

4 November 2020

## Kirloskar Oil Engines

*Strong performance, attractive valuations; upgrading to a Buy*

Rating: **Buy**

Target Price: Rs130

Share Price: Rs100

Driven by 21%/16%/14% y/y growth in industrials, agriculture and large engine, Kirloskar Oil Engines' Q2 FY21 Rs6.6bn revenue was better than expected (ARe: Rs5.7bn). Power generation revenue fell 23% y/y to Rs2.4bn (ARe: Rs2.6bn), mainly due to lower MHP sales. Other segments in PG have started seeing traction and the overall PG business was 80% of last year's levels. The company expects the situation for PG to improve gradually. Exports were up 8% y/y aided by fire-fighting equipment. With likely improvement in the PG business and healthy traction in the other segments, we upgrade our rating to a Buy, with a higher TP of Rs130 (12x FY22e), earlier Rs124.

**Better traction for PG, industrials in H2:** PG has begun picking up (demand now at 80% of last year). 100% is expected in Q3 and double-digit growth in Q4. Greater traction is being seen in the LHP, HHP and UHP segments; MHP is likely to be slow in H2. Agri business revenue grew 16% largely on a 47% y/y jump in power tiller volumes. Tractors picked up, as expected, rising 60% and demand in other industrials improved. Accordingly, we raise our FY21e revenue 2.5%.

**Margins surprised positively:** On cost efficiencies and better cost control, the EBITDA margin jumped 500bps to 11.4%. Some part of costs (travel, A&P spends, etc.) is expected to return with the rise in business activity. Management said the H2 FY21 EBITDA margin would be similar to last year's. We raise our FY21e/FY22e EBITDA margin 130bps/50bps.

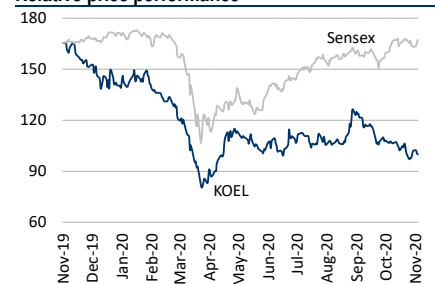
**Valuations:** The stock trades at 11x/9x FY21e/22e earnings. Aided by gradual recovery in the PG category and an optimistic outlook on the industrials and agri divisions, we upgrade our rating to a Buy with a higher target price of Rs130, earlier Rs124. **Key Risks:** More-than-expected delays in a pick-up in demand; negative surprise on the margin front.

Key data	KOEL IN / KROL.BO
52-week high / low	Rs180 / 70
Sensex / Nifty	40616 / 11909
3-m average volume	\$0.3m
Market cap	Rs14bn / \$193.3m
Shares outstanding	145m

Shareholding pattern (%)	Sep'20	Jun'20	Mar'20
Promoters	59.4	59.4	59.4
- of which, Pledged			
Free float	40.6	40.6	40.6
- Foreign institutions	10.2	10.3	10.3
- Domestic institutions	11.8	12.6	12.7
- Public	18.5	17.7	17.6

Estimates revision (%)	FY21	FY22e
Revenue	2.5	0.0
EBITDA	19.7	6.2
EPS	26.8	5.2

### Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY18	FY19	FY20	FY21e	FY22e
Sales (Rs m)	30,555	36,264	33,795	29,030	32,116
Net profit (Rs m)	1,362	2,746	1,879	1,302	1,566
EPS (Rs)	9.4	16.3	11.6	9.0	10.8
PE (x)	41.4	10.7	8.6	11.1	9.2
EV / EBITDA (x)	19.0	4.5	3.8	3.6	3.1
PBV (x)	3.6	1.5	0.8	0.8	0.8
RoE (%)	8.5	14.4	9.7	7.3	8.5
RoCE (%)	12.0	18.1	12.0	8.9	10.3
Dividend yield (%)	1.9	2.9	6.5	4.9	5.9
Net debt / equity (x)	-0.4	-0.5	-0.2	-0.3	-0.3

Source: Company, Anand Rathi Research

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## Quick Glance – Consolidated Financials and Valuations

**Fig 1 – Income statement (Rs m)**

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
Power gen	12,410	13,320	12,600	9,576	11,012
Net revenues	30,555	36,264	33,795	29,030	32,116
Growth (%)	14.3	18.7	-6.8	-14.1	10.6
Material cost	22,082	26,199	21,422	18,608	20,650
Employee & other exps.	5,817	6,329	9,500	7,867	8,564
<b>EBITDA</b>	<b>2,656</b>	<b>3,736</b>	<b>2,873</b>	<b>2,555</b>	<b>2,902</b>
EBITDA margins (%)	8.7	10.3	8.5	8.8	9.0
- Depreciation	1,233	944	873	951	986
Other income	718	651	425	299	349
Interest expenses	116	130	142	163	172
PBT	2,025	3,314	2,283	1,739	2,093
Effective tax rate (%)	32.7	28.8	26.7	25.2	25.2
+ Eol	-	550	165	-	-
Net income	1,362	2,746	1,879	1,302	1,566
Adjusted income	1,362	2,361	1,673	1,302	1,566
WANS	145	145	145	145	145
FDEPS (Rs / sh)	9.4	16.3	11.6	9.0	10.8
EPS growth (%)	-21.6	73.3	-29.1	-22.2	20.3

**Fig 3 – Cash-flow statement (Rs m)**

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
PBT	2,025	3,864	2,447	1,739	2,093
+ Non-cash items	631	422	590	815	808
Oper. prof. before WC	2,656	4,286	3,038	2,555	2,902
- Incr./ (decr.) in WC	-1,256	896	-5,008	956	-563
Others incl. taxes	-560	-1,151	-634	-438	-527
Operating cash-flow	840	4,031	-2,604	3,073	1,811
- Capex (tang. +intang.)	-2,162	-665	-837	-679	-935
Free cash-flow	-1,323	3,367	-3,441	2,394	876
Acquisitions	-	-	-	-	-
- Div. (incl. buyback & taxes)	1,305	872	1,133	714	859
+ Equity raised	-	-	-	-	-
+ Debt raised	1,270	-580	679	150	-50
- Fin investments	-3,130	360	-2,786	50	100
- Misc. (CFI + CFF)	1,269	275	-551	-149	-178
Net cash-flow	503	1,281	-558	1,929	45

Source: Company, Anand Rathi Research

**Fig 5 – Price movement**


Source: Bloomberg

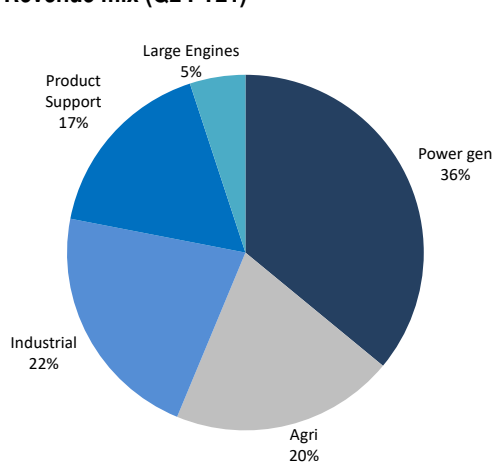
**Fig 2 – Balance sheet (Rs m)**

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
Share capital	289	289	289	289	289
Net worth	15,755	16,986	17,452	18,039	18,747
Debt	1,395	815	1,494	1,644	1,594
Minority interest	-	-	-	-	-
DTL / (Assets)	220	187	121	121	121
<b>Capital employed</b>	<b>17,369</b>	<b>17,987</b>	<b>19,066</b>	<b>19,804</b>	<b>20,461</b>
Net tangible assets	4,137	3,998	3,773	3,436	3,320
Net intangible assets	1,160	1,020	1,085	1,150	1,215
Goodwill	1,845	1,845	1,845	1,845	1,845
CWIP (tang.&intang.)	180	179	303	303	303
Investments (strategic)	0	0	743	793	843
Investments (financial)	6,752	7,112	3,583	3,583	3,633
Current assets (ex cash)	10,222	9,816	14,831	12,895	14,079
Cash	703	1,984	1,426	3,355	3,400
Current liabilities	7,630	7,967	8,522	7,555	8,176
Working capital	2,592	1,849	6,309	5,339	5,902
<b>Capital deployed</b>	<b>17,369</b>	<b>17,987</b>	<b>19,066</b>	<b>19,804</b>	<b>20,461</b>
Contingent liabilities	1,171	-	-	-	-

**Fig 4 – Ratio analysis**

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
P/E (x)	41.4	10.7	8.6	11.1	9.2
EV / EBITDA (x)	19.0	4.5	3.8	3.6	3.1
EV / Sales (x)	1.6	0.5	0.3	0.3	0.3
P/B (x)	3.6	1.5	0.8	0.8	0.8
RoE (%)	8.5	14.4	9.7	7.3	8.5
RoCE (%) - after tax	12.0	18.1	12.0	8.9	10.3
RoIC (%) - after tax	19.0	29.8	17.3	11.6	14.2
DPS (Rs / sh)	7.5	5.0	6.5	4.9	5.9
Dividend yield (%)	1.9	2.9	6.5	4.9	5.9
Dividend payout (%) - incl. DDT	95.8	31.8	60.3	54.8	54.8
Net debt / equity (x)	-0.4	-0.5	-0.2	-0.3	-0.3
Receivables (days)	48	41	45	46	46
Inventory (days)	41	31	44	42	41
Payables (days)	64	49	49	46	47
CFO : PAT %	61.6	170.8	-155.7	236.1	115.7

Source: Company, Anand Rathi Research

**Fig 6 – Revenue mix (Q2 FY21)**


Source: Company

## Result Highlights

**Fig 7 – Revenue mix**

(Rs m)	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	yoy (%)
Power gen	3,740	3,440	3,000	3,140	3,400	3,060	3,260	2,960	830	2,360	(22.9)
Agri	1,320	1,120	1,580	1,360	1,450	1,150	1,190	1,140	860	1,330	15.7
Industrial	1,650	1,550	1,650	1,640	1,460	1,190	1,120	1,290	640	1,430	20.2
Product Support	1,020	1,030	1,040	1,230	1,070	1,060	1,040	1,070	540	1,110	4.7
Large Engines	420	430	420	530	210	290	530	560	280	330	13.8

Source: Company

**Fig 8 – EBITDA-margin trend**

(Rs m)	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	yoy (%)
Material Cost	5,512	4,997	5,124	5,078	5,091	4,456	4,730	4,462	2,044	4,222	(5.3)
Employee Cost	516	545	537	560	535	573	570	500	446	418	(27.1)
Other Expenditure	1,358	1,420	1,419	1,470	1,291	1,368	1,351	1,470	759	1,222	(10.7)
<b>% of sales</b>											
Material Cost	67.2	65.6	66.2	63.7	66.5	65.2	65.5	62.8	63.8	63.8	
Employee Cost	6.3	7.2	6.9	7.0	7.0	8.4	7.9	7.0	13.9	6.3	
Other Expenditure	16.6	18.6	18.3	18.4	16.9	20.0	18.7	20.7	23.7	18.5	
EBITDA margin (%)	9.9	8.6	8.6	10.8	9.6	6.4	7.9	9.5	(1.4)	11.4	

Source: Company

**Fig 9 – Quarterly-result trend**

	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21
Sales	8,200	7,620	7,743	7,968	7,651	6,833	7,221	7,106	3,204	6,617
EBITDA	814	658	663	860	734	436	570	674	(45)	756
PAT	496	412	420	921	441	275	427	466	(108)	472

Source: Company

**Fig 10 – Quarterly results**

(Rs mn)	Q2 FY21	Q2 FY20	Y/Y (%)	Q1 FY21	Q/Q (%)	H1 FY21	H1 FY20	Y/Y (%)
Net Revenue	6,617	6,833	(3.2)	3,204	106.5	9,822	14,484	(32.2)
EBITDA	756	436	73.4	-45	-	710	1,170	(39.3)
EBITDA Margin (%)	11.4	6.4		-1.4		7.2	8.1	
Other Income	64	98	(34.4)	48	33.0	112	211	(46.8)
Depreciation	151	164	(7.9)	148	2.2	298	335	(11.1)
Interest	18	13	41.4	5	248.1	23	21	
Profit before Tax	651	357	82.3	-150	-	501	1,025	(51.1)
Tax	179	152	17.4	-42	(528.3)	137	379	
Reported PAT	472	205	130.5	-108	-	364	646	(43.6)
Adjusted PAT	472	205	130.5	-108	-	364	646	(43.6)
Net Margin (%)	7.1	3.0		-3.4		3.7	4.5	

Source: Company

## Concall Highlights

### PG business: H2 to be better y/y

Kirloskar Oil Engines' retail, corporate and institutional categories are indicating early signs of recovery, and secondary sales are growing m/m. LHP and HHP are seeing greater traction. The domestic HHP and UHP categories have a good order book for the next 3-4 months. The MHP category (30-200kVA) pickup is less than management expected.

In its overall business, the company has achieved 80% of last year, It expects 100% in Q3 and double-digit growth in Q4 FY21 and FY22 on healthy momentum in infrastructure projects (new airports, ports, roads); data centres and industrial expansions (greenfield and brownfield).

On the i-Green product, the company continues to be the market leader with significant improvements in IoT activations and is getting encouraging responses from customers. In railways, remote monitoring has been activated for all gensets on moving power cars.

### Agri division: Robust Q2 performance

- Power tiller volumes jumped 47% y/y to 1,694. The company's market share in power tillers is now 16% (up 100bps y/y). The market has grown 30%+, while the company has grown 44%. The order book is currently healthy. After import restrictions, the company started procuring components indigenously and initial trails are positive.
- Farm mechanisation products grew 11% y/y in H1 FY21 and were profitable in Q2. Management hopes profitability will continue in coming quarters.
- Electric pumps' standalone revenue grew from Rs190m a year ago to Rs220m in Q2 FY21.

### Firefighting equipment aided exports in Q2

Exports grew 8% y/y largely due to healthy business in GCC and SE Asia. The PG category was 25% lower y/y and weak across Middle East and SE Asia. Firefighting engines introduced recently are aiding growth in exports. The company has started getting orders for firefighting products from Europe and the US.

### New emission transitions progressing well

BS-4 is expected to be in place from 1<sup>st</sup> Apr'21 in terms of production, but sales could go up till Sep'21. Management said the company is prepared for the transition and its equipment has crossed 12,000 running hours (the highest) in recent trials. It said that only 35% industrial engines are eligible for emission change; the rest don't fall within the emission-change ambit.

It expects better volumes from Dec'20 to Apr and prices to rise 25-40% post-Aug'21. Transition to CPCB4+ is expected to be announced in the next 2-3 months and management expects this to be implemented by 1<sup>st</sup> Apr'22, thereby allowing for a one-year window for implementation. It said that transition to BS-4 would help to easily shift to CPCB4+ norms, as there is an overlap of 70-75% of the work.

### KOEL Americas Corp

Sale grew 89% y/y in Q2 FY21 and 18% y/y in H1 FY21 (in dollars). Growth in Q2 was due to the agri and industrials divisions. The company had a healthy order book at the start of Q3. The outlook is optimistic.

**ArkaFincap**

- The company invested Rs454m in ArkaFincap; Total investment on 30<sup>th</sup> Sep'20 was Rs5.7bn.
- With Covid-led uncertainties, Arka is lending cautiously. On a lower base, revenue was up 120% y/y. Of its ~Rs8bn loan book, 38% is to real estate, 62% to corporate bodies. The loan book grew 20% y/y and it expects to add Rs3bn-3.5bn in H2. It recently started MSME lending.
- Debt on Sep'20 was Rs5.5bn; current AUM (loans, NCDs, CP) was Rs11.3bn (Mar'20: ~Rs4.5bn).
- It has a healthy Treasury book of Rs3.2bn.

**Other key highlights**

- The tractor category in industrials grew 60% y/y. Good demand was seen in tractor. Sales of tractor engine in Q2 FY21 were one of the highest in recent times.
- Large engines grew 14% y/y.
- In fisheries, its market share in boat engines grew to 25% (FY20 was 12%).
- Steel price increase. About 50-55% raw material are indexed quarterly. The company should see a marginal impact in Q3. In Q4, however, it would be more affected. Passing on the higher prices would be difficult in the industrial category. In the PG category, it could increase prices in Q4.

## Valuation

Revenue growth would be driven by greater demand in power gen, which, we believe, is likely to be gradual. However, higher growth is expected in the industrial, agri and large-engine divisions, which we believe would provide the required cushion to the overall impact of the present uncertainty. Also, investment in its non-core business (ArkaFincap) would aid revenue and profitability in coming quarters. Based on the above, we have upgraded Kirloskar Oil Engines to a Buy with a target price of Rs130.

**Fig 11 – Change in estimates**

(Rs m)	Old estimates		Revised Estimates		Change %	
	FY21e	FY22e	FY21e	FY22e	FY21e	FY22e
Revenue	28,321	32,116	29,030	32,116	2.5	0.0
EBITDA	2135	2731	2,555	2,902	19.7	6.2
EPS (Rs)	7.1	10.3	9.0	10.8	26.8	5.2

Source:

**Fig 12 – One-year-forward PER**



Source: Bloomberg, Anand Rathi Research

### Key risks

- Negative surprise on margins.
- Greater volumes of MHP gensets.

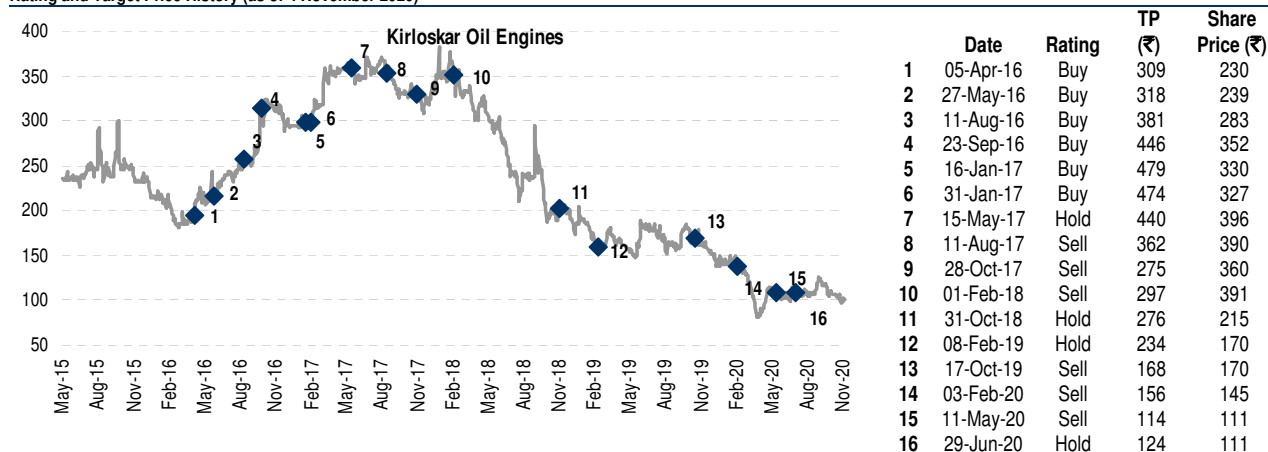
## Appendix

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