Initiating Coverage

Kirloskar Pneumatic Co. Ltd.

September 7, 2022

RETAILRESEARCH

Kirloskar Pneumatic Co. Ltd.

Industry	LTP	Recommendation	Base Case Fair Value	Bull Case Fair Value	Time Horizon
Capital Goods	Rs 559	Buy on dips in Rs 525-535 band & add more in Rs 465-475 band	Rs 617	Rs 657	2-3 quarters

HDFC Scrip Code	KIRPNEEQNR
BSE Code	505283
NSE Code	NA
Bloomberg	KKPC IN
CMP Sep 6 , 2022	559.3
Equity Capital (Rs cr)	12.9
Face Value (Rs)	2
Equity Share O/S (cr)	6.5
Market Cap (Rs cr)	3609
Book Value (Rs)	102.2
Avg. 52 Wk Volumes	91500
52 Week High (Rs)	597.0
52 Week Low (Rs)	335.0

Share holding Pattern % (Jun, 2022)	
Promoters	53.6
Institutions	19.3
Non Institutions	27.1
Total	100.0

HDFCsec Retail research stock rating meter

for details about the ratings, refer at the end of the report

* Refer at the end for explanation on Risk Ratings

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Our Take:

Kirloskar Pneumatic Co. Ltd. (KPCL) is a diversified product company, serving key sectors viz. Industrial, Oil & Gas, Infrastructure and Food Processing. The company was hitherto focussed on domestic markets but is now looking to expand geographically. It has made inroads in the Middle East Oil & Gas market and looking to increase its export revenue share from less than 5% to 15-20% over the next few years. The management is targeting to achieve Rs 2000cr revenue in the next 2-3 years which entails a CAGR of 17-18%. KPCL has a strong market share in compressor business and is well positioned to capitalise on the upcoming opportunities in the infrastructure space. Make in India, China+1 and PLI scheme in various sectors are expected to attract global manufacturers to set up facilities in India which could generate significant growth opportunities for KPCL. Its financial risk profile remains robust, supported by debt-free balance sheet, strong debt protection metrics and adequate liquidity.

Valuation & Recommendation:

KPCL seems to be in a sweet spot due to the revival in capex first by the Govt. and later by the Private sector. Its financial and operational metrics are sound. Capital Goods as a sector has got rerated over the past few months in anticipation of better order flows and execution, despite concerns of higher raw material costs. KPCL having set ambitious targets could witness an expansion in earnings and valuations.

KPCL is a debt free company with modest capex requirements. We expect its revenue/EBITDA/PAT to grow at 19/20/26% CAGR over FY22-FY24E, led by revival in industrial activity, and increasing export orders. RoCE/RoNW are expected to improve to 22.5/16.5% by FY24E. We believe investors can buy the stock on dips in Rs 525-535 band and add more in Rs 465-475 band (23.5x FY24E EPS) for a base case fair value of Rs 617 (31x FY24E EPS) and bull case fair value of Rs 657 (33x FY24E EPS) over the next 2-3 quarters.

Financial Summary

Particulars (Rs cr)	Q1FY23	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	FY21	FY22	FY23E	FY24E
Operating Income	272	169	61.2	398	-31.7	823	1,021	1,195	1,386
EBITDA	28	17	67.8	78	-63.9	113	139	166	197
APAT	16	7	130.1	54	-70.1	64	85	105	128
Diluted EPS (Rs)	2.5	1.1	129.8	8.4	-70.1	9.9	13.2	16.3	19.9
RoE (%)						11.8	13.6	15.1	16.5
P/E (x)						56.3	42.4	34.4	28.1
EV/EBITDA (x)						30.3	24.7	20.5	17.0

(Source: Company, HDFC sec)

Q1FY23 Result Update

Sales in Q1FY23 were the highest Q1 sales for the company at Rs 272cr, which registered a growth of over 60% YoY driven by export order to Oil and Gas sector in the overseas market and the project supplies in the domestic market. Project revenue were ~65% and product sales were ~35%. Material costs increased by 82% to Rs 160cr due to a strategic export order to ensure entry in the overseas Oil & Gas space. Excluding this project, material costs would have been close to previous quarter's level. Employee/Other expenses grew at a slower pace, resulting in EBITDA margin expanding 41bps to 10.3%. PAT more than doubled to Rs 16cr while PAT margins expanded 179bps to 6%.

The Company continues to remain debt-free and had a net cash position of about Rs 170cr at the end of Q1FY23. During this quarter, the Company issued 53,500 Equity Shares under the Employee Stock Option Program.

Order booking during the first quarter was close to about Rs 250cr. As a result, the Company had an order book of Rs 1225cr, as compared to Rs 1265cr at the beginning of the year.

Key Triggers

Revival in economic activity to drive demand for air compressors

Air compressors have wide applications in various industries, such as manufacturing, semiconductors & electronics, home appliances, healthcare, oil & gas, food & beverages, and energy. The global air compressor market size is expected to reach $40.4bn by 2025 registering a CAGR of 3.8% from 2019 to 2025, according to a study by Grand View Research. The Indian market is said to be about Rs 4,500cr and is largely fragmented with top 4 players having a combined share of less than 60%. The domestic market is growing at 10-12% a year.

The Indian capex cycle was delayed by the Covid pandemic and delayed announcement of the $1.5tn National Infra Pipeline (NIP). It is now expected to pick up led by the central government and its entities and unfolding of state government and private capex later. The Union Budget for FY22 raised overall capex budget by 35% YoY versus FY21BE and 26% YoY versus FY21RE. Despite the impact of Covid-19 in FY21 spending was to be 7% higher versus budget. The key FY22 spending drivers are likely highways, water, metro rail and urban infrastructure. Launch of $41bn power reforms funding in the budget should also help kickstart power capex from FY23 after cleaning up discom balance sheets.

Recovery in domestic demand, government impetus to infrastructure spending, export growth and the China+1 sourcing strategy of global players have led to strong rebound in businesses. Air compressors are required in ~80-90% of the manufacturing plants as it cannot be stored and has to be generated onsite. Compressors are among the last things ordered for any project as the lead time is of only a few weeks.

Huge market for air compressors give strong opportunity to grow

The Indian air compressor market size is Rs 4500cr with three broad product groups – reciprocating, screw and centrifugal compressors. This could rise to Rs 5200cr in FY23. KPCL has been a leading player in the reciprocating compressor segment. Although a relatively new entrant in the screw compressor segment, it has a sustainable competitive advantage as it owns the entire value chain, from design to installation to service. The investment in high speed gear box gives KPCL the advantage to deliver superior and cost effective centrifugal compressors.

Stationary-type rotary screw air compressors have a major share in the Indian air compressor market. The Indian air compressor market is projected to grow at a CAGR of 6.2% during 2020-2030. The growing automotive sector in India is expected to drive the demand for compressors. Additionally, the manufacturing sector in India is growing rapidly and is expected to reach $1 trillion by 2025, owing to the constant support from the government. The increasing demand for home appliances in the evolving economies, such as India, China, and Brazil, will enhance stationary compressor market growth through 2027.

KPCL has been a small player till now in the air compressor segment. In FY22, it sold ~150cr reciprocating compressors, ~100cr screw compressors and small amount of centrifugal compressors. With its entry into the screw compressor segment, KPCL stands to grow this. Overall it had a market share of ~8% in FY22 which it plans to grow to 10-12% in FY23.

Looking to expand geographically

KPCL is the market leader in some of the areas of its business and is now looking to expand geographically. It is targeting markets in Middle East, South East Asia, Indo China, South and West Africa. Entry into these markets would de-risk its revenue profile from slowdown in the domestic market. At the end of FY22, KPCL had outstanding export orders of over Rs 100cr (Rs 40cr executed in Q1FY23) from Oil & Gas companies, which would be executed in FY23. Historically, the company had revenues of Rs 20-25cr from exports.

These orders have provided KPCL with the required approvals to execute projects of bigger size. The management is targeting exports to constitute 15-20% of sales (currently below 10%) going forward.

Significant opportunities in newly launched products

KPCL is looking to launch hydro booster compressor in Q2FY23. It has already passed all internal and external testing and completed the approval process that is required for launching this product. This goes on the Oil and Gas stations which are not connected to the gas network. According to the management, about 6,000 compressors is the market opportunity in the next three to five years. Each compressor sells at ~Rs 45-55 lakhs taking the market size to Rs 3000cr over the next few years. There are about 14-15 local players in this market but no one large company.

It is also launching the Khione Screw Compressors which would address the refrigeration screw market, currently, being serviced by imports. The current import of this product into India is roughly about Rs 100cr. Besides these two launches, the company is working on many other products which would be launched over the next few years. It is developing further screw compressors for defense applications, and a new range of composite compressor.

Shift from unorganised to organised sector

The Rs 4,500cr Indian compressor market is highly fragmented with unorganised sector accounting for ~40% of the industry. Most players continue to import key inputs like Impeller or Rotors while smaller and niche players import complete air ends. The recent pandemic has put a significant strain on the finances on smaller and niche players many of whom have shut shop. Also, with the government's focus on 'Make in India' to strengthen India as global manufacturing hub, the organised sector is expected to gain market share in the coming years.

Established market position:

KPCL has an established market position in each product segment (air compressors, refrigeration and gas compressors, and transmission products) through technological collaboration and strong after-sales support services. Revenue is derived from diverse industries, such as oil and gas, power, cement, steel, automobiles, textiles, refinery, petrochemicals, city gas distribution, cold storage and food, besides the defence and railway departments of the Government of India.

Risk & Concern

Seasonality in order execution

Revenue recognition has an element of seasonality as it is a capital goods company. Generally Q1 is the slowest quarter for the company and revenue recognition increases in the remaining quarters.

Cyclicality in demand from user industries

KPCL's customers are mainly from the engineering and other capital-intensive industries wherein demand is cyclical.

High competitive intensity

The competitive intensity has increased in the market as high inflation and increased logistics cost has resulted in project delays and number of orders getting finalized has decreased.

Lower margins in some strategic orders

KPCL has taken some strategic orders at lower margins as it is looking to establish itself in the lucrative Oil & Gas industry in the Middle East. This could impact its profitability in the near term.

Forex risk

The contribution from exports has started to increase with the management targeting 15-20% of revenues from overseas markets in the next few years. This would expose the company to volatility in forex rates.

Raw material price volatility

Any significant increase in raw material prices could impact the company's profitability if it is not able to pass on the increased costs due to competitive/strategic reasons. Most of the contracts are on fixed price basis and very few orders have escalation clauses.

Company Background:

Founded in 1958 by Shantanurao Kirloskar, Kirloskar Pneumatic Company Limited (KPCL) is one of the core Kirloskar group companies. With a product range that includes Air Compressors, Air Conditioning and Refrigeration Systems, Process Gas Systems, Vapour Absorption Systems and Industrial Gear Boxes, KPCL serves a variety of sectors like Oil, Gas, Steel, Cement, Food and Beverage, Railways, Defence and Marine. KPCL has 3 integrated state-of-the-art manufacturing facilities located at Pune (Hadapsar and Saswad) and Nashik. Close to 50% of CNG stations in India are powered by KPCL compressors. 94% of ots sales comprises of compressors. Its product portfolio has a capacity from 30 CFM to 10000 CFM and pressure from 1 bar to 250 bar

Air compressors

Air compressors comprise a wide range of products across screw compressors, centrifugal compressors, and reciprocating compressors for air and gas duties. Its product portfolio has capacity ranging from 30 CFM to 10,000 CFM and pressure from 1 bar to 250 bar. KPCL has a technological partnership with City University, London for screw compressors.

Air Conditioning & Refrigeration Systems

KPCL manufactures compressors for air conditioning and refrigeration needs and also undertakes projects on turnkey basis encompassing planning to commissioning of refrigeration systems. It manufactures reciprocating open-type compressors, process refrigeration systems and vapour absorption chillers.

Process Gas System

Under this vertical KPCL serves the highly specialised oil & gas sector, offering gas compression system for upstream, midstream, downstream and distribution requirement of the industry.

Road Railers
KPCL entered into an agreement with the Indian Railways to operate road-railers, including the pilot project between New Delhi and Chennai, Tamil Nadu. The company has acquired the technology required to build road - railers from Wabash Inc, USA, which is a leading North American manufacturer of semi-trailers. The Indian Railways' Research Design and Standards Organisation (RDSO) has inspected and cleared the prototype and conducted the Emergency Brake Distance (EBD) test.

KPCL Sales and Market share (FY22)

Air	Refrigeration	Gas	Total Market
Addressable Market Rs. 2,900 Cr.	Addressable Market Rs. 600 Cr.	Addressable Market Rs. 1,000 Cr.	Addressable Market Rs. 4,500 Cr.
Share in KPC Sales 20% - 25%	Share in KPC Sales 30% - 35%	Share in KPC Sales 40% - 45%	Share in KPC Sales 95% - 97%
Market Share about 8%	Market Share about 55%	Market Share about 40%	Market Share about 20%

(Source: Company, HDFCsec)

Peer Comparision

FY22	CMP (Rs)	Mcap (Rs cr)	Net Sales (Rs cr)	EBITDA (%)	PAT (%)	P/E (x)	P/B (x)	RoE (%)
Elgi Equipments	550	17443	2525	11.7	7.1	97.8	16.7	18.8
Ingersoll-Rand	2039	6435	910	16.7	12.1	58.4	11.7	22.0
Kirl.Pneumatic	559	3609	1021	13.8	8.3	42.4	5.5	13.6

Financials

Income Statement

(Rs cr)	FY20	FY21	FY22	FY23E	FY24E
Net Revenues	**829**	**823**	**1021**	**1195**	**1386**
Growth (%)	***16.7***	***-0.7***	***24.0***	***17.0***	***16.0***
Operating Expenses	733	710	882	1029	1189
EBITDA	**96**	**113**	**139**	**166**	**197**
Growth (%)	***9.0***	***18.2***	***23.1***	***19.4***	***18.5***
EBITDA Margin (%)	***11.5***	***13.7***	***13.6***	***13.9***	***14.2***
Depreciation	33	38	35	38	41
Other Income	11	10	12	16	19
EBIT	**74**	**86**	**116**	**143**	**175**
Interest expenses	2	2	2	3	3
PBT	**72**	**84**	**114**	**141**	**172**
Tax	18	20	29	36	44
PAT	**54**	**64**	**85**	**105**	**128**
Share of Asso./Minority Int.	0	0	0	0	0
Adj. PAT	**54**	**64**	**85**	**105**	**128**
Growth (%)	***-3.2***	***19.3***	***33.0***	***23.5***	***22.3***
EPS	8.3	9.9	13.2	16.3	19.9

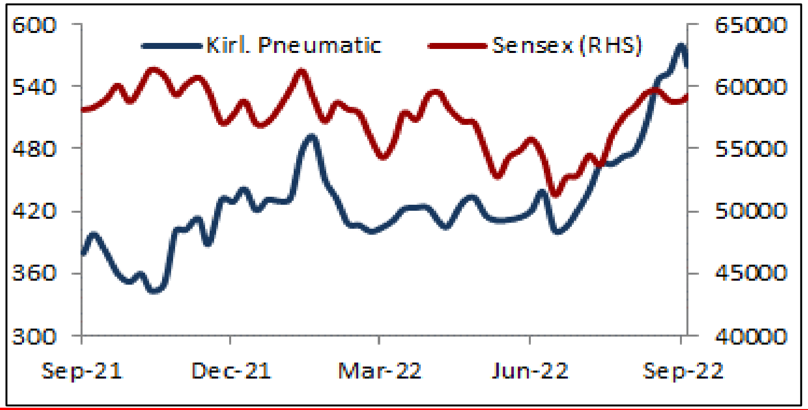
Balance Sheet

As at March (Rs cr)	FY20	FY21	FY22	FY23E	FY24E
SOURCE OF FUNDS					
Share Capital	13	13	13	13	13
Reserves	482	576	646	720	810
Shareholders' Funds	**495**	**589**	**658**	**732**	**823**
Total Debt	28	40	0	0	0
Net Deferred Taxes	1	3	5	5	5
Other Non-curr. Liab.	0	0	0	0	0
Total Sources of Funds	**523**	**632**	**664**	**738**	**828**
APPLICATION OF FUNDS					
Net Block & Goodwill	207	175	229	236	248
CWIP	9	8	11	5	3
Investments	138	223	205	235	275
Other Non-Curr. Assets	4	3	3	4	4
Total Non Current Assets	**358**	**409**	**448**	**481**	**530**
Inventories	159	114	203	219	251
Debtors	189	308	299	356	421
Cash & Equivalents	30	52	39	45	55
Other Current Assets	39	40	36	52	59
Total Current Assets	**417**	**515**	**576**	**673**	**786**
Creditors	137	146	170	203	237
Other Current Liab & Provisions	115	146	189	212	250
Total Current Liabilities	**252**	**292**	**359**	**414**	**487**
Net Current Assets	165	223	217	258	299
Total Application of Funds	**523**	**632**	**664**	**738**	**828**

Cash Flow Statement

(Rs cr)	FY20	FY21	FY22	FY23E	FY24E
Reported PBT	72	84	114	141	172
Non-operating & EO items	-1	-7	-7	-1	-1
Interest Expenses	2	1	2	3	3
Depreciation	33	38	35	38	41
Working Capital Change	-73	-43	-9	-36	-31
Tax Paid	-22	-16	-26	-36	-44
OPERATING CASH FLOW (a)	**10**	**57**	**109**	**109**	**141**
Capex	-54	-3	-89	-40	-50
Free Cash Flow	-44	54	20	69	91
Investments	44	-47	42	-30	-40
Non-operating income	4	1	1	0	0
INVESTING CASH FLOW (b)	**-6**	**-50**	**-46**	**-70**	**-90**
Debt Issuance / (Repaid)	28	12	-40	0	0
Interest Expenses	-1	-2	-2	-3	-3
FCFE	30	17	22	37	48
Share Capital Issuance	0	1	2	0	0
Dividend	-32	0	-32	-31	-38
Others	0	0	0	0	0
FINANCING CASH FLOW (c)	**-5**	**10**	**-72**	**-33**	**-41**
NET CASH FLOW (a+b+c)	**-2**	**17**	**-9**	**6**	**10**

Price chart



Key Ratios

	FY20	FY21	FY22	FY23E	FY24E
Profitability Ratios (%)					
EBITDA Margin	11.5	13.7	13.6	13.9	14.2
EBIT Margin	8.9	10.4	11.4	12.0	12.6
APAT Margin	6.5	7.8	8.3	8.8	9.3
RoE	10.8	11.8	13.6	15.1	16.5
RoCE	14.5	14.9	18.1	20.6	22.5
Solvency Ratio (x)					
Net Debt/EBITDA	0.0	-0.1	-0.3	-0.3	-0.3
Net D/E	0.0	0.0	-0.1	-0.1	-0.1
PER SHARE DATA (Rs)					
EPS	8.3	9.9	13.2	16.3	19.9
CEPS	13.4	15.8	18.6	22.2	26.3
BV	77.0	91.6	102.2	113.6	127.7
Dividend	2.7	3.5	4.0	4.8	5.9
Turnover Ratios (days)					
Debtor days	82	110	108	100	102
Inventory days	56	61	57	64	62
Creditors days	60	63	56	57	58
VALUATION					
P/E	67.1	56.3	42.4	34.4	28.1
P/BV	7.3	6.1	5.5	4.9	4.4
EV/EBITDA	36.6	30.3	24.7	20.5	17.0
EV / Revenues	4.2	4.2	3.4	2.8	2.4
Dividend Yield (%)	0.5	0.6	0.7	0.9	1.1
Dividend Payout (%)	32.4	35.2	30.4	29.5	29.6

(Source: Company, HDFC sec)

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HDFC Sec Retail Research Rating description

Green Rating stocks

This rating is given to stocks that represent large and established business having track record of decades and good reputation in the industry. They are industry leaders or have significant market share. They have multiple streams of cash flows and/or strong balance sheet to withstand downturn in economic cycle. These stocks offer moderate returns and at the same time are unlikely to suffer severe drawdown in their stock prices. These stocks can be kept as a part of long term portfolio holding, if so desired. This stocks offer low risk and lower reward and are suitable for beginners. They offer stability to the portfolio.

Yellow Rating stocks

This rating is given to stocks that have strong balance sheet and are from relatively stable industries which are likely to remain relevant for long time and unlikely to be affected much by economic or technological disruptions. These stocks have emerged stronger over time but are yet to reach the level of green rating stocks. They offer medium risk, medium return opportunities. Some of these have the potential to attain green rating over time.

Red Rating stocks

This rating is given to emerging companies which are riskier than their established peers. Their share price tends to be volatile though they offer high growth potential. They are susceptible to severe downturn in their industry or in overall economy. Management of these companies need to prove their mettle in handling cyclicality of their business. If they are successful in navigating challenges, the market rewards their shareholders with handsome gains; otherwise their stock prices can take a severe beating. Overall these stocks offer high risk high return opportunities.

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