

Kirloskar Oil Engines

BSE SENSEX 81,749 S&P CNX 24,668

CMP: INR1,113 TP: INR1,540 (+38%) Buy



Bloomberg	KOEL IN
Equity Shares (m)	145
M.Cap.(INRb)/(USD\$b)	161.4 / 1.9
52-Week Range (INR)	1450 / 618
1,6,12 Rel. Per (%)	-7/-22/62
12M Avg Val (INR M)	336

Financials & Valuations (INR b)

Y/E MARCH	FY25E	FY26E	FY27E
Net Sales	54.7	65.2	77.8
EBITDA	7.1	9.1	11.7
PAT	4.7	6.2	8.1
EPS (INR)	32.7	42.9	55.9
GR. (%)	30.7	31.4	30.3
BV/Sh (INR)	205.1	236.5	277.5

Ratios

ROE (%)	16.9	19.4	21.8
RoCE (%)	16.3	19.0	21.4

Valuations

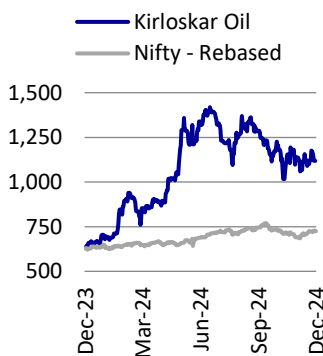
P/E (X)	34.1	25.9	19.9
P/BV (X)	5.4	4.7	4.0
EV/EBITDA (X)	22.7	17.3	13.1
Div Yield (%)	0.8	1.0	1.3

Shareholding Pattern (%)

As On	Sep-24	Jun-24	Sep-23
Promoter	41.2	41.2	41.2
DII	24.9	25.4	24.3
FII	10.8	10.0	7.8
Others	23.1	23.4	26.7

FII includes depository receipts

Stock Performance (1-year)



Attractive valuations versus near-term weakness

We hosted the Kirloskar Oil Engines Ltd (KOEL) management for an interactive session on current trends in the genset industry and other areas, such as the emission norm change in industrial engines, export markets, and KOEL's plans for B2C and Arka Fincap. The genset industry is undergoing a transition phase with near-term weakness seen in volumes, which will normalize in a few quarters. The company is ready for the CEV5 norm shift in the industrial segment from Jan'25 onwards and is gradually increasing its presence in export markets. Despite decline in volumes seen in its key powergen segment on YoY basis, we remain positive on KOEL on its 1) strategy to grow the share of high kVA rating products over medium to long term; 2) ability to benefit from the strong distribution network versus other smaller players in the industry; and 3) sharp valuation discount versus the market leader. We cut our estimates for FY25/26/27 by 7%/4%/1% to factor in lower revenues in the powergen segment. We reiterate BUY on KOEL with a revised SOTP-based TP of INR1,540 based on 29x P/E on two-year forward estimates.

Powergen volumes to ramp up in a few quarters

For the powergen segment, overall industry volumes, which used to hover at ~35k gensets per quarter last year, witnessed a transient dip to ~28k-29k in 2QFY25, post the implementation of CPCB 4+ norms. KOEL is confident of a sequential improvement to ~30k in 3QFY25 and a broad-based normalization in ensuing quarters. Historically, the company has been a dominant player in the LHP and MHP nodes (~30% market share). However, following the emission norm change, it is seeing the entry of MNC players in LHP nodes as well owing to the technologically advanced nature of products. The CPCB 4+ transition has resulted in price hikes of 30-40% and the company saw a small price correction in certain nodes during 3QFY25. On the other hand, players such as Cummins, Caterpillar, MTU, et al have been predominant in the HHP space, while KOEL has only recently forayed into the same. It currently has a high single-digit market share (>750kva) and aspires to reach a high double-digit, ultimately targeting a 25-30% market share on the back of its new launches and strong service network. Notably, it has already started getting inquiries from data centers and high tension segment.

Industrial segment benefiting from robust demand trend

The industrial segment is witnessing a growth upswing as the company is reaping the benefits of its targeted efforts in this segment. KOEL has outlined its intent to grow its defense and railways sectors, where the company sees robust opportunity potential over the coming years. However, it will take some time to scale up. The upcoming BSV norms will not see a similar pre-buying trend as the CPCB 4+ norms, as industrial customers have their own production schedules. The norm shift is both a risk and an opportunity as customers tend to switch vendors during norm transitions only.

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Export growth to fructify gradually

Alongside HHP and distribution segments, KOEL has identified exports as a key growth driver in its overall strategy. While we have seen near-term weakness in exports for the company, KOEL is confident of scaling up the business sustainably, with a strong foundation already in place. The company will approach each geography on its own merits; it will take a calculated call in terms of tying up with GOEMs and distributors, entering into JVs, or directly operating in the market based on the regulatory requirement, competitive landscape, etc. KOEL has earmarked the Middle East and US as its key focus markets. Pertinently, it has already received certifications for certain products in the US and has set up a company to operate as a GOEM.

B2C production to stabilize following the planned plant relocation

The B2C segment saw a transient dip in 2QFY25 on account of a planned relocation to the new facility, where it has consolidated five of its manufacturing locations into a single unit. This resulted in lower production and dispatches, which is slated to stabilize in the coming 1-2 quarters. This new facility will see improved cost efficiencies, streamlining of operations, and reduced delivery time. Its current product range is largely commoditized in nature (small pumps) and the company aims to move up the value chain so as to reduce the twin risks of price sensitivity and seasonality, which it is currently exposed to.

Targeting retailization of the Arka Fincap loan book

Arka's current loan book of ~INR62.8b is largely comprised of wholesale corporate loans, real estate loans, and SME loans (average ticket size of ~INR20m). The company plans to increase the granularity of the loan book and expand into retail lending. This expansion will be led by additions to its existing network of physical branches coupled with the scaling up of its digital presence. Management believes there is sufficient headroom to take additional debt to fund this growth, while equity funding from KOEL will be the last option.

Financial outlook

We revise our estimates downwards by 7%/4%/1% for FY25/26/27 to factor in slight weakness in the powergen segment. We expect a revenue CAGR of 17% over FY24-27, driven by 15%/21%/18%/20%/16% CAGR in powergen/industrial/distribution/exports/B2C. Over FY24-27E, we bake in 340bp expansion in margins to build in better product mix and operating leverage benefits. We expect a PAT CAGR of 30% over the same period.

Valuation and view

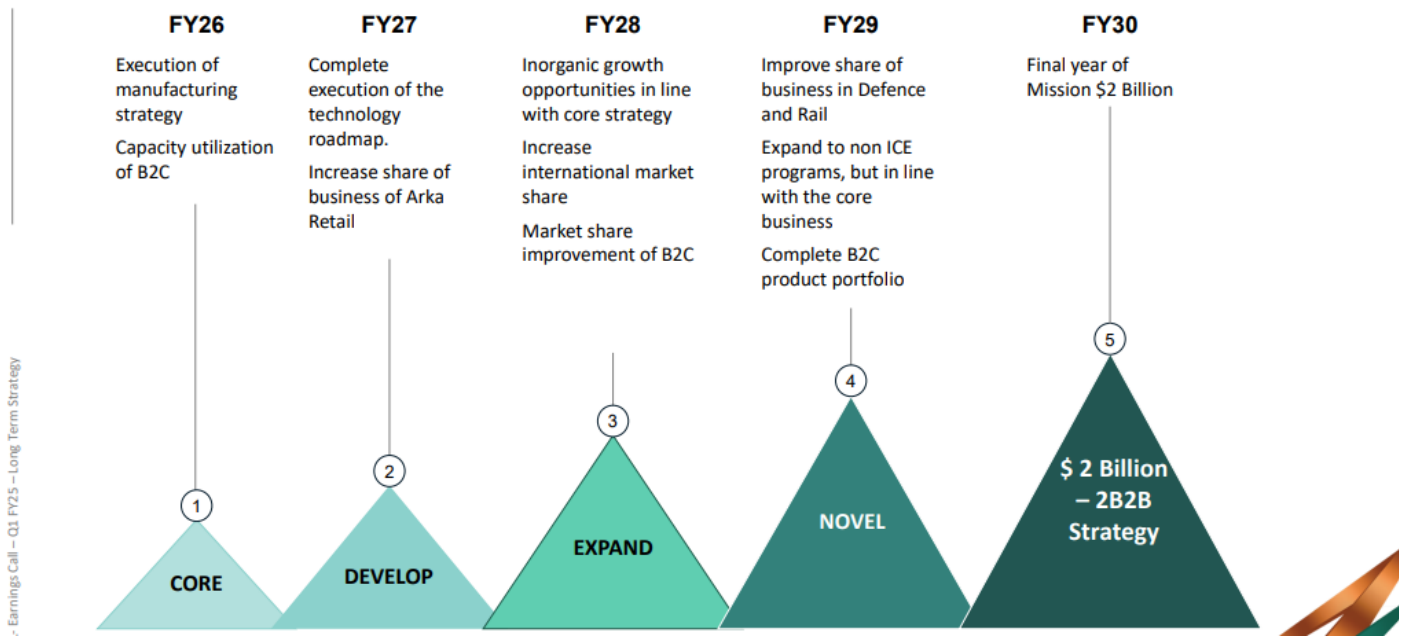
The stock is currently trading at 34x/26x/20x FY25E/26E/27E earnings. Adjusted with subsidiary valuation, KOEL is trading at 31x/23x/18x FY25E/26E/27E EPS, which is still at a 45-50% discount to the market leader. We continue to reiterate BUY on KOEL as we expect it to benefit from improved sales from higher HP segments, exports, and improving trajectory of the B2C segment.

Key risks and concerns

Demand slowdown, competitive intensity, higher costs for B2C division, the risk of further fund infusion in Arka Fincap, and technology risks are the key risks for KOEL.

Exhibit 1: KOEL has maintained its strategic roadmap to achieve USD2b size in the next five years

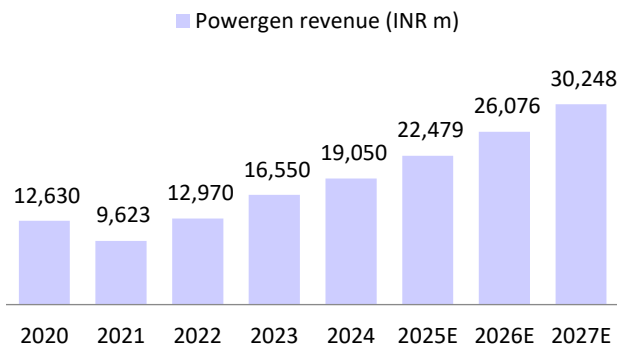
2B2B Strategy - The Ambition: Grow the Kirloskar Oil Engines business to \$2 Billion in the next 5 years at a consolidated level



Source: Company, MOFSL

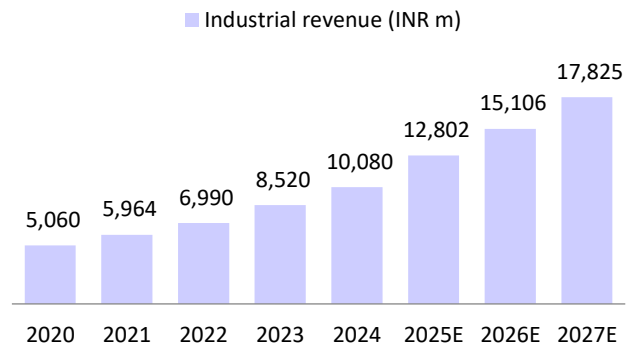
Financial outlook

Exhibit 2: We expect powergen revenue to grow at a 15% CAGR over FY24-27



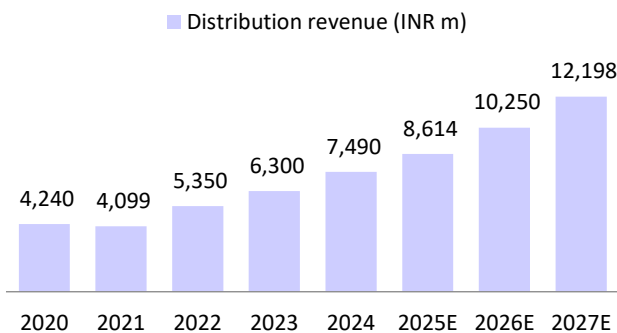
Source: Company, MOFSL

Exhibit 3: We expect industrial revenue to grow at a CAGR of 20% during FY24-27 on strong demand



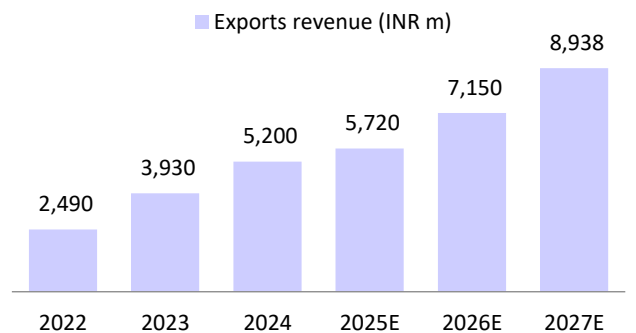
Source: Company, MOFSL

Exhibit 4: We expect distribution revenue growth to remain strong at 18% CAGR over FY24-27



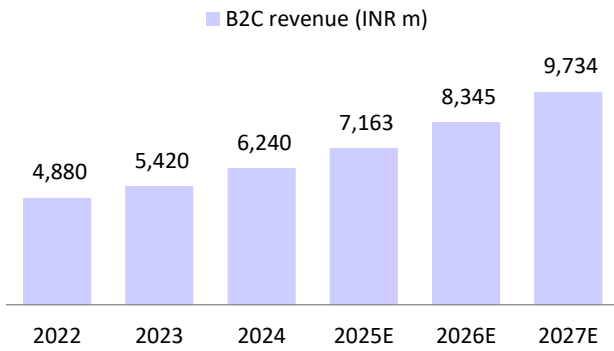
Source: Company, MOFSL

Exhibit 5: We expect exports revenue to grow at a 20% CAGR over FY24-27



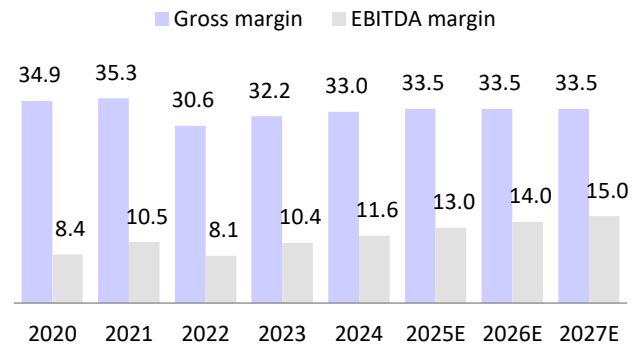
Source: Company, MOFSL

Exhibit 6: We expect B2C revenue to grow at a CAGR of 18% over FY24-27 with an expanding footprint



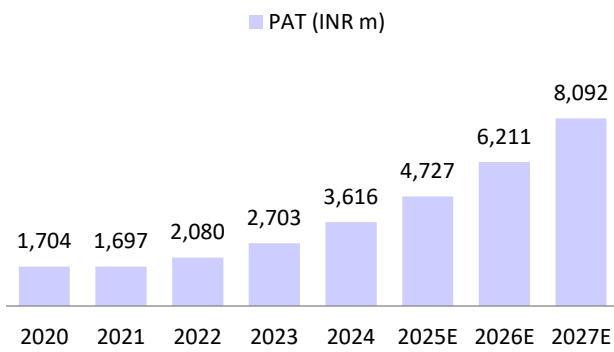
Source: Company, MOFSL

Exhibit 7: We expect margin expansion to be driven by price hikes, higher share of exports, and operating leverage (%)



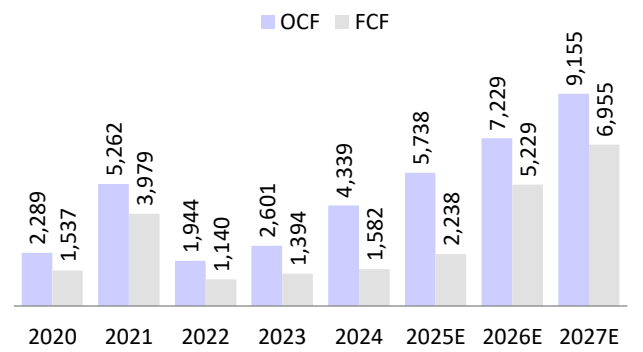
Source: Company, MOFSL

Exhibit 8: We expect PAT to post a 30% CAGR over FY24-27



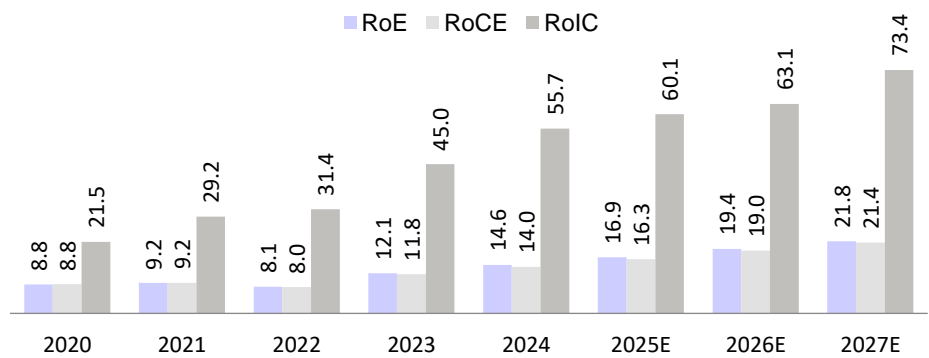
Source: Company, MOFSL

Exhibit 9: We expect OCF & FCF to improve further (INR m)



Source: Company, MOFSL

Exhibit 10: Return ratios to improve with improved profitability (%)



Source: Company, MOFSL

Exhibit 11: We tweak our estimates downward to account for lower Powergen revenues

(INR M)	FY25E			FY26E			FY27E		
	Rev	Old	Chg (%)	Rev	Old	Chg (%)	Rev	Old	Chg (%)
Net Sales	54,749	56,777	(3.6)	65,229	66,927	(2.5)	77,756	78,942	(1.5)
EBITDA	7,117	7,665	(7.1)	9,132	9,571	(4.6)	11,663	11,841	(1.5)
EBITDA (%)	13.0	13.5	-50 bps	14.0	14.3	-30 bps	15.0	15.0	0 bps
Adj. PAT	4,727	5,081	(7.0)	6,211	6,471	(4.0)	8,092	8,142	(0.6)
EPS (INR)	32.7	35.1	(7.0)	42.9	44.7	(4.0)	55.9	56.2	(0.6)

Source: MOFSL

Exhibit 12: SOTP valuation

	Earnings/ book	Valn multiple	Value	KOEL's share	Value for KOEL's share	Per share value	Valuation basis
	(INR m)	(X)	(INR m)	(%)	(INR m)	(INR)	
KOEL valuation							
Core business	7,151	29	2,07,386	100.0	2,07,386	1,431	❖ 29x two-year fwd EPS; 35% discount to KKC
Investments							
La Gajjar Machineries	104	12.0	1,251	100.0	1,251	9	❖ 12x P/E two-year forward earnings
Arka Fincap	11,100	1.3	14,541	100.0	14,541	100	❖ 1.3x P/BV on expanded two-year forward book
Total					2,23,178	1,540	

Source: Company, MOFSL

Financials and valuation

Income Statement							(INR m)
Y/E March	FY21	FY22	FY23	FY24	FY25E	FY26E	FY27E
Total Income from Operations	26,944	32,997	41,161	48,505	54,749	65,229	77,756
Change (%)	-6.4	22.5	24.7	17.8	12.9	19.1	19.2
Raw Materials	17,431	22,912	27,897	32,439	36,408	43,377	51,708
Gross Profit	9,513	10,085	13,264	16,066	18,341	21,852	26,048
Employees Cost	1,989	2,070	2,365	3,069	3,723	4,436	5,287
Other Expenses	4,686	5,327	6,630	7,355	7,501	8,284	9,097
Total Expenditure	24,106	30,309	36,892	42,864	47,632	56,097	66,092
% of Sales	89.5	91.9	89.6	88.4	87.0	86.0	85.0
EBITDA	2,838	2,688	4,269	5,642	7,117	9,132	11,663
Margin (%)	10.5	8.1	10.4	11.6	13.0	14.0	15.0
Depreciation	622	772	848	970	999	1,131	1,231
EBIT	2,217	1,915	3,422	4,672	6,119	8,002	10,432
Int. and Finance Charges	64	62	54	78	132	90	74
Other Income	245	248	273	274	383	457	544
PBT bef. EO Exp.	2,398	2,100	3,641	4,868	6,370	8,369	10,903
EO Items	-84	527	0	0	0	0	0
PBT after EO Exp.	2,314	2,627	3,641	4,868	6,370	8,369	10,903
Total Tax	617	547	939	1,252	1,642	2,158	2,811
Tax Rate (%)	26.6	20.8	25.8	25.7	25.8	25.8	25.8
Minority Interest	0	0	0	0	0	0	0
Reported PAT	1,697	2,080	2,703	3,616	4,727	6,211	8,092
Adjusted PAT	1,759	1,663	2,703	3,616	4,727	6,211	8,092
Change (%)	11.4	-5.4	62.5	33.8	30.7	31.4	30.3
Margin (%)	6.5	5.0	6.6	7.5	8.6	9.5	10.4

Balance Sheet							(INR m)
Y/E March	FY21	FY22	FY23	FY24	FY25E	FY26E	FY27E
Equity Share Capital	289	289	290	290	290	290	290
Total Reserves	19,542	21,105	23,028	25,937	29,399	33,947	39,873
Net Worth	19,832	21,395	23,318	26,227	29,689	34,237	40,163
Total Loans	793	976	751	2,091	1,219	1,019	819
Deferred Tax Liabilities	125	146	61	100	100	100	100
Sources of Funds	20,749	22,517	24,131	28,418	31,008	35,356	41,082
Gross Block	16,281	16,990	17,425	19,052	22,552	24,552	26,752
Less: Accum. Deprn.	11,826	12,488	13,174	14,144	15,142	16,273	17,504
Net Fixed Assets	4,455	4,502	4,251	4,908	7,410	8,279	9,248
Capital WIP	549	393	664	2,426	2,426	2,426	2,426
Total Investments	15,340	16,722	16,925	18,762	18,762	18,762	18,762
Curr. Assets, Loans & Adv.	8,092	8,505	11,557	13,115	14,592	20,403	27,947
Inventory	2,652	3,031	4,685	5,235	5,909	7,040	8,392
Accounts Receivable	3,558	3,945	4,672	5,684	6,416	7,644	9,112
Cash and Bank Balance	294	314	338	980	948	4,225	8,740
Loans and Advances	872	656	852	808	912	1,086	1,295
Other Assets	716	558	1,011	408	408	408	408
Curr. Liability & Prov.	7,686	7,606	9,267	10,793	12,182	14,514	17,302
Accounts Payable	6,419	6,175	6,326	7,274	8,210	9,782	11,660
Other Current Liabilities	646	729	1,700	2,223	2,509	2,989	3,563
Provisions	622	702	1,241	1,296	1,463	1,743	2,078
Net Current Assets	406	899	2,291	2,322	2,409	5,888	10,645
Appl. of Funds	20,749	22,517	24,131	28,418	31,007	35,355	41,081

Financials and valuation

Ratios

Y/E March	FY21	FY22	FY23	FY24	FY25E	FY26E	FY27E
Basic (INR)							
EPS	12.2	11.5	18.7	25.0	32.7	42.9	55.9
Cash EPS	16.4	16.8	24.5	31.7	39.6	50.8	64.5
BV/Share	137.0	147.8	161.1	181.2	205.1	236.5	277.5
DPS	1.5	4.7	5.0	6.7	8.7	11.5	15.0
Payout (%)	12.8	32.6	26.8	26.8	26.8	26.8	26.8
Valuation (x)							
P/E	91.6	96.9	59.6	44.5	34.1	25.9	19.9
Cash P/E	67.7	66.1	45.4	35.1	28.1	21.9	17.3
P/BV	8.1	7.5	6.9	6.1	5.4	4.7	4.0
EV/Sales	6.0	4.9	3.9	3.3	2.9	2.4	2.0
EV/EBITDA	56.9	60.2	37.8	28.8	22.7	17.3	13.1
Dividend Yield (%)	0.1	0.4	0.4	0.6	0.8	1.0	1.3
FCF per share	27.5	7.9	9.6	10.9	15.5	36.1	48.0
Return Ratios (%)							
RoE	9.2	8.1	12.1	14.6	16.9	19.4	21.8
RoCE	9.2	8.0	11.8	14.0	16.3	19.0	21.4
RoIC	29.2	31.4	45.0	55.7	60.1	63.1	73.4
Working Capital Ratios							
Fixed Asset Turnover (x)	1.7	1.9	2.4	2.5	2.4	2.7	2.9
Asset Turnover (x)	1.3	1.5	1.7	1.7	1.8	1.8	1.9
Inventory (Days)	36	34	42	39	39	39	39
Debtor (Days)	48	44	41	43	43	43	43
Creditor (Days)	87	68	56	55	55	55	55
Leverage Ratio (x)							
Current Ratio	1.1	1.1	1.2	1.2	1.2	1.4	1.6
Interest Cover Ratio	34.9	30.7	63.8	60.0	46.2	89.4	141.9
Net Debt/Equity	-0.7	-0.8	-0.7	-0.7	-0.6	-0.6	-0.7

Cash Flow Statement

Y/E March	FY21	FY22	FY23	FY24	FY25E	FY26E	FY27E
(INR m)							
OP/(Loss) before Tax	2,314	2,627	3,641	4,868	6,370	8,369	10,903
Depreciation	622	772	848	970	999	1,131	1,231
Interest & Finance Charges	38	50	35	78	132	90	74
Direct Taxes Paid	-324	-567	-960	-1,084	-1,642	-2,158	-2,811
(Inc)/Dec in WC	2,654	-157	-1,025	-441	-120	-202	-241
CF from Operations	5,304	2,726	2,539	4,391	5,738	7,229	9,155
Others	-42	-782	61	-52	0	0	0
CF from Operating incl EO	5,262	1,944	2,601	4,339	5,738	7,229	9,155
(Inc)/Dec in FA	-1,282	-804	-1,206	-2,757	-3,500	-2,000	-2,200
Free Cash Flow	3,979	1,140	1,394	1,582	2,238	5,229	6,955
(Pur)/Sale of Investments	-2,855	680	3,235	-1,091	0	0	0
Others	-1,316	-8,870	-3,585	-334	0	0	0
CF from Investments	-5,453	-8,994	-1,556	-4,182	-3,500	-2,000	-2,200
Issue of Shares	0	0	0	0	0	0	0
Inc/(Dec) in Debt	613	172	-236	1,338	-200	-200	-200
Interest Paid	-62	-53	-50	-107	-132	-90	-74
Dividend Paid	-217	-578	-723	-724	-1,265	-1,663	-2,166
Others	-20	7,529	-12	-21	-673	0	0
CF from Fin. Activity	314	7,070	-1,021	486	-2,271	-1,952	-2,439
Inc/Dec of Cash	123	20	23	643	-33	3,277	4,516
Opening Balance	171	294	314	338	980	948	4,225
Closing Balance	294	314	338	980	948	4,225	8,740

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NOTES

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Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	> - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

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