Grade	Assessment
5/5	Strong upside (>25% from CMP)
4/5	Upside (10-25% from CMP)
3/5	Align (+-10% from CMP)
2/5	Downside (negative 10-25% from CMP)
1/5	Strong downside (<-25% from CMP)

### Analyst Disclosure

Each member of the team involved in the preparation of the grading report, hereby affirms that there exists no conflict of interest that can bias the grading recommendation of the company.

### Additional Disclosure

This report has been sponsored by National Stock Exchange (NSE)

### Disclaimer:

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Gujarat-based Eimco Elecon (India) Ltd (Eimco Elecon) manufactures, markets and services underground mining equipments. We assign Eimco Elecon a fundamental grade of '4/5', indicating that its fundamentals are 'superior' relative to other listed securities in India. We assign a valuation grade of '3/5', indicating that the current market price is 'aligned' with our fair value.

### Increased focus on underground coal mining to meet growing demand for coal...

Demand for coal in India is expected to increase from 549 MT in FY09 to 933 MT in FY14 at a CAGR of 11% on the back of strong capacity additions in power, cement and steel industries. Coal imports are expected to treble over FY09-14. CRISIL Equities expects the government to increase its focus on extracting coal from underground mines to meet the shortage of coal. Coal India Ltd (CIL) is targeting to increase its underground coal production from 43 MT in FY10 to 48 MT by FY12 at a CAGR of 5.4%.

### ... to benefit Eimco Elecon, the largest player in underground mining equipments

In line with the growth in underground mining activity, we expect the demand for underground mining equipments to pick up. Further, as the equipments have an average life of six to ten years, the replacement demand would continue to support growth. Eimco Elecon, being the largest player in underground mining equipments, will be the key beneficiary of the increase in demand. It has sold 2,500+ equipments over the past 20 years and has established a strong presence in the industry.

### Key growth drivers: Launch of new products and entry into new sectors

In the past couple of years, Eimco Elecon has launched new and technologically-advanced products for underground mining. It has also started manufacturing drills for open cast mining. Currently, CIL accounts for nearly 88% of Eimco Elecon's revenues. In order to diversify the single-client risk, the company has ventured into manufacturing construction equipment machinery. We believe these initiatives will drive the 14% CAGR in equipment revenues over FY10-15.

### Spares sales to grow at 15% CAGR over next two years

The mining equipments operate in tough environment and, hence, require frequent replacement of hydraulics, electronics and other spares. Spares sales constitute between 50% and 65% of Eimco Elecon's revenues and enjoy higher margins than equipment sales. We believe the strong growth of 30% in equipment sales over FY08-FY10 would drive the 15% growth in spares sales over FY10-12.

### Probable restructuring exercise of the Elecon group needs to be monitored

The Elecon group, of which Eimco Elecon is a part, is considering a restructuring exercise involving group companies. Eimco Elecon's involvement in this exercise needs to be monitored closely.

### Valuation - market price is aligned with fair value

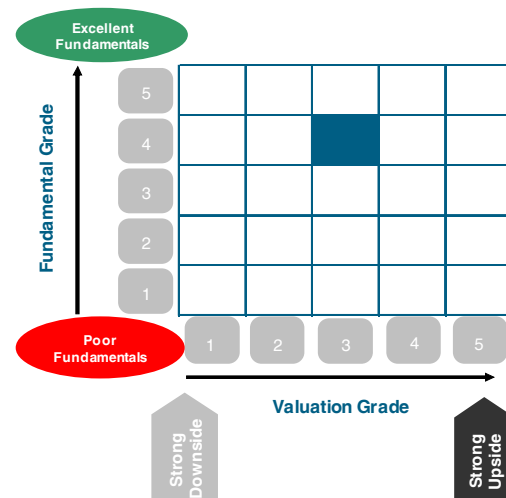
Eimco Elecon is expected to register a 17% CAGR in revenues over FY10-12. Increase in average realisation and higher contribution from the spares business will help improve margins and lead to EPS CAGR of 28% over FY10-12. We have used the discounted cash flow method to value Eimco Elecon and arrived at a fair value of Rs 314. At this fair value, the stock trades at 11.3x FY11 EPS of Rs 27.9 and 8.7x FY12 EPS of Rs 36. We initiate coverage on Eimco Elecon with a valuation grade of '3/5', indicating that the market price of Rs 298 (as on August 25, 2010) is 'aligned' with our fair value.

### Key forecast

(Rs Mn)	FY08	FY09	FY10	FY11E	FY12E
Operating income	1,182	1,476	1,638	1,953	2,246
EBITDA	280	321	266	317	387
Adj Net income	127	152	127	161	208
EPS-Rs	21.9	26.4	22.0	27.9	36.0
EPS growth (%)	50.9	16.2	(15.9)	25.6	29.2
PE (x)	14.6	5.0	10.6	10.7	8.3
P/BV (x)	1.7	0.6	1.0	1.2	1.1
RoCE(%)	17.6	19.5	14.0	16.5	19.3
RoE(%)	12.5	13.5	10.2	11.8	13.8
EV/EBITDA (x)	6.5	2.9	5.4	5.4	4.2

Source: Company, CRISIL Equities estimate

### CFV matrix



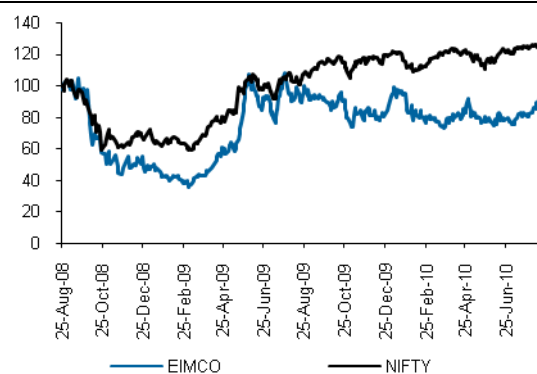
- Fundamental grade of '4/5' indicates superior fundamentals
- Valuation grade of '3/5' indicates aligned market price

### Key stock statistics

NSE Ticker	EIMCOELECO
Fair value (Rs per share)	314
Face value (Rs per share)	10
Current market price *	298
Shares outstanding (mn)	5.8
Market cap (Rs mn)	1719
Enterprise value (Rs mn)	1799
52-week range (Rs) (H/L)	329/ 212
P/E on EPS estimate (FY11E)	10.7
Beta	1.0
Free float (%)	26
Average daily volumes (3 months)	7297

\*as on 25 Aug, 2010

### Share price movement



-Indexed to 100

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**Table 1: Business environment**

Parameter	Mining equipment	Spares sales	Construction equipment
Revenue contribution (FY10)	49%	50%	1%
Revenue contribution (FY12)	49%	49%	2%
Product / service offering	<ul style="list-style-type: none"> <li>• Side dump loaders (SDL)</li> <li>• Load haul dumpers (LHD)</li> <li>• Rocker shovel loader</li> <li>• Universal drilling machines- underground</li> <li>• Blast hole drills - opencast</li> <li>• Continuous miners</li> </ul>	<ul style="list-style-type: none"> <li>• Hydraulics</li> <li>• Electronics</li> <li>• Air motors</li> <li>• Filters</li> </ul>	<ul style="list-style-type: none"> <li>• Front end loaders</li> </ul>
Geographic presence	<ul style="list-style-type: none"> <li>• Marketing and services offices in Asansol, Bilaspur, Dhanbad, Kolkatta, Nagpur, Secunderabad, Bangalore, Chennai, Jamshedpur, Mumbai, New Delhi (owned and operated by group company Emtici Engineering)</li> <li>• Factory in Vallabh Vidyanagar, Gujarat</li> </ul>		
Market position	Market leader		New entrant
Industry growth expectations	7.4% growth expected in overall coal production, 5.4% growth in underground coal production		25-30% growth in construction equipments
Sales growth (FY08-FY10 – 2-yr CAGR)	29%	10%	NA
Sales forecast (FY10-FY12 – 2-yr CAGR)	17%	15%	80%
Demand drivers	<ul style="list-style-type: none"> <li>• Rising demand for coal and need for coal imports</li> <li>• Increased focus of CIL on underground mining to boost production</li> <li>• Increase in coal prices could make underground production viable</li> <li>• Faster scrapping of old equipment by CIL</li> </ul>	<ul style="list-style-type: none"> <li>• Strong growth in equipment sales to drive requirement for spares</li> </ul>	<ul style="list-style-type: none"> <li>• Strong growth in infrastructure and construction activities</li> <li>• Increased size of project requires larger bucket size and specialised loaders for movements of materials</li> </ul>
Key competitors	<ul style="list-style-type: none"> <li>• TRF</li> <li>• Simplex Engineering</li> <li>• BEML</li> <li>• International players such as Joy Mining &amp; Machinery, Bucyrus International</li> </ul>	Same as those in equipment sales and unorganised players	<ul style="list-style-type: none"> <li>• L&amp;T Komatsu</li> <li>• Telco Construction Equipment</li> <li>• BEML</li> <li>• JCB India</li> </ul>

Source: Company, CRISIL Equities

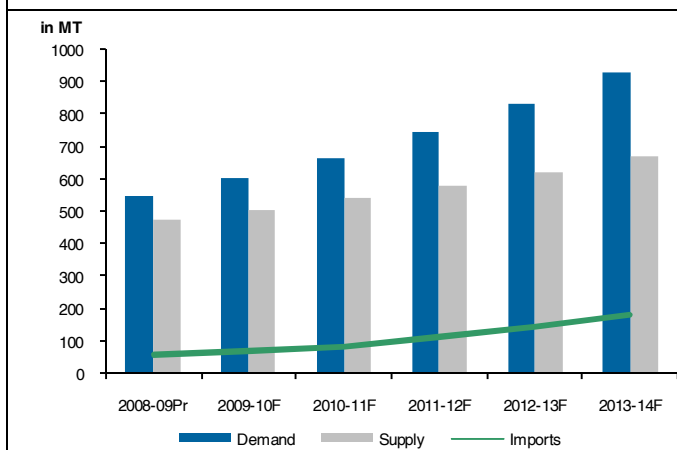
## Grading Rationale

### Increased focus on underground mining to meet growing coal demand in India

Demand for coal in India is expected to increase from 549 MT in FY09 to 933 MT in FY14 at a CAGR of 11% on the back of strong capacity additions in power, cement and steel industries. The power sector would be the major driver of coal demand as India is planning to add 78,000 MW of power capacity in the 11<sup>th</sup> Five-Year Plan and 100,000 MW in the 12<sup>th</sup> Five-Year Plan. Around 70% of the additions are expected to be coal-based. The rising demand is expected to lead to an increase in coal mining activity in the country. The demand-supply deficit is expected to widen to 180 MT in FY14 which is expected to be met through imports. CRISIL Research estimates the imports of coal in India to treble from 60 MT in FY09 to 180 MT in FY14 at a CAGR of 25%.

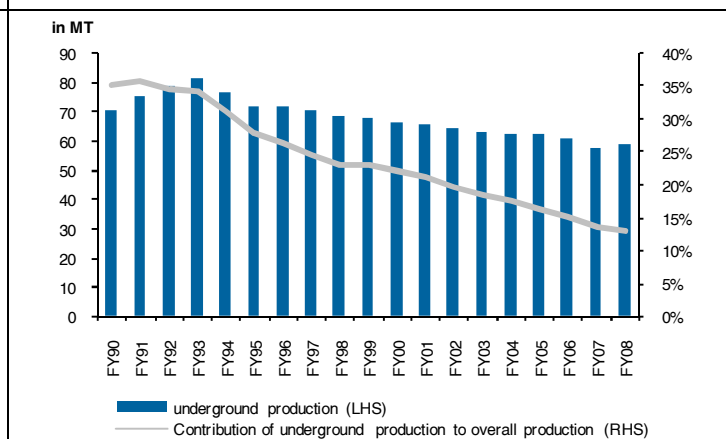
**Power, steel and cement industries to drive 11% CAGR in coal demand over FY09-14**

**Figure 1: Indian coal demand outstripping supply, imports to treble**



Source: CRISIL Research

**Figure 2: Contribution of underground mining to total coal production has been on a decline**

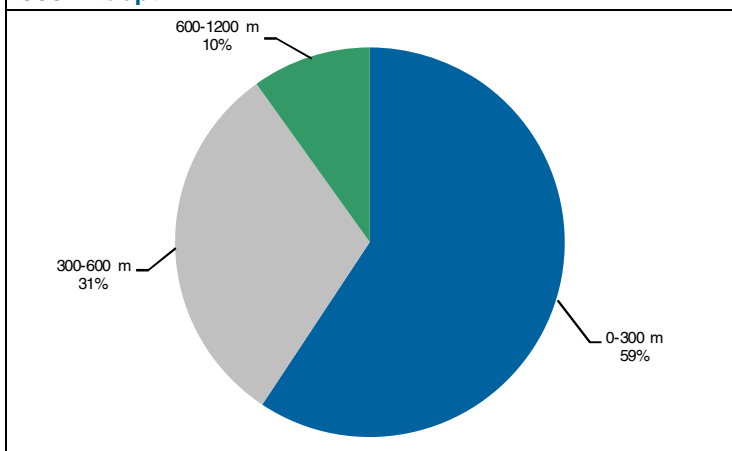


Source: Ministry of Coal

**Underground coal production had been on a decline since FY1993**

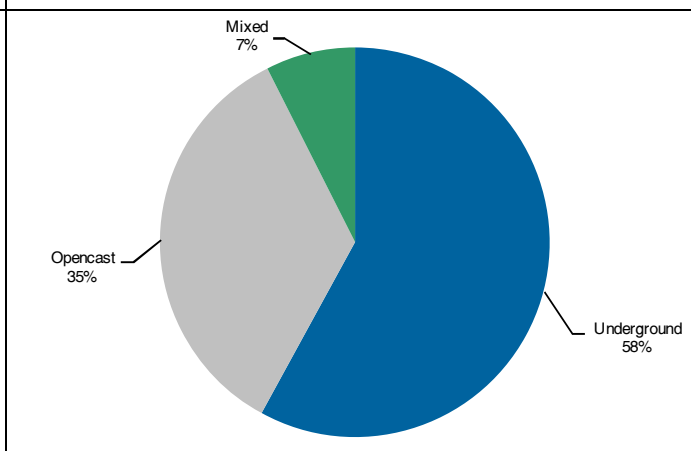
The production of coal from underground (UG) mines has been on a steady decline from FY1993 till FY07. Despite the fact that nearly 41% of the coal reserves in India are below 300 m depth, the contribution of underground coal production has declined from 35% in FY1990 to only 13% in FY08. We believe the primary reasons for lack of growth in underground mining are the high production cost and low productivity as compared to open cast mines.

**Figure 3: 41% of the Indian coal reserves are below 300 m depth**



Source: Ministry of Coal

**Figure 4: 58% of CIL mines are underground**

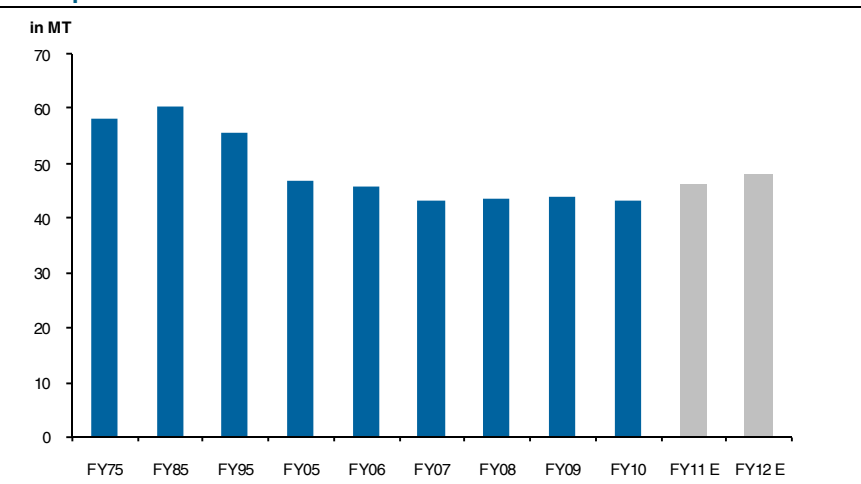


Source: Ministry of Coal

**Ministry of Coal and CIL are renewing focus on underground mining; CIL expects to increase underground coal production at 5.4% CAGR over FY10-12**

However, in view of rising demand, the Ministry of Coal and Coal India Ltd (CIL) have renewed focus on underground mining to boost production. CIL plans to increase underground coal production from 43.3 MT in FY10 to 48.0 MT in FY12 at a CAGR of 5.4%. CIL plans to restart 18 abandoned underground mines having cumulative reserves of 1,647 MT through joint ventures. It has also identified seven new underground mines to be operated contractually. Since FY08, CIL has been able to arrest the decline in underground coal production.

**Figure 5: CIL has been able to arrest a decline in underground coal production**

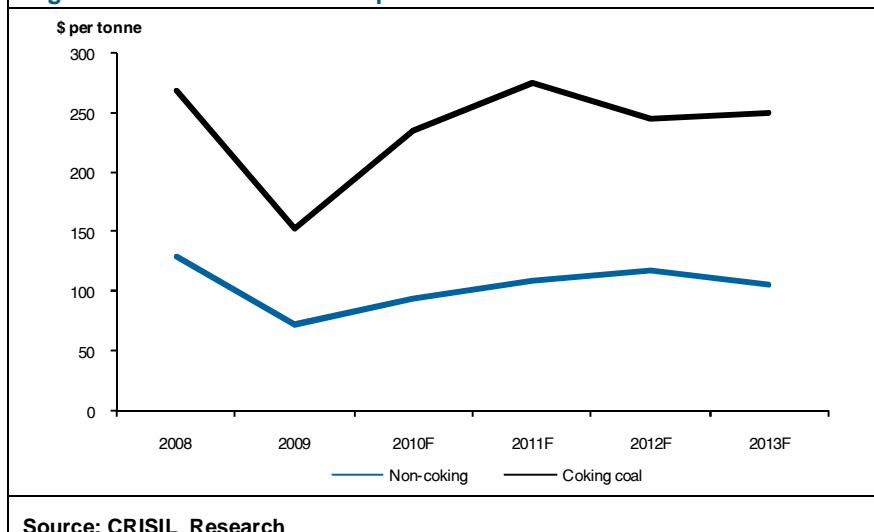


Source: CIL

### High coal prices to support underground mining

We believe the production cost for underground coal could be comparable to imports from South Africa and Australia. Currently, underground mining in India largely uses intermediate level mining technologies. We believe the introduction of advanced level mining equipments and economies of scale could help bring down the cost of producing coal from underground mines, making it comparable with importing coal or buying it in the spot market.

**Figure 6: International coal price forecast**



Source: CRISIL Research

**Table2: Comparison of coal sources**

	Open cast mines	Underground mines	Imported coal
Production cost Rs per tonne	520*	2800*	Indonesia: \$41-43 <sup>#</sup> South Africa: \$63-65 <sup>#</sup> Australia: \$72-73 <sup>#</sup>
Relative calorific value	Lower	Moderate/high	High
Output in tonnes per man shift	8.96	0.76	NA

\*for Coal India #landed costs

Source: Ministry of Coal, CIL, CRISIL Research

### Eimco Elecon to benefit from focus on underground mining

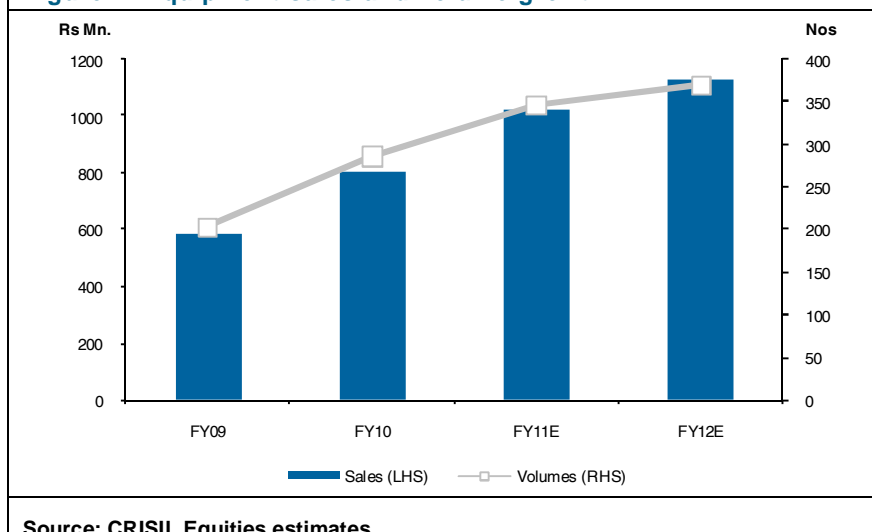
Eimco Elecon is an established player in this industry with over 20 years' track record. It has sold over 2,500-plus mining equipments. The company receives a strong marketing and after-sales support from its group company - Emtici Engineering. Emtici has branch offices across India which helps Eimco Elecon remain closer to its customers and offer quick maintenance and break-down support services.

The increase in underground mining activity in India will have obvious positive effects on the demand for underground mining equipments. Although we believe that advanced mining technology would find entry into the Indian market, the intermediate level technology comprising SDL and LHD would remain the mainstay of underground coal production in India considering the relatively smaller size of mines.

Eimco Elecon is the market leader with over 90% market share (as per management) and, hence, would be the key beneficiary of the increase in equipment demand. Also, as the average life of SDL/LHD equipment is between six and ten years, the replacement demand will also continue to support Eimco Elecon's revenues. We estimate SDL/ LHD sales to grow at 10% CAGR over FY10-12. The overall equipment sales inclusive of open cast/underground drills and construction equipments is expected to grow at 18% CAGR over FY10-12.

**SDL and LHD sales are expected to grow at 10% CAGR on the back of increased underground mining and replacement demand**

**Figure 7: Equipment sales and volume growth**



Source: CRISIL Equities estimates

*Limited competition from domestic players; entry of foreign players mainly in advanced mining machinery*

**Limited competition from domestic players; strong after-sales service network a key entry barrier**

Eimco Elecon faces limited competition from players such as Simplex Engineering, TRF and BEML. As the equipments require frequent servicing and maintenance, a strong after-sales service network is the key requirement. This acts as an entry barrier for new players as well as for imports. As the underground coal mining industry moves towards advanced mining equipments, we expect many international players to enter India. International players such as Joy Mining and Bucyrus International have already established their presence in India and executed projects for CIL.

**Table 3: Comparison of product profile**

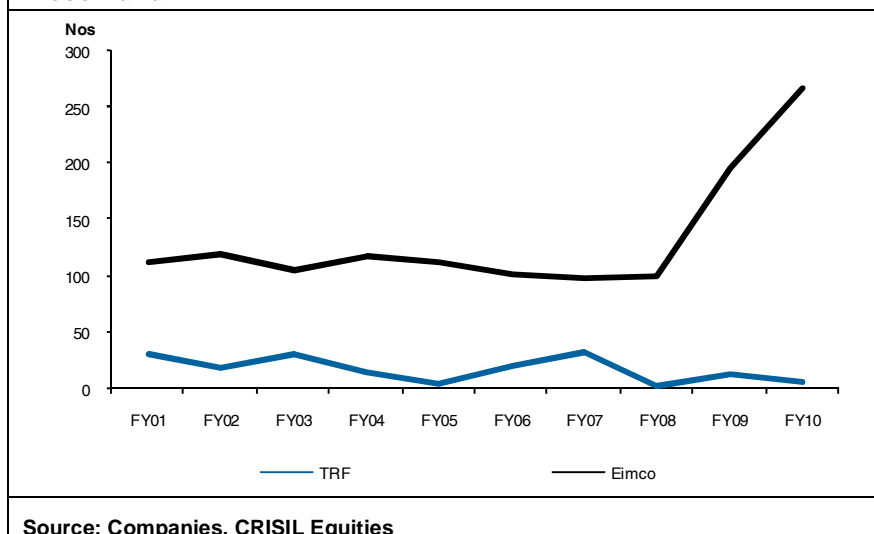
Company	SDL/ LHD	Wheel loaders	Drills	Continuous miners
<b>Domestic players</b>				
Eimco Elecon (India) Ltd	✓	✓	✓	✓
Simplex Engineering Ltd	✓	✓	✓	x
B E M L Ltd	✓	✓	x	x
T R F Ltd	✓	✓	x	x
Revathi Equipment Ltd	x	x	✓	x
P&H Mining Equipment Ltd	x	x	✓	x
<b>International Players</b>				
Bucyrus International U. S.	✓	✓	✓	✓
Sandvik Ltd, Sweden	✓	✓	✓	✓
Atlas Copco, Sweden	✓	✓	✓	✓
Terex, US	x	✓	✓	x

Source: Company websites, CRISIL Equities

Eimco Elecon has established its dominance in the underground mining equipments space, especially the SDL and LHD market in the past three years. The company had consciously adopted a strategy of lower pricing to eliminate competition and gain market share. Eimco Elecon’s volumes have grown at a 63% CAGR over FY08-10.



**Figure 8: Comparison of volume sales of SDL / LHD by Eimco Elecon and TRF**



Source: Companies, CRISIL Equities

### New products in underground mining, entry into new segments to drive growth

In the past couple of years, Eimco Elecon has introduced newer products through collaboration with various foreign technological partners. The company has launched universal drilling machines for roof and wall drilling in underground mines. It has already received orders for supply of 40 of these machines this fiscal. Further, keeping in mind the industry shift towards higher degree of mechanisation it has also launched continuous miners, which are currently under the trial phase. The company has marked its entry into open cast mining machinery with the launch of 160 mm blast hole drills.

Currently, nearly 90% of the company's revenues accrue from a single client - CIL. In order to diversify the single-client risk and leverage its existing manufacturing capabilities, Eimco Elecon has consciously entered into the manufacturing of construction equipments. It currently has a single product (front end loader) under commercial manufacturing and plans to manufacture higher capacity loaders and road construction equipments.

**Table 4: Eimco Elecon's growth strategy**

	Old products	New products
Old markets	Side dump loaders Load haul dumpers Rocker shovel loaders	Universal drill machines Continuous miners Higher capacity dumpers and loaders
New markets	Private sector coal producer	Blast hole rigs Front end loaders

Source: Company, CRISIL Equities

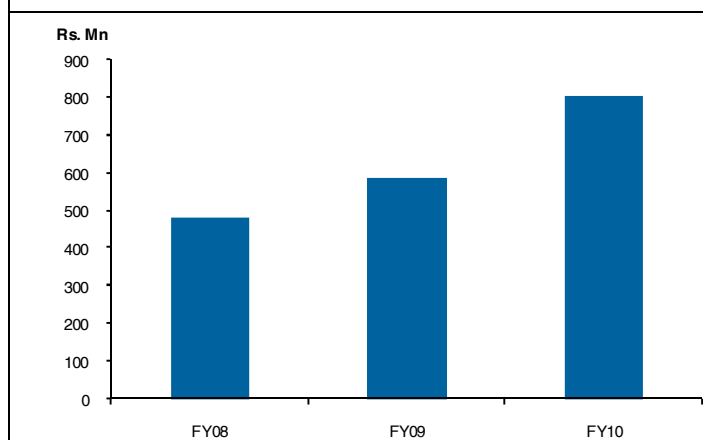
*Key growth drivers: Launch of new products in underground mining and expanding into new areas such as open cast mining and construction equipments*

### Spares sales to grow at 15% CAGR over FY10-12 as result of strong equipment sales

Since the mining equipments operate in tough environments, they entail high maintenance and servicing costs. The spares sales business has historically contributed between 50% and 65% of Eimco Elecon's revenues. The sales of equipments have grown at a CAGR of 30% over FY08-10 as a result of revival in mining activity and faster scrapping of old equipment by some subsidiaries of CIL. We expect spares sales to grow at 15% CAGR over FY10-12 on the back of strong equipment sales growth in the previous years.

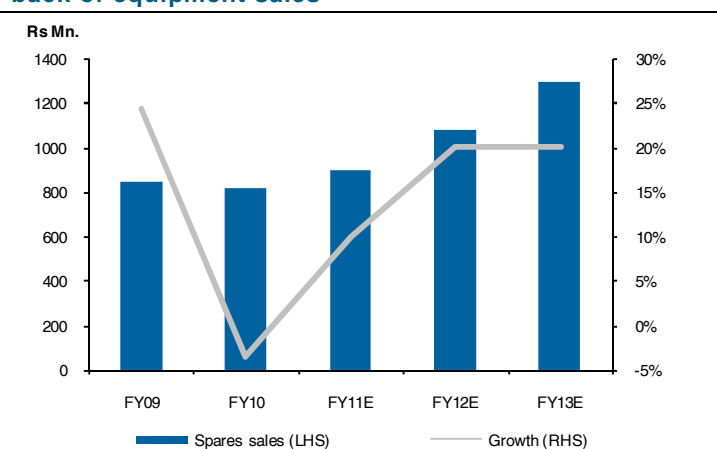
**Equipment sales growth of 30% over FY08-10 to drive 15% spares sales growth over the next two years**

**Figure 9: 30% CAGR in equipment sales over FY08-10**



Source: CRISIL Equities estimates

**Figure 10: Spares sales growth to remain strong on the back of equipment sales**



Source: CRISIL Equities estimates

## Key risks

### Probable restructuring of the Elecon group

The Elecon group, to which Eimco Elecon belongs, is planning a restructuring exercise according to the announcement made by Elecon Engineering, the flagship company of the group. Elecon Engineering and Eimco Elecon are two listed entities in the group whereas the others are unlisted. However, there is no clarity on the same. At this juncture, we are unable to comment on the impact of the restructuring exercise. The same would be closely monitored.

### A faster shift towards advanced mechanisation could impact sales

At present, the company is fully dependent upon sales of SDL/LHD and related spares, which is the intermediate level technology for underground coal mining. As the industry moves towards advanced mechanisation to improve productivity and bring down the cost of coal production, the sales of SDL/LHD could be impacted. The company has already started manufacturing advanced level continuous miners, which are under the trial phase. However, a faster shift of industry towards advanced mechanisation could impact Eimco Elecon's sales.

### Competition from established players in construction equipment segment

Eimco Elecon has entered the construction equipment segment to leverage on its existing manufacturing capabilities. Its AL 120 wheel loader is a new product in the Indian market and acceptance of this product by clients is a concern. Our estimates factor in only 2-3% contribution by this product to overall sales in the next two years. Moreover, the company is competing against established players such as L&T-Komatsu and Telco Construction Equipments. Eimco Elecon would need to scale up this business in order to diversify its client base and sector risk.

### Client concentration risk to remain in near term

Despite efforts by the company to diversify its client base, we believe CIL would remain the single largest client for Eimco Elecon over the next two years, contributing over 85% to revenues. The increasing development of coal mines by private sector players and the scale-up of construction equipment business would be critical for diversifying the client risk.

*Probable restructuring of Elecon group could involve Eimco Elecon*

*A faster shift towards advanced mining equipments would impact the demand for SDL/LHD equipments negatively*

*Competition from established players such as Telco Construction Equipments, L&T-Komatsu in construction equipments*

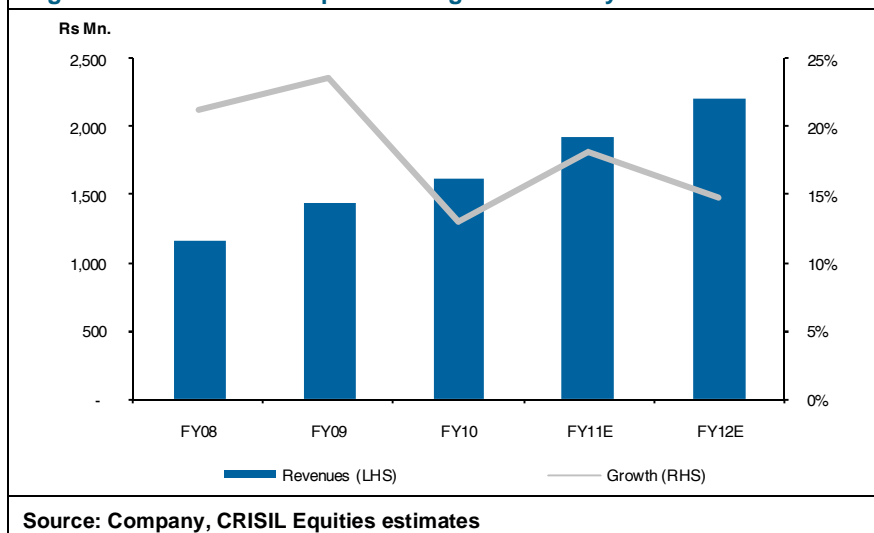
## Financial Outlook

### Revenues to grow at 17% CAGR over FY10-12

We expect Eimco Elecon's revenues to grow from Rs 1,623 mn in FY10 to Rs 2,206 mn in FY12 at a CAGR of 17%. Overall equipment sales are expected to grow at 18% CAGR over FY10-12 driven by increased underground mining activity in India and new product launches by the company. Spares sales are expected to grow at 15% CAGR over FY10-12.

*Revenues are expected to grow at a CAGR of 17% driven by increased underground mining and new product launches*

**Figure 11: Revenues expected to grow at two-year CAGR of 17%**

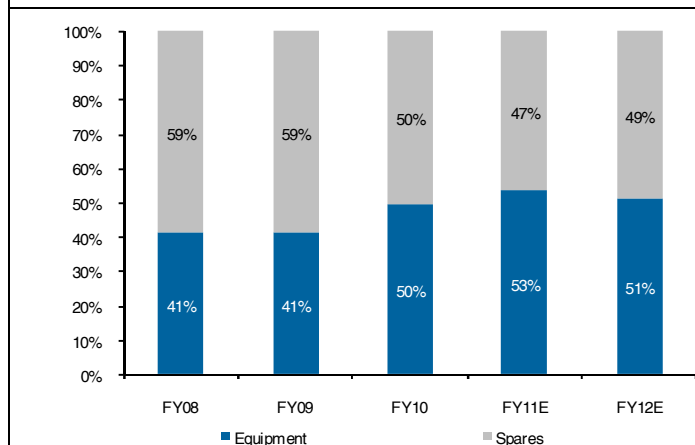


Source: Company, CRISIL Equities estimates

### EBIDTA margins to expand due to increase in realisations and higher contribution of spares sales

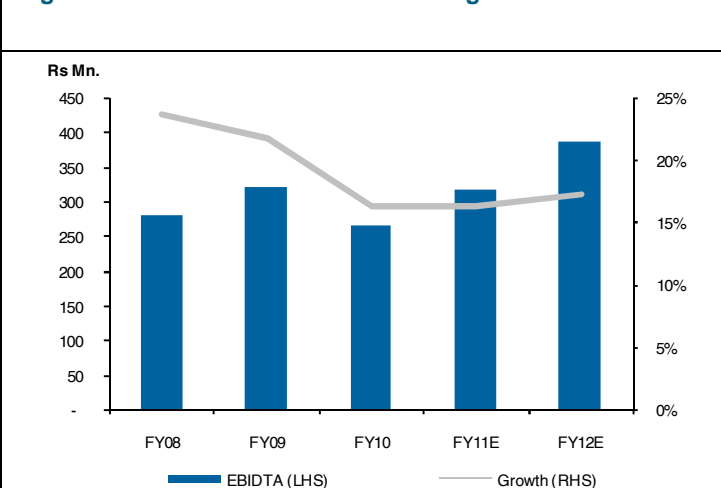
Eimco Elecon enjoys higher margins on spares sales than on products. The company's EBIDTA margin declined from 23.7% in FY08 to 16.2% in FY10 as the contribution of spares sales fell from 58.6% in FY08 to 50.7% in FY10. We expect margins to remain flat in FY11 as the decline in spares contribution to sales would be offset by an increase in realisations undertaken by the company. As the contribution of spares increases in FY12, we expect a 100 bps expansion in margin. The absolute EBIDTA margin is expected to grow at 21% CAGR over FY10-12.

**Figure 12: Contribution of spares to sales will increase FY12 onwards**



Source: CRISIL Equities estimates

**Figure 13: EBIDTA and EBIDTA margin**



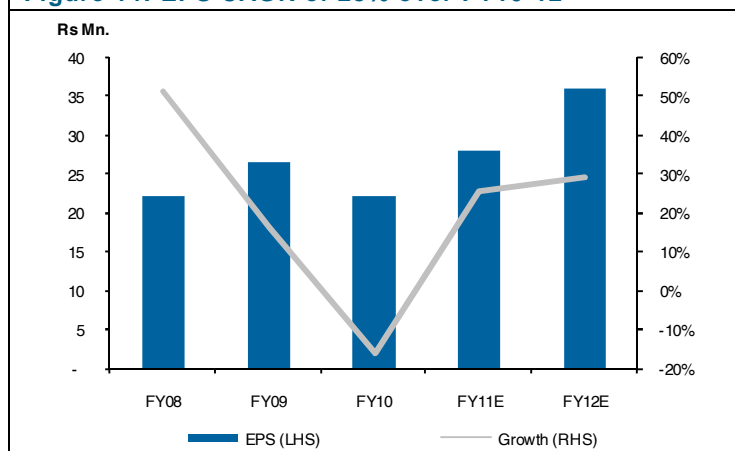
Source: CRISIL Equities estimates

### EPS to grow at 28% CAGR over FY10-12, RoE to improve from 10.2% in FY10 to 13.8% in FY12

*Strong bottom-line growth led by revenue growth and improvement in margins*

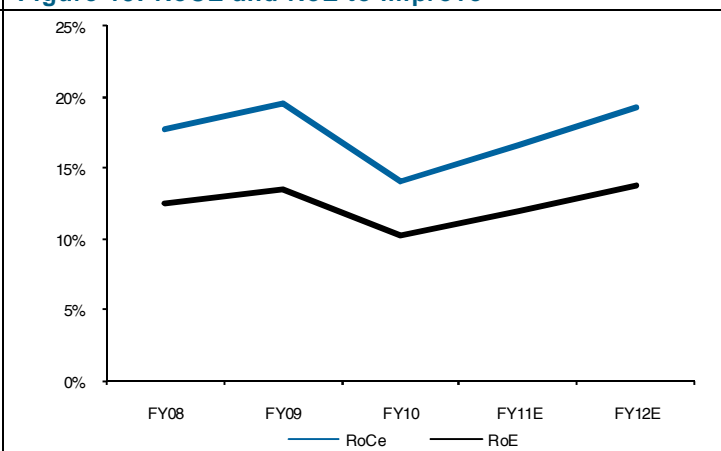
We expect the company to register a strong EPS CAGR of 28% over FY10-12 on account of improvement in EBIDTA margins and decline in interest costs. RoE is estimated to improve from 10.2% in FY10 to 13.8% in FY12 driven by higher fixed assets and inventory turnover. We believe the company will be able to achieve revenue CAGR of 17% without any significant capital expenditure. The company currently has to maintain high inventory as it imports nearly 35-40% of its raw materials, which have long delivery times. As the company starts to indigenise more products, we expect the imports to decline, which would decrease the inventory levels albeit moderately.

**Figure 14: EPS CAGR of 28% over FY10-12**



Source: Company, CRISIL Equities estimates

**Figure 15: RoCE and RoE to improve**



Source: Company, CRISIL Equities estimates

## Management Overview

CRISIL's fundamental grading methodology includes a broad assessment of management quality, apart from other key factors such as industry and business prospects, and financial performance.

### Experienced management

Eimco Elecon is headed by Mr P. B. Patel, who is the promoter and also acts as managing director. Mr Patel is a B.E. in Mechanical Engineering and MBA from USA, and has more than 34 years of experience in the engineering industry. He also acts as the MD of the group's flagship company - Elecon Engineering Ltd. He is supported by Mr A. M. Deshpande, Executive Director. He is M. E. in machine design and has more than 37 years of experience in the industry. He has been working with Eimco Elecon for the past seven years, prior to which he was working as deputy general manager at L&T Case Equipments Pvt. Ltd, which is also into the manufacturing of mining and construction equipments.

### Management has been active in identifying new growth opportunities

Eimco Elecon has been one of the pioneers in introducing intermediate level mining technology to the Indian market. The management is active in identifying newer growth opportunities within the existing segment as well as exploring new opportunities. With a shift in the Indian mining industry towards increased mechanisation, the management has been proactive in launching products such as continuous miners and universal drilling machines. Further, Eimco Elecon has been successful in introducing newer products with foreign technological collaborations and also in indigenising these technologies.

### Second line of management

Based on our interactions, we believe the company's second line is reasonably experienced and has been recently given some autonomy in functioning. Key managerial personnel have more than 10 years of experience in their respective fields.

*Top management has over 30 years of experience in the engineering business*

*Management has been active in identifying new growth opportunities*

## Corporate Governance

CRISIL's fundamental grading methodology includes a broad assessment of corporate governance practices. In this context, CRISIL Equities analyses the shareholding structure, board composition, typical board processes, disclosure standards and related-party transactions. Any qualifications by regulators or auditors also serve as useful inputs while assessing a company's corporate governance.

**Corporate governance practices meet minimum standards**

Corporate governance at Eimco Elecon meets minimum governance practices supported by a reasonable and fairly independent board.

### Board composition

Eimco Elecon's board comprises eight members, of whom four are independent directors. However, one of the independent directors - Mr Shreevardhan Sinha - has been on leave of absence and has not attended any of the board meetings in FY10. Also, except Mr H. S. Parikh, other independent directors are relatively new to the board. Tamrock Great Britain Holding, the foreign promoter (25.1% stake), withdrew its nominee directors in FY08 because it is mulling sale of its stake.

### Board's processes

The company's quality of disclosure can be considered adequate judged by the level of information and details furnished in the annual report websites and other publicly available data. The company has all the necessary committees – audit, remuneration and investor grievance - in place to support corporate governance practices. The audit committee meets regularly and is chaired by an independent director, Mr Jal Patel, who is a chartered accountant and company secretary.

### Related party transactions

The major component of the related party transaction involves a commission paid to Emtici Engineering (Emtici), a group company, for providing after-sales services for Eimco Elecon's equipments. The commission is nearly 12-13% of Eimco Elecon's sales. In our discussion, the management highlighted that Emtici provides a wide range of services at the tendering stage - sales, payment collections, providing on-site engineers for servicing, etc. These services are critical for Eimco Elecon to be able to provide quick after-sales and maintenance services to its clients. Emtici is the marketing and servicing arm for all the Elecon group companies including Elecon Engineering, Power Build Ltd and Eimco Elecon. The common marketing office helps avoid duplication in marketing network for the group. Based on interaction with the independent directors, we believe the same is reported to the board on a regular basis.

**Fair value estimate of Rs 314  
based on DCF**

## Valuation

**Grade: 3/5**

We have used the discounted cash flow (DCF) method to value Eimco Elecon and arrived at a fair value of Rs 314 per share. At this fair value, Eimco Elecon trades at 11.3x its FY11 EPS of 27.9 and 8.7x its FY12 EPS of 36.0. We initiate coverage on Eimco Elecon with a valuation grade of 3/5, indicating that the market price is aligned with our fair value.

**Table 5: Key assumptions of our valuations**

Explicit project period	FY12-FY16
Terminal growth rate	3%
Risk free rate	7%
Risk premium	6%
Cost of equity	15%

**Table 6: Sensitivity analysis**

		Terminal Growth Rate				
		1.0%	2.0%	3.0%	4.0%	5.0%
WACC	12.5%	325	348	376	411	455
	13.5%	300	319	342	369	403
	14.5%	280	296	<b>314</b>	336	363
	15.5%	262	276	291	309	330
	16.5%	247	259	271	286	304

Source: CRISIL Equities estimate

**Table 7: Peer valuation**

Companies	M Cap. (Rs mn)	EPS			Price/earnings (x)			RoE (%)		
		FY10	FY11E	FY12E	FY10	FY11E	FY12E	FY10	FY11E	FY12E
Eimco Elecon (India) Ltd. (CRISIL Equities estimates)	1719	22.0	27.9	36.0	13.6	10.7	8.3	10.2	11.8	13.8
Consensus estimates										
BEML	4,526	66.2	73.5	83.2	15.3	13.8	12.2	13.7	13.7	13.9
TRF	8,905	60.1	63.7	81.4	13.7	13.0	10.1	38.4	33.6	32.3
Action Construction	5,914	2.6	4.2	5.6	22.2	18.0	12.3	13.9	19.4	21.3
TIL Ltd.	5,803	40.5	60.6	66.7	13.4	9.0	8.1	16.7	18.9	17.6
Gujarat Apollo	3,597	22.4	27.3	33.3	9.8	8.0	6.6	25.2	24.3	23.6
Mean					15.7	12.0	9.9	21.6	22.0	21.7
Median					14.3	12.7	9.9	16.7	19.4	21.3

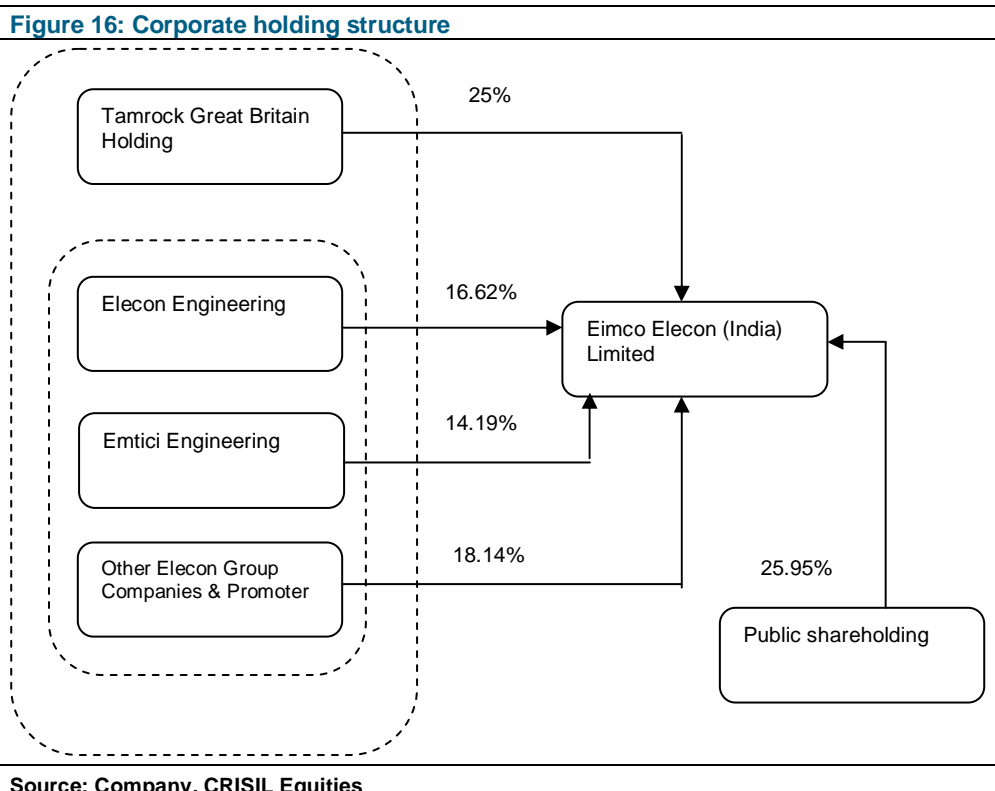
Note: Updated on 25 August 2010



## Company Overview





*Eimco Elecon is the market leader in manufacturing underground mining machinery*

Gujarat-based Eimco Elecon manufactures equipments used in underground coal mining. It was incorporated in 1974 as a joint venture between Eimco group and Elecon group. Eimco group has since undergone series of takeovers and is currently a part of Sandvik Group of Sweden. Sandvik, through its subsidiary Tamrock Great Britain Holding, now holds 25.01% stake in Eimco Elecon and is classified as a foreign promoter.



Eimco Elecon is the market leader in India for manufacturing, marketing, servicing of equipments and supply of spares required in underground mining operations. The management claims a market share of over 90% in underground mining equipments. The company currently manufactures side load dumpers, load haul dumpers, rocker shovel loaders, dump trucks and coal haulers, which form a part of intermediate level mechanisation of underground mining. Eimco Elecon has recently expanded its products portfolio to manufacture equipments catering to areas of open cast mining and infrastructure construction.

**Table 8: Product profile**

Business segment	Products	Variants/ specifications	
Underground mining equipments	Side dump loaders	1.1m <sup>3</sup> bucket capacity, crawler mounted	
	Load haul dumpers	1.5 m <sup>3</sup> , 2.0 m <sup>3</sup> , 3.5 m <sup>3</sup> bucket capacities	
	Rocker shovel loaders	0.22m <sup>3</sup> , 0.425 m <sup>3</sup> bucket capacities	
Open cast mining equipments	Universal drilling machine	25-64 mm diameter	
	Continuous miner	1.8-3.6 m cutting height	
Construction equipments	Rotary blast hole drills	288-279 mm diameter & 130-203 mm diameter	
	Front end loader	1.2 <sup>m</sup> bucket capacity	

Source: Company, CRISIL Equities

### Clients

CIL, which accounts for over 80% of India’s coal production, is Eimco Elecon’s single largest client. CIL and its subsidiaries account for 88% of FY10 revenues with South Eastern Coal Fields Ltd being the largest contributor. The other major clients are Monnet Ispat & Energy, SMS Infrastructure Ltd, Teknomin Constructions Ltd and Hutti Gold Mines Co. Ltd. With the entry of private sector players in mining we expect increasing contribution of private sector players to Eimco Elecon’s revenues. However, CIL is expected to remain the dominant contributor to revenues over the next two years.

### Manufacturing facility

Eimco Elecon’s manufacturing facility is located in Vallabh Vidyanagar, Gujarat over 15 acres of land. The facility is well equipped with advanced CNC machines, material handling cranes for internal movement of products, computerised cabinet storage systems for spares and a skilled workforce for product assembly. The company has developed a strong vendor base around the facility for sourcing of forged parts and other job works essential for its operations.

### Technological collaborations

Eimco Elecon collaborates with foreign partners for technology sourcing and introduction of newer products. Initially, the major source of technology was its foreign promoter TamRock, which is a leading player in underground mining technology globally. The company has absorbed the technology for SDL/LHD, front end loaders, whereas that for other new products is in progress. The company has now collaborated with other players to enter the new segment of manufacturing construction equipments.

**Table 9: Technological partners**

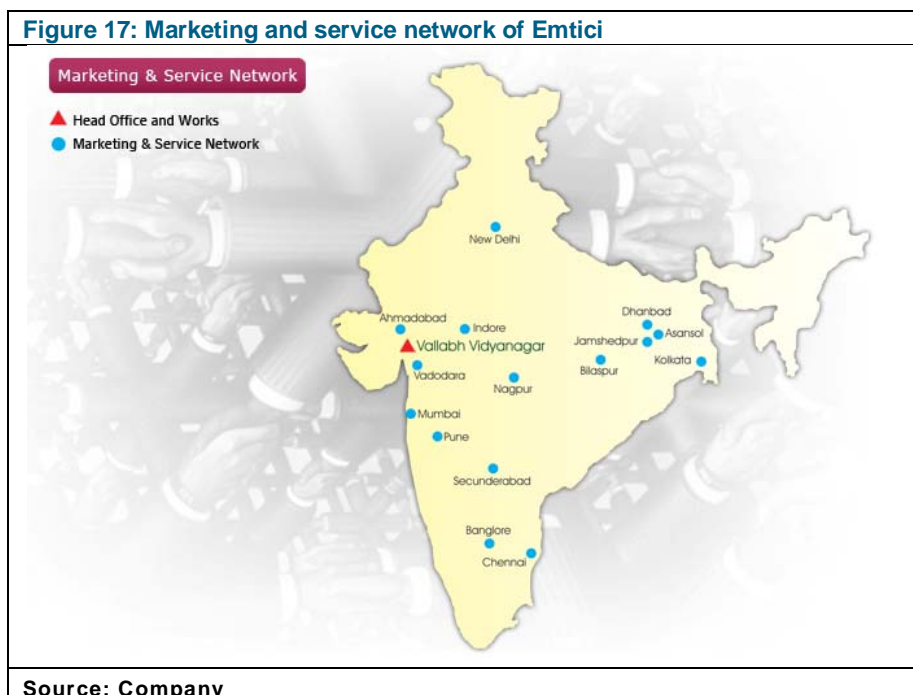
Equipment	Agreement date	Technological partner
Continuous miner	Jul 2004	Voest-Alpine Bergtechnik GmbH, Austria
Front end articulated loader	Dec 2006	Ahlmann Baumaschinen GmbH, Germany
520 G wheel loader	May 2008	Huta Stalowa Wola S.A., Poland

Source: Company, CRISIL Equities

### Strong marketing and after-sales support from Emtici Engineering

Since the underground mining equipments operate under rough working environment, maintenance and after-sales service is a critical requirement. Eimco Elecon has an arrangement with its group company Emtici Engineering to carry out different pre-sales and post-sales services for Eimco Elecon’s products. These services include tendering assistance, distribution of products, collection of payments, providing onsite service engineers, promote spares sales, etc. This arrangement helps Eimco Elecon remain close to its customers and provide quality after-sales service. Emtici has strong branch network located across India, including the major coal belts of India.

**Figure 17: Marketing and service network of Emtici**



Source: Company

## Annexure: Financials

Table 10: FINANCIAL STATEMENTS

### Income Statement

(Rs Mn)	FY08	FY09	FY10	FY11E	FY12E
Net sales	1,160	1,435	1,623	1,920	2,206
<b>Operating Income</b>	<b>1,182</b>	<b>1,476</b>	<b>1,638</b>	<b>1,953</b>	<b>2,246</b>
<b>EBITDA</b>	<b>280</b>	<b>321</b>	<b>266</b>	<b>317</b>	<b>387</b>
Depreciation	74	74	69	75	76
Interest	15	17	12	8	8
Other Income	5	3	6	8	9
<b>PBT</b>	<b>196</b>	<b>234</b>	<b>191</b>	<b>241</b>	<b>312</b>
<b>PAT</b>	<b>127</b>	<b>152</b>	<b>127</b>	<b>161</b>	<b>208</b>
No. of shares	6	6	6	6	6
<b>Earnings per share (EPS)</b>	<b>22</b>	<b>26</b>	<b>22</b>	<b>28</b>	<b>36</b>

### Balance Sheet

(Rs Mn)	FY08	FY09	FY10	FY11E	FY12E
Equity capital (FV - Rs 10)	58	58	58	58	58
Reserves and surplus	1,008	1,133	1,234	1,363	1,531
Debt	73	203	111	111	111
Current Liabilities and Provisions	151	309	362	432	491
Deferred Tax Liability/(Asset)	45	35	27	27	27
Minority Interest	-	-	-	-	-
<b>Capital Employed</b>	<b>1,334</b>	<b>1,739</b>	<b>1,793</b>	<b>1,992</b>	<b>2,218</b>
Net Fixed Assets	386	345	289	226	161
Capital WIP	4	-	3	0	0
Intangible assets	12	17	16	16	16
Investments	90	39	26	26	26
Loans and advances	58	80	122	105	121
Inventory	480	698	772	867	936
Receivables	255	534	535	638	734
Cash & Bank Balance	50	27	31	113	224
<b>Applications of Funds</b>	<b>1,334</b>	<b>1,739</b>	<b>1,793</b>	<b>1,992</b>	<b>2,218</b>

Source: Company, CRISIL Equities estimate

**Cash Flow**

<b>(Rs Mn)</b>	<b>FY08</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11E</b>	<b>FY12E</b>
Pre-tax profit	196	234	191	241	312
Total tax paid	(77)	(91)	(72)	(81)	(104)
Depreciation	74	74	69	75	76
Change in working capital	40	(360)	(64)	(112)	(121)
<b>Cash flow from operating activities</b>	<b>233</b>	<b>(143)</b>	<b>125</b>	<b>123</b>	<b>162</b>
Capital expenditure	(26)	(34)	(16)	(10)	(10)
Investments and others	(66)	51	13	-	-
<b>Cash flow from investing activities</b>	<b>(92)</b>	<b>17</b>	<b>(3)</b>	<b>(10)</b>	<b>(10)</b>
Equity raised/(repaid)	-	-	-	-	-
Debt raised/(repaid)	(162)	130	(92)	-	-
Dividend (incl. tax)	(27)	(27)	(27)	(31)	(40)
Others (incl extraordinary)	4	0	1	-	-
<b>Cash flow from financing activities</b>	<b>(185)</b>	<b>103</b>	<b>(118)</b>	<b>(31)</b>	<b>(40)</b>
<b>Change in cash position</b>	<b>(44)</b>	<b>(23)</b>	<b>5</b>	<b>82</b>	<b>111</b>
Opening Cash	94	50	27	31	113
Closing Cash	50	27	31	113	224

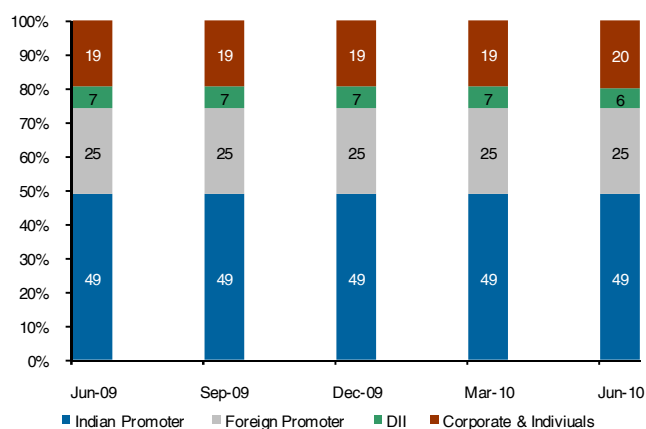
**Ratios**

	<b>FY08</b>	<b>FY09</b>	<b>FY10</b>	<b>FY11E</b>	<b>FY12E</b>
<b>Growth ratios</b>					
Sales growth (%)	20.7	24.8	11.0	19.2	15.0
EBITDA growth (%)	21.9	14.6	(17.3)	19.2	22.1
EPS growth (%)	50.9	16.2	(15.9)	25.6	29.2
<b>Profitability Ratios</b>					
EBITDA Margin (%)	23.7	21.8	16.2	16.2	17.2
PAT Margin (%)	10.7	10.3	7.7	8.2	9.2
Return on Capital Employed (RoCE) (%)	17.6	19.5	14.0	16.5	19.3
Return on equity (RoE) (%)	12.5	13.5	10.2	11.8	13.8
<b>Dividend and Earnings</b>					
Dividend per share (Rs)	4.7	4.7	4.7	4.7	6.0
Dividend payout ratio (%)	20.6	17.7	21.0	16.7	16.7
Dividend yield (%)	1.5	3.6	2.0	1.6	2.0
Earnings Per Share (Rs)	21.9	26.4	22.0	27.9	36.0
<b>Efficiency ratios</b>					
Asset Turnover (Sales/GFA)	1.4x	1.6x	1.8x	2.1x	2.4x
Asset Turnover (Sales/NFA)	2.9x	4.0x	5.2x	7.6x	11.6x
Sales/Working Capital	1.8x	1.8x	1.6x	1.7x	1.8x
<b>Financial stability</b>					
Net Debt-equity	0.0	0.1	0.1	0.0	-0.1
Interest Coverage	14.1	14.8	17.0	29.6	38.1
Current Ratio	5.9	4.3	4.0	4.0	4.1
<b>Valuation Multiples</b>					
Price-earnings	14.6x	5.0x	10.6x	10.7x	8.3x
Price-book	1.7x	0.6x	1.0x	1.2x	1.1x
EV/EBITDA	6.5x	2.9x	5.4x	5.4x	4.2x

**Source: Company, CRISIL Equities estimate**

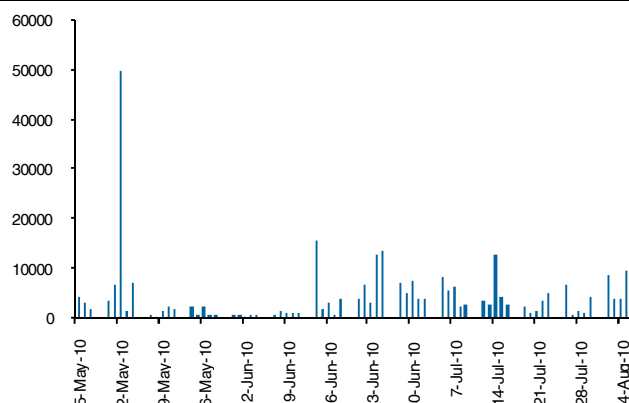
Focus Charts

Figure 18: Shareholding pattern



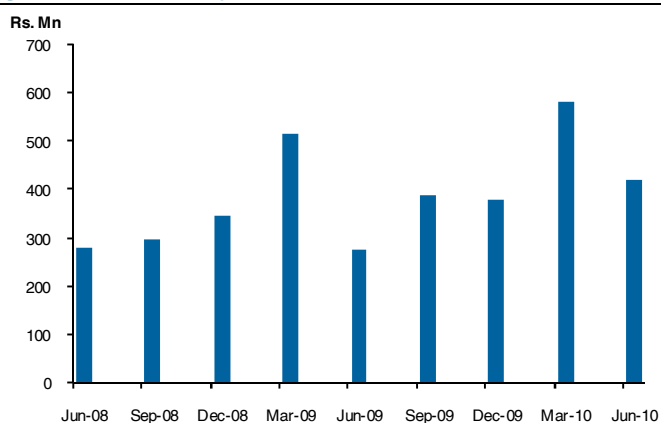
Source: NSE

Figure 19: Stock has low liquidity



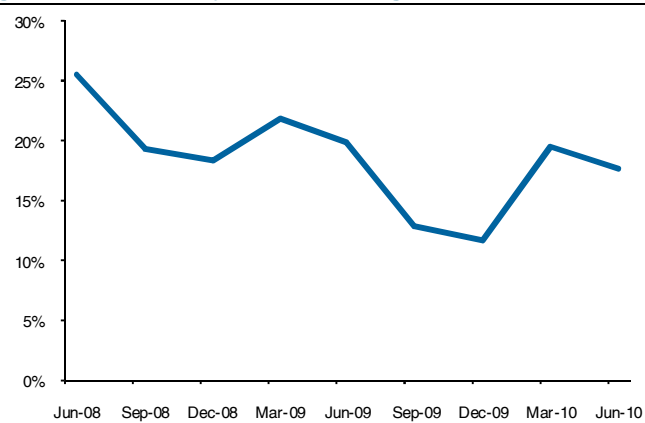
Source: NSE, BSE

Figure 20: Quarterly net sales



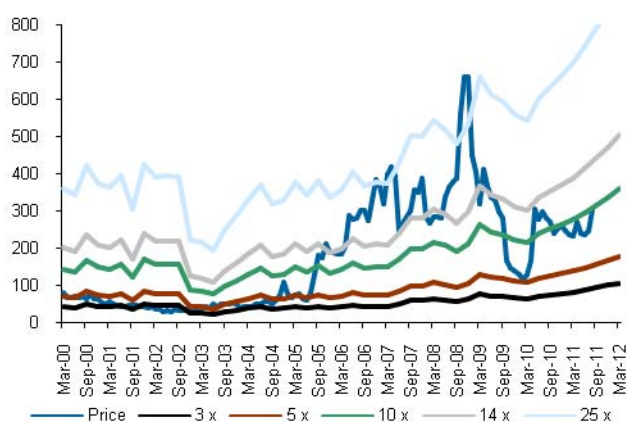
Source: Company, CRISIL Equities

Figure 21: Quarterly EBIDTA margins



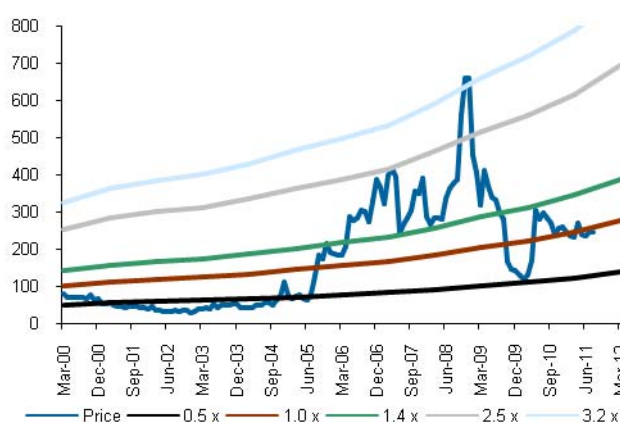
Source: Company, CRISIL Equities

Figure 22: Rolling one-year forward PE chart



Source: Company, CRISIL Equities

Figure 23: Rolling one-year forward P/BV chart



Source: Company, CRISIL Equities

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