

# Kirloskar Brothers Ltd.: Q4FY18 Result Update

CMP INR: 260  
 Rating: Buy  
 Target Price INR: 350  
 Upside: 32%

## Profitability outlook improves substantially

Kirloskar Brothers Ltd (KBL) reported numbers marginally below our estimates on standalone basis while surpassed expectations on both international and domestic front. During the quarter, net sales grew by 6.9% to INR 615cr and net profits grew by 91.6% to INR 32.5cr against our expectation of INR 635cr and INR 40cr respectively. Delays in execution of large irrigation/power projects led to lower growth in projects business. Projects business revenues declined by 16% to INR 149cr while EBIT margins improved to 13.9% in Q4FY18 from 7.6% in Q4FY17. Products business maintained growth momentum with yoy growth of 10% and EBIT margin of 18.1%. Though international business reported healthy revenue growth of 111% and net profits came in at INR 11cr compared to a loss of INR 24cr in Q4FY17, for the entire year of CY17, the business reported heavy loss of INR 40cr. Domestic subsidiaries including joint ventures reported net profits of INR 21cr in FY18 against net profits of INR 13cr in FY17 and Net loss of INR 10cr in FY16. We expect company's consolidated net sales and net profits to grow at a CAGR of 9.3%/78.4% respectively over FY18-20E. We continue to remain bullish on the long term potential in company's capability to capture large market share in both large and small pumps business with improved profitability in all the business lines. We maintain our TP of INR 350/share, valuing the company at 16x P/E on FY20E basis.

### Domestic operations – Margins improved significantly but growth still below mark of 15%

KBL reported growth in net sales to the tune of 6.9% as projects business de-grew by 16% as domestic projects faced various execution issues and completion of 2 projects under letter of credit funding tilted more towards FY19E. Projects business which has close to 72% business derived from large products, reported EBIT margins of 13.9% v/s 7.6%. For FY18, projects division reported EBIT margin of 0.2% v/s 3.3% in FY17 due to loss provisioning of almost INR 40cr in FY18. Products business witnessed growth of only 10% v/s 13% expected but the EBIT margins improved significantly to 18.1% v/s 13% in Q4FY17. For FY18, products business grew by 11% with EBIT margin of 16.6% (v/s 12.5%). KBL is seeing faster closures of legacy projects due to political compulsions in AP/Telangana. KBL still has almost INR 225cr of legacy retention money stuck with the various government authorities which the company is confident of recovering in next 2-3 years.

### Domestic subsidiaries contributing to profitability:

Domestic subsidiaries as well as Kirloskar Corrocoat witnessed substantial improvement in profitability in FY18 compared to previous years. Combined net profits improved to INR 21cr in FY18 vis-a-vis INR 13cr PAT in FY17 and INR 10cr net loss in FY16. Net profits expansion has been as a result of sustained investments by the parent company in process improvements and productivity. Till date, domestic subsidiaries were entirely dependent on KBL for revenues, but now, these companies have started supplies to external customers as well.

### International business – Turned profitable in Q4CY17, order booking strong

International business grew by 111% to INR 324cr while also turning net positive to INR 11cr v/s loss of INR 24cr in Q4CY17. Order booking in the international operations has picked up post Q2FY18, witnessing order flow of INR 661cr in the last 6 months. taking current order backlog close to INR 700cr. Delays in execution in few orders, postponement of pick-up of material by customers, currency fluctuations, and high fixed costs has lead to net loss of INR 40cr in CY17 (v/s INR 45cr in CY16). We believe cost reduction measures, higher opening order book in Rodelta/Thailand operations, and higher ruling crude oil prices will lead to improvements in profitability in the next two years – zero loss in CY18 and INR 20cr PAT in CY19.

| (INR cr)          | Q4FY18 | Q4FY17 | % Change | Q3FY18 | % Change | FY18* | FY19E* | FY20E* |
|-------------------|--------|--------|----------|--------|----------|-------|--------|--------|
| Net Sales         | 615    | 575    | 7%       | 442    | 39%      | 2,742 | 3,034  | 3,273  |
| % Growth          |        |        |          |        |          | 8.5   | 10.7   | 7.9    |
| EBITDA            | 60     | 41     | 47%      | 23     | 157%     | 150   | 255    | 309    |
| PAT               | 33     | 17     | 92%      | 9      | 257%     | 50    | 133    | 173    |
| % Growth          |        |        |          |        |          |       | 178.5  | 31.1   |
| Diluted EPS (INR) |        |        |          |        |          | 6.3   | 16.8   | 21.8   |
| Diluted P/E (x)   |        |        |          |        |          | 13.5  | 16.2   | 12.4   |
| ROACE (%)         |        |        |          |        |          | 8.4   | 16.7   | 19.8   |

\* Consolidated Figures

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| Bloomberg:                       | KKB:IN        |
|----------------------------------|---------------|
| 52-week range (INR):             | 432.8 / 229.0 |
| Share in issue (cr):             | 7.94          |
| M cap (INR cr):                  | 2,301         |
| Avg. Daily Vol. BSE/NSE :('000): | 84            |
| Promoter Holding (%)             | 65.52         |

Date: 15<sup>th</sup> May 2018

## Conference call highlights:

### Domestic Business

- Small product business continues to grow at a double digit rate with demand from housing, agriculture, and industry. Gap between unorganised and organised pumps manufacturers is narrowing post GST. KBL continues to benefit from the shift towards efficient branded pumps
- KBL is selectively participating in the various government projects advocating solar energy based pumps. KBL has doubled the volumes in this segment while maintaining working capital days at lower levels.
- Execution in large projects is still below expectations due to various reasons like land availability, financial issues.etc. Thermal power segment is very slow while irrigation is picking up and water segment is witnessing strong traction.
- Legacy projects stuck for past 7-8 years are seeing steady closures. KBL has recovered legacy retention money of almost INR 160cr in the past 3 years from different states. KBL is hopeful of higher number of projects to see closure in FY19, being an election year.
- Projects won in African states of Surinam and Senegal under letter of credit (LOC) funding from Exim Bank of India are likely to witness significant execution in next 1-1.5 years.

### International business

- SPP UK has completed redundancy program along with other cost rationalisation programs in CY17. We believe the one time cost related to these measures have been more than INR 20cr, leading to higher losses in the international business.
- Rodelta and Kirloskar Pompen, the acquired companies, were in deep losses in CY17 due to higher fixed costs and lower order backlog.
- The company's business in Thailand also suffered losses due to order cancellations – one from company itself and other one from the customer.
- In CY17, order booking increased by healthy 82% to INR 1382cr , levels achieved when crude oil prices were ruling at \$ 140-150/barrel levels. Importantly, out of the current order backlog of ~INR 700cr, orders related to oil industry are only 40% compared to almost 80% at the peak of crude oil prices.
- With oil prices soaring above \$65/barrel in the past few months, the company has started to receive enquiries for highly profitable spares and services business.
- Rodelta and Thailand, both are expected to reduce the losses drastically, with a possibility of turning into black in CY18, as both the companies have started CY18 with healthy order backlog.

**Q4FY18 Result Highlights**

| <b>Year to March</b>                      | <b>Q4FY18</b> | <b>Q4FY17</b> | <b>% Change</b> | <b>Q3FY18</b> | <b>% Change</b> | <b>FY18*</b> | <b>FY17*</b> | <b>% Change</b> |
|---|---------------|---------------|-----------------|---------------|-----------------|--------------|--------------|-----------------|
| Income from operations                    | 615           | 575           | 7%              | 442           | 39%             | 1,935        | 1,753        | 10%             |
| Direct costs                              | 360           | 328           | 10%             | 262           | 37%             | 1,133        | 1,020        | 11%             |
| Employee costs                            | 62            | 62            | 0%              | 58            | 7%              | 227          | 216          | 5%              |
| Other expenses                            | 133           | 144           | -8%             | 99            | 34%             | 440          | 410          | 7%              |
| Total operating expenses                  | 555           | 534           | 4%              | 419           | 32%             | 1,801        | 1,646        | 9%              |
| EBITDA                                    | 60            | 41            | 47%             | 23            | 157%            | 134          | 107          | 25%             |
| Depreciation and amortisation             | 9             | 9             | -4%             | 9             | -2%             | 35           | 40           | -11%            |
| EBIT                                      | 52            | 32            | 61%             | 15            | 253%            | 99           | 67           | 47%             |
| Interest expenses                         | 7             | 7             | 2%              | 7             | 9%              | 26           | 32           | -18%            |
| Other income                              | 6             | 6             | 1%              | 4             | 44%             | 20           | 18           | 8%              |
| Profit before tax                         | 50            | 31            | 63%             | 12            | 317%            | 93           | 54           | 72%             |
| Provision for tax                         | 18            | 14            | 28%             | 3             | 503%            | 27           | 20           | 36%             |
| Core profit                               | 33            | 17            | 92%             | 9             | 257%            | 66           | 34           | 92%             |
| Extraordinary items                       | -             | -             |                 | -             |                 | -            | -            |                 |
| Profit after tax                          | 33            | 17            | 92%             | 9             | 257%            | 66           | 34           | 92%             |
| Other Comprehensive Income                | -             | -             |                 | -             |                 | -            | -            |                 |
| Adjusted net profit (incl share of asso.) | 33            | 17            | 92%             | 9             | 257%            | 66           | 34           | 92%             |
| No. Of Shares (Cr)                        | 3.4           | 3.4           | 0%              | 3.4           | 0%              | 3.4          | 3.4          | 0%              |
| Diluted EPS (INR)                         | 9.5           | 5.0           | 92%             | 2.7           | 257%            | 19.4         | 10.1         | 92%             |

| <b>As a % of Revenue</b> | <b>Q4FY18</b> | <b>Q4FY17</b> | <b>Q3FY18</b> | <b>FY18</b> | <b>FY17</b> |
|--------------------------|---------------|---------------|---------------|-------------|-------------|
| Raw Material Cost        | 58.6          | 57.1          | 59.3          | 58.6        | 58.2        |
| EBITDA                   | 9.8           | 7.1           | 5.3           | 6.9         | 6.1         |
| EBIT                     | 8.4           | 5.6           | 3.3           | 5.1         | 3.8         |
| Net Profit               | 5.3           | 2.9           | 2.1           | 3.4         | 2.0         |

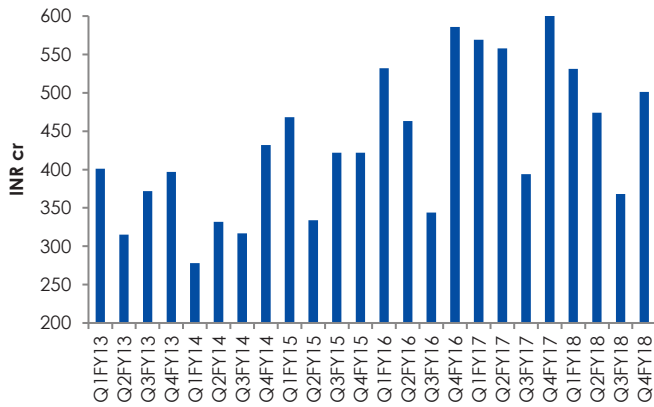
\*-standalone numbers

**Q4FY18 Result Highlights**

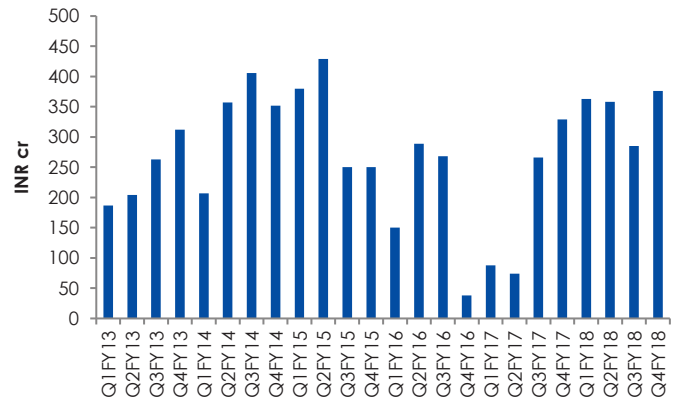
| INR Cr                             | Q1FY17     | Q2FY17      | Q3FY17     | Q4FY17     | FY17 | Q1FY18      | Q2FY18       | Q3FY18       | Q4FY18       | FY18  |
|------------------------------------|------------|-------------|------------|------------|------|-------------|--------------|--------------|--------------|-------|
| <b>Segmental Revenues (INR cr)</b> |            |             |            |            |      |             |              |              |              |       |
| Project Sectors                    | 67         | 85          | 133        | 177        | 463  | 78          | 82.1         | 116.2        | 149          | 426   |
| Product Sectors                    | 309        | 308         | 317        | 424        | 1358 | 365         | 352.0        | 325.9        | 466          | 1509  |
| <b>Total Segment Revenue</b>       | <b>376</b> | <b>394</b>  | <b>450</b> | <b>601</b> | 1821 | <b>444</b>  | <b>434.1</b> | <b>442.1</b> | <b>614.8</b> | 1935  |
| <b>yoy growth</b>                  |            |             |            |            |      |             |              |              |              |       |
| <b>Project Sectors</b>             |            |             | 15%        | 25%        |      | 16%         | -4%          | -13%         | -16%         | -8%   |
| <b>Product Sectors</b>             |            |             | 5%         | 11%        |      | 18%         | 14%          | 3%           | 10%          | 11%   |
| <b>Total Segment Revenue</b>       |            |             | 8%         | 15%        |      | 18%         | 10%          | -2%          | 2%           | 6%    |
| <b>Segmental EBIT (INR cr)</b>     |            |             |            |            |      |             |              |              |              |       |
| Project Sectors                    | -12.7      | 6.8         | 7.7        | 13.5       | 15   | -11.7       | -8.8         | 0.7          | 20.7         | 1     |
| Product Sectors                    | 40.7       | 43.3        | 30         | 55         | 169  | 45.5        | 74.8         | 46.4         | 84.4         | 251   |
| EBIT                               | 28.0       | 50.1        | 38         | 69         | 185  | 33.8        | 66.0         | 47.1         | 105.1        | 252   |
| Other Un-allocable Expenditure     | 23.87      | 20.77       | 26         | 31         | 102  | 19.8        | 38.1         | 28.6         | 48           | 134   |
| <b>EBIT(including unallocable)</b> | <b>4.2</b> | <b>29.3</b> | <b>12</b>  | <b>38</b>  | 83   | <b>14.1</b> | <b>27.9</b>  | <b>18.5</b>  | <b>57.1</b>  | 118   |
| Less : Interest                    | 7.87       | 8.14        | 9          | 7          | 32   | 6.7         | 5            | 6.5          | 7.1          | 25    |
| Net Profit/Loss Before Tax         | -3.7       | 21.2        | 3.3        | 30.6       | 51   | 7.3         | 22.9         | 12.0         | 50.0         | 92    |
| <b>EBIT Margins</b>                |            |             |            |            |      |             |              |              |              |       |
| Project Sectors                    | -18.8%     | 8.0%        | 5.8%       | 7.6%       |      | -15.0%      | -10.7%       | 0.6%         | 13.9%        | 0.2%  |
| Product Sectors                    | 13.2%      | 14.0%       | 9.4%       | 13.0%      |      | 12.5%       | 21.3%        | 14.2%        | 18.1%        | 16.6% |
| EBIT(including unallocable)        | 1.1%       | 7.4%        | 2.6%       | 6.3%       |      | 3.2%        | 6.4%         | 4.2%         | 9.3%         | 6.1%  |
| <b>CAPITAL EMPLOYED</b>            |            |             |            |            |      |             |              |              |              |       |
| Segmental Cap employed             | 495        | 495         | 573        | 575        | 575  | 530         | 571          | 530          | 546          | 546   |
| Project Sectors                    | 263        | 263         | 278        | 331        | 331  | 256         | 230          | 280          | 266.1        | 266   |
| Product Sectors                    | 232        | 232         | 295        | 244        | 244  | 274         | 341          | 249          | 279.7        | 280   |
| Unallocated Net Assets/Liabilities | 300        | 530         | 460        | 263        | 263  | 313         | 283          | 334          | 218.4        | 218   |
| Total Capital Employed             | 796        | 1026        | 1033       | 838        | 838  | 843         | 854          | 863          | 764          | 764   |

Order booking remains strong: Consolidated order backlog remains strong at INR 22bn

Domestic orders inflow picked up in Q4, backlog remains strong

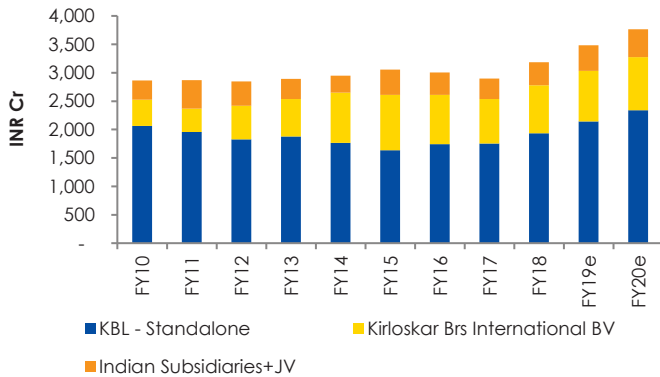


International orders inflow - Picking up steadily

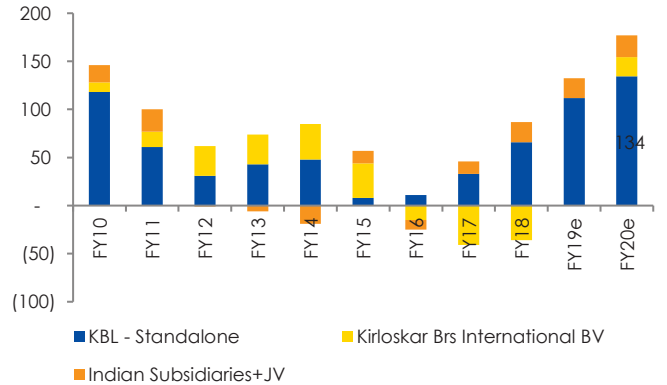


Business wise financials: Standalone business to remain dominant, subsidiaries' contribution to improve

Standalone revenues to witness highest growth



All the segments to witness improved profitabilities



Source: Edelweiss Investment Research

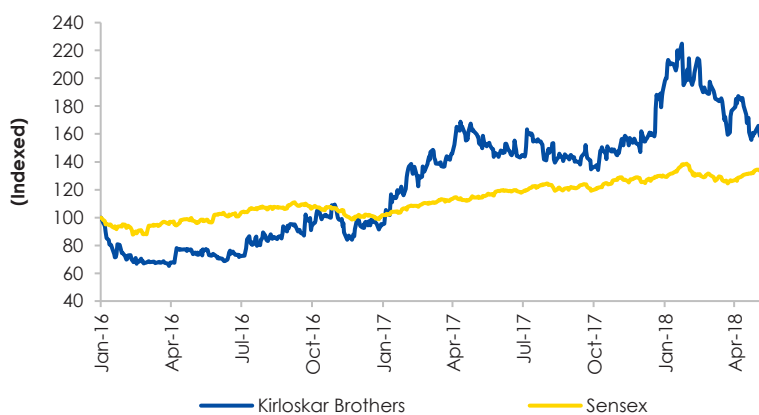


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| Rating | Expected to                                     |
|--------|---|
| Buy    | appreciate more than 15% over a 12-month period |
| Hold   | appreciate between 5-15% over a 12-month period |
| Reduce | Return below 5% over a 12-month period          |



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