Action Construction Equipment

Turn-around on the Cards...

Action Construction Equipment (ACE) is among the leading crane manufacturers in the Indian construction equipment (CE) market with a share of 35% in the Pick and Carry crane market. ACE's product portfolio comprises of a range of Cranes, Backhoe Loaders and Forklifts, Tractors, and Harvesters.

Business set to turn-around: Recent announcements in the Union Budget 2015-16 strengthen our view that Cranes, CE, and Material Handling (MH) business segments are up for revival. Considering ACE's strong market positioning, wide pan-India dealership network, long-standing relationship with customers who give repeat business, and wide range of product portfolio, we expect segment volumes and blended realization to catch-up from here-on. We expect ACE to post an18.8% top-line CAGR during FY2015-17E to ₹838.5cr. Demand recovery, coupled with cost cutting initiatives at the floor level, higher localization initiatives, focus on lowering imports, and expected decline in Mild Steel (forms biggest raw material component) prices, strengthens our view that ACE is well positioned to absorb fixed costs and experience margin expansion. Accordingly, EBITDA margins of the company would expand from 3.0% in FY2015E to 8.2% in FY2017E. Since its last round of capex in FY2011-12, with the onset of infra capex down-cycle, poor demand led Cranes, CE and MH division plants to run at sub-50% capacity utilization levels. ACE's Management highlighted that there is no need for the company to pursue any major capex, until their revenues cross ₹1,200cr. In absence of any major capex, we expect entire benefits of EBITDA margin expansion to trickle down to PAT level (PAT margins to expand from 0.9% in FY2015E to 4.6% in FY2017E). In-line with strong growth in profitability and improved cash flow generating potential, RoEs would improve from 1.7% in FY2015E to 11.3% in FY2017E.

Compelling valuations at current levels: We are optimistic that ACE would be able to maintain its numero uno position in the domestic Pick and Carry cranes segment. Further, the company's wide range of product offerings, wide pan-India distribution network, and recent cost cutting initiatives, put ACE in a strong position. Given the backdrop of strong earnings growth and RoE expansion, we assign a P/E multiple of 14.0x to our FY2017E EPS of ₹3.9 and arrive at a price target of ₹54 for the stock. Being a turnaround story, we alternatively checked ACE's stock on EV/sales multiple. At target P/E multiple of 14.0x, the implied FY2017E EV/sales multiple comes in at 0.75x, which is comforting. Given the 28.4% upside from the current market price of the stock, **we initiate coverage on ACE with a BUY recommendation.**

Key Financials

Y/E March (₹ cr)	FY14	FY15E	FY16E	FY17E
Net Sales	615	594	660	839
% chg	*(7.9)*	*(3.3)*	*11.0*	*27.1*
Net Profit	4	5	10	38
% chg	*(37.6)*	*30.4*	*93.5*	*276.8*
EBITDA (%)	3.9	3.0	4.7	8.2
EPS (₹)	0.4	0.5	1.0	3.9
P/E (x)	103.7	79.5	41.1	10.9
P/BV (x)	1.4	1.3	1.3	1.2
RoE (%)	1.3	1.7	3.2	11.3
RoCE (%)	3.4	4.2	5.3	13.1
EV/Sales (x)	0.9	0.9	0.8	0.6
EV/EBITDA (x)	22.0	28.7	16.6	7.5

Source: Company, Angel Research; Note: CMP as of March 17, 2015

BUY

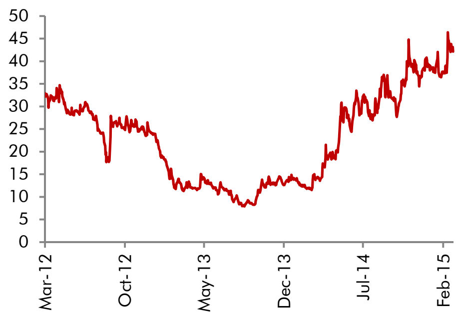
CMP	₹42
Target Price	₹54
Investment Period	12 Months

Stock Info	
Sector	Construction Equip.
Market Cap (₹ cr)	417
Net debt (₹ cr)	128
Beta	1.5
52 Week High / Low	49/12
Avg. Daily Volume	107,463
Face Value (₹)	2
BSE Sensex	28,736
Nifty	8,723
Reuters Code	ACEL.BO
Bloomberg Code	ACCE@IN

Shareholding Pattern (%)	
Promoters	68.3
MF / Banks / Indian FIs	3.3
FII / NRIs / OCBs	0.4
Indian Public / Others	28.1

Abs. (%)	3m	1yr	3yr
Sensex	1.7	31.6	66.4
ACE	10.2	195.4	28.1

3-Year Daily price chart



Source: Company, Angel Research

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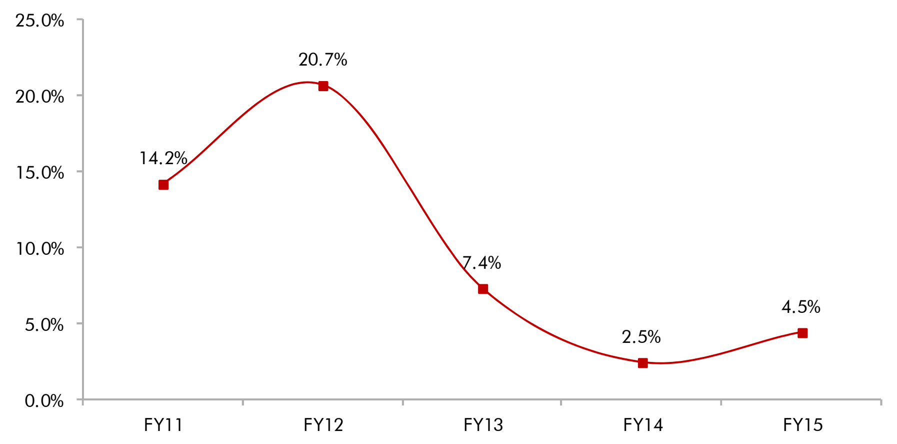
Construction Industry to see strong revival

In the last few years, Construction spending has witnessed a sharp decline. Construction spending growth on a yoy basis during FY2011-12 witnessed a double digit growth. Since then (during FY2013-14) spending has been on a declining growth trend. In FY2015, Construction spending is expected to report a 4.5% yoy increase.

Exhibit 1: Construction Spending Growth (yoy)



Source: MoSPI, Angel Research

The new government in the last few months (1) passed an ordinance with amends to land acquisition bill, (2) increased foreign direct investment (FDI) in Defense and Railways sectors, (3) is working on merging the Power and Coal ministries, (4) merged/ abolished committees/ Ministerial groups for quicker Infra projects' clearances, (5) exempted environmental clearance (EC) for Irrigation projects with command area of up to 2,000 hectares, (6) made banks to adopt '5/25 lending structure', where loans can now be made up to 25 years (vs. earlier 15 years), with an option to refinance after every 5 years, (7) delegated powers for grant of forest clearances to the regional state level offices, (8) enabled online filing for clearances to construct road overbridge (RoB) and road underbridge (RuB), (9) increased limits on sand mining, (10) EC through the e-portal route for Infra projects, (11) brought more clarity on Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs), and (12) empowered Ministry of Road Transport & Highways (MoRTH) to appraise and approve projects on its own up till ₹1,000cr and made changes to Model Concession Agreement (MCA). Also, positive commentary in the Union Budget FY2015-16, higher budgetary allocation towards Infra sub-sectors, assurance to provide quicker clearances, and opening-up of new funding avenues, indicate the government's intent to revive the ailing Infrastructure sector.

As highlighted below, budgetary allocation towards some of the key Ministries which would impact the government's Infra spending has been increased by 52.7% yoy to ₹83,255cr in FY2015-16E. The government's reformist agenda and its upbeat mood to spend towards the Infra sector creates a favourable outlook towards the Infra sector in the near-to-medium term.

Exhibit 2: Budgetary Allocation for FY2015-16

Details of the Ministry (₹ in cr)	Actual (2013-14)	Revised (2014-15)	Budget (2015-16)	*Change (%)*
Ministry of Housing & Urban Develop.	6,703	7,547	10,068	*33.4*
Ministry of Roads & Highways	14,891	16,770	33,049	*97.1*
Ministry of Water Resources, River Development & Ganga Rejuvenation	86	103	138	*34.0*
Ministry of Railways	27,072	30,100	40,000	32.9
Total Budgetary Allocations	48,752	54,520	83,255	52.7

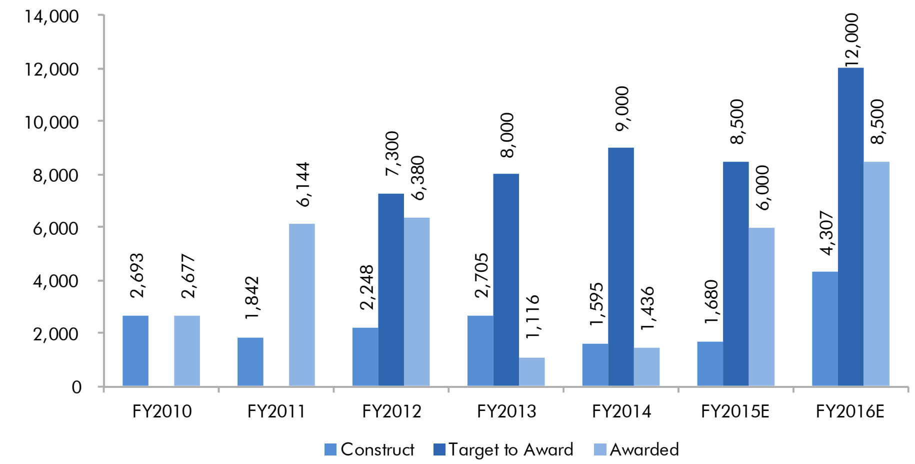
Source: Union Budget Docs, Angel Research

In order to understand growth drivers for the CE sector, we try to study the outlook of some of the key Infra sub-verticals.

Roads & Highways

Taking into consideration (1) 97.1% yoy increase in budgetary allocation (to ₹33,049cr), (2) ~100,000km of rural roads construction across the country (at different stages), and (3) government target to construct another ~100,000km of rural roads in years to come, we expect the outlook for the Road sector to improve form here on. In addition to higher award activity, reform announcements strengthen our view that road construction/ day would pick-up from 4.3km/day in FY2014 to 11.8km/day in FY2016E.

Exhibit 3: MoRTH Road Activity (in kms)



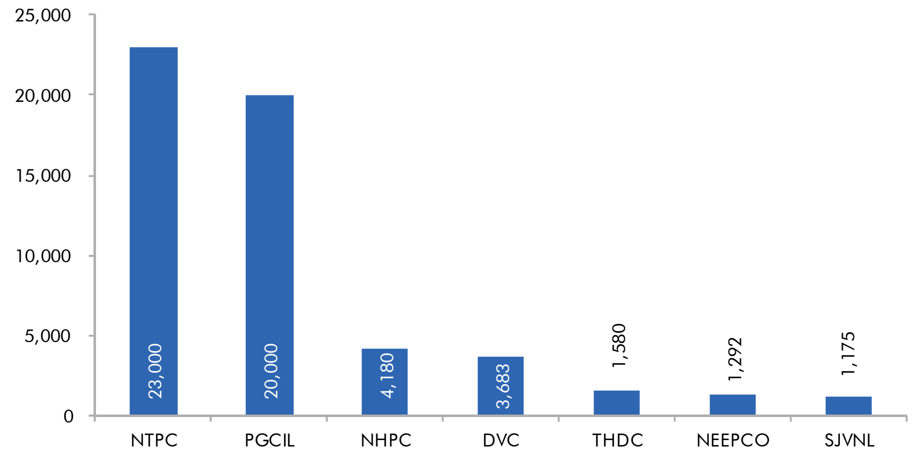
Source: NHAI, Media Publication, Angel Research

On the whole, we expect ₹90,000cr of road construction (MoRTH + State Highways + Rural) business opportunity to emerge during FY2016-17E. Our above-stated estimates factor major contribution of private road Engineering Procurement and Construction (EPC) players.

Power

The government has timely announced its support to ensure faster completion of ~87GW of Thermal Power plants, which are under different stages of construction. In order to address issues impeding the sector, the government has set ambitious coal production targets to address fuel linkage issues, assured quicker EC and forest clearance (FC) clearances for power projects, and opened up new avenues of fund raising for power developers. In the recent Union Budget 2015-16E, the Finance Minister (FM) announced that Power PSUs would increase their yoy capex outlay by 6.8% to ₹54,910cr.

Exhibit 4: Power PSUs Capex (₹ cr)



Source: Company, Angel Research

We expect revival in the Power capex cycle to be led by PSUs and Power Gencos. We see strong visibility over 15GW of Thermal and Hydro Power projects to be awarded by PSU Gencos, which have EPC works scope.

Exhibit 5: Power PSUs' capex (₹ cr)

Project Details	Power Gen. Type	Size (MW)	Contract Size (₹ cr)
Udangudi, TANGEDCO	Thermal	1,320	6,600
Manuguru, TSGENCO	Thermal	1,080	5,400
Darjeeling, NTPC	Hydro	120	300
Khargone, NTPC	Thermal	1,320	6,600
Kothagudem, APGENCO	Thermal	800	4,000
Nellore, APGENCO	Thermal	800	4,000
Nashik, MAHAGENCO	Thermal	660	3,300
Para, MAHAGENCO	Thermal	250	1,300
Sagardighi, WBPDCL	Thermal	500	2,500
Patratu, JSEB	Thermal	1,320	6,600
Ghatampur, Nevyeli Lignite	Thermal	1,980	9,900
Harduagunj, UPRVUNL	Thermal	660	3,300
Bhanswara, RRVUNL	Thermal	1,320	6,600
Satpura, MPPGCL	Thermal	660	3,300
Dondaicha, MAHAGENCO	Thermal	1,980	9,900
Totals		**14,770**	**73,600**

Source: Company, Govt. website, Media Publications, Angel Research

In the recent budget, the FM has shown thrust towards Renewable Energy by raising Renewable Energy capacity target to 175GW by 2022. NTPC recently got approval to set up 15GW of grid-connected solar power projects under National Solar Mission (NSM).

On the whole, considering Power PSUs' capex and the EPC opportunity from Power Gencos, we expect overall award activity to be northwards of ~₹91,495cr during 4QFY2015-FY2017E. For our calculation purpose, we have excluded EPC works originating from both, Renewable Energy and Private Power Genco Developers.

Irrigation & Water Treatment

Irrigation & Water Treatment also happen to be the focus area of the government. This can be gauged from the following announcements in the Union Budget FY2015-16E, (1) ₹1,000cr allocation towards "Pradhan Mantri Krishi Sinchayee Yojna (PMKSY)" for assured irrigation, (2) ₹4,173cr budgetary allocation towards Water Resources and Namami Ganga project (clubbed under other Ministry), and (3) announcement on National River Linking Project (NRLP). Even though budgetary allocation in the recent Union Budget was increased by 34.0% yoy to ₹138cr, we expect higher state government spending and private sector participation in irrigation to increase as some large ticket projects could be implemented on PPP basis. We expect an opportunity northward of ₹6,104cr to emerge from this vertical over FY2016-17E.

Railways

Recent announcements by the Railway Minister, like (1) allowing 100% FDI in select sub-segments in Railways, (2) decentralization of tendering process, (3) rewarding railway officers for delivering results (with 2% of the project value as incentives), (4) increase in freight tariff rates, (5) willingness to modernize and upgrade Railway resources through PPP route, (6) monetize idly lying land bank of Railways, (7) increase dependency on Alternate energy, (8) shift in focus from announcement of new trains in the Budget to improvement of existing train services, indicate Railways Ministers intent to revive the ailing Indian Railways (IR).

In the Rail Budget FY2015-16, the Railways Minister announced that in the next five years, IR would spend ₹856,000cr with focus on network decongestion and expansion. As a first step, in order to arrange long-term financing, IR signed a MoU with Life Insurance Corporation (LIC) to raise ₹150,000cr in the form of bonds (on an average ₹30,000cr worth of bonds would be issued every year by Railway entities).

Even though the above mentioned initiatives would not make IR efficient immediately, but all these announcements are in the positive direction. In the long-run, with a gradual improvement in the health of IR, we expect gradual uptick in the Railway capex cycle. Till then IR would have to continue to depend on government funding. The government in the Union Budget FY2015-16E increased yoy allocation towards IR by 32.9% to ₹40,000cr. Again, if we look into the details, ₹14,170cr would flow towards the new lines construction and RoB/RuB works (reflecting 28.8% yoy increase). Notably, we have excluded award activity flowing in from any of the PPP projects and new monetization avenues identified by the Railways Ministry.

Exhibit 6: Railways Capex Cycle (₹ cr)

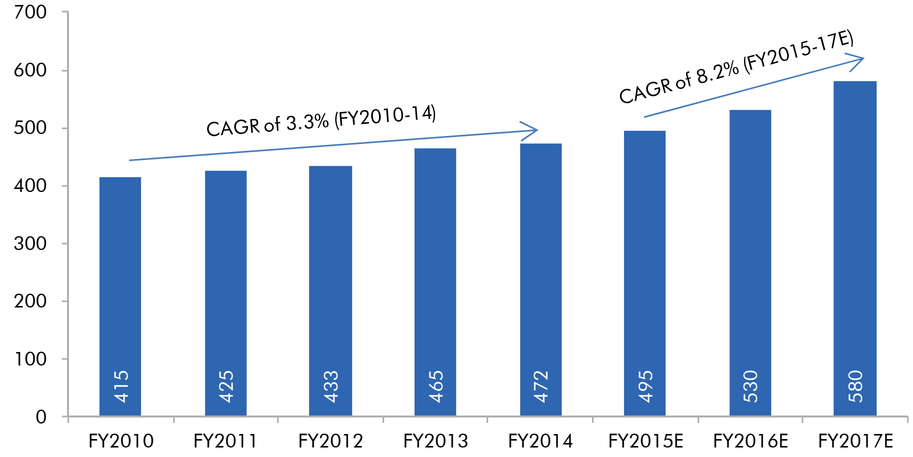
Particulars	FY2015- BE	FY2015- RE	FY2016- BE	(%)
New Lines (Construction)	8,569	8,984	12,830	42.8
Road Safety Work - RoB/RuB	2,287	2,017	1,340	(33.6)
Totals	10,856	11,001	14,170	28.8

Source: Indian Railways, , Angel Research

Coal Mining

Intending to tackle the fuel security issue, the government initiated (1) amends to Mines & Mineral (Development and Regulation) bill, (2) re-auction/ auction of the coal/ mineral resources, and (3) made favourable announcements to make Thermal Power plants more efficient. The Government of India (GoI) has guided at Coal India (accounts for over 80% of the domestic produce) doubling its production from 494mn tonne in FY2014 to 1bn tonne by FY2020E.

Exhibit 7: Coal India Sales Volume (mn tn)



Source: Company, Angel Research

With conclusion of Phase I and II coal block auctions, we expect coal production from the private sector to increase from ~30mn tonne to ~60mn tonne in the next 1-2 years. Most of the coal blocks auctioned have all the clearances in place. On the whole, we expect domestic coal production to see 115mn tonne of incremental production during FY2016-17E. We expect ₹38,640cr worth of capex investments to be made during FY2016-17E.

Urban Rail Transport

In the Union Budget FY2015-16, the government increased allocation towards Metro Railway services for 11 cities, where either works are ongoing or are yet to commence. We expect works across Ahmedabad, Nagpur, Lucknow and Mumbai (expansion) to gain traction in FY2016-17E, whereas works across other cities would commence in the next 3-5 years. We expect ~₹16,000cr worth of Infra award activity from this vertical to private players in the next 1-2 years (assuming awarding from only these 4 cities).

Large Infra Projects- DFC & DMIC

The government's focus on larger Infra projects (such as Dedicated Freight Corridor [DFC]) and Delhi Mumbai Industrial Corridor [DMIC]) would also contribute to the revival of Infra award activity.

DFC is a ₹120,000cr project covering ~3,300km, connecting Mumbai to Delhi on the Western Corridor and Ludhiana to Kolkata on the Eastern Corridor. With more than 80% of the land acquired, and majority of the clearances in place, award activity would gain momentum across packages. These 2 corridors are expected to commence operations in March 2018.

DMIC (Phase I) is a gigantic ₹540,000cr project, developed across the 1,500km stretch on the Western corridors of DFC. Currently, land acquisition is going on at Dholera, Shendra, and Pithampur stretches. Soon we expect civil works award activity to commence.

On the whole, we expect awards to the tune of ₹174,400cr from these large ticket Infra projects in the next 1-2 years.

Real Estate & 100 Smart Cities

The government has called for "Housing for all" by 2022, where it plans to build 6cr homes (4cr in rural and 2cr in urban areas). In line with its vision to have *Pucca* house for everyone by 2022, the government in the Union Budget FY2015-16, increased allocation under various ministries to ₹22,407cr. The ambitious target set under "Housing for all" scheme translates to 85 lakh new homes every year.

As per Cushman Wakefield report, new launches declined 12% yoy across top 8 cities (Ahmedabad, Bengaluru, Chennai, Delhi NCR, Hyderabad, Kolkata, Mumbai Metropolitan and Pune) to 1.53 lakh housing units in CY2014, reflecting weak absorption trends. Research firm RNCOS, predicts urban housing shortage of 1.8cr units in 2012, which is expected to grow at a CAGR of 6.6% for the next 10 years till 2022. Considering the demand-supply mismatch, GDP revival, decline in interest rates, and improvement in home-buyer affordability, we expect the Real Estate sector to see strong growth in FY2017E.

The government announced the '100 Smart cities' program, and as a first step, city-wise task forces were identified for 3 cities viz Ajmer, Allahabad and Visakhapatnam. Even though the Smart city program is a long-term play, we expect increase in Civil and Real Estate works across these 3 cities in the next 2-5 years. On a whole, the Smart city Program opens up a huge window of opportunity for Civil construction companies.

We have only considered the government spending targets, which in our view, could open civil construction opportunity worth ₹14,565cr.

Manufacturing/ Industrial Capex

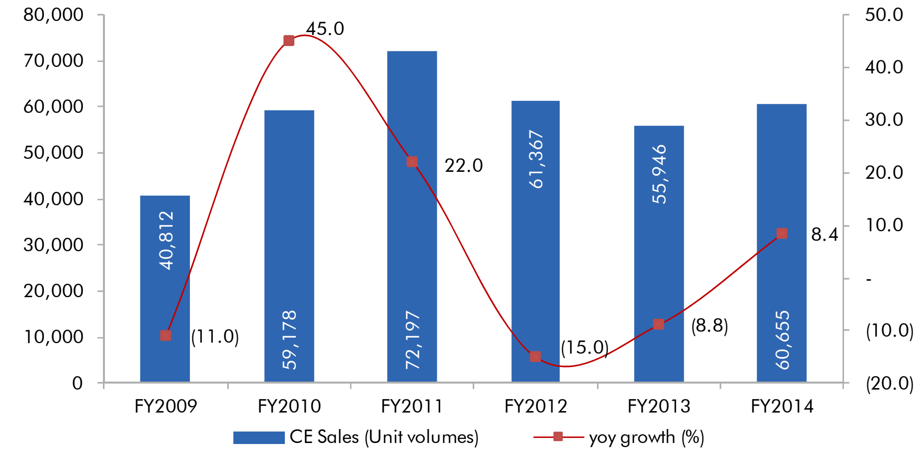
In order to understand how the Corporate Capex Cycle is likely to shape-up during FY2016-17E, we studied the 110 widely tracked companies of the BSE 500 index. Based on Bloomberg consensus estimates, capex spends during FY2016-17E for these companies are expected to be northward of ~₹450,000cr.

On the whole, we expect Infrastructure spending to pick-up, led by government spending. With government increasing emphasis on Roads & Highways and Urban Infra verticals, we expect Industrial Capex cycle to join the race soon.

CE market to report strong growth

With slow-down in the Infra capex cycle, as per Off Highway Research estimates, CE Industry sale volumes also witnessed 15.0% yoy decline in FY2012 and 8.8% yoy decline in FY2013.

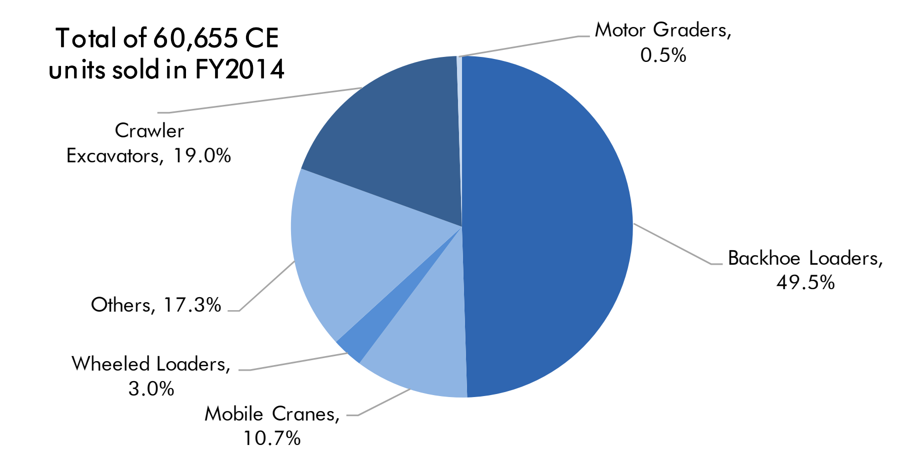
Exhibit 8: CE Industry Sale Volumes



Source: Off Highway Research, Angel Research

As per Off Highway Research estimates ~60,655 CEs were sold in FY2014, reflecting 8.4% yoy growth. Of the total FY2014 CE sales, 49.5% were Backhoe Loaders, followed by Crawler Excavators (accounting for 19.0% of CE sales), and Mobile Cranes (accounting for 10.7% of CE sales). Again, if we split the Mobile Cranes market, then Pick and Carry Cranes accounted for 86% of the total volumes. The remaining domestic Mobile Crane market was constituted by Crawler Cranes, Truck Mounted Cranes and Rough Terrain Cranes.

Exhibit 9: CE Industry Sale Volumes (FY2014)

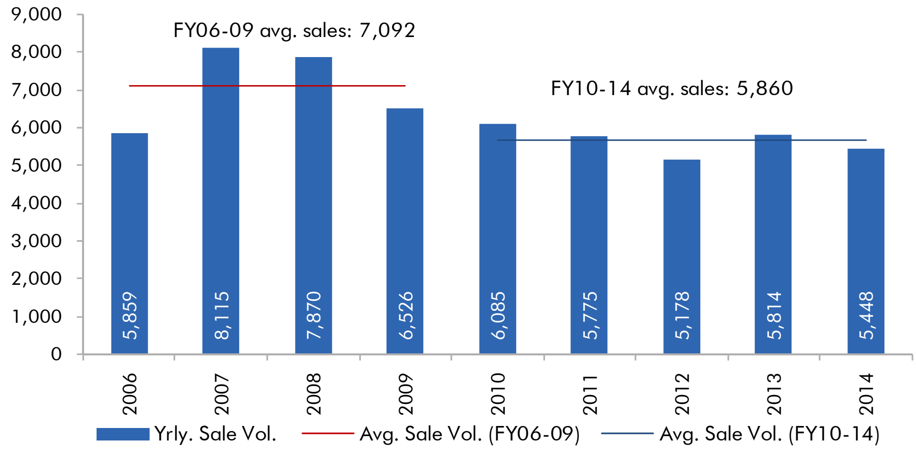


Source: Off Highway Research

The above table clearly highlights that a major chunk of the Indian CE market in FY2014 was constituted by Earthmoving and Road Construction Equipments.

In line with the CE industry volumes, which have seen de-growth, industry level Pick-n-Carry crane volumes also reported de-growth. Average sale volumes for the industry declined from 7,092 units (in FY2006-09) to 5,860 units (in FY2010-14).

Exhibit 10: Pick-n-Carry Cranes Industry Volumes



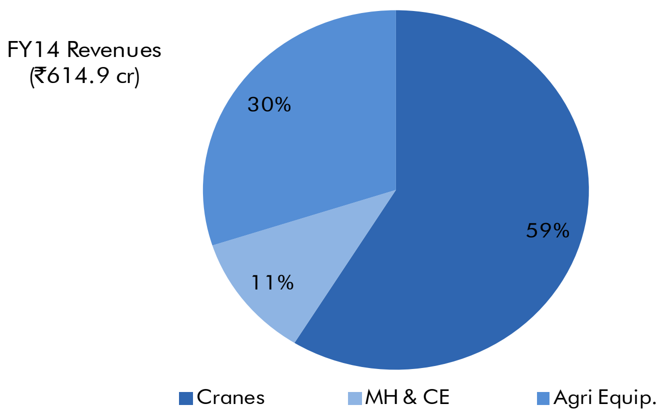
Source: Company, Angel Research

With government emphasizing increased spending towards Roads & Highways and Urban Infra verticals, we are optimistic that Infra capex cycle would pick-up from here on. Higher Infrastructure spending in our view would lead to multiplier effect on the entire CE sector. ACE being a market leader in the Pick-n-Carry Cranes space, would resultantly benefit from such government focus on the infrastructure sector.

ACE to gain from CE market revival

Having set its foot-hold successfully in the domestic Cranes market, at a time when GDP was growing over 8%, ACE in FY2008-09 diversified in to MH and Agri-Equipments (especially Tractors) business. In FY2011-12, ACE went for aggressive capacity expansion across sub-verticals. Since completion of the capex, end-user Infra industry experienced a sharp slowdown, as it grappled with various structural issues related to land acquisition, getting requisite clearances and project funding. As a result the entire CE industry witnessed a sharp de-growth in business and ACE was no exception to it.

Exhibit 11: Segment-wise Revenue mix (FY2014)



Source: Company, Angel Research

Starting as a Crane manufacturer, over the years, ACE diversified in to MH and Tractors business. ACE in FY2014 reported a major 59% of its sales from Cranes segment with a majority of the sales being accounted by Pick-n-Carry cranes. The MH&CE segment contributed 11% of revenues, where revenues from Forklifts were a major contributor at the segment level. The Agri Equipments segment contributed 30% to total sales, mainly led by tractors.

Notably, ACE enjoys strong market positioning in the domestic Pick-n-Cary Cranes market (with 35% market share) and Forklifts market (with 18% market share). We expect the company to be able to maintain its market share across these 2 categories, as the overall pie is likely to see sharp growth. In addition to Pick and Carry cranes, ACE also manufactures Self Erecting Mobile cranes used in construction of buildings up to 4/5 floors, and Fixed Tower cranes which are used in the construction of high-rise buildings.

With outlook for the entire CE industry expected to improve, we are optimistic that both, Crane and MH-CE segment sale volumes for ACE would catch-up from here on. Even though many new players, especially MNCs, have entered Indian markets in the last few years, the current unfavorable USD-INR rates make imports costlier. Hence, foreign competition may not be a threat to the domestic players' growth outlook.

Further, with revival in the Construction sector, we expect a majority of the Construction companies to first put their idly lying Construction Equipments into use and then pursue CE purchases. We therefore expect domestic CE players' sale volumes to report strong growth from FY2017E onwards. On the backdrop of sharp catch-up in demand, despite increased competition across segments, we expect ACE to maintain its current market share.

Exhibit 12: ACE Market Positioning

Segment Type	Equipment Type	Market Share (%)	Competitors	Application
Cranes				
	Pick n Carry Crane	35	Escorts, TIL, Indo Farm	Supports equipment in construction projects; Lift and move Stone slabs for realty projects
	Crawler Cranes	ND	Tata-Hitachi, Escorts	Power, Industrial & Infra projects
	Fixed Tower Cranes	ND	Potain, Escorts	High Rise Buildings
MH & CE (Material Handling & Other Construction Equipments)				
	Backhoe Loaders/ Wheeled Loaders	1	JCB, BEML, Escorts, Tata-Hitachi	Load-Unload, Move, Erect Aggregates
	Forklifts	18	Godrej, Voltas (Kion), Toyota	To lift and stack material in Manufacturing/ Logistics/Warehousing units
	Road Compactors	ND	Escorts, JCB, L&T Komatsu	Used mainly for Road Construction
Agri Equipment				
	Tractors	1	M&M, Escorts, Tafe	Farming purposes
	Harvesters	2	Hind Agro, CLASS, John Deere	Harvesting of grain crops (mainly Paddy & Wheat)

Source: Company, Angel Research; Note: Market share calculated on Volume basis, ND- Not Determined

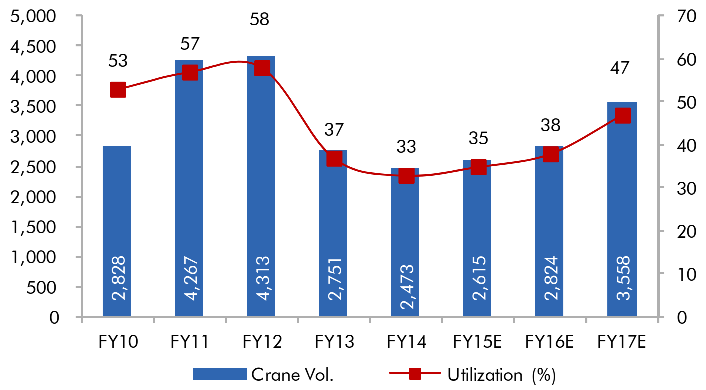
Business segments set to revive

On ACE's expanded capacity base, slowdown in overall Infrastructure spending led to 24.3% and 25.9% (CAGR) volume de-growth during FY2012-14 across Cranes and MH-CE business segments, respectively. This de-growth across business segments reflect lower utilization levels and decline in overall asset-turnover ratios (from 3.9x in FY2012 to 1.9x in FY2014), which further translated to a decline in the EBITDA margin (from 6.0% in FY2012 to 3.9% in FY2014) and Net margins (from 3.2% in FY2012 to 0.7% in FY2014).

Strong volumes to drive Crane segment sales

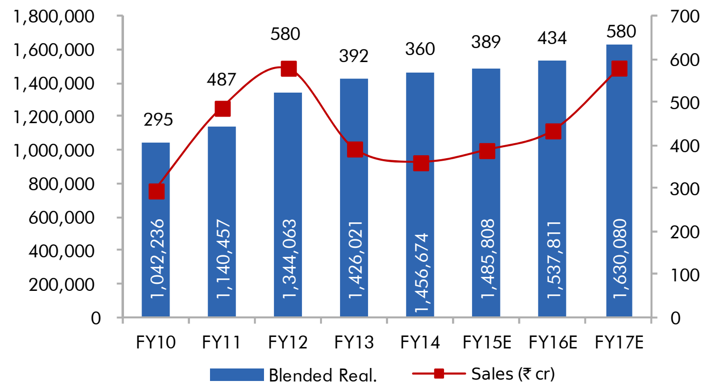
We expect the Cranes segment to report a 16.7% volume CAGR during FY2015-17E to 3,558 units. On the backdrop of demand revival and higher realization, we expect the Cranes segment sales to report a 22.2% CAGR during FY2015-17E to ₹580.1cr.

Exhibit 13: Crane Volumes & Utilization (%)



Source: Company, Angel Research

Exhibit 14: Crane Realization & Sales (₹ cr)



Source: Company, Angel Research

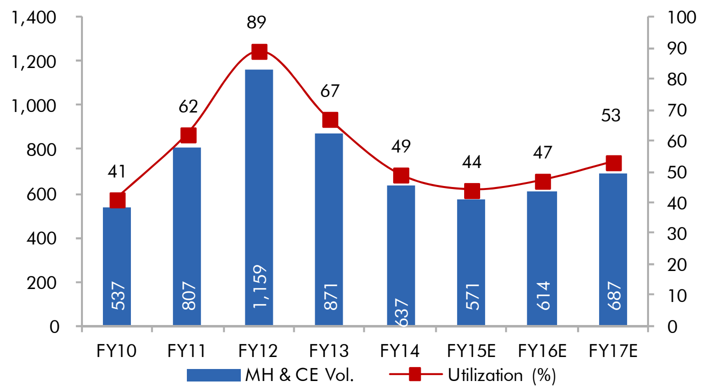
Road CE growth rate to outpace that of MH

At its peak, ACE sold ~850 Forklift units (reflecting 106.3% capacity utilization) in FY2012. Recent reform announcements, expectations of GDP revival and government's increased thrust towards Warehouse and Logistics sector, strengthen our view that long-term demand for Forklifts would catch-up from here on. Being a top 3 player, and with industry expected to report strong growth, we expect ACE to benefit. With demand revival, we expect ACE to increase Forklift prices.

We expect segment volumes to report 9.7% CAGR during FY2015-17E to 687 units. Of the total 637 units sold in FY2014, 530 were Forklifts (66.3% utilization) and the remaining 107 were Road Construction & Other Construction Equipments (21.4% utilization). We expect the rate of growth of Road CE to outpace Forklift growth rate, going forward.

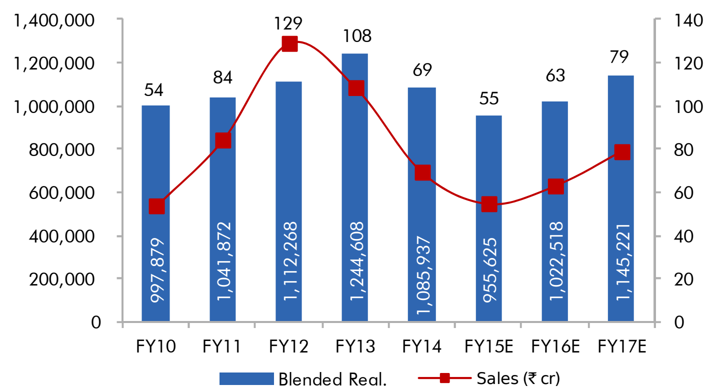
ACE currently reports sales of Forklifts, Backhoe Loaders, Wheeled Loaders, Road Compactors and Motor Graders under the MH and CE segment. On the whole, uptick in Forklift prices and shift in product mix (with higher contribution from Road CEs, which have high realization), lead us to assume the segment to report a 20.1% CAGR in sales during FY2015-17E to ₹78.7cr.

Exhibit 15: MH&CE Volumes & Utilization (%)



Source: Company, Angel Research

Exhibit 16: MH&CE Blended Realization & Sales (₹ cr)

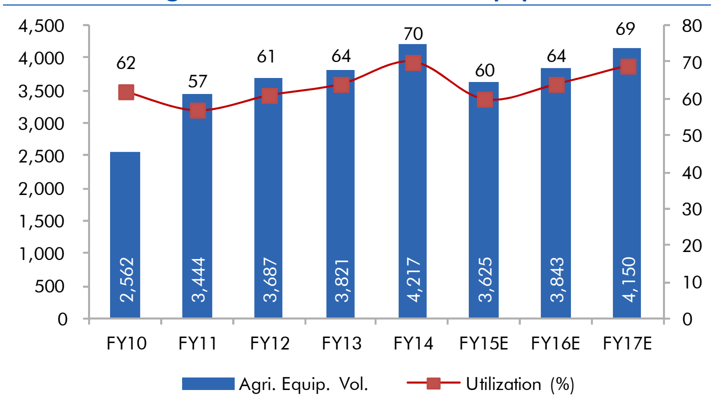


Source: Company, Angel Research

Entry into new geographies to drive Agri-Equipment volumes

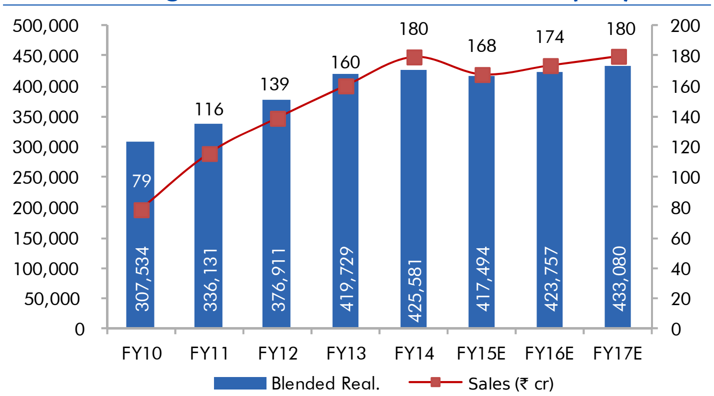
Since its entry in the domestic tractors market 4-5 years back, ACE has tasted success with the launch of 35hp, 45hp and 50hp tractors. The states of Punjab, Haryana and Uttar Pradesh account for a majority of ACE's tractor sales. ACE, in FY2015, embarked upon a geographical expansion strategy, wherein it entered Gujarat, Jharkhand, Bihar, Maharashtra and Tamil Nadu. The full benefits of entry into the new geographies are to be accrued in the mid-to-long run. Tractor sales currently account for ~70% of Agri-Equipment division's sales, while harvesters account for the balance ~30%.

Exhibit 17: Agri Volumes & Utilization (%)



Source: Company, Angel Research

Exhibit 18: Agri Blended Realization & Sales (₹ cr)



Source: Company, Angel Research

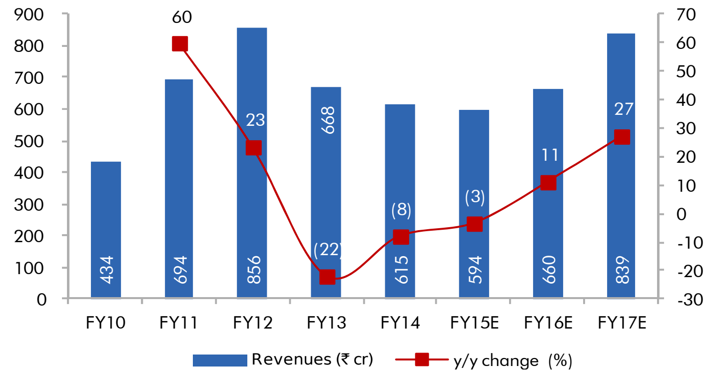
Given that tractor and harvester sales in India are highly dependent on rainfall and rural spending power, we have modeled a 9.0% top-line CAGR for this segment over FY2015-17E to ₹179.7cr.

Market penetration efforts, new launches, to scale up business

ACE, over the years, has added new products and variants, with different capacities and power, to its product portfolio. Also, since 2010, the company has been investing in building a strong distribution network. The sales network of ACE has increased from ~80 distributors in FY2010 to ~200 distributors by mid-FY2015. Widened range of product offerings coupled with their wide sales network should help ACE scale its business from here on. ACE's Research & Development

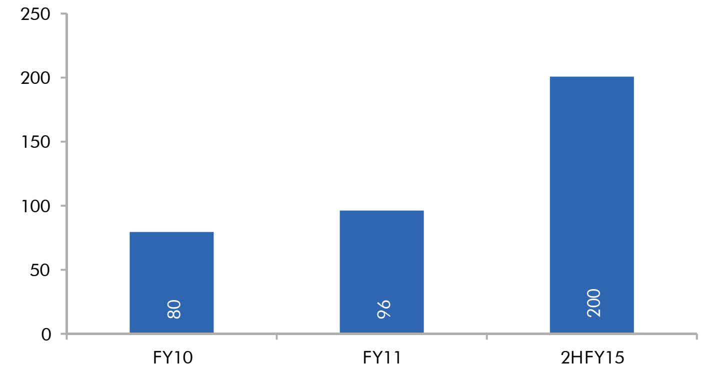
(R&D) team is working on developing (1) Skid-Steer Loader, (2) Truck Mounted Full Slew cranes with different capacities, (3) Crawler cranes (varied capacities), (4) Self propelled Truck Mounted cranes, (5) Power Tillers, and (6) new variants of Harvesters, amongst others. In absence of launch dates for these products, we have not modeled any growth from these launches.

Exhibit 19: Standalone Revenues (₹ cr) & yoy change



Source: Company, Angel Research

Exhibit 20: Sales Network



Source: Company, Angel Research

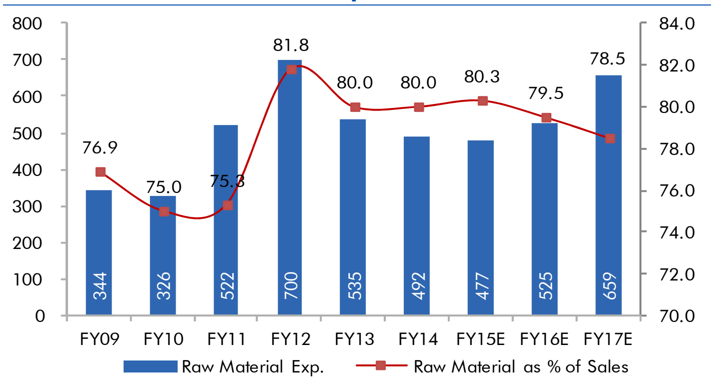
Higher Utilization to drive FY2015-17E sales

Increase in capacity utilization levels across the Cranes (from 33% in FY2014 to 47% in FY2017E) and MH and CE segments (from 49% in FY2014 to 53% in FY2017E) should help ACE report a decent top-line growth. This coupled with realization growth across all 3 segments should help ACE report an 18.8% top-line CAGR over FY2015-17E to ₹838.5cr.

Cost rationalization, weak RM prices to aid Margin expansion

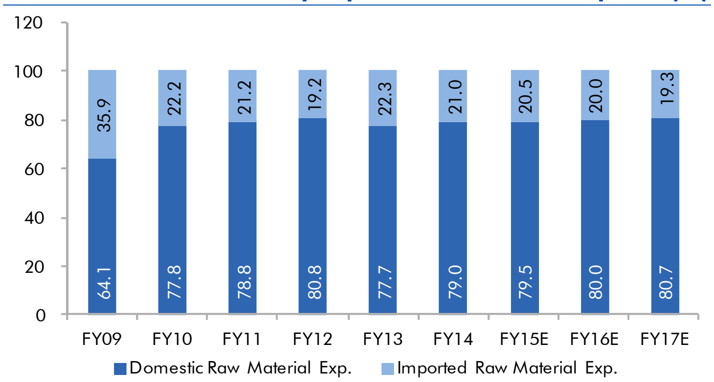
Hit by infra capex cycle slowdown, ACE in the last few quarters initiated cost cutting measures. Till a few quarters back, ~90% of Forklift manufacturing was done using imported inputs, which has now been brought down to ~40%, thus indicating that ~60% of Forklift manufacture is now localized. The Management highlighted on attaining scale; it would allow further localization, which in turn could further lower import costs. This strategy lowers dependency on import, thereby alleviating ACE from any forex risk. Imported raw materials in FY2014 accounted for 21% of the reported raw material costs. We expect this ratio to decline to 19.3% by FY2017E.

Exhibit 21: Raw Material Exp. & RM as % of sales



Source: Company, Angel Research

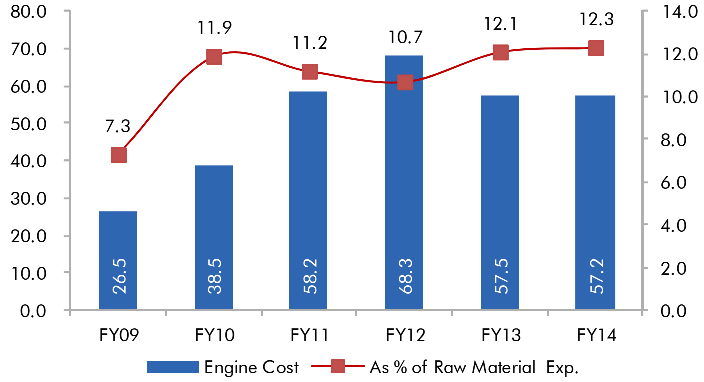
Exhibit 22: Raw Mat. Exp. split - Domestic & Imports (%)



Source: Company, Angel Research

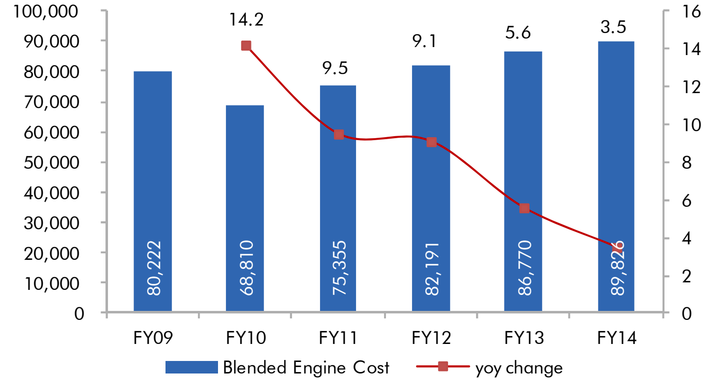
Till now, ACE has been procuring engines for all of its business segments from companies like Simpson, Mahindra Navstar, and Kirloskar, among others. In order to further cut down costs, ACE backed by its 80-90-member R&D team, has started making in-house engines for its tractors. By January 2015-end, ACE got in place a Central Pollution Control Board (CPCB) clearance for manufacturing tractor engines. The Management expects to save ~₹15,000 per tractor by using in-house developed engines. ACE is also working on engines for its other products, ie Motor Grader, Wheel Loader, Mini Compactor, Cranes, and other CEs. The Management highlighted that if the company tastes success with the in-house engines currently used in tractors, then it could extrapolate the use of in-house engines across other products as well. We have not modeled the same into our estimates.

Exhibit 23: Engines cost (₹ cr) & as % of Raw Mat. Exp.



Source: Company, Angel Research

Exhibit 24: Engine cost & As % of Raw Material Exp.

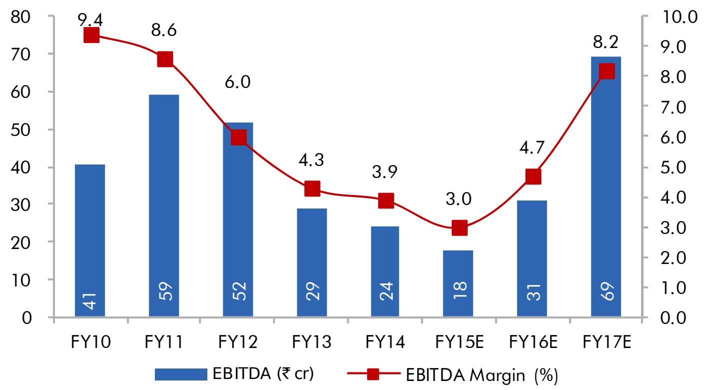


Source: Company, Angel Research

Mild Steel is a major raw material (accounting for 25-35% of the total raw material cost) item used for manufacturing all types of equipments. Our Metals sector analyst is of the view that domestic steel prices are likely to be under pressure over FY2016-17E. This could result in cost savings for the company and in turn contribute to our margin expansion assumption.

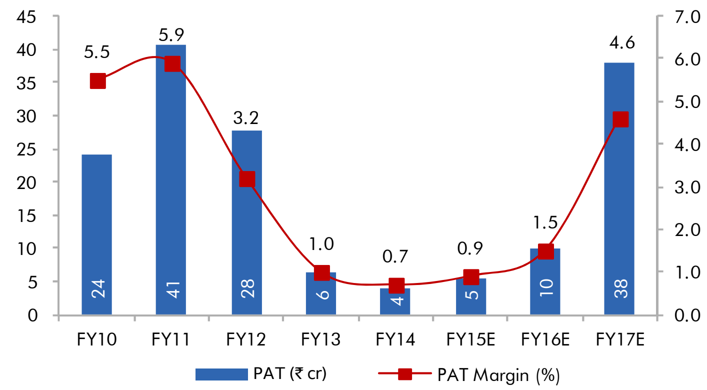
Already, results of some of the floor level cost cutting initiatives are evident, as operating expenses in the last 12 months declined 10.9% yoy in comparison to just 2.0% yoy decline in sales. We are of the view that demand recovery should support our margin expansion assumption.

Exhibit 25: Standalone EBITDA & EBITDA Margin



Source: Company, Angel Research

Exhibit 26: Standalone PAT & PAT Margin



Source: Company, Angel Research

Operating leverage to trickle down to PAT level

Considering (1) benefits of cost cutting measures initiated earlier, (2) higher emphasis on localization of Forklift manufacture, (3) lower Mild Steel prices assumption; when coupled with demand recovery suggest that ACE is poised for a sharp 522bp EBITDA margin expansion over FY2015-17E to 8.2%. We expect the operating leverage to result in a strong 97.2% EBITDA CAGR over FY2015-17 to ₹68.7cr. Notably, we have not modeled any savings resulting from ACE pursuing in-house engines manufacturing.

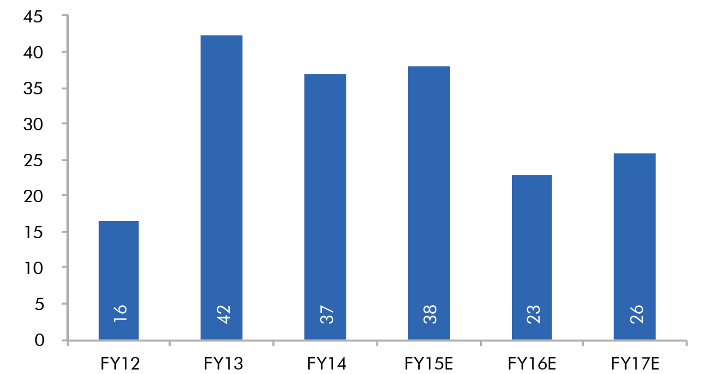
With no capex lined-up (except maintenance capex), and ACE expected to generate ₹87cr of cash flow from operations during FY2015-17E, we expect ACE to reduce its debt partially. Accordingly, we expect debt and interest expenses to decline from FY2014 levels. For 9MFY2015 ACE reported a 36.3% yoy decline in depreciation expenses to ₹7.2cr, as (1) the depreciation policy was changed to meet amended Companies Act requirements and (2) the company sold one of its major assets. However, we have assumed aggressive depreciation numbers for FY2016 and FY2017 at ₹13cr and ₹14cr, respectively. Sale of the major asset led ACE report ₹6.5cr of profit from sale of asset in 3QFY2015 (of the reported other income of ₹7.5cr). As a result, Other Income numbers for FY2015 will look higher at ~₹11cr. We have assumed ₹5cr and ₹4cr of other income for FY2016E and FY2017E. ACE is expected to be subjected to an effective tax rate of 22-23% for FY2015-17E, on account of 200% deduction on their approved R&D centre. We have assumed a 23% effective tax rate for FY2015-17E.

On the whole, strong EBITDA growth coupled with (1) decline in interest expenses, and (2) lower effective tax rate assumption of 23%, translate to an 170.0% PAT CAGR over FY2015-17 to ₹38.3cr.

Well positioned to move to the next growth level

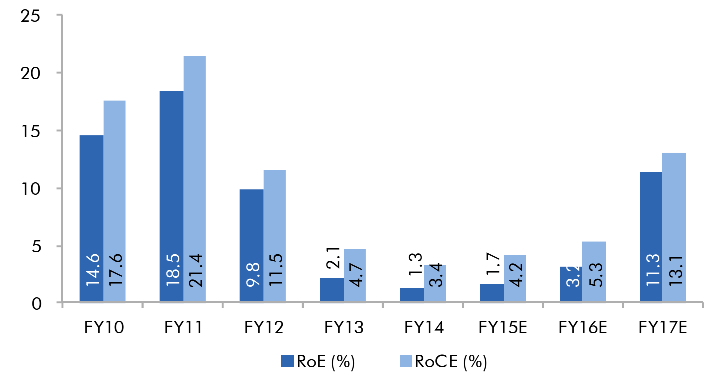
ACE last pursued capacity expansion in FY2011-12. With slowdown in the infra capex cycle; Cranes, CE and MH division plants have been running at sub-50% capacity utilization levels. Given the smaller base, and presence only in lower engine capacity tractors, the Agri-division (mainly led by tractors) has been operating at 70% capacity levels. The Management highlighted that it does not need to pursue any major capex until their revenues cross ₹1,200cr. With a revival on the cards, expected improvement in utilization levels, and with minimal requirement for incremental capital investments, we see ACE well positioned to scale its business quickly.

Exhibit 27: Cash flow from Operations (₹ cr)



Source: Company, Angel Research

Exhibit 28: RoE & RoCE



Source: Company, Angel Research

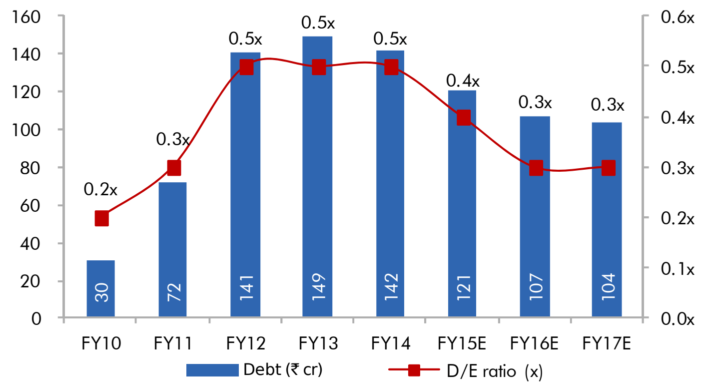
We expect ACE to generate ₹87cr of cash flow from operations during FY2015-17E, which could be used to partly repay debt and partly re-invest back into the business. In-line with the strong growth in profitability and improved cash flow generating potential, the RoEs should improve from 1.7% in FY2015E to 11.3% in FY2017E.

D/E ratio to decline

Despite the severe slowdown in CE cycle, after ACE having pursued its last round of capex in FY2011-12, ACE has been able to maintain its D/E ratio within comfort levels.

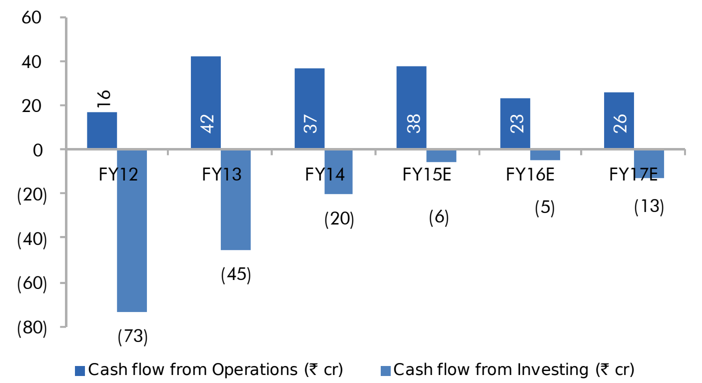
ACE's D/E ratio stands at 0.4x and its business model has the potential to generate over ₹87cr of cash flow from operations over FY2015-17E. Hence, we are comforted about the company's future growth prospects, which would come with minimal capital requirement.

Exhibit 29: Debt (₹ cr) and D/E ratio (x)



Source: Company, Angel Research

Exhibit 30: CFO & CFI (₹ cr)



Source: Company, Angel Research

With uptick in the infra-capex cycle, we expect the working capital cycle days to decline from 69 days in FY2014 to 51 days in FY2017E. This could be on expectation of lower debtor as well as inventory days. A squeeze in working capital days and strong profitability growth should help ACE report ₹87cr of cash flow from operations during FY2015-17E. We expect ACE to deploy cash flow generated from operations towards (1) maintenance capex of ₹20cr in FY2016 and ₹21cr in FY2017, and (2) towards debt repayment of ₹17cr during FY2015-17E. Accordingly, we expect the D/E ratio to slightly decline to 0.3x by FY2017E.

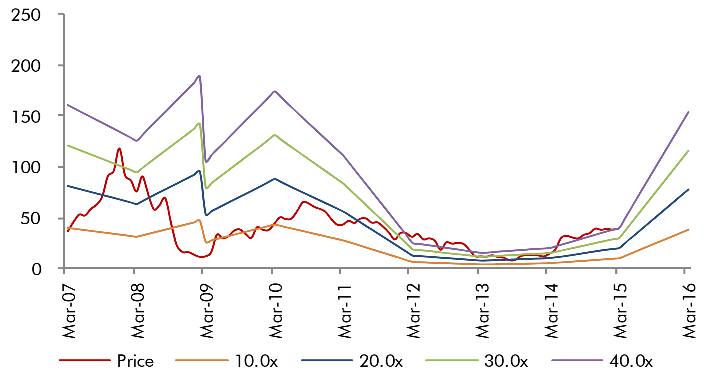
Risks to Our Estimates

- Any further delays in infra capex cycle recovery from here on could be a big risk to our estimates.
- Loss of market share vs. our assumption of holding market share could be a risk to our assumptions.
- Any sharp appreciation in the Rupee (INR) could make CE imports lucrative, thereby increasing competition, which again could be a threat to our estimates.
- Any increase in raw material prices from here on would be a risk to our margin expansion assumption and our estimates.

Valuation

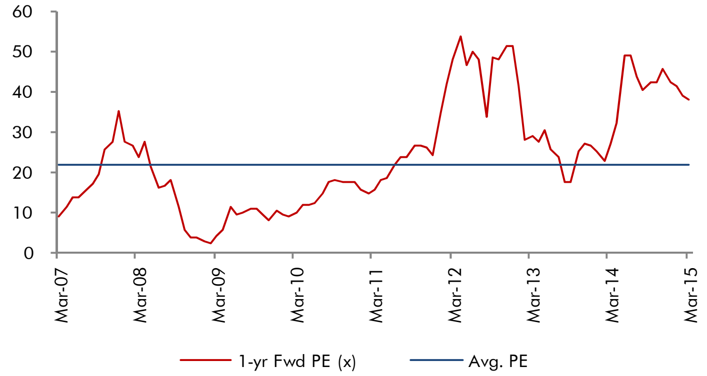
At the current market price of ₹42/share, ACE is trading at FY2016E and FY2017E P/E multiple of 41.1x and 10.9x, respectively. Historically, since the time of listing (January-2007), ACE's stock has traded at a 1-year forward P/E multiple of 24.3x. The earnings growth of the company has been volatile and the street has always built higher earnings growth expectation from ACE. This has led ACE's stock to trade at higher valuations.

Exhibit 31: 1-year forward P/E band



Source: Company, Angel Research

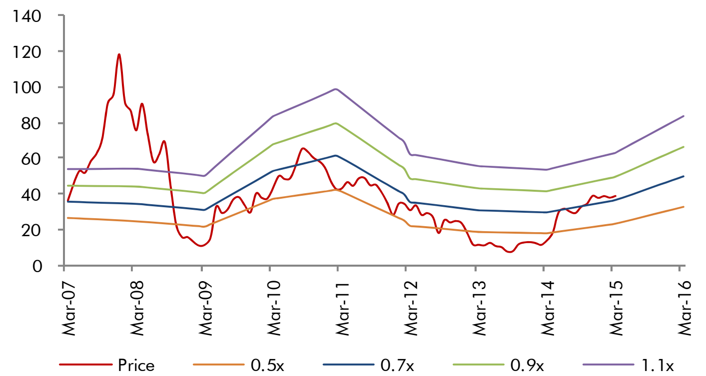
Exhibit 32: 1-year forward P/E (x)



Source: Company, Angel Research

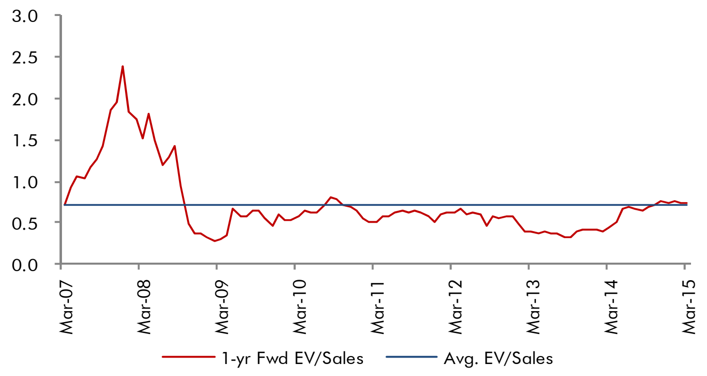
Given that ACE is more of a turnaround story, we did a check to assess whether the assigned target P/E multiple justifies the target price. ACE's stock is alternatively trading at FY2016E and FY2017E EV/sales multiple of 0.8x and 0.6x, respectively. We assign a multiple of 0.75x to our target FY2017E EV/sales to arrive at a FY2017E based price target of ₹54/share. This translates into FY2017E based implied P/E multiple of 14.0x.

Exhibit 33: 1-year forward EV/Sales band



Source: Angel Research

Exhibit 34: 1-year forward EV/Sales (x)



Source: Angel Research

We are optimistic that ACE would be able to maintain its numero uno position in the domestic Pick and Carry cranes business. This, when coupled with a wide range of product offerings, wide pan-India distribution network, along with their recent cost cutting initiatives, comforts us. We estimate ACE to report an 18.8% and 170.0% top-line and bottom-line CAGR, respectively, during FY2015-17E. Accordingly, we expect the RoE to improve from 1.3% in FY2014 to 11.3% in FY2017E. **At the backdrop of sharp growth in profitability and RoE expansion, we assign 14.0x P/E multiple to our FY2017E EPS estimate of ₹3.9/share to arrive at a price target of ₹54. Given the 28.4% upside in the stock from the current levels, we initiate coverage on the stock with a BUY rating.**

Profit and Loss Statement

Y/E March (₹ cr)	FY11	FY12	FY13	FY14	FY15E	FY16E	FY17E
Net Sales	**694**	**856**	**668**	**615**	**594**	**660**	**839**
% Chg	*59.8*	*23.4*	*(21.9)*	*(7.9)*	*(3.3)*	*11.0*	*27.1*
Total Expenditure	**634**	**804**	**639**	**591**	**577**	**629**	**770**
Cost of Raw Mat. Consumed	476	667	530	491	475	522	656
Purchase of Stock-in-trade	47	33	5	1	2	2	3
Employee benefits Expense	33	45	49	46	48	52	58
Other Expenses	79	59	56	52	52	53	53
EBITDA	**59**	**52**	**29**	**24**	**18**	**31**	**69**
% Chg	*46.2*	*(13.1)*	*(43.9)*	*(16.6)*	*(26.8)*	*74.7*	*122.6*
EBIDTA %	*8.6*	*6.0*	*4.3*	*3.9*	*3.0*	*4.7*	*8.2*
Depreciation	7	11	14	15	10	13	14
EBIT	**52**	**40**	**15**	**9**	**8**	**18**	**54**
% Chg	*65.9*	*(23.2)*	*(61.9)*	*(42.2)*	*(12.2)*	*129.7*	*204.2*
Interest and Fin. Charges	4	7	10	10	12	10	8
Other Income	5	5	5	7	11	5	4
PBT	54	37	10	5	7	13	50
Tax	14	10	4	1	2	3	11
% of PBT	*25.3*	*26.4*	*37.3*	*21.4*	*23.0*	*23.0*	*23.0*
PAT before Exceptional item	41	28	6	4	5	10	38
Exceptional item	0	0	0	0	0	0	0
PAT	**41**	**28**	**6**	**4**	**5**	**10**	**38**
% Chg	*69.5*	*(32.1)*	*(76.6)*	*(37.6)*	*30.4*	*93.5*	*276.8*
PAT %	*5.9*	*3.2*	*1.0*	*0.7*	*0.9*	*1.5*	*4.6*
Basic EPS	4.4	2.8	0.7	0.4	0.5	1.0	3.9
Diluted EPS	4.4	2.8	0.7	0.4	0.5	1.0	3.9
% Chg	*69.5*	*(32.1)*	*(76.6)*	*(37.6)*	*30.4*	*93.5*	*276.8*

Balance Sheet

Y/E March (₹ cr)	FY11	FY12	FY13	FY14	FY15E	FY16E	FY17E
Sources of Funds							
Equity Capital	19	20	20	20	20	20	20
Reserves Total	249	278	284	288	292	300	335
Networth	**267**	**298**	**303**	**308**	**312**	**319**	**355**
Total Debt	72	141	149	141	121	107	104
Other Long-term Liabilities	3	3	4	4	5	5	5
Deferred Tax Liability	1	3	5	5	5	5	5
Total Liabilities	**343**	**445**	**461**	**458**	**443**	**436**	**469**
Application of Funds							
Gross Block	174	260	297	333	338	358	379
Accumulated Depreciation	22	33	46	65	75	88	102
Net Block	**152**	**227**	**251**	**268**	**263**	**270**	**277**
Capital WIP	3	5	10	2	0	0	0
Investments	**8**	**10**	**16**	**15**	**19**	**7**	**1**
Current Assets							
Inventories	121	136	143	161	148	161	200
Sundry Debtors	83	86	83	68	65	69	84
Cash and Bank Balance	24	20	17	14	13	4	3
Loans, Advances & Deposits	46	41	29	29	32	36	46
Current Liabilities	153	147	160	163	164	178	209
Net Current Assets	**121**	**135**	**112**	**108**	**93**	**92**	**124**
Other Assets	58	67	72	65	68	68	68
Total Assets	**343**	**445**	**461**	**458**	**443**	**436**	**469**

Cash Flow Statement

Y/E March (₹ cr)	FY11	FY12	FY13	FY14	FY15E	FY16E	FY17E
Profit before tax	54	38	11	5	7	13	50
Depreciation	7	11	14	15	10	13	14
Change in Working Capital	(52)	(25)	12	7	11	(10)	(34)
Interest & Financial Charges	4	7	10	10	12	10	8
Direct taxes paid	(12)	(15)	(5)	(1)	(2)	(3)	(11)
Cash Flow from Operations	**(0)**	**16**	**42**	**37**	**38**	**23**	**26**
(Inc)/ Dec in Fixed Assets	(30)	(73)	(42)	(25)	(6)	(20)	(22)
(Inc)/ Dec in Inv. & Int. reced.	(2)	(0)	(3)	5	0	15	8
Cash Flow from Investing	**(32)**	**(73)**	**(45)**	**(20)**	**(6)**	**(5)**	**(13)**
Issue/ (Buy Back) of Equity	21	0	0	0	0	0	0
Inc./ (Dec.) in Loans	41	72	11	(7)	(20)	(14)	(3)
Dividend Paid (Incl. Tax)	(21)	(11)	(2)	(2)	(2)	(3)	(3)
Interest Expenses	(4)	(7)	(10)	(10)	(12)	(10)	(8)
Cash Flow from Financing	**37**	**54**	**(2)**	**(19)**	**(34)**	**(26)**	**(14)**
Inc./(Dec.) in Cash	5	(3)	(4)	(2)	(2)	(8)	(1)
Opening Cash balances	**19**	**24**	**21**	**17**	**15**	**13**	**4**
Closing Cash balances	**24**	**21**	**17**	**15**	**13**	**4**	**3**

Key Ratios

Y/E March	FY11	FY12	FY13	FY14	FY15E	FY16E	FY17E
Valuation Ratio (x)							
P/E (on FDEPS)	9.6	15.1	64.7	103.7	79.5	41.1	10.9
P/CEPS	8.2	10.7	20.8	21.6	27.6	18.0	7.9
Dividend yield (%)	5.5	0.6	0.6	0.3	0.4	0.6	0.6
EV/Sales	0.6	0.6	0.8	0.9	0.9	0.8	0.6
EV/EBITDA	7.3	10.2	18.4	22.0	28.7	16.6	7.5
EV / Total Assets	1.3	1.2	1.2	1.2	1.1	1.2	1.1
Per Share Data (₹)							
EPS (Basic)	4.4	2.8	0.7	0.4	0.5	1.0	3.9
EPS (fully diluted)	4.4	2.8	0.7	0.4	0.5	1.0	3.9
Cash EPS	5.1	3.9	2.0	1.9	1.5	2.3	5.3
DPS	2.3	0.2	0.2	0.1	0.2	0.3	0.3
Book Value	29	30	31	31	32	32	36
Returns (%)							
RoCE (Pre-tax)	21.4	11.5	4.7	3.4	4.2	5.3	13.1
Angel RoIC (Pre-tax)	17.1	10.2	4.6	3.5	4.3	5.3	12.6
RoE	18.5	9.8	2.1	1.3	1.7	3.2	11.3
Turnover ratios (x)							
Asset Turnover (Gross Block) (x)	5.3	3.9	2.4	1.9	1.8	1.9	2.3
Inventory / Sales (days)	47	55	76	90	95	85	79
Receivables (days)	35	36	46	45	41	37	33
Payables (days)	49	42	50	66	71	66	61
WC days	33	49	73	69	65	56	51
Leverage Ratios (x)							
D/E ratio (x)	0.3	0.5	0.5	0.5	0.4	0.3	0.3
Interest Coverage Ratio (x)	16.4	6.1	2.0	1.5	1.6	2.4	7.0

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Disclosure of Interest Statement	**Action Construction Equipment**
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	No
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors

Ratings (Based on expected returns over 12 months investment period):	*Buy (> 15%)*	*Accumulate (5% to 15%)* *Reduce (-5% to -15%)*	*Neutral (-5 to 5%)* *Sell (< -15*