

# Kirloskar Electric Company Ltd

Industry	CMP	Recommendation	Add on Dips to band	Target	Time Horizon
<b>CAPITAL GOODS - ELECTRICAL EQUIPMENT</b>	<b>Rs. 67</b>	<b>BUY at CMP and add on dips</b>	<b>Rs.67 - 57</b>	<b>Rs. 91</b>	<b>1 Year</b>

HDFC Scrip Code	<b>KIRELE</b>
BSE Code	533193
NSE Code	KECL
Bloomberg	KECL IN
CMP as on 20 Oct 16	66.5
Equity Capital (Rs Cr)	63.7
Face Value (Rs)	10
Equity shares O/S (Cr)	6.37
Market Cap (Rs Cr)	422
Book Value (Rs)	-8
Avg. 52 Week Volumes	434071
52 Week High	72
52 Week Low	23

Shareholding Pattern (%)	
Promoters	54.0
Institutions	6.5
Non Institutions	39.5
Total	100.0

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Kirloskar Electric is a pre-independence era company established in 1946. With seven decades of manufacturing experience, the company has evolved to become an integrated multi-locational manufacturing entity. It manufactures wide range of products under three product groups namely Rotating Machines Group, Power Generation and Distribution Group and Others that cater to core sector of the economy like power, renewal energy, mining, irrigation and water supply, railways, road transport, sugar, steel, cement, oil and gas and allied industries.

#### Investment Rationale:

Company is an established manufacturer of electrical capital goods equipment in India and manufactures and sells products under 'Kirloskar Electric' name. The company's focus on maintaining customized design, engineering, quality and reliability across product verticals and on continuous technological improvements of products, together with extensive sales and marketing efforts have enabled it to develop a strong brand recognition in the industry.

Indian Electrical Equipment Industry Mission Plan 2012-2022 sets the guidelines for making India the choice for production of electrical equipment, thereby making way for domestic production of electrical equipment and reach an output of US\$ 100 billion by balancing exports and imports.

Kirloskar Electric is a B2B focused manufacturer of electrical capital goods equipment; Company significantly expanded product portfolio catering to requirements of a diversified customer base.

Company was set up in 1946 for the manufacture of AC motors for various industrial applications. With seven decades of manufacturing experience, company has grown into a multiproduct company with a basket of electrical products, catering to industrial segments.

The company is in the midst of a restructuring exercise, the completion of which will see a reduction in manufacturing expense and raw material costs by improvement in the supply chain (which is ~75% of total expenses), increased utilization of in-house manufacturing facilities, increased marketing and expansion of the after-sale services network.

The company will monetize the non-core assets and deploy the proceeds to reduce the debt. The QIP money will also be used to taper off debt.

**Risk & Concerns:**

- High fluctuation in Foreign Currency may affect the profitability of the business.
- Highly Competitive Industry.
- Slowdown in economy may affect the order book of the company.

**View & Valuation:**

Kirloskar Electric has reported revenues of Rs551cr with 3.7% operating margin in FY 2016. This is a sharp improvement from FY15's massive loss. In FY15 company had posted EBITDA loss of Rs50cr; company had provided Rs160cr impairment loss due to its investment in European company which impacted performance substantially. With orders from defence and railways we expect revenues to post 20% CAGR and 90% EBITDA CAGR over FY16-18E on the back of cost optimization and operational efficiencies. We believe company would report PAT of Rs 37 Cr in FY18E.

Company has raised Rs37cr via QIP by issuing ~80 lakh equity shares to institutional investors at Rs46. Company has put many of its spare land and real estate holdings up for sale and the money earned from this will be used to pare down debt. We expect company to reduce debt and hence D/E is also expected to come down significantly over the next 2-3 years. At CMP, stock trades at ~13x FY18E earnings. Considering strong turnaround in operational performance and strong revenue growth we value the stock at~17x FY18E earnings with price target of Rs91.

**Business Background:**

Kirloskar Electric is one of the leading electrical capital goods equipment manufacturing companies in India. Primarily company is engaged in the business of manufacturing and sales of electric motors, that is, AC machines and DC machines, AC generators (**Rotating Machines Group**), transformers, switchgears and silent diesel generator sets (**Power Generation and Distribution Group**), projects and systems (**Others**). Kirloskar Electric is in the business of manufacturing and sales of electrical capital goods equipment for over six decades. This has not only resulted in getting repeat orders but also helped in adding new customers and new geographies.

Company manufacture wide range of products under three product groups namely Rotating Machines Group, Power Generation and Distribution Group and Others like power, renewal energy, mining, irrigation and water supply, railways, road transport, sugar, steel, cement, oil and gas and allied industries. Company has strong design and engineering capabilities with in-depth knowledge of electrical capital goods equipment.

The manufacturing facilities located at Govanhalli, Budihal, Hubballi, Gabbur, Tumkur, Pune, Mysore and Kolkata. All the manufacturing facilities are equipped with engineering development facilities which primarily cater to in-house requirements of the company in material since, new product design and development, product optimization, prototyping and test validation. Engineering and development efforts include offering solutions for import substitutes for electric motors, motors for electric vehicles, mining transformers, high frequency generator sets and test setups amongst others.

Company manufacture and sell products under 'Kirloskar Electric' and possess strong marketing network across geographies for sales and marketing and aftermarket support. The products are exported to several countries including Tanzania, Kuwait, Bangladesh, Netherlands and Oman. As on June 30, 2016, company has a strong network of over 150 dealers and 22 sales and branch offices across India.

**Product Portfolio**

<p><b>AC Motors &amp; Generators</b></p>	<ul style="list-style-type: none"> <li>• KEC offers a wide range of motors from 012kW to 20MW in frames 63 to 900. Motors are offered in closed type, open type and heat exchanger type enclosures Voltages range from 340V to 13,800V</li> <li>• Also offers AC Generators from 1kVA to 20MVA, voltage from 220V to 11,000V and speed from 3,000 rpm down to 375 rpm, with standard frequencies of 50/60Hz and special requirements too</li> </ul>	
<p><b>DC Motors</b></p>	<ul style="list-style-type: none"> <li>• The wide product range of DC Motors satisfies the need of a multitude of applications</li> <li>• The Industrial Laminated Yoke range starts from frame 80 up to 1,250 with outputs of 075kW to 3,250kW with torques up to 200 kNm</li> </ul>	
<p><b>Traction Equipment</b></p>	<ul style="list-style-type: none"> <li>• The Traction Division was started in 1990 to cater to mainline electric and diesel locomotives</li> <li>• KEC is a major supplier of electrical equipment to the Indian Railways</li> </ul>	
<p><b>Electronics &amp; Switchgear</b></p>	<ul style="list-style-type: none"> <li>• KEC has the competence to design, manufacture and deliver Inverters, Convertors and Uninterrupted Power Source (UPS)</li> <li>• KEC manufactures Switchgears of SF6 and VCB range up to 2,500Amps and 33kV</li> </ul>	
<p><b>Transformers</b></p>	<ul style="list-style-type: none"> <li>• The Company has the capacity to design, manufacture and supply Distribution &amp; Power Transformers up to 100MVA, 220 kV class and Cast Resin Transformers up to 10 MVA, 33 kV class</li> </ul>	
<p><b>Diesel Generating Sets</b></p>	<ul style="list-style-type: none"> <li>• KEC has recently entered into India's growing Diesel Generating Set market with ranges from 75kVA to 500 kVA As every business is dependant on power, these Diesel Generating Sets serve as a source of efficient and reliable power supply</li> </ul>	

**Industry Background:**

India’s electrical equipment industry is highly diverse and manufactures a wide range of high and low technology products. The industry directly employs around half a million persons and provides indirect employment to another one million people. The industry production in fiscal 2015 was ₹ 136,953 Cr. and contributes 9.5% in value to the entire Indian manufacturing sector, translating to 1.2% of India’s GDP. The exports during the same fiscal year were ₹ 35,419 Cr. Further, the generation equipment segment is targeted to reach a size of ₹ 125,000 Cr. and the T&D equipment segment is targeted to reach a size of ₹ 375,000 Cr. by 2022.

**Indian Electrical Equipment Industry Mission Plan 2012-2022**

The plan sets the guidelines for making India the choice for production of electrical equipment, thereby making way for domestic production of electrical equipment and reach an output of US\$ 100 billion by balancing exports and imports. Some of the focus areas as part of the mission plan include achieving industry competitiveness, technology up-gradation, skill development, promoting growth in exports, including export to emerging markets and enabling conversion of latent demand.

**Changing Scenario of Indian Electrical Equipment Industry**



Source: Company, HDFC sec Research

**INVESTMENT RATIONALE:****Established brand in the electrical capital goods equipment industry**

Company is an established manufacturer of electrical capital goods equipment in India and manufacture and sells products under 'Kirloskar Electric'. The company's focus on maintaining customized design, engineering, quality and reliability across product verticals and on continuous technological improvements of products, together with extensive sales and marketing efforts have enabled company to develop a strong brand recognition in the industry. Kirloskar enjoy significant brand recall and customer loyalty for the products which enables it to expand business on continuous basis.

**Large and diversified product portfolio**

Kirloskar Electric is a B2B focused manufacturer of electrical capital goods equipment; Company significantly expanded product portfolio catering to requirements of a diversified customer base. Company manufacture wide range of products under three product groups namely Rotating Machines Group, Power Generation and Distribution Group and Others that cater to core sector of the economy like power, renewal energy, mining, irrigation and water supply, railways, road transport, sugar, steel, cement, oil and gas and allied industries.

**Restructuring Initiatives – a Turnaround Story**

The company has adopted restructuring initiative to improve its performance like, reduction in manufacturing expenses, reduction in raw material cost by improved supply chain (which is ~75% of total expenses), increased utilization of in house manufacturing facilities, increased marketing and network and after sale services etc. Monetization of non-core assets and Reduction in high cost debt by QIP money are company's step for financial restructuring. The company has also taken steps to improve gross sales realization by offering value added Products and Product mix combinations. This may prove to be a positive turnaround point for the company. Management expects to get sizable order from Telangana state for supplying high and low voltage pump set. Company has also bagged orders for ~Rs70cr for Solar Project. Overall debt position stood at Rs289cr as on March 2016.

Company had raised Rs37cr via QIP by issuing ~80 lakh equity shares to Institutional investors at Rs46. With that the company would reduce its debt and the D/E ratio is expected to come down significantly over the next 2-3 years. Company has non-core real estate assets i.e. 100 acre land bank near Hubballi Airport and also assets in Mysore, which could fetch substantial amounts if disposed and thus company's debt may come down.

In the medium term company can fetch to the tune of ~Rs200cr from the sale of the properties likes Mysore Land, Bengaluru facility and some of the properties owned by company at Pune and Mumbai. The sale of non-current assets would result in exceptional gains to the company and thus may provide incremental surge in profitability. Moreover, company has regional offices in major cities such as Delhi, Hyderabad, Pune and Bengaluru. Company may decide to sell off the offices and take office spaces on rental basis which would in turn help to reduce debt burden of the company.

**Long standing market presence and relationship with customers for over six decades**

With over six decades of manufacturing experience, Company has grown into a multiproduct company with a basket of electrical products, catering to industrial segments. The products are exported to several countries. Company has a strong network of over 150 dealers and 22 sales and branch offices pan India. Now company is also focusing on Renewable sector and expects huge potential from the sector given govt. initiatives and push for the same.

**Defense Segment**

Kirloskar Electric had been one of the significant player in defense segment for supplying AC Generators, Diesel Generating sets & Frequency convertor sets for the last 5 decades to Army, Air force & Navy for every conceivable applications like Power source for Battery charging, Power source for communication equipment, Power source for Radars, Power source for Missile systems, Power source for Launchers, Power source for Aircraft starting, Power source for front in line Battle ships, Power source for Destroyers, Power source for Offshore petrol vessels, Power source for Fleet tankers, Power source for Antisubmarine warfare, Power source for Stealth ships, Power source for Advanced destroyers, Power source for Survey vessels. Now company is trying to revive defense segment and would focus on the same.

**NAVY**

Company has orders worth Rs16cr for 1MW Alternators for Advanced stealth ships. Seven such ships are being constructed by Mazgaon docks and Garden reach Ship builders and engineers where Kirloskar Electric is the preferred supplier for alternators. The order is expected to be finalised during current year and execution would happen from next year onwards. Company also has an opportunity for supplying AC generators, Frequency converter sets, AC Motors and DC Motors for Submarines.

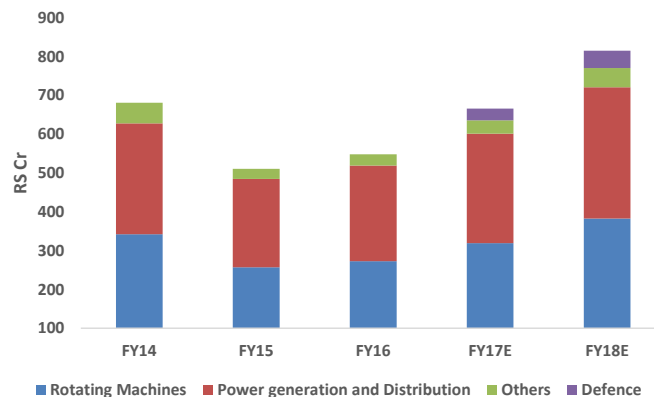
**Air Force & Air Craft carriers**

High frequency Ground power units for Air craft starting & testing business is estimated to add around Rs12-15cr revenues to the company.

**Army**

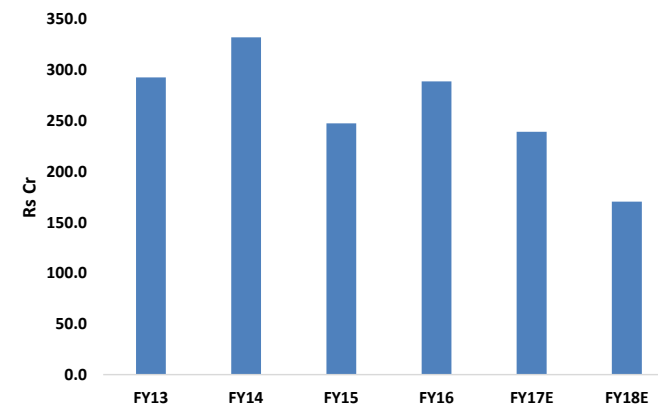
DG Sets for Stimulators and for Radar applications: Discussions are in progress with PSU player like BEL for supply of DG Power sources like Quick Reaction Surface to Air Missiles and other Radar Applications which has business potential of ~Rs17cr.

### Segment Revenue Verticals (%)



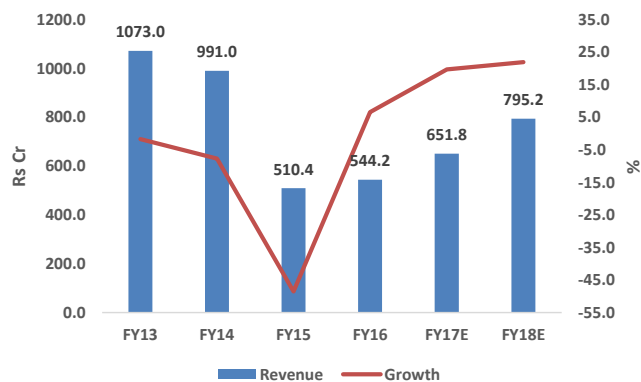
Source: Company, HDFC sec Research

### Debt to be reduced in the coming years



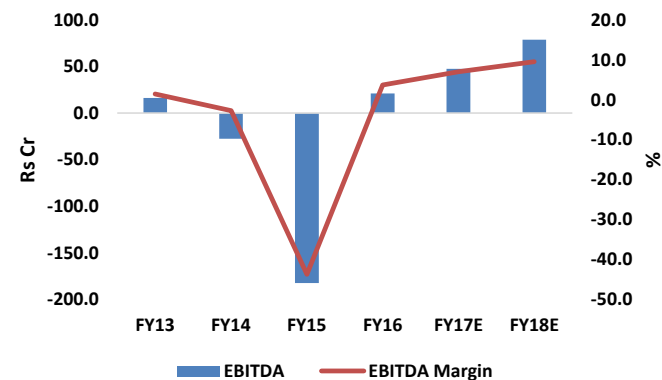
Source: Company, HDFC sec Research

### Revenue Trajectory



Source: Company, HDFC sec Research

### EBITDA Margin to Surge



Source: Company, HDFC sec Research



**Income Statement (Rs Cr)**

Rs.Cr	FY14	FY15	FY16	FY17E	FY18E
<b>Net Sales</b>	1020.9	417.4	572.8	672	825
% Growth	-7.5	-59.1	37.2	17.3	22.8
Raw Materials	704.6	300.5	405.0	457.7	552.6
Power & Fuel Cost	16.9	7.8	5.5	6.1	6.8
S&A Expenses	78.1	52.5	23.5	25.4	29.7
Employee Expenses	198.4	75.6	78.2	85.2	97.1
Miscellaneous Expenses	37.0	157.9	35.0	42.0	52.2
Other Expenses	14.5	5.8	4.0	8.0	8.0
<b>Total Expenses</b>	1049.3	599.9	551.2	624.3	746.5
<b>EBITDA</b>	-28.4	-182.5	21.7	47.5	78.8
Margin %	-2.7	-43.7	3.7	7.1	9.5
Depreciation	20.4	12.1	12.1	11.6	11.8
EBIT	-47.9	-194.6	9.1	36.0	67.0
Margin %	-4.7	-46.6	1.6	5.4	8.1
Interest	49.4	45.5	48.6	30.7	21.0
PBT	-97.2	-240.0	-39.5	5.3	46.0
Tax	-0.8	0.0	0.0	0.0	9.0
<b>Reported PAT</b>	-106.0	-240.3	-39.5	5.3	37.0
% Growth	116.4	126.8	-83.6	-113.3	604.2
EPS (Rs.)	0.0	0.0	0.0	0.7	5.2

Source: Company, HDFC sec Research

**Balance Sheet (Rs Cr)**

Rs.Cr	FY14	FY15	FY16	FY17E*	FY18E*
<b>SOURCES OF FUNDS</b>					
Share Capital- Equity	50.5	69.2	63.9	71.8	71.8
Reserves	72	-222	-256	-178	-74
Total Shareholder's funds	122	-153	-192	-84	-2
Total Debt	333	248	289	223	158
Other Liabilities	27	35	32	45	52
Minority Interest	-3.0	0.0	0.0	0.0	0.0
<b>TOTAL SOURCES OF FUNDS</b>	<b>478</b>	<b>130</b>	<b>128</b>	<b>183</b>	<b>208</b>
<b>APPLICATION OF FUNDS</b>					
Gross Block	588	270	276	287	302
Net Block	340	100	92	91	95
CWIP	2	2	0	10	14
Investments	2	1	1	0	0
Total Non-current Assets	344	102	93	101	109
Inventories	234	93	98	112	140
Debtors	200	166	168	180	229
Loans & Advances	53	28	12	10	8
Cash & Equivalents	73	20	26	39	50
Total Current Assets	560	307	304	342	427
Provisions	15	34	30	25	22
Total Current Liabilities	464	302	312	363	432
Net Deferred Tax	22	0	0	0	0
Other Assets	19	24	24	22	22
Net Current Assets	94	5	11	18	6
<b>TOTAL APPLICATION OF FUNDS</b>	<b>478</b>	<b>130</b>	<b>128</b>	<b>183</b>	<b>208</b>

Source: Company, HDFC sec Research, \* - post QIP issue

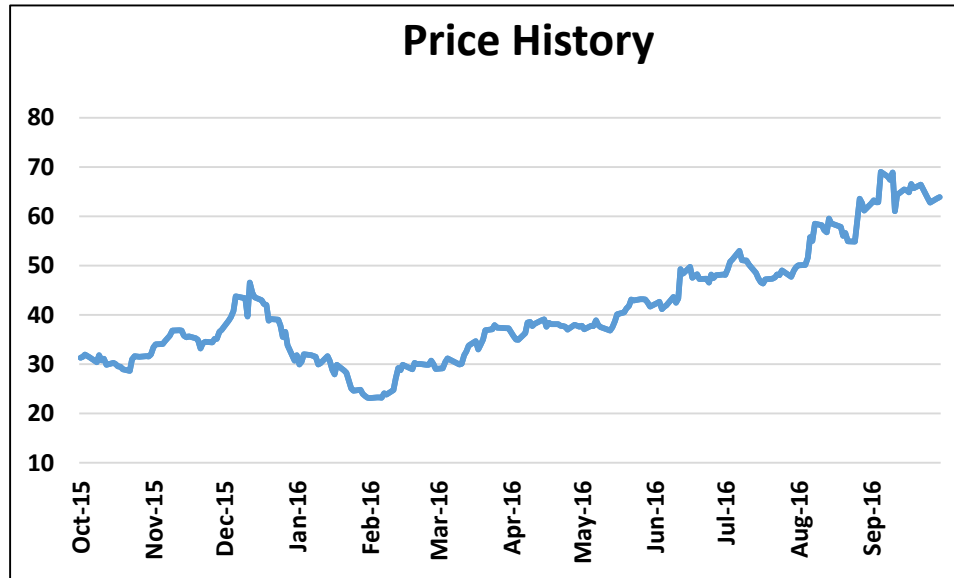
**Key Ratios**

(Rs Cr)	FY14	FY15	FY16	FY17E	FY18E
Reported PBT	-97.2	-240.0	-39.5	5.3	46.0
Interest Expenses	49.4	45.5	48.6	30.7	21.0
Depreciation	20.4	12.1	12.1	11.6	11.8
Working Capital Change	75.5	39.3	18.7	27.0	-5.4
Tax Paid	-2.0	0.0	0.0	0.0	-9.0
<b>OPERATING CASH FLOW ( a )</b>	<b>46.0</b>	<b>-143.2</b>	<b>39.9</b>	<b>74.5</b>	<b>64.3</b>
Capex	-51.3	317.6	-6.4	-10.5	-14.9
Free Cash Flow	-34.7	161.4	8.4	43.9	19.4
Investments	0.0	0.0	0.0	0.0	0.0
Non-operating income	29.4	13.0	25.1	20.1	30.1
<b>INVESTING CASH FLOW ( b )</b>	<b>-56.5</b>	<b>492.0</b>	<b>27.2</b>	<b>53.5</b>	<b>34.5</b>
Debt Issuance / (Repaid)	39.5	-84.9	41.5	-66.5	-64.5
Interest Expenses	-49.4	-45.5	-48.6	-30.7	-21.0
FCFE	-44.6	31.0	1.3	-53.3	-66.2
Share Capital Issuance	0.0	18.6	-5.3	7.9	0.0
Dividend	0.0	0.0	0.0	0.0	0.0
<b>FINANCING CASH FLOW ( c )</b>	<b>-9.9</b>	<b>-111.8</b>	<b>-12.4</b>	<b>-89.3</b>	<b>-85.6</b>
<b>NET CASH FLOW (a+b+c)</b>	<b>-20.4</b>	<b>237.1</b>	<b>54.6</b>	<b>38.7</b>	<b>13.3</b>

Source: Company, HDFC sec Research

**Key Ratios**

(Rs Cr)	FY14	FY15	FY16	FY17E	FY18E
EBITDA Margin	-2.7	-43.7	3.7	7.1	9.5
EBIT Margin	-4.7	-46.6	1.6	5.4	8.1
APAT Margin	0.2	-4.4	-10.4	-57.6	-6.9
<b>Solvency Ratio</b>					
Net Debt/EBITDA (x)	-9.5	-1.2	12.4	3.9	1.4
D/E	2.7	-1.6	-1.5	-2.1	-74.4
Net D/E	2.1	-1.5	-1.4	-1.7	-50.9
Interest Coverage	-1.0	-4.3	0.2	1.2	3.2
<b>PER SHARE DATA</b>					
EPS	0.0	0.0	0.0	0.7	5.2
BV	23.2	-32.1	-30	-14.8	-0.3
<b>Turnover Ratios (days)</b>					
Debtor days	82	131	112	101	105
Inventory days	82	143	61	61	62
Creditors days	196	170	163	171	174
Working capital days	-31.9	104	10	-9	-7
<b>VALUATION</b>					
P/E	0.0	0.0	0.0	0.0	12.8
P/BV	-	-	-	-	-
EV/EBITDA	-19.5	-2.9	25.2	11.3	6.8
EV / Revenues	0.5	1.0	1.0	0.8	0.7



**Rating Definition:**

Buy: Stock is expected to gain by 10% or more in the next 1 Year.

Sell: Stock is expected to decline by 10% or more in the next 1 Year.

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