

## Revenues strong but margin disappoints...

**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)

**Q1FY23 Results:** Elgi reported good Q1FY23 results. Revenue came in higher than our estimates.

- Consolidated revenues came in at ₹ 693.8 crore, up 41.8% YoY
- EBITDA margins came in at 11.3% in Q1FY23 (below our estimate of 13.3%) as increase in employee cost and other expenses has gone up as travel, etc, have started
- Consequently, PAT was at ₹ 48.7 crore, up 305% YoY

**What should investors do?** Elgi's share price has grown by ~5.9x over the past six years (from ~₹ 65 in March 2016 to ~₹ 449 levels in August 2022).

- We remain long term positive on the stock and change our rating from BUY to HOLD

**Target Price and Valuation:** We value Elgi at ₹ 475 i.e. 52x P/E on FY24E EPS

**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 20.5%, 29.6%, respectively, in FY22-24E owing to various cost control initiatives improving margins
- Net debt free b/s, double-digit return ratios & strong cash generation

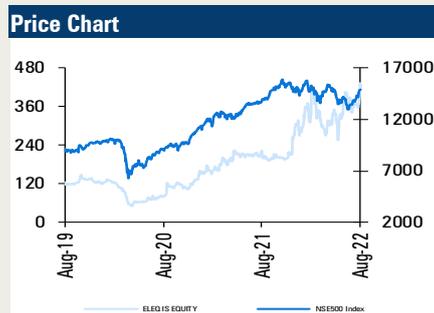
**Alternate Stock Idea:** We also like AIA Engineering in our coverage.

- AIA's strong balance sheet, decent cash flows, efficient working capital management are expected to support long term growth.
- BUY with target price of ₹ 3010



Particulars	
Particular	Amount
Market Capitalization	₹ 14229 Crore
Total Debt (FY22)	₹ 326 Crore
Cash & Inv. (FY22)	₹ 122 Crore
EV (FY22)	₹ 14434 Crore
52 week H/L (₹)	464 / 191
Equity capital	₹ 31.7 Crore
Face value	₹ 1

Shareholding pattern				
(in %)	Sep-21	Dec-21	Mar-22	Jun-22
Promoter	31.9	31.9	31.3	31.3
FII	23.8	24.9	26.2	27.0
DII	7.3	6.8	6.0	5.9
Others	36.9	36.4	36.3	35.8



**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)	FY20	FY21	FY22	5 Year CAGR (FY17-FY22)	FY23E	FY24E	2 year CAGR (FY22-24E)
Revenue	1,829.4	1,924.1	2,524.7	13.0%	3,057.4	3,668.9	20.5%
EBITDA	133.9	215.7	294.9	16.2%	366.9	495.3	29.6%
EBITDA Margin (%)	7.3	11.2	11.7		12.0	13.5	
Net Profit	42.6	102.5	181.0	19.6%	209.0	288.9	26.3%
EPS (₹)	1.3	3.2	5.7		6.6	9.1	
P/E (x)	334.1	138.8	78.6		68.1	49.3	
EV/EBITDA (x)	108.5	66.5	49.0		38.7	28.4	
RoCE (%)	6.5	11.7	18.9		17.8	21.0	
RoE (%)	5.5	11.8	18.7		18.5	21.1	
Growth		5.2	31.2		21.1	20.0	

## Key takeaways of recent quarter....

### Q1FY23 Results: Revenues strong but margin disappoints

- Consolidated revenue grew 41.8% YoY to ₹ 693.8 crore vs. I-direct estimate of ₹ 620 crore. Standalone revenue (domestic & direct exports compressor) grew 37.4% YoY to ₹ 414.2 crore (~60% of consolidated topline) led by better demand in domestic market and robust exports. Despite challenges, automotive (ATS) segment revenue grew 80% YoY to ₹ 48.3 crore
- EBITDA margins came in at 11.3% in Q1FY23 (below our estimate of 13.3%) amid higher commodity prices, operating costs. Consequently, absolute EBITDA grew 143.2% YoY to ₹ 78.1 crore (vs. our estimate of ₹ 82.5 crore)
- PAT came in at ₹ 48.7 crore, up 305% YoY aided by strong operational performance

### Q1FY23 Earnings Conference Call highlights

- Elgi's standalone air compressor (domestic & direct exports compressor) grew 37.4% YoY to ₹ 414.2 crore (~60% of consolidated topline). The compressor business in the domestic market was in line. Business growth in Europe, North America and Brazil was robust. Business growth in the Middle East, Africa, Australia and South-East Asian countries was subdued. The automotive business witnessed good growth but was subdued compared to management expectation. Q1FY23 growth led by 28% volume, 12% price hike and 2% from exchange rate
- Geographically, India was excellent across all verticals while Sri Lanka was a problem. Australia was better than last year but not as anticipated by the management. In North America, Elgi had a good Q1 across regions. Brazil was also good. Europe continues to be strong. The company is focusing on addressing distribution gaps and enhancing the quality of distribution. The management sounded cautiously optimistic on demand in Q3FY23 given the macro challenges of inflation may have their repercussion from Q3FY23
- The company's working capital has got stuck in GST related challenges, bank guarantees in Europe and some in inventory. The management is hopeful that by next quarter they should be able to release it
- On the cost side, Elgi has hiked prices to cope with commodity inflation but not fully passed on. However, the management is reviewing the processes to anticipate and execute strategic price increases to avoid margin erosion. On the freight cost front, the situation is improving slowly, availability of containers is a lot better now. Hence, freight rates are beginning to come down though it is still early days. This quarter employee cost has gone up on account of the revision after two years
- The company is cautiously optimistic on moving towards its strategic business plans and aspires to keep margins at 12% consistently. For Q1FY23, the EBITDA margin miss was on account of normalisation of other expenditure and hike in employee expenses given two years of Covid saw no hike in employee costs

Exhibit 1: Variance Analysis

	Q1FY23	Q1FY23E	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	Comments
Revenue	693.8	620.0	489.4	41.8	727.6	-4.6	Standalone revenue grew 37.4% YoY led by good domestic demand
Other Income	11.8	14.0	11.9	-1.2	15.0	-21.5	
Total Revenue	705.5	634.0	501.3	40.7	742.6	-5.0	
Raw material cost	358.4	322.5	263.0	40.2	379.2	-8.8	
Employee Expenses	141.6	120.0	118.6	19.4	123.0	15.2	
Total Other expenses	115.6	95.0	75.6	52.8	119.2	-3.1	
Operating Profit (EBITDA)	78.1	82.5	32.1	143.2	106.2	-26.4	
EBITDA Margins	11.3	13.3	6.6	470 bps	14.6	-333 bps	
Interest	2.8	2.4	2.9	-3.6	2.4	17.0	
Depreciation	18.9	20.0	18.5	1.8	19.9	-5.4	
Total Tax	21.8	19.3	10.6	105.4	26.6	-18.0	
PAT	48.7	54.8	12.0	305.1	73.1	-33.4	

	Q1FY23	Q1FY23E	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	
<b>Revenue (Segment-wise)</b>	693.8	620.0	489.4	41.8	727.6	-4.6	
Air Compressors	646.2	610.0	462.9	39.6	667.6	-3.2	Getting gradual traction in domestic business and decent incremental growth in international market
% of Sales	93%	92%	95%		92%		
Automotive Equipments	48.3	52.0	26.8	80.3	60.6	-20.2	
% of Sales	7%	8%	5%		8%		
<b>EBT Margin</b>							
Air Compressors	57.3	75.0	39.5	45.2	71.6	-19.9	
EBT Margin	8.9%	12.3%	8.5%		10.7%		
% 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	13.7%	9.0%	24.0%		8.0%		
% of EBT	10.3	5.9	14.0		6.3		

Source: Company, ICICI Direct Research

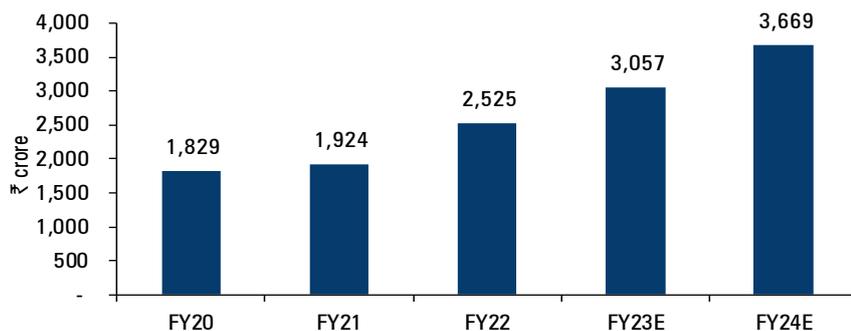
Exhibit 2: Change in estimates

	FY21	FY22	FY23E		%	FY24E		%
₹ crore			Old	New	Change	Old	New	Change
Revenue	1,924.1	2,524.7	3,057.4	3,057.4	0.0	3,668.9	3,668.9	0.0
EBITDA	215.7	294.9	366.9	366.9	0.0	477.0	495.3	3.8
EBITDA margin (%)	11.2	11.7	12.0	12.0	0 bps	13.0	13.5	50 bps
PAT	102.5	181.0	209.0	209.0	0.0	275.5	288.9	4.8
EPS (₹)	3.2	5.7	6.6	6.6	-0.1	8.7	9.1	4.8

Source: Company, ICICI Direct Research

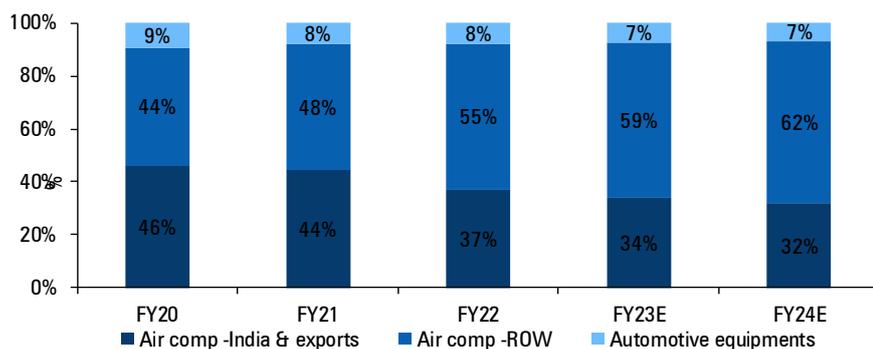
## Financial story in charts

Exhibit 3: Revenue trend



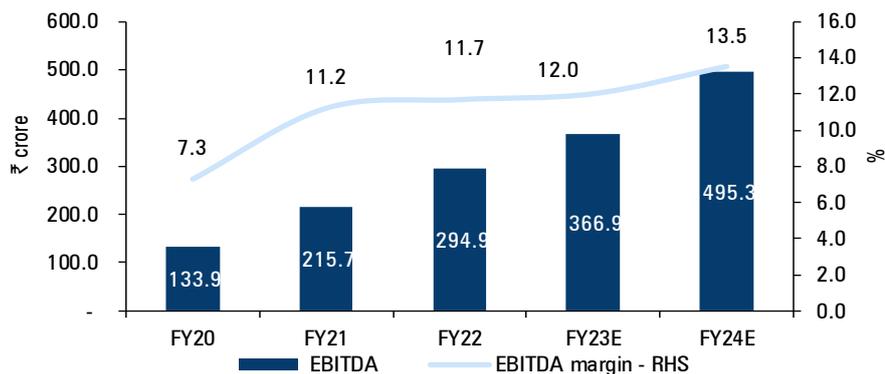
Source: Company, ICICI Direct Research

Exhibit 4: Revenue segmentation



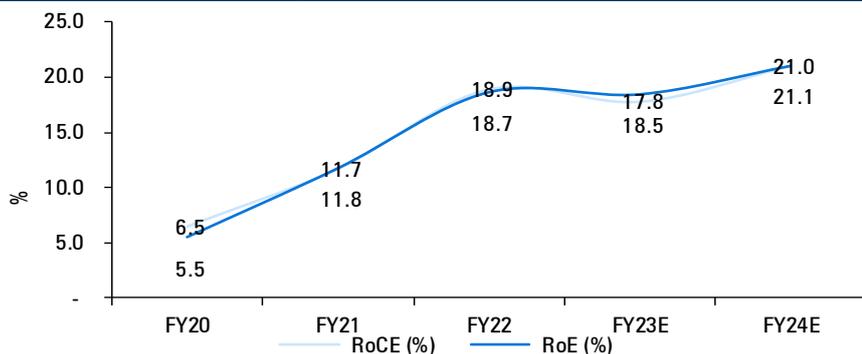
Source: Company, ICICI Direct Research

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)	FY21	FY22	FY23E	FY24E
<b>Net Sales</b>	<b>1,924.1</b>	<b>2,524.7</b>	<b>3,057.4</b>	<b>3,668.9</b>
Other Operating Income	-	-	-	-
Total Operating Income	1,924.1	2,524.7	3,057.4	3,668.9
% Growth	40.4	31.2	21.1	20.0
Other Income	23.5	55.0	24.5	24.5
Total Revenue	1,947.5	2,579.7	3,081.9	3,693.4
Growth (%)	40.9	32.5	19.5	19.8
Total Raw Material Costs	1,027.6	1,354.5	1,644.9	1,944.5
Employee Expenses	411.7	483.9	605.4	715.4
Other expenses	269.1	391.4	440.3	513.6
Total Operating Expense	1,708.4	2,229.8	2,690.5	3,173.6
<b>EBITDA</b>	<b>215.7</b>	<b>294.9</b>	<b>366.9</b>	<b>495.3</b>
Growth (%)	55.0	36.7	24.4	35.0
Interest	13.5	11.1	9.1	8.5
PBDT	225.7	338.7	382.3	511.3
Depreciation	74.3	74.5	97.8	117.4
PBT before Exceptional	151.3	264.2	284.5	393.9
Total Tax	50.3	84.6	76.8	106.4
PAT before MI	101.1	179.6	207.6	287.5
Minority Interest	-	-	-	-
<b>PAT</b>	<b>102.5</b>	<b>181.0</b>	<b>209.0</b>	<b>288.9</b>
Growth (%)	38.6	76.5	15.5	38.2
EPS*	3.2	5.7	6.6	9.1

Source: Company, ICICI Direct Research

Exhibit 8: Cash flow statement				
₹ crore				
(₹ Crore)	FY21	FY22	FY23E	FY24E
Profit after Tax	102.5	181.0	209.0	288.9
Depreciation	74.3	74.5	97.8	117.4
Interest	13.5	11.1	9.1	8.5
Cash Flow before WC changes	190.3	266.6	315.9	414.8
Changes in inventory	0.7	(140.4)	5.6	(95.5)
Changes in debtors	(53.0)	(72.2)	(72.6)	(108.9)
Changes in loans & Advances	0.9	3.1	(6.3)	(1.8)
Changes in other current assets	13.6	(32.3)	(8.0)	(28.1)
Net Increase in Current Assets	(37.8)	(241.6)	(81.3)	(234.3)
Changes in creditors	80.1	29.7	91.8	82.1
Changes in provisions	1.1	2.7	3.8	3.9
Net Increase in Current Liabilities	117.0	33.4	150.7	128.8
<b>CF from operations</b>	<b>269.5</b>	<b>58.3</b>	<b>385.4</b>	<b>309.3</b>
Changes in deferred tax assets	(15.7)	(7.5)	-	-
(Purchase)/Sale of Fixed Assets	(54.3)	(54.3)	(95.0)	(95.0)
<b>CF from Investing</b>	<b>(58.0)</b>	<b>(62.1)</b>	<b>(95.0)</b>	<b>(95.0)</b>
Dividend and Dividend Tax	(25.4)	(25.4)	(47.5)	(47.5)
<b>CF from Financing</b>	<b>(35.2)</b>	<b>(136.5)</b>	<b>(79.4)</b>	<b>(76.0)</b>
Net Cash flow	176.3	(140.3)	210.9	138.2
Opening Cash/Cash Equivalent	85.7	262.0	121.6	332.5
Closing Cash/ Cash Equivalent	262.0	121.6	332.5	470.8

Source: Company, ICICI Direct Research

Exhibit 9: Balance sheet				
₹ crore				
(₹ Crore)	FY21	FY22	FY23E	FY24E
Equity Capital	31.7	31.7	31.7	31.7
Reserve and Surplus	838.2	937.2	1,098.6	1,339.9
Total Shareholders funds	869.9	968.9	1,130.3	1,371.6
Minority Interest	-	-	-	-
Other Non Current Liabilities	53.1	48.4	48.4	48.4
Total Debt	369.6	326.2	303.4	283.4
<b>Total Liabilities</b>	<b>1,306.6</b>	<b>1,363.7</b>	<b>1,502.3</b>	<b>1,723.6</b>
Gross Block	868.7	922.2	1,022.2	1,117.2
Acc: Depreciation	281.4	355.9	453.8	571.2
Net Block	587.3	566.2	568.4	546.0
Capital WIP	4.1	5.0	-	-
Total Fixed Assets	591.4	571.2	568.4	546.0
Non Current Assets	55.9	63.0	63.0	63.0
Inventory	342.7	483.1	477.5	573.0
Debtors	399.7	471.9	544.5	653.4
Loans and Advances	6.0	2.9	9.2	11.0
Other Current Assets	100.4	132.7	140.6	168.8
Cash	262.0	121.6	332.5	470.8
Total Current Assets	1,110.8	1,212.1	1,504.3	1,876.8
Current Liabilities	288.9	318.7	410.4	492.5
Provisions	13.2	15.9	19.7	23.6
Net Current Assets	650.7	718.6	860.1	1,103.8
<b>Total Assets</b>	<b>1,306.6</b>	<b>1,363.7</b>	<b>1,502.3</b>	<b>1,723.6</b>

Source: Company, ICICI Direct Research

Exhibit 10: Key ratios				
₹ crore				
	FY21	FY22	FY23E	FY24E
<b>Per Share Data</b>				
EPS	3.2	5.7	6.6	9.1
BVS	27.5	30.6	35.7	43.3
Dividend per share	0.8	0.8	1.5	1.5
Dividend payout ratio	24.8	14.0	22.7	16.5
<b>Operating Ratios</b>				
EBITDA Margin	11.2	11.7	12.0	13.5
PAT Margin	5.3	7.2	6.8	7.9
Inventory days	65.0	69.8	57.0	57.0
Debtor days	75.8	68.2	65.0	65.0
Creditor days	54.8	46.1	49.0	49.0
<b>Return Ratios</b>				
RoE	11.8	18.7	18.5	21.1
RoCE	11.7	18.9	17.8	21.0
RoIC	12.4	16.5	20.4	26.1
<b>Valuation Ratios</b>				
EV / EBITDA	66.5	49.0	38.7	28.4
P/E	138.8	78.6	68.1	49.3
EV / Net Sales	7.5	5.7	4.6	3.8
Sales / Equity	2.2	2.6	2.7	2.7
Market Cap / Sales	7.4	5.6	4.7	3.9
Price to Book Value	16.4	14.7	12.6	10.4
<b>Turnover Ratios</b>				
Asset turnover	1.4	1.7	1.8	1.9
Debtors Turnover Ratio	5.2	5.8	6.0	6.1
Creditors Turnover Ratio	7.7	8.3	8.4	8.1
<b>Solvency Ratios</b>				
Debt / Equity	0.4	0.3	0.3	0.2
Current Ratio	2.8	3.3	2.7	2.7
Quick Ratio	1.7	1.8	1.6	1.6

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)	1,850	2,175	Buy	259592	56.8	65.0	76.7	32.6	28.5	24.1	8.9	10.2	11.6	12.1	12.7	13.6
Siemens Ltd	2,835	3,040	Buy	100960	29.5	36.7	48.5	96.1	77.2	58.4	13.9	15.7	18.6	10.1	11.6	13.7
AIA Engineering (AIAENG)	2,555	3,011	Buy	24099	64.6	79.8	86.0	39.6	32.0	29.7	16.5	17.9	17.1	13.2	14.3	13.6
Thermax (THERMA)	2,111	2,405	Buy	25154	26.2	38.7	53.4	80.5	54.6	39.5	11.3	15.4	18.7	8.9	12.0	14.6
KEC International (KECIN)	391	474	Hold	10053	12.9	15.5	29.6	30.3	25.2	13.2	11.9	13.5	19.3	10.6	10.8	17.6
Greaves Cotton (GREAVE)	172	209	Buy	3977	0.7	3.5	3.6	243.0	48.8	48.1	2.5	9.4	10.7	1.3	6.7	7.7
Elgi Equipment (ELGEQU)	449	474	Hold	14229	5.7	6.6	9.1	78.6	68.1	49.3	18.9	17.8	21.0	18.7	18.5	21.1
Bharat Electronics (BHAELE)	291	315	Buy	70905	9.6	11.3	12.6	30.2	25.8	23.1	26.2	28.5	28.6	19.6	21.3	21.4
Cochin Shipyard (COCSHI)	336	340	Hold	4420	42.9	38.6	42.3	7.8	8.7	7.9	10.9	12.5	12.7	12.7	10.8	11.1
SKF (SKFIND)	4,500	4,920	Buy	22247	77.0	104.8	122.9	58.4	42.9	36.6	26.0	29.8	30.1	20.6	22.7	22.4
Timken India (TIMIND)	3,115	2,810	Buy	23431	43.5	54.8	62.5	103.4	82.1	72.0	25.3	32.3	36.8	19.7	24.9	28.4
NRB Bearing (NRBBEA)	140	220	Buy	1357	7.8	9.2	12.1	20.6	17.3	17.3	15.0	15.3	19.2	12.6	12.6	14.8
Action Construction (ACTCON)	230	285	Buy	2739	8.8	12.5	15.7	26.1	18.4	14.6	23.0	22.5	23.6	13.9	15.6	16.4
Data Patterns (DATPAT)	840	900	Buy	4358	18.1	21.7	28.0	46.4	38.7	30.0	23.8	24.4	26.4	16.4	18.1	19.6
HAL (HINAER)	2,282	2,200	Buy	76308	151.9	123.6	137.4	15.0	18.5	16.6	27.4	29.7	30.5	26.3	22.5	23.2

Source: Company, ICICI Direct Research

## RATING RATIONALE

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Buy: > 15%

Hold: -5% to 15%;

Reduce: -5% to -15%;

Sell: < -15%



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