

Rating matrix	
Rating	: Buy
Target	: ₹ 310
Target Period	: 12 - 15 months
Potential Upside	: 30%

What's changed?	
Target	Changed from 350 to 310
EPS FY19E	Changed from 7.0 to 6.3
EPS FY20E	Changed from 10 to 9.1
Rating	Unchanged

Quarterly performance					
	Q3FY19	Q3FY18	YoY (%)	Q2FY19	QoQ (%)
Revenue	470.2	415.4	13.2	451.8	4.1
EBITDA	47.5	47.5	(0.1)	43.4	9.3
EBITDA (%)	10.1	11.4	(1.3)	9.6	0.5
PAT	23.4	28.1	(16.6)	25.5	(8.1)

Key financials				
₹ Crore	FY17	FY18	FY19E	FY20E
Net Sales	1,370	1,605	1,878	2,216
EBITDA	139	176	188	255
Net Profit	74	95	99	144
EPS (₹)	4.7	6.0	6.3	9.1

Valuation summary				
(x)	FY17	FY18	FY19E	FY20E
P/E	51.0	39.6	38.0	26.3
Target P/E	66.4	50.5	49.5	34.2
EV / EBITDA	27.9	22.1	20.8	15.1
P/BV	6.2	5.5	5.0	4.4
RoNW (%)	12.2	14.1	13.3	16.6
RoCE (%)	11.7	14.3	13.9	17.9

Stock data	
Particular	Amount
Market Capitalization	₹ 3771.2 Crore
Total Debt (FY18)	₹ 222.8 Crore
Cash and Investments (FY18)	₹ 108.9 Crore
EV (FY18)	₹ 3885.1 Crore
52 week H/L (₹)	350 / 210
Equity capital	₹ 15.8 Crore
Face value	₹ 1

Price performance				
Return (%)	1M	3M	6M	12M
Elgi Equipments	(4.9)	(7.8)	(16.8)	(25.9)
Ingersoll Rand	(2.6)	2.0	11.7	(2.6)
Kirloskar Pneumatic	(6.0)	7.8	0.2	(9.1)

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## Elgi Equipments (ELGEQU)

₹ 238

### Traction in overseas market remains key...

- Elgi Equipments (Elgi) reported Q3FY19 numbers that were below our estimates in terms of topline mainly due to comparatively lower growth of 10.4% in standalone entity (i.e. India, direct export & products sold to foreign subsidiaries) compared to robust growth of ~19% YoY in the international market
- The overall topline was at ₹ 470.2 crore, up 13.2% YoY. We had estimated 17% revenue growth at ₹ 486 crore. On a segmental basis, air compressor segment grew 15.5% YoY to ₹ 423 crore while automotive equipment de-grew 4.3% YoY to ₹ 47.3 crore
- Absolute EBITDA was flat at ₹ 47.5 crore. EBITDA margins came in at 10.1% vs. 11.4% YoY. EBITDA margins were primarily lower due to higher operational expenses, investments in newer geographies. Gross margins improved ~140 bps YoY. Employee expenses rose 22.0% YoY. We expected EBITDA margins of 10.7% for the quarter
- Profit for the quarter de-grew 16.6% YoY at ₹ 23.4 crore (vs. I-direct estimate: ₹ 31.6 crore) impacted by contraction in profitability margin

#### Steady India operating performance; some turbulence likely, going ahead

In Q3FY19, standalone revenues (i.e. India, direct exports and products sold to foreign subsidiaries) rose 10.4% YoY. EBITDA margins contracted ~40 bps to 11.7% mainly led by ~66 bps increase in other expense. Overall, Elgi's domestic operations show a direct correlation and multiplier effect with pace of manufacturing and industrial activity (IIP) in India. Industrial production in India grew 8.4%, 0.5% YoY in October-November 2018 led by steady performance in the manufacturing sector. As per the management, the domestic market continues to witness a healthy rate of enquiries for its air compressor products from clients. However, there has been select instances of hesitation in finalising orders by clients suggesting potential sluggishness in demand, going ahead. We expect India & direct exports to grow at 15% CAGR from ₹ 894.5 crore to ₹ 1182.9 crore in FY18-20E.

#### Greater traction in international markets to drive foreign subsidiaries

Elgi, through acquisitions has several foreign subsidiaries in key markets such as US and Europe i.e. Patton's in US, Rotair in Europe. It recently acquired 'Pulford' with an intention to expand into Australian market. The company has scaled down its operations and rationalised costs in markets like China, Brazil. Over the past two years, Elgi has managed to consistently increase profitability of foreign subsidiaries (EBITDA margins ~7.7% in FY18) and has plans improve further. With continued traction in key subsidiaries such as Patton's and Rotair & newer acquisitions, we expect revenues to grow 24.0% CAGR from ₹ 519 crore in FY18 to ₹ 801.4 crore in FY20E. Thus, it would improve share of foreign subsidiaries in consolidated revenue from 32.3% to 36.2% over FY18-20E.

#### Market leader, profitable growth, solid fundamentals; maintain BUY!

Elgi Equipments has continued to strengthen its domestic & international operations for air compressor. It also dominates automotive equipment segment through ATS Elgi. We believe Elgi is an excellent combination of market leader, robust balance sheet, efficient working capital management, consistent dividends and able management. Consequently, we expect Elgi to deliver revenue, EBITDA and PAT growth of 17.5%, 20.3% and 22.7% CAGR, respectively, in FY18-20E. Accordingly, we ascribe a P/E multiple of 34x on FY20E EPS of ₹ 9.1 to arrive at a fair value of ₹ 310/ share. We have a **BUY** recommendation on the stock.

### Variance analysis

	Q3FY19	Q3FY19E	Q3FY18	YoY (%)	Q2FY19	QoQ (%)	Comments
Revenue	470.2	486.0	415.4	13.2	451.8	4.1	India & direct export grow 10.4% YoY; foreign subsidiaries at 18.9% YoY
Other Income	2.1	2.0	2.4	-13.1	2.7	-22.4	
Total Revenue	472.2	488.0	417.8	13.0	454.5	3.9	
Raw material cost	200.5	267.3	183.7	10.3	171.8	3.2	
Purchases of stock in trade	54.0	0.0	53.3		72.0		
Changes in inventory	2.5	0.0	-4.1		5.3		
Employee Expenses	88.6	88.0	72.6	22.0	83.1	6.5	Increased hiring in newer markets resulted in upfront costs
Total Other expenses	77.1	78.7	62.4	23.6	76.2	1.2	Investments in newer markets resulted in upfront costs
Operating Profit (EBITDA)	47.5	52.0	47.5	-0.1	43.4	9.3	
EBITDA Margins	10.1	10.7	11.4		9.6		
Interest	2.7	1.9	1.4	99.4	2.3	16.9	
Depreciation	14.5	11.5	11.5	25.9	12.5	16.4	
Total Tax	9.2	10.0	9.1	1.2	7.6	21.9	
PAT	23.4	31.6	28.1	-16.6	25.5	-8.1	

	Q3FY19	Q3FY19E	Q3FY18	YoY (%)	Q2FY19	QoQ (%)	
Revenue (Segment-wise)							
Air Compressors	423.0		366.1	15.5	401.1	5.5	
% of Sales	90%		88%		89%		
Automotive Equipments	47.3		49.4	-4.3	50.8	-6.9	Automotive business experiencing sluggish growth
% of Sales	10%		12%		11%		
EBIT Margin							
Air Compressors	29.8		32.7	-8.8	27.4	8.9	
EBIT Margin	7%		9%		7%		
% of EBIT	92.3		88.4		87.5		
Automotive Equipments	2.5		4.3	-42.3	3.9	-36.5	
EBIT Margin	5%		9%		8%		
% of EBIT	7.7		11.6		12.5		

Source: Company, ICICI Direct Research

### Change in estimates

	FY18	FY19E		%	FY20E		%	
₹ crore		Old	New	Change	Old	New	Change	
Revenue	1,605.3	1,894.3	1,878.2	-0.8	2,235.2	2,216.3	-0.8	- Traction seen in international market. Domestic to remain steady
EBITDA	176.1	193.8	187.8	-3.1	262.2	254.9		
EBITDA margin (%)	11.0	10.2	10.0		11.7	11.5		Margins to normalise in FY20E
PAT	95.3	111.3	99.3	-10.8	157.2	143.6	-8.7	
EPS (₹)	6.0	7.0	6.3	-10.8	10.0	9.1	-9.1	

Source: Company, ICICI Direct Research

## Company background

Among India's leading domestic air compressor manufacturer with 22.3% market share, Elgi Equipments (Elgi) began its operations in 1960. It is also a dominant leader with market share of ~40-45% in the garage equipment space for automotive equipments through its subsidiary ATS Elgi. Elgi provides a wide range of compressed air solutions (oil-free and oil-flooded) from reciprocating compressors, rotary screw air compressors, centrifugal compressors, portable compressors to dryers, filters and downstream accessories. The company's portfolio of over 400 products finds wide application across industries. Elgi's products find application in industries such as oil & gas, food processing, automobiles, textiles, pharma, plastics and packaging, mining, bore well drilling and general purpose engineering. Air-ends, a critical component of an air compressor are manufactured in-house by the company in Coimbatore plant. The fully backward integrated facility produces high-precision grey and SG iron castings, with a yearly capacity of 9,000 metric tonnes. The average weight of the castings ranges between 30-3,200 kilograms. The factory has the best-in-class machine tools to produce 38,000 parts per year with high accuracy levels of less than 2 microns.

On the international front, Elgi has foreign subsidiaries that cater to compressed air solutions worldwide. The company has two prominent subsidiaries Rotair Spa (₹ 180.6 crore in FY18) that operates out of Europe while Patton's & Patton's medical operates out of the US (₹ 253.1 crore in FY18), both exporting their products worldwide. It recently acquired Australia's largest air compressor distributor Pulford Air & Gas.

### Exhibit 1: Elgi's subsidiaries & JV

Company	Subsidiary/ Associate	% Ownership
Elgi Equipments (Zhejiang) Ltd	Subsidiary	100
Elgi Compressors Trading (Shanghai) Co. Ltd	Subsidiary	100
Elgi Gulf (FZE)	Subsidiary	100
Elgi Compressores Do Brazil Imp. E. Exp. LTDA	Subsidiary	100
Elgi Australia PTY Ltd	Subsidiary	100
Elgi Compressors Italy S.R.L	Subsidiary	100
Rotair SPA (Elgi Compressors Italy)	Step down Subsidiary	100
Elgi Compressors USA Inc.	Subsidiary	100
Pattons Inc (Elgi Compressors USA)	Step down Subsidiary	100
Pattons Medical LLC (Elgi Compressors USA)	Step down Subsidiary	100
PT Elgi Equipments Indonesia	Subsidiary	100
ATS Elgi Ltd	Subsidiary	100
Adisons Precision Instruments	Subsidiary	100
Ergo Design private Ltd	Subsidiary	100
Elgi Sauer Compressors Ltd	Subsidiary	26
Pulford Air & Gas	Subsidiary	100

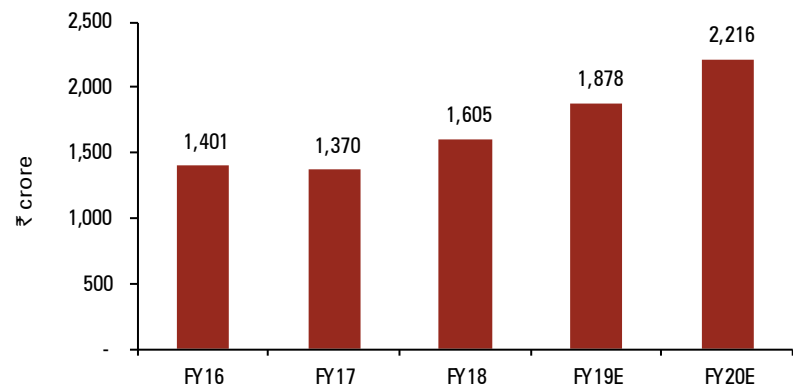
Source: Company, ICICI Direct Research

India business & direct exports for air compressors contributed ₹ 894.5 crore i.e. ~56% of overall revenue in FY18. The company has relatively higher market share in the smaller rated compressors. ATS Elgi is a wholly owned subsidiary and provides garage equipments solutions generating ₹ 191.7 crore i.e. ~12% of consolidated revenues.

## Story in Charts: Financials

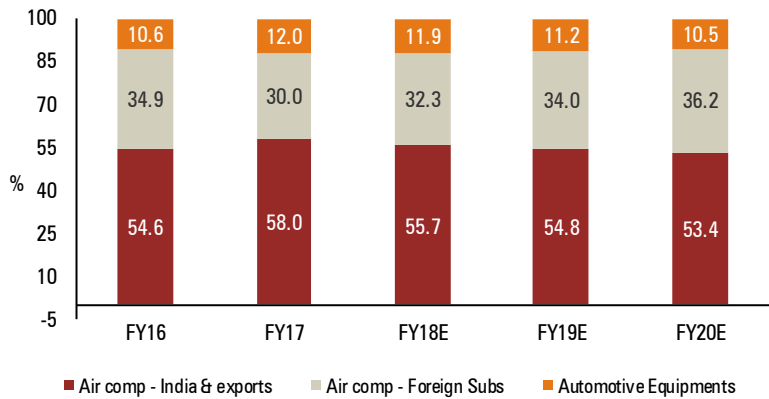
We expect Elgi to report revenue growth of 17.5% CAGR in FY18-20E on the back of accelerated growth in the air compressor segment. We expect this segment to grow at 18.5% CAGR in FY18-20E

**Exhibit 2: Revenue trend**



Source: Company, ICICI Direct Research

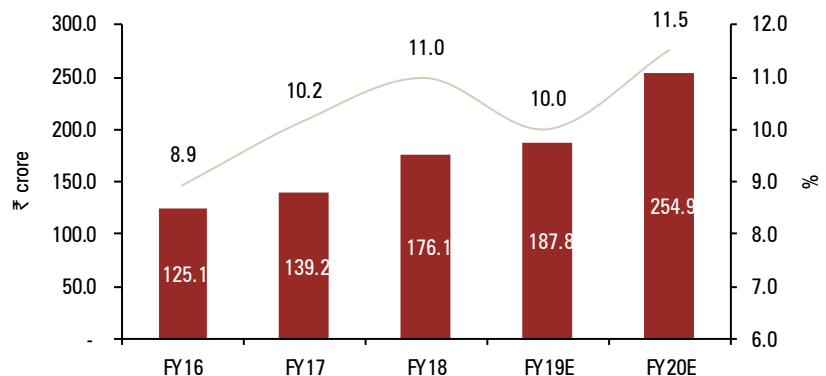
**Exhibit 3: Revenue segmentation (%)**



Source: Company, ICICI Direct Research

We expect Elgi to expand its EBITDA margins, going forward. This will be primarily driven by improved profitability in their overseas subsidiary. We expect EBITDA margins to increase from 11.0% in FY18 to 11.5% in FY20E

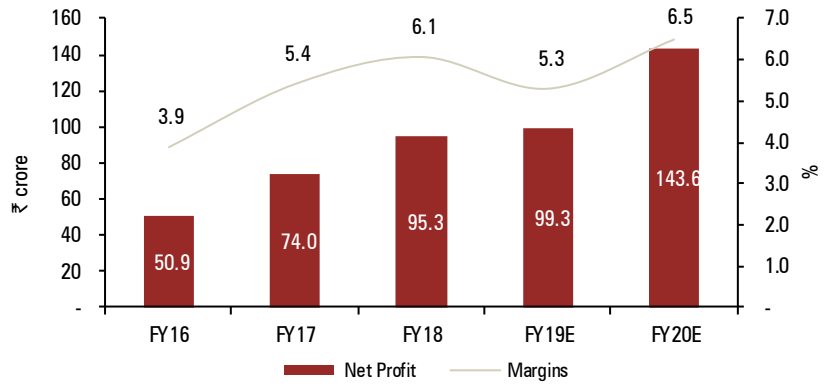
**Exhibit 4: EBITDA and EBITDA margin trend**



Source: Company, ICICI Direct Research

We expect PAT to grow at a CAGR of 22.7% from ₹ 95.3 crore in FY18 to ₹ 143.6 crore in FY20E

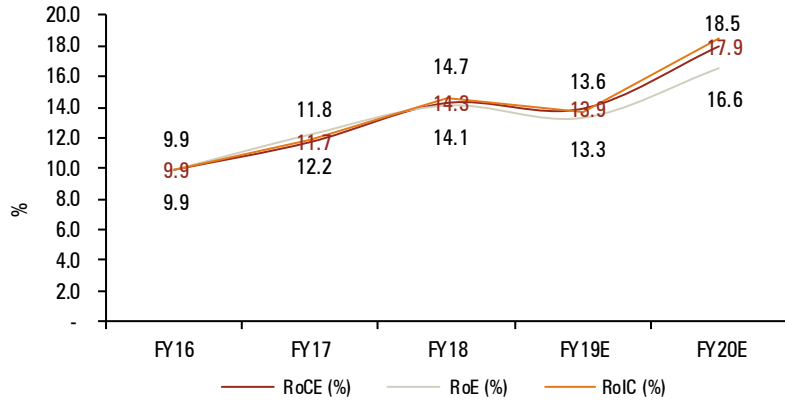
**Exhibit 5: PAT and PAT margin trend**



Source: Company, ICICI Direct Research

Driven by an improved margin profile, Elgi is expected to deliver superior returns on capital employed. We believe Elgi will be able to earn an RoIC of 18.5% in FY20E

**Exhibit 6: Return ratios to improve**

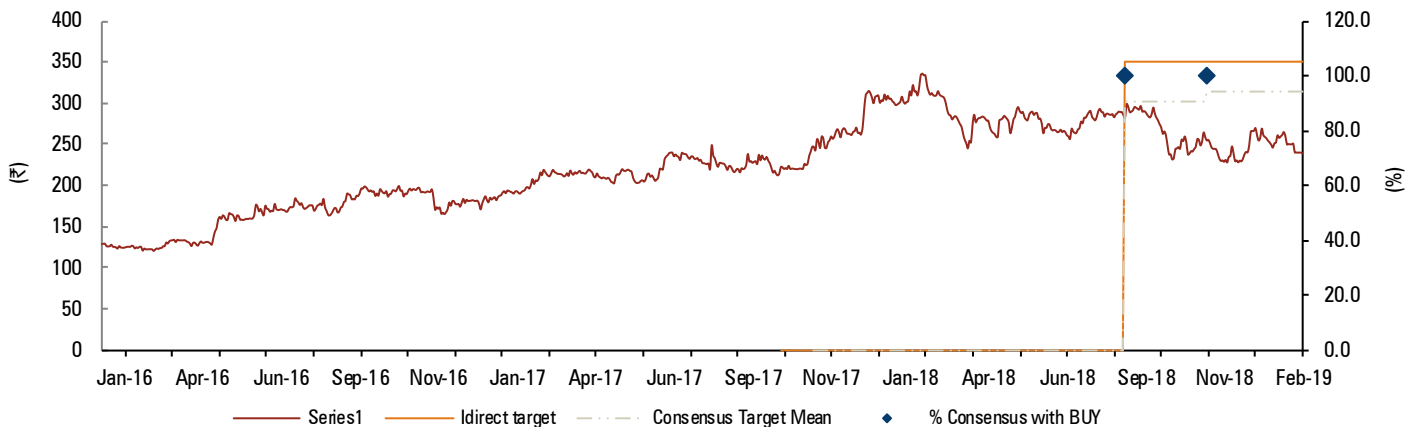


Source: Company, ICICI Direct Research

## Outlook and Valuation

Elgi Equipments has continued to strengthen its domestic & international operations for air compressor. It also dominates automotive equipment segment through ATS Elgi. We believe Elgi is an excellent combination of market leader, robust balance sheet, efficient working capital management, consistent dividends and able management. Consequently, we expect Elgi to deliver revenue, EBITDA and PAT growth of 17.5%, 20.3% and 22.7% CAGR, respectively, in FY18-20E. Accordingly, we ascribe a P/E multiple of 34x on FY20E EPS of ₹ 9.1 to arrive at a fair value of ₹ 310/ share. We have a **BUY** recommendation on the stock.

### Recommendation history vs. consensus



Source: Bloomberg, Company, ICICI Direct Research, Initiated coverage on 17<sup>th</sup> August 2018.

### Key events

Date	Event
FY11	ELGI launches its first Oil-free screw air compressor
FY12	Acquires two key subsidiaries; Italy-based Rotair SPA and US based Patton's Inc
FY14	Begins operations at the Air center plant and foundry in Coimbatore; Launches diesel-powered, portable screw air compressors for drilling applications
FY17	Aspires to become global leader in air compressor business; launches the silent version of the portable screw air compressor
FY19	Acquires Australia's largest industrial compressor distributor, Pulford Air and Gas

Source: Company, ICICI Direct Research

### Top 10 Shareholders

Rank	Name	Latest Filing Date	O/S	Position	Position Change
1	Dark Horse Portfolio Investment, Ltd.	31-12-2018	16.32%	25.86M	0
2	SBI Funds Management Pvt. Ltd.	31-12-2018	8.92%	14.13M	0
3	Varadaraj (Jairam)	31-12-2018	8.72%	13.81M	0
4	Pari Washington Co., Pvt. Ltd.	31-12-2018	7.81%	12.38M	+2.85M
5	Gagandeep Credit Capital Pvt. Ltd.	31-12-2018	5.15%	8.15M	0
6	Sara Elgi Group	31-12-2018	3.84%	6.08M	0
7	Nalanda India Equity Fund Ltd.	31-12-2018	2.80%	4.44M	0
8	East Sail	30-09-2018	1.79%	2.83M	-0.77M
9	Shah (Nemish S)	31-12-2018	1.69%	2.68M	0
10	Prescient Wealth Management (Pty) Ltd	31-12-2018	1.68%	2.67M	+2.67M

Source: Reuters, ICICI Direct Research

### Shareholding Pattern

(in %)	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
Promoter	31.9	31.9	31.9	31.9	31.9
FII	15.7	16.1	16.4	16.7	17.4
DII	11.8	11.5	11.3	11.3	10.1
Others	40.6	40.5	40.4	40.1	40.7

### Recent Activity

Buys			Sells		
Investor name	Value	Shares	Investor name	Value	Shares
Pari Washington Co., Pvt. Ltd.	+10.70M	+2.85M	First State Investments (Singapore)	-7.45M	-1.98M
Prescient Wealth Management (Pty) Ltd	+10.02M	+2.67M	Wasatch Advisors, Inc.	-3.54M	-0.94M
Stewart Investors	+4.20M	+1.12M	East Sail	-2.64M	-0.77M
Sundaram Asset Management Company Limited	+0.06M	+0.02M	ICICI Prudential Asset Management Co. Ltd.	-0.81M	-0.24M
			HDFC Asset Management Co., Ltd.	-0.62M	-0.16M

Source: Reuters, ICICI Direct Research

## Financial summary (consolidated)

Profit and loss statement		₹ Crore			
(₹ Crore)	FY17	FY18	FY19E	FY20E	
Net Sales	1,370.1	1,605.3	1,878.2	2,216.3	
Other Operating Income	-	-	-	-	
<b>Total Operating Income</b>	<b>1,370.1</b>	<b>1,605.3</b>	<b>1,878.2</b>	<b>2,216.3</b>	
% Growth	(2.2)	17.2	17.0	18.0	
Other Income	12.1	12.3	18.2	16.7	
<b>Total Revenue</b>	<b>1,382.2</b>	<b>1,617.6</b>	<b>1,896.4</b>	<b>2,233.0</b>	
Growth (%)	(2.0)	17.0	17.2	17.8	
Total Raw Material Costs	753.9	904.9	1,042.4	1,250.0	
Employee Expenses	253.8	281.3	341.8	394.5	
Other expenses	18.3	8.7	31.9	22.2	
<b>Total Operating Expenditure</b>	<b>1,230.9</b>	<b>1,429.2</b>	<b>1,690.4</b>	<b>1,961.4</b>	
<b>Operating Profit (EBITDA)</b>	<b>139.2</b>	<b>176.1</b>	<b>187.8</b>	<b>254.9</b>	
Growth (%)	11.2	26.6	6.6	35.7	
Interest	7.8	6.0	11.2	9.1	
PBDT	143.5	182.4	194.8	262.5	
Depreciation	44.6	44.7	52.6	55.4	
PBT before Exceptional Items	98.8	137.7	142.2	207.1	
Total Tax	26.4	41.3	46.0	67.5	
PAT before MI	74.0	95.3	96.2	139.6	
Minority Interest	-	-	-	-	
<b>PAT</b>	<b>74.0</b>	<b>95.3</b>	<b>99.3</b>	<b>143.6</b>	
Growth (%)	45.2	28.8	4.2	44.6	
EPS	4.7	6.0	6.3	9.1	

Source: Company, ICICI Direct Research

Cash flow statement		₹ Crore			
(₹ Crore)	FY17	FY18	FY19E	FY20E	
Profit after Tax	74.0	95.3	99.3	143.6	
Depreciation	44.6	44.7	52.6	55.4	
Interest	7.8	6.0	11.2	9.1	
<b>Cash Flow before WC changes</b>	<b>126.4</b>	<b>145.9</b>	<b>163.0</b>	<b>208.1</b>	
Changes in inventory	(0.4)	(47.6)	(50.5)	(58.4)	
Changes in debtors	10.8	(101.1)	(68.2)	(74.1)	
Changes in loans & Advances	(2.8)	(1.6)	(1.6)	(2.0)	
Changes in other current assets	2.1	12.8	(6.9)	(8.6)	
<b>Net Increase in Current Assets</b>	<b>9.7</b>	<b>(137.6)</b>	<b>(127.2)</b>	<b>(143.0)</b>	
Changes in creditors	1.7	42.1	36.3	44.9	
Changes in provisions	(3.8)	2.6	4.6	4.0	
<b>Net Increase in Current Liabilities</b>	<b>(10.3)</b>	<b>56.1</b>	<b>59.5</b>	<b>71.0</b>	
<b>Net CF from Operating activities</b>	<b>125.8</b>	<b>64.5</b>	<b>95.3</b>	<b>136.1</b>	
Changes in deferred tax assets	(1.5)	(3.1)	-	-	
(Purchase)/Sale of Fixed Assets	(21.4)	(48.9)	(60.0)	(50.0)	
<b>Net CF from Investing activities</b>	<b>(44.9)</b>	<b>(73.6)</b>	<b>(60.0)</b>	<b>(50.0)</b>	
Dividend and Dividend Tax	(19.0)	(19.0)	(19.0)	(23.8)	
<b>Net CF from Financing Activities</b>	<b>(71.7)</b>	<b>(7.4)</b>	<b>(32.8)</b>	<b>(72.9)</b>	
<b>Net Cash flow</b>	<b>9.2</b>	<b>(16.5)</b>	<b>2.5</b>	<b>13.2</b>	
Opening Cash/Cash Equivalent	72.7	81.9	65.4	67.9	
<b>Closing Cash/ Cash Equivalent</b>	<b>81.9</b>	<b>65.4</b>	<b>67.9</b>	<b>81.1</b>	

Source: Company, ICICI Direct Research

Balance sheet		₹ Crore			
(₹ Crore)	FY17	FY18	FY19E	FY20E	
Equity Capital	15.8	15.8	15.8	15.8	
Reserve and Surplus	591.0	673.1	731.1	850.9	
<b>Total Shareholders funds</b>	<b>606.9</b>	<b>689.0</b>	<b>746.9</b>	<b>866.7</b>	
Minority Interest	-	-	-	-	
Other Non Current Liabilities	5.9	4.5	4.5	4.5	
<b>Total Debt</b>	<b>211.1</b>	<b>222.8</b>	<b>242.5</b>	<b>202.5</b>	
<b>Total Liabilities</b>	<b>837.7</b>	<b>929.7</b>	<b>1,007.4</b>	<b>1,087.2</b>	
<b>Gross Block</b>	<b>529.4</b>	<b>579.8</b>	<b>641.8</b>	<b>691.8</b>	
Acc: Depreciation	83.4	128.1	180.7	236.1	
<b>Net Block</b>	<b>446.0</b>	<b>451.7</b>	<b>461.1</b>	<b>455.7</b>	
Capital WIP	3.6	2.1	-	-	
<b>Total Fixed Assets</b>	<b>449.5</b>	<b>453.7</b>	<b>461.1</b>	<b>455.7</b>	
Non Current Assets	21.1	25.5	25.5	25.5	
Inventory	226.0	273.7	324.2	382.5	
Debtors	242.3	343.4	411.7	485.8	
Loans and Advances	7.7	9.3	10.9	12.9	
Other Current Assets	53.5	40.7	47.6	56.2	
<b>Cash</b>	<b>81.9</b>	<b>65.4</b>	<b>67.9</b>	<b>81.1</b>	
<b>Total Current Assets</b>	<b>611.5</b>	<b>732.5</b>	<b>862.3</b>	<b>1,018.5</b>	
Current Liabilities	171.3	213.4	249.7	294.6	
Provisions	15.3	17.9	22.5	26.5	
<b>Net Current Assets</b>	<b>332.9</b>	<b>397.8</b>	<b>468.1</b>	<b>553.3</b>	
<b>Total Assets</b>	<b>837.7</b>	<b>929.7</b>	<b>1,007.4</b>	<b>1,087.2</b>	

Source: Company, ICICI Direct Research

Key ratios		(Year-end March)			
	FY17	FY18	FY19E	FY20E	
<b>Per Share Data</b>					
EPS	4.7	6.0	6.3	9.1	
Cash per Share	6.7	6.9	7.0	7.9	
BV	38.3	43.5	47.1	54.7	
Dividend per share	1.0	1.2	1.2	1.5	
Dividend payout ratio	21.4	20.0	19.2	16.6	
<b>Operating Ratios</b>					
EBITDA Margin	10.2	11.0	10.0	11.5	
PAT Margin	5.4	5.9	5.3	6.5	
<b>Return Ratios</b>					
RoE	12.2	14.1	13.3	16.6	
RoCE	11.7	14.3	13.9	17.9	
RoIC	11.8	14.7	13.6	18.5	
<b>Valuation Ratios</b>					
EV / EBITDA	27.9	22.1	20.8	15.1	
P/E	51.0	38.8	38.0	26.3	
EV / Net Sales	2.8	2.4	2.1	1.7	
Sales / Equity	2.3	2.3	2.5	2.6	
Market Cap / Sales	2.8	2.3	2.0	1.7	
Price to Book Value	6.2	5.5	5.0	4.4	
<b>Turnover Ratios</b>					
Asset turnover	1.5	1.6	1.7	1.8	
Debtors Turnover Ratio	5.5	5.5	5.0	4.9	
Creditors Turnover Ratio	8.0	8.3	8.1	8.1	
<b>Solvency Ratios</b>					
Debt / Equity	0.3	0.3	0.3	0.2	
Current Ratio	2.8	2.9	2.9	2.9	
Quick Ratio	1.6	1.7	1.7	1.7	

Source: Company, ICICI Direct Research



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Sell: -10% or more;



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