

16 May 2021

## Kirloskar Oil Engines

*Strong performance, attractive valuations; maintaining a Buy*

Rating: Buy

Target Price: Rs297

Share Price: Rs210

**Driven by healthy performance in all divisions (except Large Engines), Kirloskar Oil Engines reported the best revenue of Rs9.1bn in Q4 FY21 (ARe Rs8.4bn). This was on the back of recovery in Powergen, the highest-ever sales in the Industrials division (partially led by pre-buying of BS-III engines) and strong growth in Agricultural and Product Support. With the government's focus on infrastructure development, Atma-Nirbhar and a strong pick-up of end-user demand, management expects a double-digit revenue growth in the next few years. We raise our FY22e/ FY23e earnings by 15%/23%. We maintain our Buy rating, with a higher TP of Rs297 (15x FY23e), earlier Rs193.**

**Better-than-expected pick-up in PG:** Except for Railways, all PG's major segments recovered notably (better than expected). PG revenue was up 20% y/y (ARe 8%) to Rs3.5bn. Agri/industrial revenues were largely in line at Rs1.75bn/Rs2.1bn. Continued growth momentum is expected in Industrials, led by higher engine volumes, while agriculture growth would be driven by product launches and deeper penetration. With rising demand and the upbeat outlook, we raise our FY22e/FY23e revenue 4%/10%.

**Margins could see near-term impact:** On cost efficiencies and better cost control, EBITDAM jumped 313bps to 12.8%. Some costs (travel, A&P, etc.) are expected to return with normality, leading to a slight dip in the margin. Also, higher commodity prices could dent near-term margins, addressed through price hikes and greater cost efficiencies due to higher volumes.

**Valuations:** The stock trades at 13x/11x FY22e/23e earnings. Aided by recovery in the PG category and an optimistic outlook in Industrials and Agriculture, we increase our FY22e/FY23e earnings 15%/23%. We expect revenue/PAT CAGRs of 14%/19%, over FY21-23. We have raised our target multiple to 15x, arriving at a revised TP of Rs297 (earlier Rs193), and retain a Buy. **Risks:** Less demand than expected; negative margin surprise.

Key data	KOEL IN / KROL.BO
52-week high / low	Rs220 / 94
Sensex / Nifty	48733 / 14678
3-m average volume	\$0.8m
Market cap	Rs30bn / \$414.3m
Shares outstanding	145m

Shareholding pattern (%)	Mar'21	Dec'20	Sep'20
Promoters	59.4	59.4	59.4
- of which, Pledged	-	-	-
Free float	40.6	40.6	40.6
- Foreign institutions	6.2	10.3	10.2
- Domestic institutions	14.1	10.5	11.8
- Public	20.2	19.8	18.5

Estimates revision (%)	FY22e	FY23e
Revenue	4.3	9.6
EBITDA	16.9	22.4
EPS	15.0	23.0

### Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY19	FY20	FY21	FY22e	FY23e
Sales (Rs m)	36,264	33,795	32,961	37,246	43,121
Net profit (Rs m)	2,746	1,852	1,950	2,349	2,863
EPS (Rs)	16.3	12.0	13.9	16.2	19.8
PE (x)	10.7	17.6	15.1	12.9	10.6
EV / EBITDA (x)	4.5	9.1	6.9	6.4	5.3
PBV (x)	1.5	1.7	1.6	1.5	1.3
RoE (%)	14.4	10.0	11.0	11.7	13.1
RoCE (%)	18.1	12.0	13.3	12.7	14.2
Dividend yield (%)	2.9	3.1	1.9	2.2	2.7
Net debt / equity (x)	-0.5	-0.2	-0.2	-0.2	-0.2

Source: Company, Anand Rathi Research

**Ashwani Sharma**  
Research Analyst

**Rahul Jain**  
Research Associate

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## Quick Glance – Consolidated Financials and Valuations

**Fig 1 – Income statement (Rsm)**

Year-end: Mar	FY19	FY20	FY21	FY22e	FY23e
Power gen	13,320	12,600	9,660	10,626	12,539
Net revenues	36,264	33,795	32,961	37,246	43,121
<i>Growth (%)</i>	18.7	-6.8	-2.5	13.0	15.8
Material cost	26,199	21,422	20,500	23,614	27,338
Employee & other exps.	6,329	9,425	8,604	9,407	10,772
<b>EBITDA</b>	<b>3,736</b>	<b>2,948</b>	<b>3,857</b>	<b>4,225</b>	<b>5,010</b>
<i>EBITDA margins (%)</i>	10.3	8.7	11.7	11.3	11.6
- Depreciation	944	873	840	872	899
Other income	651	351	265	363	379
Interest expenses	130	142	501	576	663
PBT	3,314	2,283	2,781	3,140	3,827
<i>Effective tax rate (%)</i>	28.8	23.1	26.7	25.2	25.2
+ Eol	550	165	-84	-	-
Net income	2,746	1,852	1,950	2,349	2,863
Adjusted income	2,361	1,728	2,012	2,349	2,863
WANS	145	145	145	145	145
FDEPS (Rs / sh)	16.3	12.0	13.9	16.2	19.8
<i>EPS growth (%)</i>	73.3	-26.8	16.4	16.7	21.9

**Fig 3 – Cash-flow statement (Rsm)**

Year-end: Mar	FY19	FY20	FY21	FY22e	FY23e
PBT	3,864	2,448	2,697	3,140	3,827
+ Non-cash items	422	665	1,076	1,085	1,183
Oper. prof. before WC	4,286	3,113	3,773	4,225	5,010
- Incr./ (decr.) in WC	896	-5,008	-1,887	-2,252	-1,894
Others incl. taxes	-1,151	-634	-691	-791	-964
Operating cash-flow	4,031	-2,529	1,195	1,182	2,152
- Capex (tang. +intang.)	-665	-837	-1,366	-377	-819
Free cash-flow	3,367	-3,366	-171	805	1,333
Acquisitions	-	-	-	-	-
- Div. (incl. buyback & taxes)	872	1,133	578	675	823
+ Equity raised	-	-	-	-	-
+ Debt raised	-580	679	5,375	400	400
- Fin investments	360	-2,786	4,010	100	500
- Misc. (CFI + CFF)	275	-476	-541	222	215
Net cash-flow	1,281	-558	1,157	207	195

Source: Company, AnandRathi Research

**Fig 5 – Price movement**



Source: Bloomberg

**Fig 2 – Balance sheet (Rs m)**

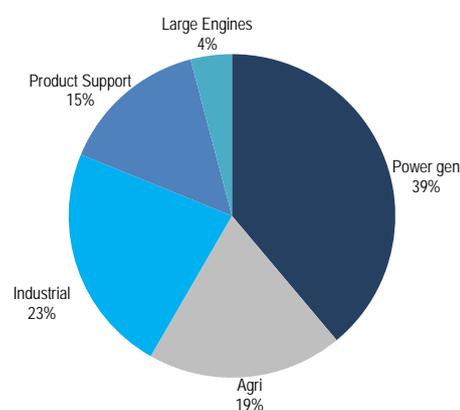
Year-end: Mar	FY19	FY20	FY21	FY22e	FY23e
Share capital	289	289	289	289	289
Net worth	16,986	17,452	19,221	20,895	22,934
Debt	815	1,494	6,868	7,268	7,668
Minority interest	-	-	-	-	-
DTL/(Assets)	187	121	153	153	153
<b>Capital employed</b>	<b>17,987</b>	<b>19,066</b>	<b>26,243</b>	<b>28,316</b>	<b>30,755</b>
Net tangible assets	3,998	3,773	4,116	3,556	3,411
Net intangible assets	1,020	1,085	1,254	1,319	1,384
Goodwill	1,845	1,845	1,845	1,845	1,845
CWIP (tang.&intang.)	179	303	317	317	317
Investments (strategic)	0	743	479	529	529
Investments (financial)	7,112	3,583	7,857	7,907	8,407
Current assets (ex cash)	9,816	14,831	19,517	21,854	24,329
Cash	1,984	1,426	2,583	2,790	2,985
Current liabilities	7,967	8,522	11,724	11,800	12,452
Working capital	1,849	6,309	7,793	10,053	11,878
<b>Capital deployed</b>	<b>17,987</b>	<b>19,066</b>	<b>26,243</b>	<b>28,316</b>	<b>30,755</b>
Contingent liabilities	-	-	-	-	-

**Fig 4 – Ratio analysis**

Year-end: Mar	FY19	FY20	FY21	FY22e	FY23e
P/E (x)	10.7	17.6	15.1	12.9	10.6
EV / EBITDA (x)	4.5	9.1	6.9	6.4	5.3
EV / Sales (x)	0.5	0.8	0.8	0.7	0.6
P/B (x)	1.5	1.7	1.6	1.5	1.3
RoE (%)	14.4	10.0	11.0	11.7	13.1
RoCE (%) - after tax	18.1	12.0	13.3	12.7	14.2
RoIC (%) - after tax	29.8	18.1	17.3	17.5	19.0
DPS (Rs /sh)	5.0	6.5	4.0	4.7	5.7
Dividend yield (%)	2.9	3.1	1.9	2.2	2.7
Dividend payout (%) - incl. DDT	31.8	61.2	29.7	28.8	28.8
Net debt / equity (x)	-0.5	-0.2	-0.2	-0.2	-0.2
Receivables (days)	41	45	49	49	44
Inventory (days)	31	44	42	41	39
Payables (days)	49	49	75	64	59
CFO: PAT %	170.8	-146.3	59.4	50.3	75.2

Source: Company, Anand Rathi Research

**Fig 6 – Revenue mix (Q4 FY21)**



Source: Company

## Result Highlights

**Fig 7 – Revenue mix**

(Rs m)	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Y/Y (%)
Power gen	3,000	3,140	3,400	3,060	3,260	2,940	830	2,360	2,950	3,520	19.7
Agri	1,580	1,360	1,450	1,150	1,190	1,140	860	1,330	1,710	1,750	53.5
Industrials	1,650	1,640	1,460	1,190	1,120	1,290	640	1,430	1,820	2,070	60.5
Product support	1,040	1,230	1,070	1,060	1,040	1,070	540	1,110	1,110	1,330	24.3
Large engines	420	530	210	290	530	560	280	330	300	370	(33.9)

Source: Company

**Fig 8 – Cost and EBITDA-margin trends**

(Rs m)	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Y/Y (%)
Material cost	5,124	5,078	5,091	4,456	4,730	4,462	2,044	4,222	5,241	5,925	32.8
Employee cost	537	560	535	573	570	500	446	418	557	567	13.3
Other expenditure	1,419	1,470	1,291	1,368	1,351	1,453	759	1,222	1,242	1,479	1.8
<b>% of sales</b>											<b>bps y/y</b>
Material cost	66.2	63.7	66.5	65.2	65.5	62.8	63.8	63.8	65.7	64.8	199
Employee cost	6.9	7.0	7.0	8.4	7.9	7.0	13.9	6.3	7.0	6.2	(84)
Other expenditure	18.3	18.4	16.9	20.0	18.7	20.4	23.7	18.5	15.6	16.2	(427)
<b>EBITDA margins (%)</b>	<b>8.6</b>	<b>10.8</b>	<b>9.6</b>	<b>6.4</b>	<b>7.9</b>	<b>9.7</b>	<b>(1.4)</b>	<b>11.4</b>	<b>11.8</b>	<b>12.8</b>	<b>313</b>

Source: Company

**Fig 9 – Quarterly-result trend**

	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Y/Y (%)
Sales	7,743	7,968	7,651	6,833	7,221	7,106	3,204	6,617	7,977	9,146	28.7
EBITDA	663	860	734	436	570	691	(45)	756	938	1,175	70.0
PAT	420	921	441	275	427	466	(108)	472	606	831	78.4

Source: Company

**Fig 10 – Quarterly and annual performance**

(Rsm)	Q4 FY21	Q4 FY20	Y/Y (%)	Q3 FY21	Q/Q (%)	FY21	FY20	Y/Y (%)
Net revenue	9,146	7,106	28.7	7,977	14.7	26,944	28,775	(6.4)
EBITDA	1,175	691	70.0	938	25.2	2,823	2,418	16.8
EBITDA margins (%)	12.8	9.7	313bps	11.8	109bps	10.5	8.4	208bps
Other Income	81	94	(13.1)	66	23.1	260	374	(30.5)
Depreciation	170	163	4.9	153	11.4	622	666	(6.7)
Interest	13	13	(0.8)	27	(51.3)	64	38	66.5
Profit before Tax	1,073	609	76.2	824	30.2	2,398	2,087	14.9
Tax	262	143	83.3	218	20.1	617	548	12.5
Reported PAT	727	466	56.0	606	19.9	1,697	1,704	(0.4)
Adjusted PAT	831	466	78.4	606	37.1	1,801	1,609	11.9
<b>Net margins (%)</b>	<b>9.1</b>	<b>6.6</b>	<b>253bps</b>	<b>7.6</b>	<b>149bps</b>	<b>6.7</b>	<b>5.6</b>	<b>110bps</b>

Source: Company

## Concall Highlights

### Q4 FY21 update

Revenue was up ~29% y/y to Rs9.1bn, led by good performances in all divisions (except institutional and project solutions, i.e. ITS). The low base due to the lockdown in the last week of Mar'20 also helped. Domestic business grew 31% y/y to Rs8.4bn in Q4 FY21; international was up 7% y/y to Rs660m. The growth momentum in various countries continued in Q4 FY21. The company generated Rs5.3bn cash-flow in FY21 from operations vs. Rs2.3bn the year prior. Liquidity continues strong.

### Q1 FY22 could see supply and production impact

On the better rainfall expected, rural demand should be healthy. On the supply side, there could be some loss of production and sales in Q1 FY22, due to local lockdowns. Delays in raw-material supplies and shortage of manpower would further aggravate the impact on business performance. However, all other plants are operational, except at Nashik.

### Rising input cost partly passed on

The EBITDA margin expanded 313bps y/y to 12.8% in Q4 FY21, largely due to cost savings and price rises. Costs, post-Covid, however (selling and administrative), would go up with the business slowly returning to normal. The company effectively managed higher input costs by increasing prices, and it is in talks with OEMs to raise prices further in order to absorb the higher costs. In Q3 FY21, the company hiked prices 6-7%, with water management prices up 8-9%, power-gen and industrials 5-5.5%. In Jan, it passed on 75% of the cost increase in the industrials, power gen and water management divisions. It would continue to pass on the costs in power gen and water management. While, on the industrials side, it finds it difficult to pass on price increases due to BS4 (already higher prices than BS3). Hence pricing pressure in the industrials category would continue.

### The Power Generation (PG) division

Demand has stabilised for the UHHP product range (750kVA, 900kVA and 1,000kVA), which is well accepted in the market, thereby growing 50% y/y in FY21. The company is among the top two in UHHP and is the leader in LHP and MHP. The near-term impact due to the second Covid-19 wave could eat into growth. However, the overall medium to longer term growth is intact with various opportunities in construction and infrastructure in the country. The company targets 9-9.5% growth in its PG business.

### The Industrials division

Kirloskar expected Apr and May'21 to be slow for BS3, but all the pre-demand purchasing was completed by mid-Apr. The transition to BS4 was completed with OEMs, and demand should come from April. The strategy to supply fire-fighting products to export markets has turned out very well with a 40% market share in the Middle East and the company will target a similar market share in the US and LatAM. Tractor engines have been continuously in great demand. Thus the company delivered the highest volumes to its biggest OEMs and the open market in FY21.

### The Agriculture division

In farm mechanisation, the company has 90% products localised and it will be using its own engines. The power tiller performance is the best in the industry. Weeders has a 40%+ market share. Along with the current diesel weeders, the company would offer a petrol range from this quarter, thereby completing the entire range of weeders. This range would be offered even to small and marginal farmers, and further help gain market share. The company has also launched a combined innovative product of weeders and reapers. This will be cost-effective for farmers compared to being purchased separately at very high cost. Electric pump revenue break-up: KOEL Rs490m in Q4, Rs1.3bn in FY21; LGM Rs1.6bn in Q4, Rs5.2bn in FY21. Power tiller volumes increased from 900 units in Q4 FY20 to 1,339 in Q4 FY21 and revenue rose from Rs140m to Rs203m.

### The Large Engines division

This business declined 34% y/y due to the closure of many customer premises and delayed decisions. In fishing boat-engines, its market share grew to 25%. It has a healthy order book of ~Rs1bn.

### New-emission transitions progressing well

- CPCB4+ - Management expects the timeline for the transition to be Jul'22. Prices can rise by more than 20-30% due to new technologies.
- Q4 FY21 saw the transition to BS4. KOEL hit the market on completing 25,000+ field trials, leading to the successful transition to BS4. BS3 pre-demand buying was robust in Q3, and carried on to Q4 with healthy weekly ordering from OEMs. BS4 prices have stabilised to great extent and the company is seeing better demand than anticipated.

### ArkaFincorp

Revenue increased from Rs480m in FY20 to Rs1,020m in FY21. KOEL infused Rs1.2bn in ARKA in FY21. At end-Mar'21 it total investment in Arka was Rs6.5bn. AUM grew from Rs4.5bn in FY20 to Rs11.2bn in FY21. Of this, the mid-corporate segment accounted for 55%, real estate and allied activities 40% and 5% from SME and MSME. Of the real estate and allied activities, real estate made up Rs3.8bn and allied activities, Rs710m. KOEL has invested Rs6.5bn till end-Mar'21 and the Board has capped the investment at Rs10bn. Hence, in the next 2-3 years it will be investing Rs3.5bn.

### Planned capex toward high-growth segments

In this decade, the company's capex focus would be on new emission norms and launching a new range. It will then spend on R&D for its water management solutions and would have a dedicated plant for this, targeting global and domestic markets. With greater traction in farm mechanisation, it will launch products targeting small and marginal farmers, investing Rs750bn-1,000bn a year in these areas in the next 2-3 years. It would also invest in inorganic opportunities.

### La-Gajjar Machineries (LGM)

LGM's sales in Q4 FY21 grew ~52%; for FY21 they were up 12% y/y to Rs5.2bn. PBT was Rs267m in FY21 vs. Rs233m in FY20. All segments delivered healthy growth in Q4 (retail, exports, OEMs and the government). Retail and exports grew 14% and 17% y/y, respectively, in FY21, while OEMs declined a marginal 3% y/y. The company's efforts to capture market share in water management has helped it grow in double digits in FY21 compared to the overall market declining. Margin pressure was seen due to the migration to Oracle (a one-time impact in Q3 and Q4) and copper prices have significantly moved up. The passing on of prices is not yet fully done. Due to the lag of 2-3 months passing on prices, the margin could continue to be hit, though, temporarily. The exports contribution to revenue was 25%, mostly from Africa and the Middle East (a 10%+ market share). It targets to increase the exports share to 35-40% over the next three years.

LGM has formed a wholly-owned subsidiary, Optiqua Pipes and Electricals Pvt. Ltd. in Feb'21 to tap market opportunities in the allied segment and adjacencies in the water-management vertical. There was no material transaction in Q4 as it was formed in Feb'21. Optiqua bought an Ahmedabad-based 'Optiflex' in a slump sale, at an enterprise value of Rs150m, for which the company took on debt of Rs110m and the net assets were Rs40m. Optiflex sells winding electrical wires used in submersible pumps, flat cables, poly-coated tapes and UPVC column pipes. This will strengthen Optiqua's position in electrical pumps and would help in extending its offerings to the entire value chain in electric pumps. Optiflex also has synergies with KOEL in water management.

### KOEL Americas Corporation

Revenue went up from \$2.5m in FY20 to \$3.8m in FY21. PBT of \$116,000 in 2021 vs. \$129,000 the previous year. Growth was driven by the agriculture and industrials divisions.

### Other key highlights

- The company aims to reduce its revenue dependence on engines from 80% now to 60% in the next 3-5 years.
- R&D – To focus on providing CNG and PNG engines in the next two years led by transitioning toward these products before moving to other newer technologies.
- Dividend payout would be maintained at the current level.
- B2C accounted for 30% of FY21 revenue. B2C sales of electric pumps was 70-80%, the rest was to OEMs and the government. most of the business in farm mechanisation comes from B2C.
- Exports – The company aims to increase export revenue to 20% in coming years, from 9% in FY21.
- Growth guidance for the next 2-3 years: 15-20% y/y in all its divisions.

## Valuation

We raise our FY22e/23e earnings 15/23%, mainly due to higher revenue and EBITDA growth. The EBITDA margin (%) is expected to be in the similar range of FY21, with a small contraction expected in FY22 due to commodity price headwinds and some costs returning with normalcy. Over FY21-23, we expect revenue/PAT to register CAGRs of 14%/19%.

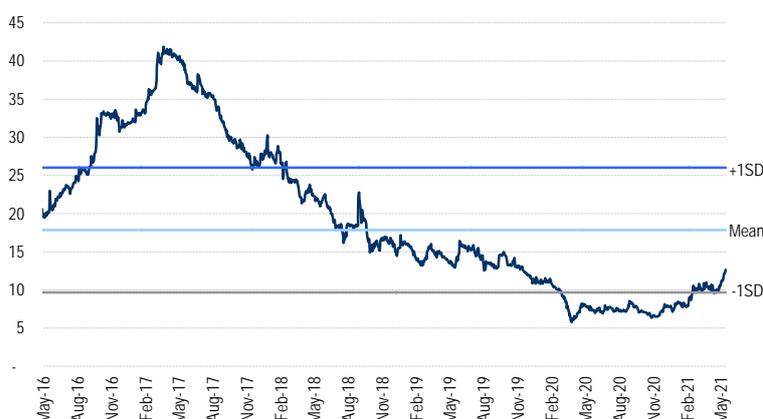
We believe the company would be a beneficiary from the government's focus on infrastructure, rising private sector confidence in the domestic market and increasing product acceptance internationally. Hence, with the brighter demand outlook in the industrials and agriculture divisions and improvement in PG, we have raised our target multiple to 13x for FY23e earnings. The stock trades at 13x/11x FY22e/23e earnings. We retain our Buy rating on it with a higher TP of Rs297 (15x FY23e), earlier Rs193.

**Fig 11 – Change in estimates**

(Rs m)	Old estimates		Revised Estimates		Change %	
	FY22	FY23	FY22	FY23	FY22	FY23
Revenue	35,724	39,344	37,246	43,121	4.3	9.6
EBITDA	3,615	4,094	4,225	5,010	16.9	22.4
EPS (Rs)	14.1	16	16.2	19.8	15.0	23.0

Source: Company, Anand Rathi Research

**Fig 12 – One-year-forward PER**



Source: Bloomberg, Anand Rathi Research

### Key risks

- Negative surprise on margins.
- Less-than-anticipated demand.

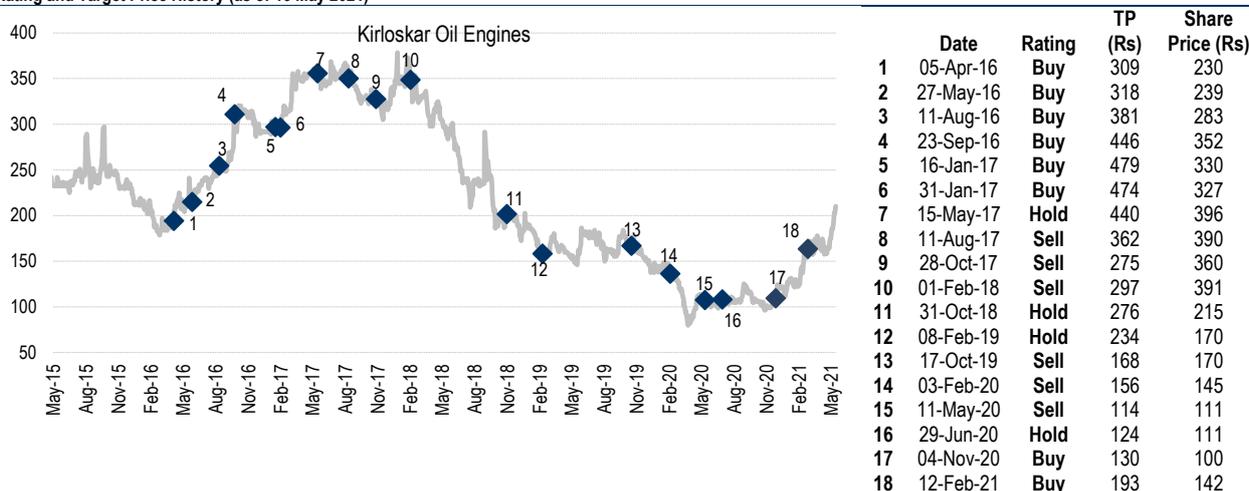
## Appendix

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#### Ratings Guide (12 months)

	Buy	Hold	Sell
Large Caps (>US\$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US\$1bn)	>25%	5-25%	<5%

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