Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Viewpoint

Company Update

Kirloskar Brothers Ltd

Well poised for further growth

Capital Goods	Sharekhan code: KIRLOSBROS
Reco/View: Positive ↔	CMP: Rs. 679
	Upside potential: 23% ↑

↑ Upgrade ↔ Maintain ↓ Downgrade

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral – Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

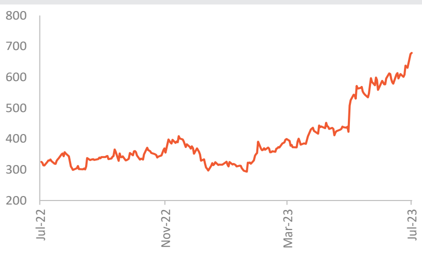
Company details

Market cap:	Rs. 5,398 cr
52-week high/low:	Rs. 685/286
NSE volume: (No of shares)	2.4 lakh
BSE code:	500241
NSE code:	KIRLOSBROS
Free float: (No of shares)	2.7 cr

Shareholding (%)

Promoters	66.0
FII	1.6
DII	9.3
Others	23.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	15.4	55.1	118.6	108.8
Relative to Sensex	10.8	46.4	109.2	87.0

Sharekhan Research, Bloomberg

Summary

- Kirloskar Brothers Limited's (KBL's) annual report review highlights strong demand from key user industries in both B2C and B2B segments. The company is also focused on expanding its product range to gain market share in India and overseas.
- Company continues to explore opportunities in irrigation, solar, nuclear power, and other emerging sectors.
- Its working capital cycle is also shrinking, while net asset turnover is high, debt is low and operating cash flows are rising.
- Despite a sharp run-up, KBL trades at an attractive valuation of ~18x FY2024E/~15x its FY2025E EPS. We expect Q1FY24E to be a strong quarter on all parameters and see potential upside of 23% from CMP.

Kirloskar Brothers Limited's (KBL's) annual report review highlights strong underlying demand from key domestic industries andexpansion of the company's product and services portfolio that would help it capture market share in both domestic and international markets. The company's strong position in the retail business with a market share of 10-14% and green energy offerings (energy-efficient pumps) bode well for growth. Its international order book also stands strong at Rs. 1,511 crore registering a growth of 36% y-o-y in FY23. The company has minimal exposure to low-margin and working capital-intensive EPC business. Hence, its working capital cycle, net asset turnover ratios improved considerably. Thus, a promising business outlook and multiple growth triggers make us positive on the stock.

- **Pumps biz gushes forth –** For FY23, the company's topline grew at a healthy pace, driven by a better product mix, recovery in key geographies and robust momentum in B2C pumps in the domestic market. Further, a reduced exposure to the engineering, procurement and construction (EPC) business (75% in FY10 to 5% in FY23) shortened the working capital cycle and cash flows. The company also diversified its presence in the water, power, and irrigation sectors. KBL is the only company to offer energy-efficient pumps with IE4 and IE5 motors, priced higher as compared to regular pumps. Although these pumps are costlier, the lifecycle cost of a pump comes down drastically due to energy savings. Hence, many players, particularly in the oil & gas space, are shifting to these pumps.
- **B2B space growing robustly -** In FY23, the water resources department received substantial orders from large OEMs and contractors in Uttar Pradesh, Rajasthan, and Uttarakhand. Furthermore, it secured a significant number of orders for the multi-stage pumps, split-case pumps and large VT pumps. Moreover, the solar power business is seeing growth in the institutional segment and the open market. In Irrigation, opportunities are likely to emerge in the large metallic volute pump (MVP) business as the government's river linkage programme to manage water resources is likely to pick up pace in the medium to long term. The building and construction segment grew by 25% y-o-y in FY23 and the company commissioned fire pumps at GMR Goa International Airport and Sabarmati High-Speed Rail depot, Ahmedabad. In power, KBL achieved a milestone by indigenously designing and manufacturing boiler feedwater pump for the Rajasthan Atomic Power Station (RAPP) nuclear power plant.
- **We expect Revenue/PAT CAGR of 11.5%/21% over FY23-FY25E -** Our revenue growth estimates are built in taking into account the higher base of FY2023. Going forward, we believe growth will be driven by a healthy standalone/consolidated order book of Rs. 1,820 crore/Rs. 2,888 crore for made-to-order and engineered-to-order products. Further, rising demand for energy efficient pumps in various industries such as oil & gas, irrigation and agriculture, power, and building and construction would drive demand for its standard pumps. Falling commodity prices, improvement in global supply chain as well as some of the cost-rationalization and the rising share of services revenue in the total overseas business would boost margins. Further, we expect balance sheet to strengthen further as debt declines, cash flows pick up and working capital cycle shortens. We build in a revenue/PAT CAGR of 11.5%/21% over FY23-FY25E.t.

Change in Estimates: We have maintained our estimates for FY24-FY25E.

Our Call

Valuation – Maintain Positive view; Expect 23% upside: KBL is leveraging its brand equity and has diversified its portfolio in the pumps industry to capitalize on the emerging opportunities in its key target industries, including sunrise sectors such as solar and nuclear. KBL is concentrating on building its competitiveness by new product launches and focusing on scaling its spares, services, and subscription platform and maintenance business, which would help counter the cyclicality and create a recurring revenue stream and upfront cash payments. We also expect its margin trajectory to improve, driven by healthy growth in revenues, stable commodity prices, improving supply chain, and increasing share of services business. Despite the sharp run-up in the stock since our viewpoint initiation in February, 2023, the stock trades at a reasonable valuation of ~18/~15x its FY2024E/FY2025E EPS. Hence, we maintain our Positive view on the stock and expect an upside of 23% from the current price levels as we expect its strong performance to continue backed by strong industry demand, product innovation and improvement in internal efficiencies.

Key Risks

- Fluctuations in raw-material prices (steel and cast iron) could adversely impact margins.
- Company has considerable exposure to international markets in terms of exports and international subsidiaries. Hence, forex fluctuations could impact profitability.
- High competition in the pumps industry is a key risk.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenue	3,058	3,730	4,178	4,637
OPM (%)	6.7	10.7	11.7	12.3
Adjusted PAT	94	235	294	350
% YoY growth	(41.4)	149.1	25	19.0
Adjusted EPS (Rs.)	11.9	30.1	37.0	44.0
P/E (x)	57.2	22.4	18.4	15.4
P/B (x)	25.8	13.0	10.3	8.4
EV/EBITDA (x)	4.6	3.8	3.3	2.8
RoNW (%)	8.3	18.7	19.2	19.4
RoCE (%)	9.1	17.8	18.6	18.9

Source: Company; Sharekhan estimates

Key annual report excerpts

Strong recovery in pumps space – Topline grew at a healthy pace in FY23 which was driven by an improved product mix, recovery in key geographies and robust momentum in B2C pumps in the domestic market. Further, its reduced exposure to the engineering, procurement and construction (EPC) business (75% in FY10 to 5% in FY23) helped improve working capital cycle and cash flows. The company also diversified its presence in the water, power, and irrigation sectors.

Sector-wise Order book break up (Rs. Crore)

Order Book	Q3FY22	Q4FY22	Q1FY23	Q2FY23	Q3FY23	Q4FY23
Irrigation + Water Resource Mgmt.	718	691	664	893	885	851
Power	490	485	491	486	473	504
Oil & Gas	68	69	91	91	86	71
Marine & Defence	76	63	83	61	53	42
Industry	111	128	137	146	125	102
Building & Construction	101	120	136	118	111	90
Customer Support & ESD	85	88	107	108	103	91
Valves	83	69	68	97	86	69
KBL Standalone Order Book	**1,732**	**1,713**	**1,777**	**2,000**	**1,922**	**1,820**
Subsidiaries Order Book	**614**	**757**	**834**	**848**	**923**	**1,068**
Total Orderbook	**2,346**	**2,470**	**2,611**	**2,848**	**2,845**	**2,888**

Sector-wise performance in FY23

Water - In FY23, the water resources department received substantial orders from large OEMs and contractors in Uttar Pradesh, Rajasthan, and Uttarakhand. Furthermore, it secured a significant number of orders for multi-stage pumps, split-case pumps and large VT pumps. The Company sold 79 units of value-added products. The company also bagged its largest-ever order, for nine large vertical turbine (VT) pumps. The solar business is experiencing growth in the institutional segment and the open market. The company's efforts in both the water and solar power segments have resulted in significant orders from large OEMs and mid-sized contractors.

Irrigation - In FY23, the company executed major irrigation projects in Uttar Pradesh, Madhya Pradesh, Gujarat and Odisha for large and medium-range VT pumps. Further, opportunities are likely to emerge in the large metallic volute pump (MVP) business as the government's river linkage programme to manage water resources is likely to pick up pace in the medium to long term.

Valves - In FY23, order intake improved considerably for valves due to increased government focus on providing clean drinking water and sanitation projects. Additionally, demand for large valves increased from irrigation projects. The exports in the Middle East also gained traction in FY23.

Building and construction – This segment grew by 25% y-o-y in FY23 and the company commissioned fire pumps at GMR Goa International Airport Limited and Sabarmati High-speed rail depot, Ahmedabad.

Industry - In FY23, industry growth was driven by steel, chemical, sugar and zero liquid discharge segments. Also, replacement business grew by 12-15% y-o-y. Additionally, orders for value-added products also increased in FY23. Moreover, focus on replacing old pumps with energy-efficient products also aided revenue growth in this segment.

Oil & Gas - Under its oil & gas segment, the company offers non-API pumps for upstream, midstream, and downstream applications, such as crude oil transfer, refinery processes and fertilisers. In FY23, the segment clocked a robust 29% y-o-y growth in sales, driven by robust demand from oil & gas sector, among others. The company's strong focus on innovation, quality and customer satisfaction has enabled it to establish a stronghold in both domestic and international markets. The company has a strong pipeline of orders and projects in the oil & gas sector.

Power - KBL secured significant orders in the thermal, hydel and nuclear sectors. KBL achieved a milestone by indigenously designing and manufacturing boiler feedwater pump for the Rajasthan Atomic Power Station (RAPP) nuclear power plant.

Small pumps - In FY23, increasing acceptance for energy saving products led to strong demand for KBL's energy efficient pumps.

Customer service support (CSS) - The CSS or engineered service division (ESD) achieved significant revenue growth of 24% y-o-y and order inflows increased by 11% y-o-y.

International business - The company's international business witnessed a strong surge in order intake and its order backlog was at its highest in FY23. Its international order book has increased by 36% y-o-y to reach Rs. 1,511 crore, which accounts for 50% of its total order book. The international addressable market for the company is valued at $40 billion in the US, UK, and Thailand.

Product launches to spur growth

KBL plans to sell its recently launched product - DBxe pump in the UK, Europe, the US, Africa, Southeast Asia, the Middle East and other countries in the Indian subcontinent. The company also supplied its first indigenously designed and manufactured boiler feed water pumps to the Rajasthan Atomic Power Station (RAPP), nuclear power plant in Rajasthan, India. The company spent KBL has 16,250 channel partners in India and 250 overseas.

Eyeing a robust Q1FY24

We expect Q1FY24 to be yet another strong quarter for the company as demand environment continues to be encouraging. Pricing action and volume growth would drive up revenues by ~16% y-o-y to ~Rs. 911 crore. Operating profit is expected to grow to Rs. 98 crore with 10.7% OPM. Net profit is expected to be Rs. ~57 crore for the quarter.

Results Preview Q1FY24

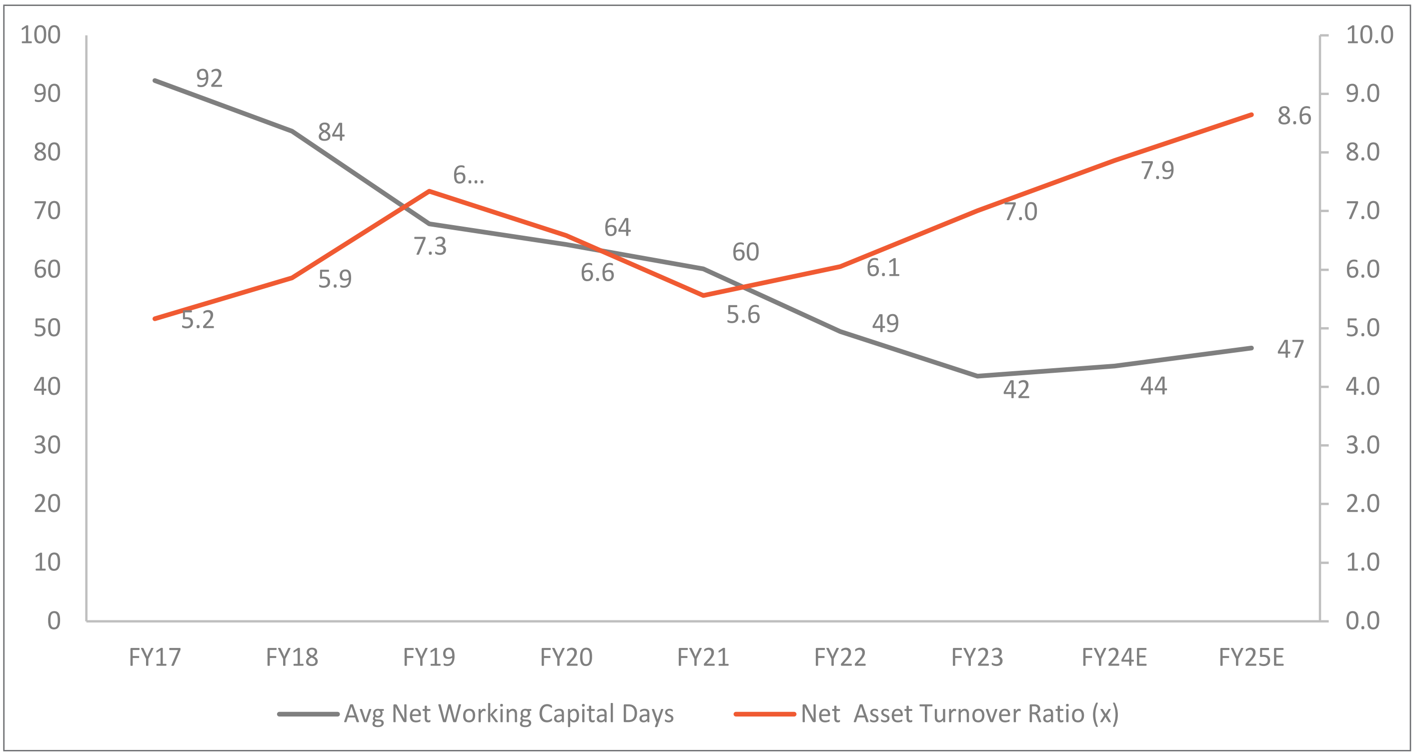
Particulars (Rs crore)	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)
Net Sales	911	784	16.2	1,125	-19.0
Operating Profit	97	41	138.9	145	-32.8
Adjusted PAT	57	16	265.6	101	-43.7
Adj. EPS (Rs.)	7.1	1.9	265.6	12.7	-43.7
Margin			**BPS**		**BPS**
OPM (%)	10.7	5.2	549.7	12.9	-220.2
NPM (%)	6.2	2.0	424.4	9.0	-273.3
Tax rate (%)	31.0	38.0	-695.9	31.4	-39.2

Source: Company; Sharekhan Research

Low working capital cycle and improving turnover ratio

At the end of FY2023, debt stood at Rs. 253 crore (down ~25% y-o-y), which is largely utilised towards working capital requirements. The company has a cash and bank balance of Rs. 253 crore. Inventory levels are a tad high at around 127 days (but reduced from 135 days in FY22); however, the total average net working capital is around 42 days.

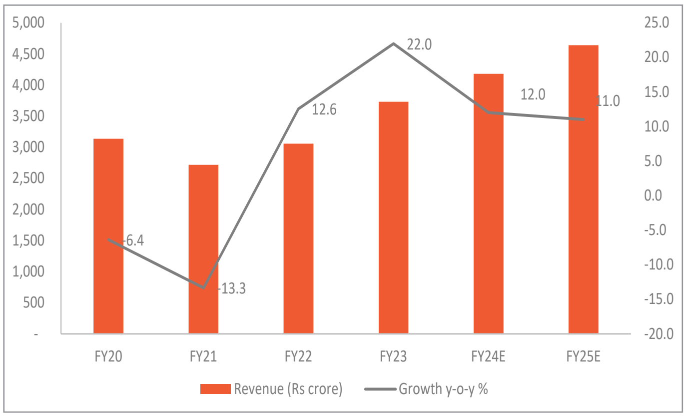
Improving asset turnover (x) and working capital days



Source: Company; Sharekhan Research

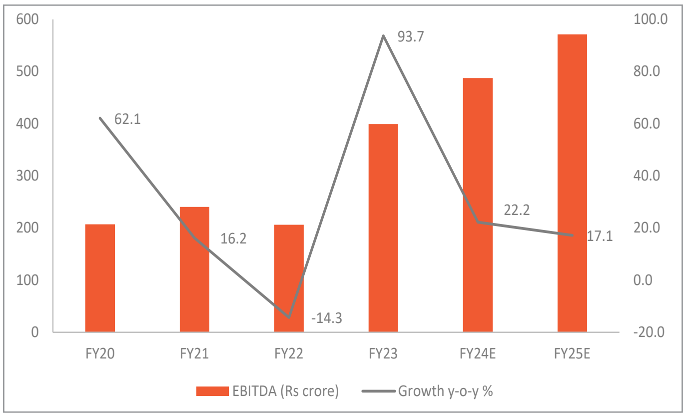
Financials in charts

Revenue and growth trend



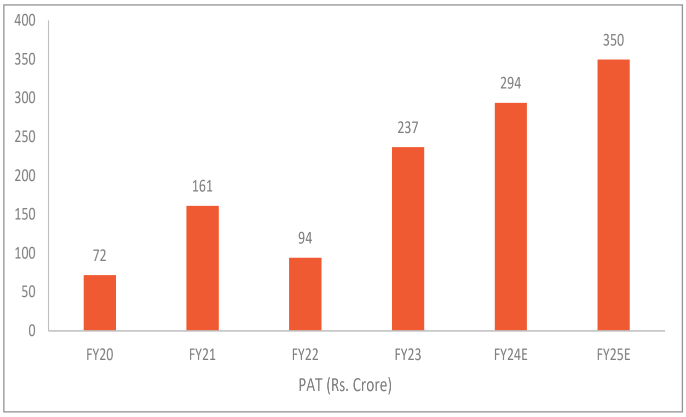
Source: Company, Sharekhan Research

EBITDA and growth trend



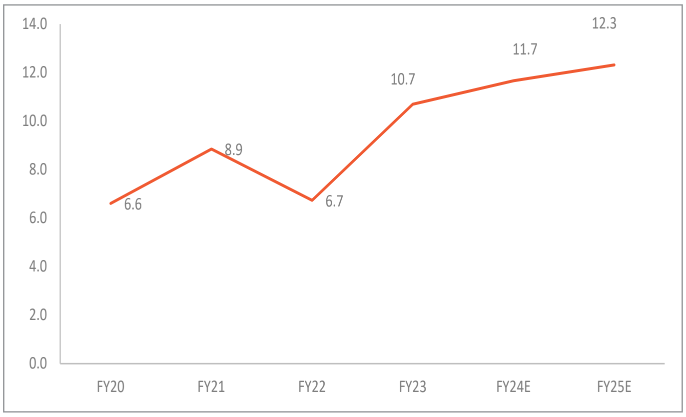
Source: Company, Sharekhan Research

PAT trend



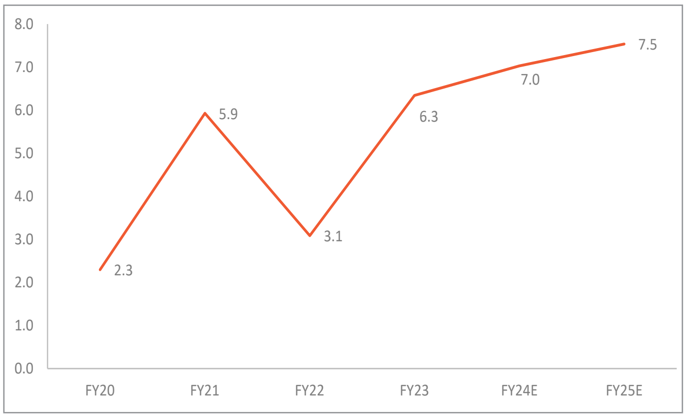
Source: Company, Sharekhan Research

EBITDA margin (%) trend



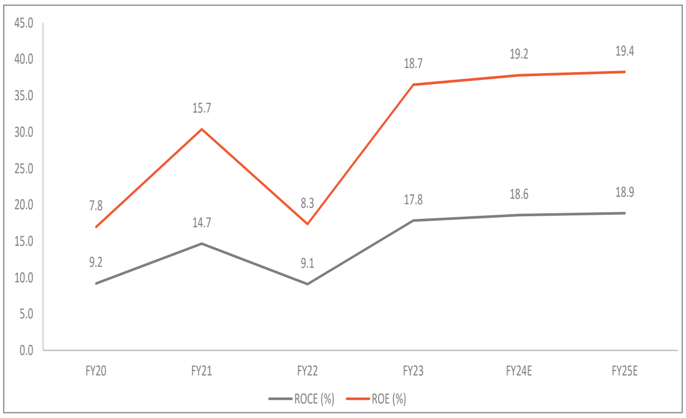
Source: Company, Sharekhan Research

PAT margin (%) trend



Source: Company, Sharekhan Research

Return ratios trend



Source: Company, Sharekhan Research

Outlook and Valuation

Sector View – Pumps industry to benefit from domestic and global capex upcycle

The global pumps industry is $46 billion and India contributes less than US$2 billion to the total market. Global demand for pumps has increased as economic recovery has led to a rise in demand. Among industries, oil and gas saw demand recovery on account of global refinery capacity expansion. Further, initiation of water and waste-water treatment projects by many countries has resulted into requirement for pumps. Demand is likely to increase from the power sector as the recent energy crisis has compelled many countries to take up capacity expansion. Moreover, the need for energy-efficient pumps, primarily driven by the need to save energy costs, is also likely to drive demand for pumps. As far as the domestic pumps market is concerned, the Indian pump market is seeing a significant demand surge, driven by government spending on large infrastructure projects, including irrigation, water transport, water and waste-water treatment plants, roads, and tunnels. Investments in industries like chemical and petrochemical, textile, foods and beverage, steel, and coal would also lead to higher demand for pumps. Further, on the residential side, demand for fire-fighting and smart water circulation pumping systems has been strong. Moreover, recent budgetary announcements/allocations towards rural infrastructure development, irrigation, and water supply would spur demand for pumps. The domestic pumps industry is highly fragmented and there are 4-5 key players in the organised pumps market such as KBL, KSB Limited, Sulzer, Shakti Pumps, and Crompton Greaves Consumer Electricals. We believe KBL, being one of the top players in the pumps and valves industry, is well positioned to capitalise on the emerging domestic and international opportunities.

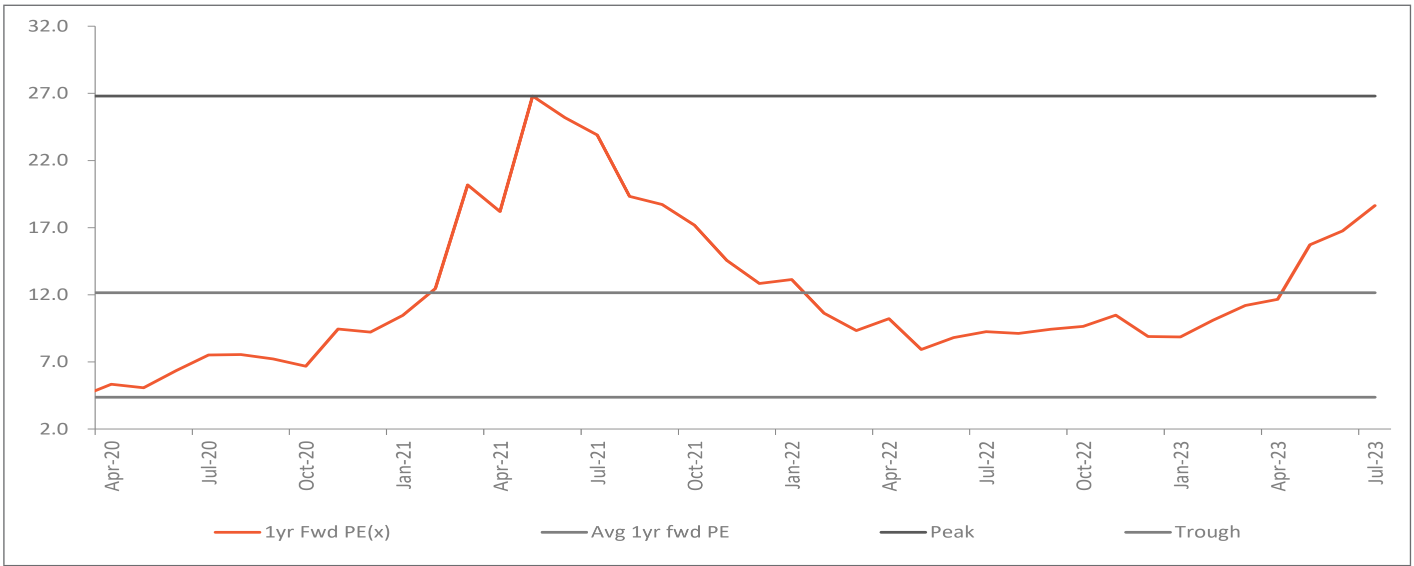
Company Outlook – At an inflection point

KBL is focusing on increasing the share of value-added products across geographies and promoting its proprietary innovative solutions and unique IoT platform for the maintenance of pumps based on subscription services in key international subsidiaries. Diversified offerings of pumps and strong presence in sunrise sectors such as chemicals, petrochemicals, waste-water management, and renewable energy in both domestic and global markets are likely to drive revenue growth in the coming years. For margin expansion, debottlenecking at key domestic subsidiaries and cost-optimisation measures should lead to sustainable improvement in operating margins. KBL has also reduced its exposure to low-margin and working capital-intensive EPC projects; and currently, the share of these legacy orders is ~5% in the total revenue. Hence, the company is on the cusp of a turnaround, backed by its strong market presence, sector tailwinds in terms of capex upcycle, and efforts towards improving internal efficiencies.

Valuation – Maintain Positive view; Expect 23% upside

KBL is leveraging its brand equity and has diversified its portfolio in the pumps industry to capitalize on the emerging opportunities in its key target industries, including sunrise sectors such as solar and nuclear. KBL is concentrating on building its competitiveness by new product launches and focusing on scaling its spares, services, and subscription platform and maintenance business, which would help counter the cyclicality and create a recurring revenue stream and upfront cash payments. We also expect its margin trajectory to improve, driven by healthy growth in revenues, stable commodity prices, improving supply chain, and increasing share of services business. Despite the sharp run-up in the stock since our viewpoint initiation in February, 2023, the stock trades at a reasonable valuation of ~18/~15x its FY2024E/FY2025E EPS. Hence, we maintain our Positive view on the stock and expect an upside of 23% from the current price levels as we expect its strong performance to continue backed by strong industry demand, product innovation and improvement in internal efficiencies.

One-year forward P/E (x) band



Source: Company Data; Sharekhan Research

About the company

KBL is the flagship company of the US$2.1 billion Kirloskar Group and is headquartered in Pune, Maharashtra. The company is engaged in the engineering and manufacturing of systems for fluid management. The company manufactures industrial and petrochemical, agriculture and domestic pumps, valves (for industrial and largescale applications), and hydro turbines (3 KW - 10 MW). KBL offers fluid management solutions for industries such as irrigation, building and construction, water supply, power plants, irrigation, oil and gas, and marine and defence. The company also offers small pumps for day-to-day use at households and farms. KBL offers 75 types of pumps and 28 types of valves and manufactures pumps up to 22MW. The company has manufacturing plants in Pune, Coimbatore, Shirwal, Sanand, and Dewas. Internationally, the company's plants are located in the U.S., U.K., UAE. and South Africa. KBL has three domestic subsidiaries, one domestic joint venture, and its international operations come under the subsidiary – Kirloskar Brothers International B.V. (The Netherlands), which has six main international subsidiaries under it.

Investment theme

KBL would leverage its market leadership to capitalise on the opportunities in the pumps industry, driven by public and private capex in the domestic market. The company's international operations are also on a recovery path with an increase in diversification to non-oil and gas sectors such as power, building and construction, water management, and others. Thus, strong order book in both consolidated and standalone business would drive revenue growth. Further, the company is expediting efforts to increase the share of its services business, which provides consistent revenue and profit growth. Margin tailwinds in terms of subsiding cost headwinds, reduction in exposure to the low-margin and lumpy EPC business, and increasing share of services business would result in strong profitability. Further, the company has low debt, improving cash flows, and return ratios as well as a short working capital cycle. The company is now being run by the next generation of promoters and, therefore, there seems no succession risk.

Key Risks

- Fluctuations in raw-material prices (steel and cast iron) could adversely impact margins.
- The company has considerable exposure to international markets in terms of exports and international subsidiaries. Hence, foreign exchange fluctuations could impact its overall profitability.
- High competition in the pumps industry is a key risk.

Additional Data

Key management personnel

Mr. Sanjay Kirloskar	Executive Director – Chairperson-MD
Mr. Chittaranjan M Mate	Vice President (Finance) and Chief Financial Officer
Mr. Alok Kirloskar	Director – Kirloskar Brothers and MD – Kirloskar Brothers International B.V.
Ms. Rama Sanjay Kirloskar	MD of Kirloskar Ebara Pumps Ltd and Joint MD of Kirloskar Brothers Limited
Mr. Devang Trivedi	Company Secretary and Compliance Officer

Source: Bloomberg

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Nippon Life India Asset Management	5.42
2	Investor Education & Protection FD	2.23
3	New India Assurance Company Limited	1.21
4	IDFC Mutual Fund	0.99
5	Warburg Invest KAG	0.63
6	Mahindra Manulife Investment Management	0.35
7	Prakar Investments Private Limited	0.34
8	Dimensional Fund Advisors LP	0.15
9	Achyut & Neeta Holdings & Finance	0.09
10	Acadian Asset Management LLC	0.04

Source: Bloomberg old data

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

Sharekhan

by BNP PARIBAS

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Registration and Contact Details: Name of Research Analyst - Sharekhan Limited, Research Analyst Regn No.: INH000006183. (CIN): - U99999MH1995PLC087498. Registered Office: The Ruby, 18th Floor, 29 Senapati Bapat Marg, Dadar (West), Mumbai – 400 028, Maharashtra, INDIA. Tel: 022-6115000.

Other registrations of Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669.

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For any complaints/grievance, email us at igc@sharekhan.com or you may even call Customer Service desk on - 022- 41523200/022- 33054600