

16 August 2021

Kirloskar Oil Engines

Second wave hit Q1, though outlook still bright; maintaining a Buy

Rating: Buy

Target Price: Rs.297

Share Price: Rs.232

On a lower base, except large engines, all Kirloskar Oil divisions grew in Q1 FY22, though less than expected on the more than anticipated second wave impact. Revenue was Rs6.5bn. Post-June, business began to pick up and recovery would be stronger from Q2. Lower capacity utilisation, higher raw material prices and an unfavourable product mix led to the lower EBITDA margin to 7.6%. We believe passing of raw-material cost, cost controls and greater productivity will improve the margin. With the government's focus on infrastructure, Atma Nirbhar and a strong end-user-demand pick-up, we expect better growth in the medium to longer term. We reduce our FY22e margin slightly, maintaining a Buy with a target price of Rs297 (15x FY23e).

Second wave hit Q1. Though y/y up 102%, Q1 revenue (Rs6.5bn) was below our est. as the second wave impacted the initial part of the quarter. Power generation sales was up 219% y/y to Rs2.6bn. Agri revenue was Rs1.3bn, up 53% y/y. Industrials/customer support sales were Rs1.3bn/Rs904m. Large-engine sales declined 4% y/y to Rs273m. Expecting revenue to recover in coming quarters, we keep our estimates unchanged.

Margin impact, more than expected. We expected the Q1 EBITDA margin to be q/q lower, because of growth being curbed by the second wave. Higher RM costs and lower productivity, though, were more than we expected, leading to a weak 7.6% EBITDA margin. We believe improvement will be seen in coming quarters, driven by higher sales and prices passed on. Hence, we lower our FY22e EBITDA just 2.3%.

Valuations. The stock trades at 15x/12x FY22e/23e earnings. We expect 14.4%/19% revenue/PAT CAGRs over FY21-23. The strategic focus on reducing dependence on engines over the longer term and launches in diverse segments augurs well, leading to better diversification into segments and markets. We maintain our Buy on the stock with a TP of Rs297 (15x FY23e).

Risks: Less demand than expected; negative margin surprise.

Key financials (YE Mar)	FY19	FY20	FY21	FY22e	FY23e
Sales (Rs m)	36,264	33,795	32,961	37,254	43,129
Net profit (Rs m)	2,746	1,852	1,950	2,252	2,845
EPS (Rs)	16.3	12.0	13.9	15.6	19.7
P/E (x)	10.7	18.7	16.0	14.3	11.3
EV / EBITDA (x)	4.5	9.7	7.4	7.1	5.8
P/BV (x)	1.5	1.8	1.7	1.5	1.4
RoE (%)	14.4	10.0	11.0	11.2	13.0
RoCE (%)	18.1	12.0	13.3	12.3	14.2
Dividend yield (%)	2.9	2.9	1.8	2.0	2.5
Net debt / equity (x)	-0.5	-0.2	-0.2	-0.1	-0.1

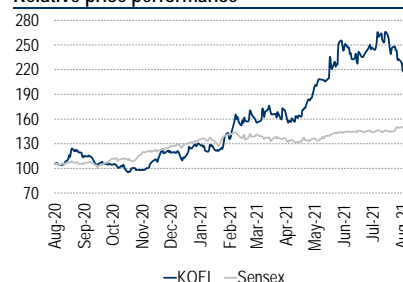
Source: Company, Anand Rathi Research

Key data	KOEL IN / KROL.BO
52-week high / low	Rs.278 / 94
Sensex / Nifty	55583 / 16563
3-m average volume	\$1.2m
Market cap	Rs.33bn / \$447.9m
Shares outstanding	145m

Shareholding pattern (%)	Jun'21	Mar'21	Dec'20
Promoters	59.4	59.4	59.4
- of which, Pledged			
Free float	40.6	40.6	40.6
- Foreign institutions	6.3	6.2	10.3
- Domestic institutions	13.8	14.1	10.5
- Public	20.5	20.2	19.8

Estimates revision (%)	FY22e	FY23e
Revenue	0.0	0.0
EBITDA	-2.6	0.0
EPS	-3.9	0.0

Relative price performance



Source: Bloomberg

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Quick Glance – Consolidated Financials and Valuations

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY19	FY20	FY21	FY22e	FY23e
Power gen	13,320	12,600	9,655	10,621	12,532
Net revenues	36,264	33,795	32,961	37,254	43,129
Growth (%)	18.7	-6.8	-2.5	13.0	15.8
Material cost	26,199	21,422	20,500	23,731	27,343
Employee & other exps.	6,329	9,425	8,604	9,408	10,773
EBITDA	3,736	2,948	3,857	4,115	5,012
EBITDA margins (%)	10.3	8.7	11.7	11.0	11.6
- Depreciation	944	873	840	883	911
Other income	651	351	265	355	365
Interest expenses	130	142	501	576	663
PBT	3,314	2,283	2,781	3,010	3,803
Effective tax rate (%)	28.8	23.1	26.7	25.2	25.2
+ Eol	550	165	-84	-	-
Net income	2,746	1,852	1,950	2,252	2,845
Adjusted income	2,361	1,728	2,012	2,252	2,845
WANS	145	145	145	145	145
FDEPS (Rs / sh)	16.3	12.0	13.9	15.6	19.7
EPS growth (%)	73.3	-26.8	16.4	11.9	26.3

Fig 3 – Cash-flow statement (Rs m)

Year-end: Mar	FY19	FY20	FY21	FY22e	FY23e
PBT	3,864	2,448	2,697	3,010	3,803
+ Non-cash items	422	665	1,076	1,104	1,209
Oper. prof. before WC	4,286	3,113	3,773	4,115	5,012
- Incr. / (decr.) in WC	896	-5,008	-1,887	-2,255	-1,894
Others incl. taxes	-1,151	-634	-691	-759	-958
Operating cash-flow	4,031	-2,529	1,195	1,101	2,160
- Capex (tang. + intang.)	-665	-837	-1,366	-682	-824
Free cash-flow	3,367	-3,366	-171	420	1,335
Acquisitions	-	-	-	-	-
- Div. (incl. buyback & taxes)	872	1,133	578	647	818
+ 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	229	228
Net cash-flow	1,281	-558	1,157	-157	189

Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 2 – Balance sheet (Rs m)

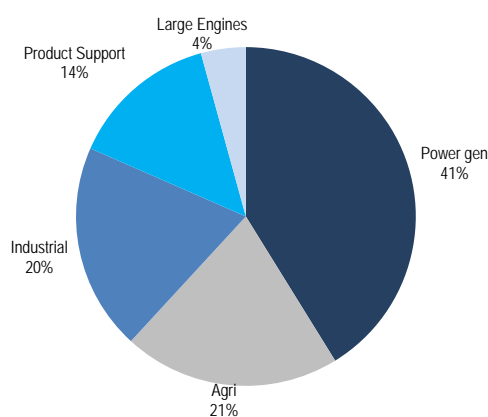
Year-end: Mar	FY19	FY20	FY21	FY22e	FY23e
Share capital	289	289	289	289	289
Net worth	16,986	17,452	19,221	20,826	22,852
Debt	815	1,494	6,868	7,268	7,668
Minority interest	-	-	-	-	-
DTL / (Assets)	187	121	153	153	153
Capital employed	17,987	19,066	26,243	28,247	30,674
Net tangible assets	3,998	3,773	4,116	3,849	3,697
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	21,858	24,334
Cash	1,984	1,426	2,583	2,426	2,615
Current liabilities	7,967	8,522	11,724	11,802	12,453
Working capital	1,849	6,309	7,793	10,056	11,880
Capital deployed	17,987	19,066	26,243	28,247	30,674
Contingent liabilities	-	-	-	-	-

Fig 4 – Ratio analysis

Year-end: Mar	FY19	FY20	FY21	FY22e	FY23e
P/E (x)	10.7	18.7	16.0	14.3	11.3
EV / EBITDA (x)	4.5	9.7	7.4	7.1	5.8
EV / Sales (x)	0.5	0.9	0.9	0.8	0.7
P/B (x)	1.5	1.8	1.7	1.5	1.4
RoE (%)	14.4	10.0	11.0	11.2	13.0
RoCE (%) - after tax	18.1	12.0	13.3	12.3	14.2
RoIC (%) - after tax	29.8	18.1	17.3	16.8	18.6
DPS (Rs / sh)	5.0	6.5	4.0	4.5	5.7
Dividend yield (%)	2.9	2.9	1.8	2.0	2.5
Dividend payout (%) - incl. DDT	31.8	61.2	29.7	28.8	28.8
Net debt / equity (x)	-0.5	-0.2	-0.2	-0.1	-0.1
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	48.9	75.9

Source: Company, Anand Rathi Research

Fig 6 – Revenue mix (Q1 FY22)



Source: Company

Result Highlights

Fig 7 – Revenue mix

(Rs m)	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	Y/Y (%)
Power generation	3,140	3,400	3,060	3,260	2,940	825	2,360	2,950	3,520	2,634	219.3
Agri	1,360	1,450	1,150	1,190	1,140	861	1,330	1,710	1,750	1,319	53.2
Industrials	1,640	1,460	1,190	1,120	1,290	637	1,430	1,820	2,070	1,263	98.3
Product support	1,230	1,070	1,060	1,040	1,070	541	1,110	1,110	1,330	904	67.1
Large engines	530	210	290	530	560	284	330	300	370	273	(3.9)

Source: Company

Fig 8 – Cost and EBITDA-margin trends

(Rs m)	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	Y/Y (%)
Material cost	5,078	5,091	4,456	4,730	4,462	2,044	4,222	5,241	5,925	4,458	118.1
Employee cost	560	535	573	570	500	446	418	557	567	489	9.6
Other expenditure	1,470	1,291	1,368	1,351	1,453	759	1,222	1,242	1,479	1,036	36.4
% of sales											bps y/y
Material cost	63.7	66.5	65.2	65.5	62.8	63.8	63.8	65.7	64.8	68.9	509
Employee cost	7.0	7.0	8.4	7.9	7.0	13.9	6.3	7.0	6.2	7.6	(637)
Other expenditure	18.4	16.9	20.0	18.7	20.4	23.7	18.5	15.6	16.2	16.0	(769)
EBITDA margins (%)	10.8	9.6	6.4	7.9	9.7	(1.4)	11.4	11.8	12.8	7.6	NA

Source: Company

Fig 9 – Quarterly-result trend

	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	Q3 FY21	Q4 FY21	Q1 FY22	Y/Y (%)
Sales	7,968	7,651	6,833	7,221	7,106	3,204	6,617	7,977	9,146	6,472	102.0
EBITDA	860	734	436	570	691	(45)	756	938	1,174	490	NA
PAT	921	441	275	427	466	(108)	472	606	831	245	NA

Source: Company

Fig 10 – Quarterly and annual performance

(Rs m)	Q1 FY22	Q1 FY21	Y/Y (%)	Q4 FY21	Q/Q (%)	FY21	FY20	Y/Y (%)
Net revenue	6,472	3,204	102.0	9,146	(29.2)	26,944	28,775	(6.4)
EBITDA	490	-45	NA	1,174	(58.3)	2,822	2,418	16.7
EBITDA margins (%)	7.6	-1.4	NA	12.8	-528bps	10.5	8.4	208bps
Other income	57	48	18.7	82	(30.3)	261	374	(30.3)
Depreciation	196	148	32.7	170	14.9	622	666	(6.7)
Interest	16	5	209.6	13	22.0	64	38	66.5
Profit before tax	335	-150	NA	1,073	(68.8)	2,398	2,087	14.9
Tax	90	-42	NA	262	(65.5)	617	548	12.5
Reported PAT	245	-108	NA	727	(66.3)	1,697	1,704	(0.4)
Adjusted PAT	245	-108	NA	831	(70.6)	1,801	1,609	11.9
Net margins (%)	3.8	-3.4	NA	9.1	-531bps	6.7	5.6	110bps

Source: Company

Concall Highlights

Second wave impacted sales during Q1

Though the initial part of the quarter was hit by the second wave, recovery was seen in June. The company made greater efforts to improve productivity and efficiencies, in cost controls and the faster supply of products. Still, standalone revenue rose 29% y/y to Rs6.5bn, less than we estimated. The company's focus on expanding its distribution network, widening its product range and greater efficiencies will continue.

Management is seeing traction from housing, healthcare, infrastructure and data centres. Except for large engines, all other engine categories grew. Electric pumps revenue was up 70% y/y, farm mechanization (tractors, tillers, weeders) grew 19% y/y and engines increased 112% y/y. A clear shift is being seen, with OEMs shifting sourcing from China to India, which is thereby a major beneficiary.

Margin to be better in Q2 FY22

The Q1 FY22 EBITDA margin contracted significantly to 7.6%, from 12.8% the prior quarter and a loss a year ago (due to lower productivity owing to the pandemic). The contraction was due to lower capacity utilisation, higher raw material prices and an unfavourable product mix (a 1% impact). The company could not pass on the 2-2.5% higher raw material price impact. This was partly done in Jul and Aug; hence, the higher raw-material prices will have a mere 1% impact on margins in Q2 FY22. The passing on the higher raw-material price is usually done with a lag of 1-1.5 months.

Strategic shifting focus to non-engine categories

The company has worked out a plan to reduce dependence on engines for revenue from 80% now to 60% in the next 4-5 years. Prime focused areas would be water management (already Rs10bn+ revenue) and allied domains (control panels, cables, pipes). The Optiqua Pipes & Electricals acquisition is in line with its focus on allied products. It will also be looking into induction motors (in connection with water solutions), and revenue should touch Rs1bn-1.5bn in the next 2-3 years.

The company is also looking at cleaner energy (emission norms, natural gas, biogas engines, petrol and hybrid engines). A bio-waste product is ready and will be launched with a fresh campaign in Aug. The category is very synergistic with the power-generation trade channel (distributors). The product look and feel is similar and margins too will be similar to those in power generation.

With regard to opportunities in power cars in railways, the company is focusing on transformers. Backup power for prime/co-generation products be for hybrid solutions. Water management has a similar distribution network to engines. Bio-waste products margins will be better than the company's traditional engine margins.

The Power Generation (PG) division

Revenue was up 249% y/y. The domestic PG market bounced back from June. Covid-related investments in regard to plants for oxygen concentrators and Covid hospitals have led to mounting demand. The medium HP order book has grown substantially. The UHHP division registered good growth and the company will be launching products; prototypes are ready and trials will soon start, followed by launches.

The Industrials division

Demand for industrial engines is strong with sales growing. Growth is expected during the year. BS IV saw a smooth ramp-up with all OEMs. Sales of fire-fighting pump-sets started in Q1 FY22. The Industrial division's revenue was Rs1.3bn (Rs440m from tractors in Q1 FY22, vs Rs220m a year ago).

The Agriculture division

The fastest-growing product in the Agriculture division has been electric pumps. 838 power tillers were sold in Q1 FY22 (1,133 a year ago), retail market sales grew y/y. Significant inroads into power weeders saw sales growing 81% y/y. The company has developed a new range of power tillers with 'K-cool' engines (LV 12, LV 15).

The Large Engines division

The large engine category declined 4% y/y. The Covid-19 second wave led to the shuttering of many customers' premises, curtailing execution. The fishing-boat engines' 25% market share, was maintained. On the healthy ~Rs1bn order book, the outlook is positive.

Exports

Exports registered good growth y/y. The PG and agri categories saw good demand and high growth y/y. The fire-fighting engines are well accepted in the UAE.

New-emission transitions progressing well

- BS IV. The company's BS-4 engines have been well accepted and much buying took place in Feb and Mar. Demand will be driven by sustainable government efforts on infrastructure, despite the pandemic.
- For implementation of CPCB4+, various bodies are working with companies in this industry. Oct'22 can be the expected time for implementation. However, due to the semi-conductor shortage, this may be delayed. Post-transition, prices are expected to jump 30-40%. For products above 30 kVA, the price rises can be absorbed by customers with project costing being done accordingly.

Arka Fincap

KOEL will investing Rs10bn in Arka Fincap over time. It invested Rs500m in Q1 FY22 (till Jun'21: Rs7bn). Revenue was Rs378m in Q1 FY22, growing 127% y/y. PAT was up 76% y/y to Rs62m. AUM at end-Jun'21 was Rs12.8bn (Rs11.2bn at end-Mar'21), of which the loan book was Rs11.9bn, followed by CP of Rs500m and NCDs of Rs450m. Arka has no asset-liability mismatch.

La-Gajjar Machinery (LGM)

Sales increased 64% y/y to Rs1.4bn in Q1 FY22, driven by performance from all segments (except government). The EBITDA margin was 5.6%. Optiqua started commercial sales in Q1 FY22.

KOEL Americas Corporation

Revenue was Rs89m, growing 337% y/y, led by agri sales in Central America, followed by gensets and air-cooled industrial engine sales in LatAM. Gensets and G-drive engine growth was healthy in the US in FY22. Opportunities in CBCP4+ and BS-IV are healthy and the company will be shifting to BS-V.

Other key highlights

- The data-centre market is growing rapidly. Earlier 750-2,000 kVA were being considered in this segment. Now, however, the larger portion of demand is coming for 1,500 kVA engines and above. The company is small in this market due to its limited range. However, with launches, it could see significant business here.
- The extended credit period has been reversed, rolled back to the earlier one. Hence, working capital required has increased, temporarily.
- The company has filed a patent for a product for hydrogen vehicles.
- **DB series sales volume:** High HP (above 750 kVA): 39 units, sales of Rs150m in Q1 FY22 (11 units, sales of Rs40m a year ago). Medium HP (320-625 kVA): 218 units, sales of Rs320m in Q1 FY22 (50 units, sales of Rs77m a year back).

Valuation

Due to the weaker Q1, we lower our FY22e margin 3%. However, we believe the margin would recover in ensuing quarters. With recovery post-Jun expected and pent-up demand in Q2, we have not changed our revenue estimates. Overall, we expect 14%/19% revenue/PAT CAGRs over FY21-23.

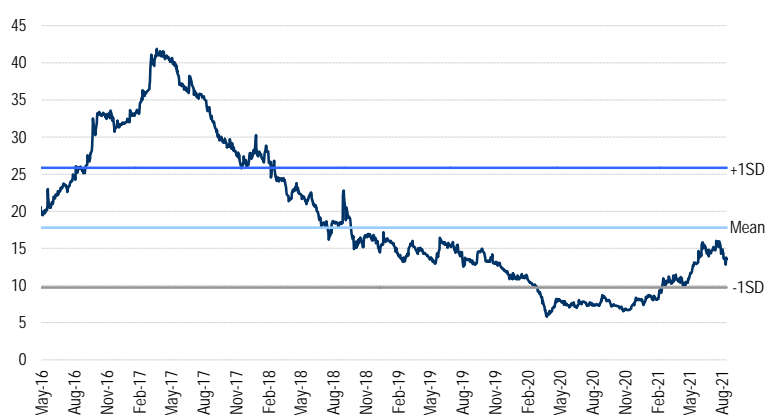
We believe the company would benefit from the government's focus on infrastructure, the rising private-sector confidence in the home market and greater product-acceptance internationally. With the company's strategic focus on reducing dependence on its engines division over the longer term, product launches in diverse segments augurs well for it, leading to better diversification into segments and markets. The stock trades at 15x/12x FY22e/23e earnings. We retain our Buy rating on it with a target price of Rs297 (15x FY23e).

Fig 11 – Change in estimates

(Rs m)	Old estimates		Revised Estimates		Change %	
	FY22	FY23	FY22	FY23	FY22	FY23
Revenue	37,254	43,121	37,254	43,129	0.0	0.0
EBITDA	4,225	5,010	4,115	5,012	-2.6	0.0
EPS (Rs)	16.2	19.7	15.6	19.7	-3.9	0.0

Source: Company, Anand Rathi Research

Fig 12 – One-year-forward PER



Source: Bloomberg, Anand Rathi Research

Key risks

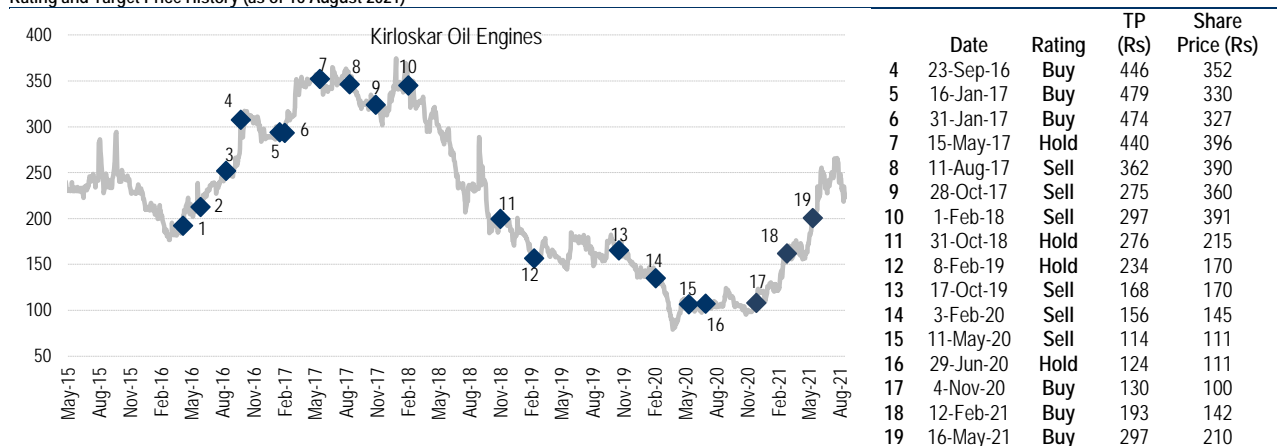
- Negative surprise on margins.
- Less-than-anticipated demand.

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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