June 29, 2018

EPC Industrie (EPCIND)

₹ 126

Sustenance holds key…

- EPC Industrie (EPC) reported a robust Q4FY18 performance
- Net sales for the quarter came in at ₹ 76.3 crore, up 37.7% YoY. EBITDA in Q4FY18 was at ₹ 8.7 crore with corresponding EBITDA margins at 11.5%, up 250 bps YoY. PAT in Q4FY18 was at ₹ 4.5 crore vs. ₹ 3.3 crore in the base quarter (Q4FY18)
- For full year FY18, EPC clocked sales at ₹ 204.6 crore, EBITDA at ₹ 12.2 crore (EBITDA margins at 6.0%) and PAT at ₹ 4.9 crore. FY18 was marred by loss of sales in Q2FY18 post implementation of GST and was an industry wide phenomenon. Hence, GST on micro-irrigation system stands reduced to 12% vs. 18% imposed initially

Micro-irrigation need of the hour; quite essential to augment farm income

Micro irrigation system (MIS) is essentially an irrigation technique wherein regulated quantum of water is applied to the most critical part of the plant i.e. roots. The benefits of MIS vis-à-vis traditional method of irrigation include: increase in crop yield (~20-30%) and savings of labour (~30-50%), water (~30-40%) & power (~20-40%). The current domestic industry size of MIS is pegged at ~₹ 5,000 crore with penetration merely at ~13% [8 million hectares (MH) out of the net irrigated area of ~70 MH]. The medium term potential of MIS is pegged at ~17 MH. The government supports the industry by subsidising the product for farmers with allocation on the rise since its inception. However, execution machinery at the state is weak leading to elongated working capital cycle for micro-irrigation players and consequent lower profitability. Of the total MIS industry size of ~₹ 5,000 crore, EPC realises sales of ~₹ 200 crore, thereby commanding a market share of ~4%.

Drive towards efficiency; niche segment; strong government's thrust!

The domestic industry has grown at 15% CAGR in FY09-14. Since then, it has faced challenges due to subdued farm incomes amid muted monsoon activity (CY14, CY15), change in subsidy disbursal mechanisms by various state governments (CY2017) and introduction of GST on MIS products (CY18). Going forward, in FY18-20E, it is expected to grow at 20% CAGR. Recent government initiatives, which will help in this pursuit are: increase in Centre's share of subsidy for MIS to ₹ 4,000 crore in FY19E vs. ₹ 3,400 crore in FY18 (up 17.6% YoY) and setting up of a fund under Nabard for MIS with initial corpus of ₹ 5,000 crore. MIS is essentially a niche segment with oligopolistic industry structure. The main players are Jain Irrigation, Netafim India & EPC.

Working capital cycle elongates further, muted FY18 performance, HOLD!

The Q4FY18 performance was encouraging. However, the company witnessed headwinds in the last three years resulting in a flat performance in FY16-18. On the balance sheet front, working capital cycle is on an uptrend. It got further stretched in FY18, with NWC days for FY18 at ~190 days vs. ~110 days in FY14. This acts as a big overhang on capital efficiency for EPC thereby resulting in negative cash flow from operations in FY18. Therefore, we downgrade the stock to **HOLD** and will look for sustained performance before any meaningful upgrade and change in stance. Going forward, we build in sales CAGR of 17.5% in FY18-20E and expect the company to clock ~400 bps margin improvement in FY18-20E, albeit on a lower base (EBITDA margins in FY18 were at 6.0%). We expect EPC to report PAT of ₹ 13.0 crore in FY19E & ₹ 18.8 crore in FY20E. We value EPC at ₹ 135, i.e. 20x P/E on FY20E EPS of ₹ 6.8/share.

Rating matrix

Rating	:	Hold
Target	:	₹ 135
Target Period	:	12-18 months
Potential Upside	:	7%

What's changed?

Target	Changed from ₹ 230 to ₹ 135
EPS FY19E	Changed from ₹ 6.7 to ₹ 4.7
EPS FY20E	Introduced at ₹ 6.8
Rating	Changed from Buy to Hold

Key financials

₹ Crore	FY17	FY18	FY19E	FY20E
Net Sales	201.7	204.7	245.6	282.4
EBITDA	12.4	12.2	20.9	28.2
Net Profit	9.8	4.9	13.0	18.8
EPS (₹)	3.5	1.8	4.7	6.8

Valuation summary

	FY17	FY18	FY19E	FY20E
P/E	35.6	70.7	26.7	18.5
Target P/E	38.2	75.8	28.6	20.0
EV / EBITDA	26.8	28.6	16.2	11.6
P/BV	2.6	2.5	2.3	2.1
RoNW	7.3	3.5	8.6	11.2
RoCE	6.9	6.3	11.7	14.8

Stock data

Stock Data	
Market Capitalization	₹ 348.6 Crore
Total Debt (FY18)	₹ 3.7 Crore
Cash and Investments (FY18)	₹ 4.4 Crore
EV	₹ 347.9 Crore
52 week H/L	215 / 122
Equity capital	₹ 27.7 Crore
Face value	₹ 10
MF Holding (%)	1.9
FII Holding (%)	0.0

Stock data

	1M	3M	6M	12M
EPC Industrie	(9.9)	(6.7)	(31.4)	(32.2)
Jain Irrigation	(16.4)	(20.1)	(31.8)	(15.4)

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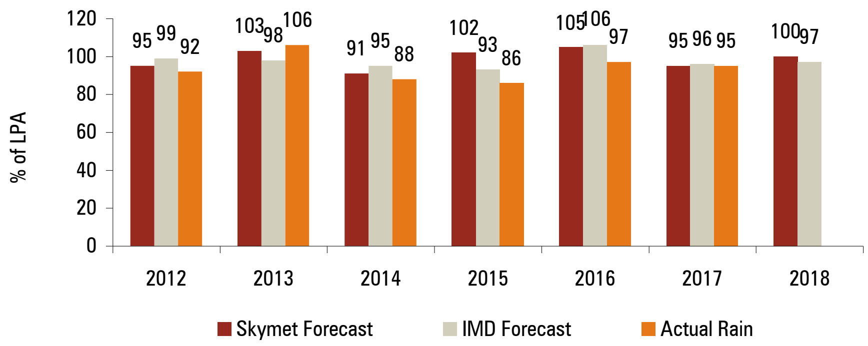
Normal monsoon forecast at 97% of LPA

South West Monsoon, which accounts for ~70% of annual rainfall domestically, has been forecast to be normal in nature. It is forecast at 97% of the long period average (LPA) by the Indian Meteorological Department (IMD) and 100% of LPA by private weather monitoring agency Skymet. Absence of El Niño conditions and fading away of La Niña over the Pacific Ocean amid neutral dipole movement in the Indian Ocean have contributed to this normal rainfall forecast.

Exhibit 1: Skymet vs. IMD forecast



Source: IMD, Skymet, ICICI Direct Research

This bodes well for all agri-input companies and rural demand focused consumer industries viz. FMCG & consumer durables. In the past, it has been observed that majority of agri input companies, particularly in the farm mechanisation segment (tractors, tillers, pumps) witness volume growth of ~20% during years of normal monsoons.

Exhibit 2: Rainfall probability range

Monsoon Categorization	Rainfall Range (% of LPA)	IMD (97% of LPA) Forecast Probability (%)	Skymet (100% of LPA) Forecast Probability (%)
Deficient	<90	14	0
Below Normal	90-96	30	20
Normal	96-104	42	55
Above Normal	104-110	12	20
Excess	>110	2	5

Source: IMD, Skymet, ICICI Direct Research

IMD has forecast monsoon 2018 to be normal to positive in nature with a probability of 56% while the probability assigned to below normal monsoon 2018 is pegged at 30%. Skymet forecast is more aggressive, with 80% probability of normal to positive monsoon while probability assigned to below normal monsoon at 20%. Interestingly, Skymet has assigned a zero probability to monsoon 2018 being deficient in nature.

Currently, as per the latest press release by the IMD, total cumulative rainfall in the ongoing monsoon season as of June 28 was at -6% of LPA. The rainfall is surplus in the southern region while it is in deficit in the rest of the country. Cumulative sowing as of June 22 was at 11.6 million hectares, down 10% YoY. Monsoon activity was weak in the past week (June 12-22) and largely in line with the IMD forecast. However, the rainfall activity has picked up pace post June 23 and is expected to progress well covering the entire country by the month end (June) as against the usual trend of mid-July. Muted sowing activity was largely following muted rainfall spell and is likely to pick up pace as the monsoon progresses.

Company Analysis

In FY18, EPC got itself re-registered in Maharashtra for five years (up to September 2022)

EPC, a Mahindra & Mahindra (M&M) subsidiary, is a micro-irrigation system (MIS) and component manufacturer based out of Nashik, Maharashtra. The company was acquired by M&M in February 2011 and has been well capitalised over the years by M&M (net cash of ~₹ 8 crore in FY14 vis-à-vis net debt of ~₹ 30 crore in FY10). EPC commands a market share of ~4% (sales of ~₹ 200 crore in FY18) out of the total industry size, which is pegged at ~₹ 5000 crore as of FY18. EPC recently ventured into the greenhouse farming & agri pumps segment with the aim of becoming a total agri solutions player domestically. As of FY17, EPC is registered in 15 states under subsidy programme in India. It has more than 900 channel partners and 18 regional offices

Union Budget 2018-19: Focus on income insurance benefits EPC Industrie

Institutional credit for agriculture sector has been modestly raised to ₹ 11 lakh crore, up 10% YoY

Union Budget 2018-19 was pro-farmer in nature and well aligned to double farm income by 2022. Apart from the increase in allocation towards risk mitigation (crop insurance) and efficiency (irrigation including micro irrigation) schemes, it lays special emphasis on augmenting farm income through remunerative farm gate prices thereby targeting "income insurance". Emphasis has been put on fixing MSP prices at a mark-up of 50% above cost of production while at the same time bringing more crops under the MSP net. On the risk mitigation front, in its flagship insurance scheme i.e. PMFBY, allocation has been increased to ₹ 13,000 crore. On the efficiency front, in the irrigation space, total allocation under PMKSY is being increased to ₹ 9,429 crore, up 28% YoY. EPC Industrie is one of the leading MIS player domestically with quality product profile & strong brand recall. Hence, it will be a key beneficiary of increasing MIS irrigation penetration domestically.

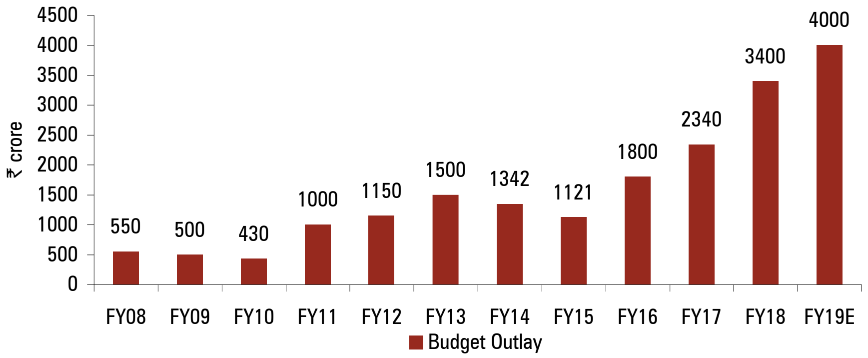
Government support: National Mission on Micro-Irrigation (NMMI)

From April 1, 2014, NMMI has been subsumed under the National Mission on Sustainable Agriculture (NMSA) and is now being implemented as "On Farm Water Management" (OFWM).

Given the savings arising out of using MIS, a wide array of incentives is being provided by the central & state governments towards its implementation. The central government, in the past, has been promoting MIS through its flagship programme National Mission on Micro Irrigation (NMMI). It has been providing a subsidy of 50% (40% central government's share + 10% state government's share) of the cost of MIS to farmers (cap of 5 hectares per farmer). However, as of now, on the back of highly lucrative payback period (one to two years) and with the aim of increasing the farmer base benefiting out of it, the subsidy share is reduced to 35% (25% central government's share + 10% state government's share). This, however, does not cap the state government's share, which are free to incentivise their local farmers. For FY19E, the Centre's share of subsidy for MIS has been increased to ₹ 4,000 crore vs. ₹ 3400 crore in FY18 (up 17.6% YoY).

The medium term potential of MIS in India is pegged at ~17 MH (~₹ 11000 crore) with long term potential at ~70 MH. Out of the 70 MH of opportunity, sprinkler share is envisaged at ~60% (42.5 MH) while the drip share is envisaged at ~40% (27 MH)

Exhibit 3: Central government assistance for MIS

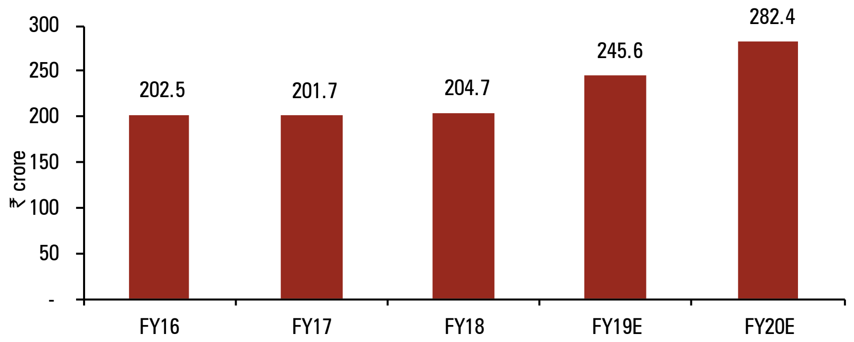


Source: Ministry of Agriculture, Budget Document, ICICI Direct Research

Revenues expected to grow at 17.5% CAGR in FY18-20E

We expect EPC to clock robust revenue growth of 17.5% CAGR in FY18-20E primarily on a pick-up in MIS activity domestically.

Exhibit 4: Revenue trend

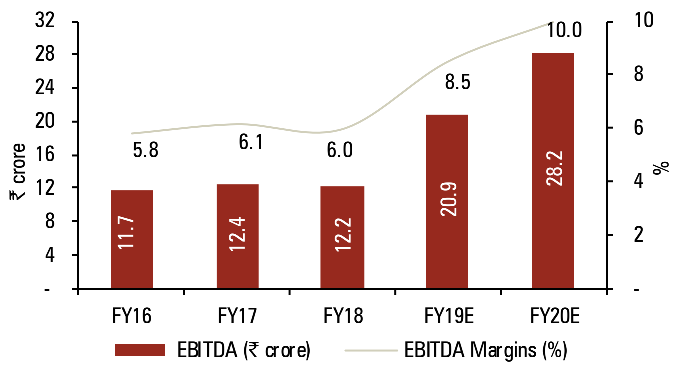


Source: Company, ICICI Direct Research

Margin expansion to drive EBITDA & PAT going forward

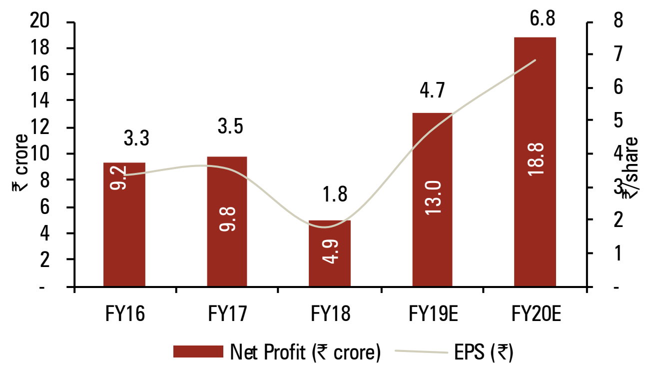
We expect the EBITDA to grow at a healthy rate in FY18-20E on account of expansion in margins by 400 bps in FY18-20E, albeit on a lower base. We expect EPC to clock EBITDA of ₹ 28.2 crore in FY20E with corresponding EBITDA margins expected at 10.0% in FY20E. PAT is also expected to grow at a healthy rate in FY18-20E with FY20E PAT expected at ₹ 18.8 crore with corresponding EPS of ₹ 6.8/share.

Exhibit 5: EBITDA & EBITDA margins trend



Source: Company, ICICI Direct Research

Exhibit 6: PAT & EPS trend

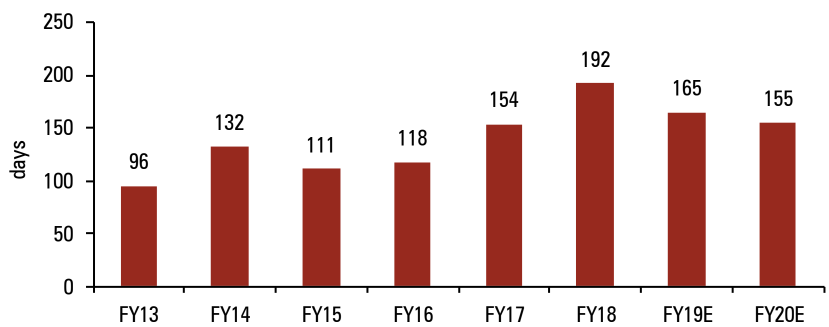


Source: Company, ICICI Direct Research

Working capital gets stretched, expect situation to normalise by FY20E

Working capital cycle got stretched further in FY18 for EPC with net working capital days coming in at 192 days. However, given healthy farm income and rectification of subsidy disbursal mechanisms by various state governments we expect the working capital cycle to improve, going forward. We expect net working capital days at 165 days in FY19E and further to 155 days in FY20E

Exhibit 7: Net working capital days



Source: Company, ICICI Direct Research

Outlook and valuation

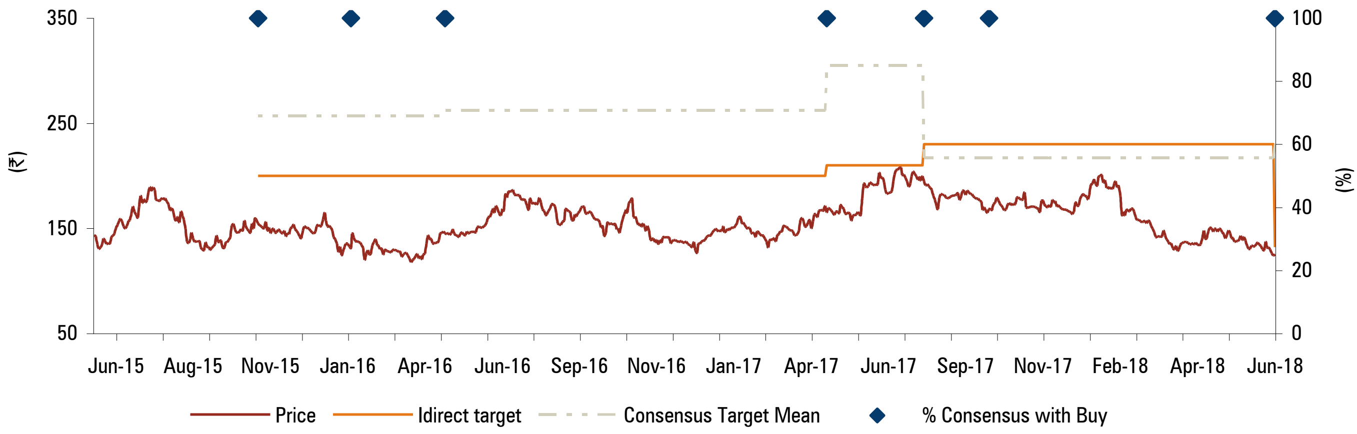
The Q4FY18 performance was encouraging. However, the company witnessed headwinds in the last three years resulting in a flat performance in FY16-18. On the balance sheet front, working capital cycle is on an uptrend. It got further stretched in FY18, with NWC days for FY18 at ~190 days vs. ~110 days in FY14. This acts as a big overhang on capital efficiency for EPC thereby resulting in negative cash flow from operations in FY18. Therefore, we downgrade the stock to **HOLD** and will look for sustained performance before any meaningful upgrade and change in stance. Going forward, we build in sales CAGR of 17.5% in FY18-20E and expect the company to clock ~400 bps margin improvement in FY18-20E, albeit on a lower base (EBITDA margins in FY18 were at 6.0%). We expect EPC to report PAT of ₹ 13.0 crore in FY19E & ₹ 18.8 crore in FY20E. We value EPC at ₹ 135, i.e. 20x P/E on FY20E EPS of ₹ 6.8/share.

Exhibit 8: Valuation Summary

	Sales (₹ cr)	Growth (%)	EPS (₹)	Growth (%)	PE (x)	EV/EBITDA (x)	RoNW (%)	RoCE (%)
FY16	202.5	22.5	3.3	450.0	37.7	27.8	7.5	7.3
FY17	201.7	-0.4	3.5	5.8	35.6	26.8	7.3	6.9
FY18	204.7	1.5	1.8	-49.6	70.7	28.6	3.5	6.3
FY19E	245.6	20.0	4.7	164.6	26.7	16.2	8.6	11.7
FY20E	282.4	15.0	6.8	44.4	18.5	11.6	11.2	14.8

Source: Company, ICICI Direct Research

Recommendation history vs. Consensus



*Source: Bloomberg, Company, ICICI Direct Research ; *IDirect Coverage on EPC Industrie was initiated on Nov 2014*

Key events

Date/Year	Event
2006	In 2006, it reached a one-time settlement (OTS) with its lenders and came out of BIFR in 2007
2007	The company received a total investment of ₹ 40 crore, in 2007, from New York-based PE player Credit Renaissance Partners LLC
2011	Mahindra acquired EPC and made its foray into micro irrigation in February 2011 (through preferential issuance of equity shares @ ₹ 66/share). Credit Renaissance Partners' LLC stake got reduced from 43.6% to 32.4%
2013	In FY13, through a rights issue (3:5; @ ₹ 40/share; total amount raised was ₹ 40 crore) M&M increased its stake further from 38.1% to 54.8%
2014	In FY14, EPC clocked a topline of ₹ 175 crore; EBITDA margins of 6% and PAT of ₹ 7.7 crore
2015	In FY15, EPC reported a subdued performance in Q2FY15 & Q3FY15 primarily on the delay in finalisation of scheme by state governments. For FY15, the National Mission on Micro Irrigation (NMMI) got subsumed under National Mission on Sustainable Agriculture (NMSA)
2016	Central Govt. has increased funds allocation for micro-irrigation to ₹ 2340 crore in FY17 from ₹ 1800 crore in FY16
2017	Budget FY2017-18 set up a dedicated Micro Irrigation Fund in NABARD to achieve ' per drop more crop' with an initial corpus of ₹ 5,000 crore
2018	FY18 again turns out to be a washed year for EPC Industrie with near flat sales and muted profitability.

Source: Company, ICICI Direct Research

Top 10 Shareholders

Rank	Name	Latest Filing Date	% O/S	Position (m)	Change (m)
1	Mahindra Group	31-Mar-18	54.7	15.1	0.0
2	SBI Funds Management Pvt. Ltd.	31-Mar-18	1.9	0.5	-0.2

Source: Reuters, ICICI Direct Research

Shareholding Pattern

(in %)	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Promoter	54.7	54.7	54.7	54.7	54.7
FII	0.0	0.0	0.0	0.0	0.0
DII	2.0	2.7	2.7	2.7	1.9
Others	43.3	42.6	42.6	42.7	43.4

Recent Activity

Buys			Sells		
Investor name	Value	Shares	Investor name	Value	Shares
NA			SBI Funds Management Pvt. Ltd.	-0.42	-0.21

Source: Reuters, ICICI Direct Research

Financial summary

Profit and loss statement				₹ Crore
(Year-end March)	FY17	FY18	FY19E	FY20E
Net Sales	201.7	204.7	245.6	282.4
Other Operating Income	0.1	-0.1	0.0	0.0
Total Operating Income	201.9	204.6	245.6	282.4
Growth (%)	-1.4	1.3	20.1	15.0
Raw Material Expenses	114.4	111.6	136.3	156.8
Employee Expenses	23.2	23.9	27.0	28.2
Other Operating Expense	51.9	56.9	61.4	69.2
Total Operating Expenditure	189.5	192.4	224.7	254.2
EBITDA	12.4	12.2	20.9	28.2
Growth (%)	5.6	-1.6	71.4	35.3
Depreciation	3.1	3.1	3.2	3.3
Interest	1.6	0.5	0.2	0.0
Other Income	1.9	1.8	0.6	1.2
PBT	9.6	10.4	18.1	26.2
Exceptional Item	0.0	0.0	0.0	0.0
Total Tax	-0.2	5.4	5.1	7.3
PAT	9.8	4.9	13.0	18.8
Growth (%)	5.8	-49.6	164.6	44.4
EPS (₹)	3.5	1.8	4.7	6.8

Source: Company, ICICI Direct Research

Cash flow statement				₹ Crore
(Year-end March)	FY17	FY18	FY19E	FY20E
Profit after Tax	9.8	4.9	13.0	18.8
Add: Depreciation	3.1	3.1	3.2	3.3
(Inc)/dec in Current Assets	-23.3	-27.2	-10.1	-17.0
Inc/(dec) in CL and Provisions	4.7	4.2	6.6	8.8
Others	1.6	0.5	0.2	0.0
CF from operating activities	-4.2	-14.5	12.9	14.0
(Inc)/dec in Investments	-4.5	4.5	-5.0	-5.0
(Inc)/dec in Fixed Assets	0.0	-2.2	-2.0	-2.0
Others	-0.8	0.1	0.0	0.0
CF from investing activities	-5.3	2.4	-7.0	-7.0
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Inc/(dec) in loan funds	-0.1	3.4	-3.0	-0.5
Dividend paid & dividend tax	0.0	-1.7	-1.7	-1.7
Inc/(dec) in Share Cap	-0.5	2.5	0.0	0.0
Others	-0.8	-0.5	-0.2	0.0
CF from financing activities	-1.4	3.7	-4.8	-2.2
Net Cash flow	-10.8	-8.4	1.1	4.8
Opening Cash	23.5	12.8	4.4	5.4
Closing Cash	12.8	4.4	5.4	10.2

Source: Company, ICICI Direct Research

Balance sheet				₹ Crore
(Year-end March)	FY17	FY18	FY19E	FY20E
Liabilities				
Equity Capital	27.7	27.7	27.7	27.7
Reserve and Surplus	106.5	112.2	123.6	140.8
Total Shareholders funds	134.2	139.9	151.3	168.5
Total Debt	0.2	3.7	0.7	0.2
Deferred Tax Liability	0.0	0.0	0.0	0.0
Minority Interest / Others	0.0	0.0	0.0	0.0
Total Liabilities	134.4	143.5	151.9	168.6
Assets				
Gross Block	66.7	69.5	71.5	73.5
Less: Acc Depreciation	41.2	44.3	47.5	50.8
Net Block	25.5	25.1	24.0	22.7
Capital WIP	0.6	0.0	0.0	0.0
Total Fixed Assets	26.1	25.2	24.0	22.7
Investments	4.5	0.0	5.0	10.0
Inventory	32.5	34.7	40.4	46.4
Debtors	92.4	117.9	121.1	131.5
Loans and Advances	9.0	10.6	11.1	11.3
Other Current Assets	3.3	1.3	2.0	2.3
Cash	12.8	4.4	5.4	10.2
Total Current Assets	149.9	168.8	179.9	201.7
Current Liabilities	39.6	44.8	50.5	58.0
Provisions	8.6	7.5	8.4	9.7
Current Liabilities & Prov	48.2	52.3	58.9	67.7
Net Current Assets	101.8	116.4	121.0	134.0
Others Assets	2.0	1.9	1.9	1.9
Application of Funds	134.4	143.5	151.9	168.6

Source: Company, ICICI Direct Research

Key ratios				
(Year-end March)	FY17	FY18	FY19E	FY20E
Per share data (₹)				
EPS	3.5	1.8	4.7	6.8
Cash EPS	4.6	2.9	5.9	8.0
BV	48.5	50.6	54.7	60.9
DPS	0.0	0.5	0.5	0.5
Cash Per Share (Incl Invst)	4.6	1.6	2.0	3.7
Operating Ratios (%)				
EBITDA Margin	6.1	6.0	8.5	10.0
PAT Margin	4.8	2.4	5.3	6.7
Inventory days	58.8	61.9	60.0	60.0
Debtor days	167.2	210.2	180.0	170.0
Creditor days	71.6	79.9	75.0	75.0
Return Ratios (%)				
RoE	7.3	3.5	8.6	11.2
RoCE	6.9	6.3	11.7	14.8
RoIC	8.0	6.5	12.5	16.8
Valuation Ratios (x)				
P/E	35.6	70.7	26.7	18.5
EV / EBITDA	26.8	28.6	16.2	11.6
EV / Net Sales	1.6	1.7	1.4	1.2
Market Cap / Sales	1.7	1.7	1.4	1.2
Price to Book Value	2.6	2.5	2.3	2.1
Solvency Ratios				
Debt/EBITDA	0.0	0.3	0.0	0.0
Debt / Equity	0.0	0.0	0.0	0.0
Current Ratio	3.1	3.2	3.1	3.0
Quick Ratio	2.4	2.6	2.3	3.0

Source: Company, ICICI Direct Research

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Strong Buy: >15%/20% for large caps/midcaps, respectively, with high conviction;
Buy: >10%/15% for large caps/midcaps, respectively;
Hold: Up to +/-10%;
Sell: -10% or more;

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