

Capital Goods



Winds of change: Powering up for sustainable growth

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 - ✓ Railways
 - ✓ Water
 - ✓ Defence
- Private sector capex to increase from PLI, Data Centre, EV etc
 - ✓ PLI-led capex
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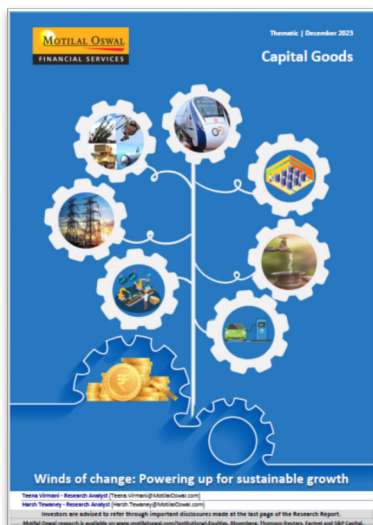
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Capital Goods



Winds of change: Powering up for sustainable growth

The capital goods sector has started benefitting from the government's initiatives towards incremental capex spending, revival in select pockets of the private sector, improving growth outlook from international geographies (particularly GCC nation) and favorable raw material prices. Government has already set the ball rolling by undertaking long-term capex across key areas such as transmission, clean energy, railways, Make in India, PLI, defense indigenization, et al. until FY30, which provides a strong addressable market for capital goods companies. Energy transition-related investments too are driving capex across domestic as well as international markets. The combined capex of government and listed corporates increased to INR21.3t in FY23 from INR14.3t in FY19. This is budgeted to grow to INR26t in FY24 and will move up further with these initiatives. As per our analysis of BSE500 companies, private sector capex has also started growing over last two years and will get further boost from PLI led capex, expected investments in energy transition initiatives as well as growth seen in data centres, EV etc. Thus, we believe that the entire capex is falling in place for the next decade that will augur well for the capital goods companies.

Key areas of investments

We expect uptick in capex to be driven by: 1) government spending across infrastructure segments such as transmission, railways, water, defense, etc., 2) private capex for core sectors, PLI-led schemes, data center and EV/EV charging-led infrastructure, 3) increasing spend towards industrial automation and digitization, and 4) sustainability-led capex.

Increasing acceptance for exports; near-term may remain weak

We expect exports to report near-term weakness owing to slowdown in capex spending seen in developed economies (such as the US and Europe). This can have an adverse impact on product-based companies. Nevertheless, companies are well placed with their product portfolio as well as mandate from global parents to increase exports. Moreover, spending by GCC nations particularly on hydrocarbon, energy transition, new city development and transmission is expected to remain strong over the next few years based on the capex plans of key players.

Raw material price correction provides a tailwind

Correction in raw material prices bodes well for the sector, particularly for companies where fixed-price contracts have a dominant share. We expect product-specific companies to pass on the gains from lower RM prices to consumers. However, EPC companies will still take time to reach the double-digit EBITDA margin mark as competition has increased and companies have been continuously investing in technology, manpower and resources to build capabilities and expand their geographical presence as well as due to low margin legacy projects.

Valuation metrics

Companies	CMP INR	TP INR	Rating
L&T	3,184	3,660	Buy
ABB	4,387	5,280	Buy
Siemens	3,753	4,460	Buy
Bharat Electronics	147	165	Neutral
Thermax	2,610	2,740	Neutral
Cummins	1,920	2,250	Buy
Kirloskar Oil Engine	584	710	Buy
Triveni Turbine	430	520	Buy
Hitachi Energy	4,733	4,150	Sell
KEC Int.	590	640	Neutral
Kalpataru Proj.	668	820	Buy

Sustainability of inflows critical

We have not witnessed any major decline in base order inflows during the quarter except a few companies. Weakness is seen in large orders for product companies. Though inflow growth has slowed down sequentially, the structural trend is positive. One can attribute some improvement to up-fronting of inflows prior to elections but the overall macro environment in growth areas such as transmission, power, railways, PLI, defense, data center, energy efficiency, renewables continues to remain positive. However, sustainability of order inflows is vital from near- to medium-term perspective.

Reinitiate coverage on the capital goods sector with a positive bias

We believe that there are enough levers in place for companies to benefit from the upcoming opportunities across segments over the long term despite near-term disruption due to elections. This provides visibility for healthy revenue CAGR. Strong demand and RM tailwinds are positive catalysts, some of which will have to be passed on by the companies. **We reinitiate coverage on the sector with a positive long-term bias.** However, current valuations for a few of these names have limited risk-reward ratio. **We thus recommend a selective stance on the sector and recommend BUY on L&T, ABB, Siemens, Cummins, Kalpataru Power International, Kirloskar Oil Engine, Triveni Turbine; Neutral stance on BEL, Thermax and KEC and SELL on Hitachi Energy. We are positive on the business models of these companies but would look for better entry points owing to unfavorable risk reward at current valuations.**

Key risks and concerns

a) Slowdown in order inflows; b) election risk; c) Steep increase in raw material prices; and d) Slowdown in exports and international revenue.

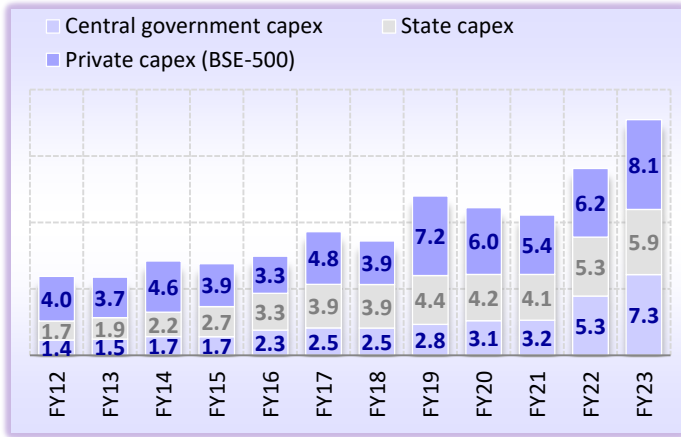
Exhibit 1: Valuation metrics for capital goods companies

Companies	CMP	TP	% upside	Rating	Mcap (INRb)	EPS (INR)			P/E (X)			RoE (%)			RoCE%		
						FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
L&T	3,184	3,660	15	Buy	4,485	98.1	121.9	147.2	32.5	26.1	21.6	15.1	17.6	18.7	7.0	8.1	8.8
ABB India	4,387	5,280	20	Buy	930	56.7	67.8	81.4	77.3	64.7	53.9	21.9	21.5	21.2	22.1	21.6	21.3
Siemens	3,753	4,460	19	Buy	1,337	64.2	76.4	90.6	58.4	49.2	41.4	16.4	17.2	18.0	16.3	17.1	17.9
Bharat Electronics	147	165	12	Neutral	1,078	4.7	5.1	5.7	31.1	28.9	26.0	22.1	20.8	20.4	23.7	22.3	21.8
Thermax	2,610	2,740	5	Neutral	311	51.8	61.0	72.1	50.4	42.8	36.2	14.4	15.2	15.9	12.6	13.1	13.7
Cummins India	1,920	2,250	17	Buy	532.3	45.7	54.6	64.3	42.0	35.2	29.9	22.5	24.4	25.9	10.2	12.1	14.7
Kirloskar Oil Engine	584	710	22	Buy	84.6	23.9	29.9	36.9	24.4	19.5	15.8	14.1	15.8	17.3	13.8	15.6	17.1
Triveni Turbine	430	520	21	Buy	136.7	7.9	10.6	14.0	54.4	40.5	30.7	29.6	31.8	33.1	29.7	31.9	33.2
Hitachi Energy	4,733	4,150	-12	Sell	200.6	28.4	74.5	109.4	166.8	63.5	43.3	9.0	19.1	21.9	10.1	18.8	21.3
KEC International	590	640	8	Neutral	151.6	16.9	30.0	43.6	35.0	19.7	13.5	10.9	17.1	21.0	12.4	15.0	17.6
Kalpataru Projects Int.	668	820	23	Buy	108.5	36.3	55.8	65.8	18.4	12.0	10.2	10.6	14.4	14.8	9.5	12.3	12.8

Source: Company, MOFSL

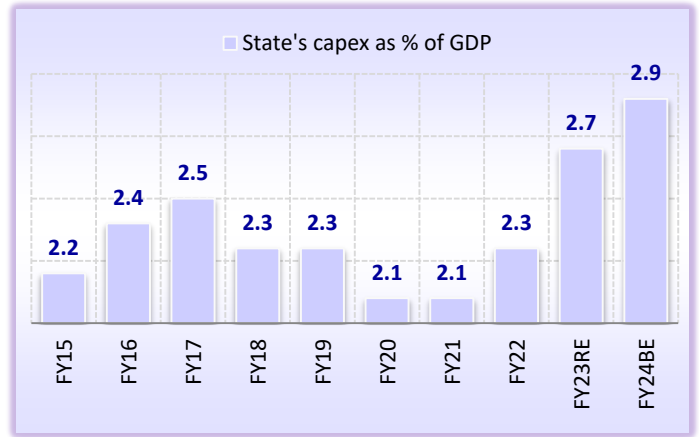
STORY IN CHARTS

Government capex has been growing well while private capex is selective (INR t)



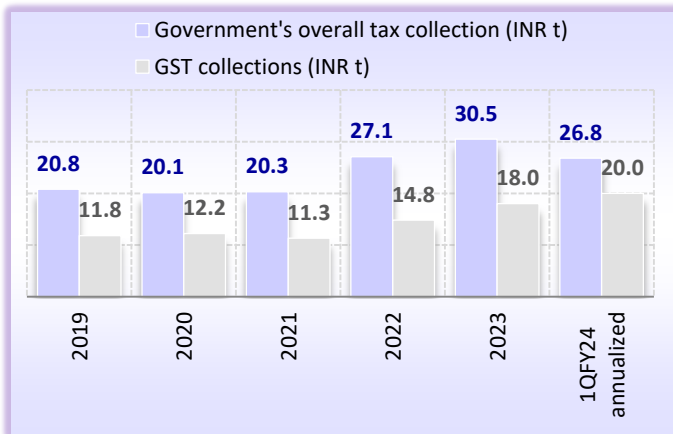
Source: Budget documents, Capitaline, MOFSL

State capex has remained in the range of 2.1-2.3% of GDP and is budgeted to move up in FY2024E (%)



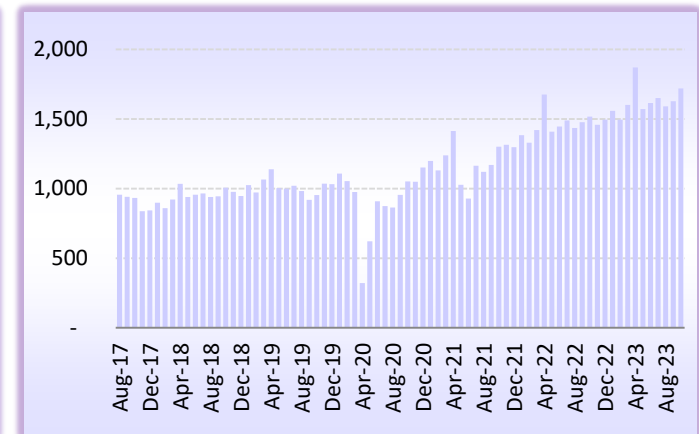
Source: Budget documents, Capitaline, MOFSL

Government's overall tax collections are healthy so far in 1HFY24



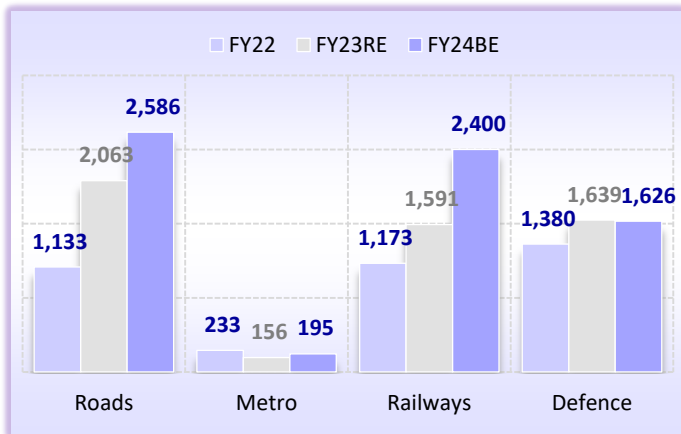
Source: Government documents, MOFSL

Monthly GST collections too are in line with full year target (INR b)



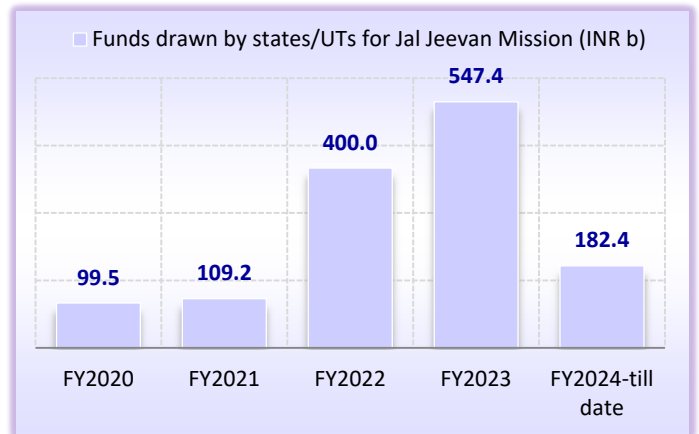
Source: Government documents, MOFSL

Higher budgetary allocation for roads, metro, railways, defence to augur well for the sector (INR b)



Source: Budget documents, MOFSL

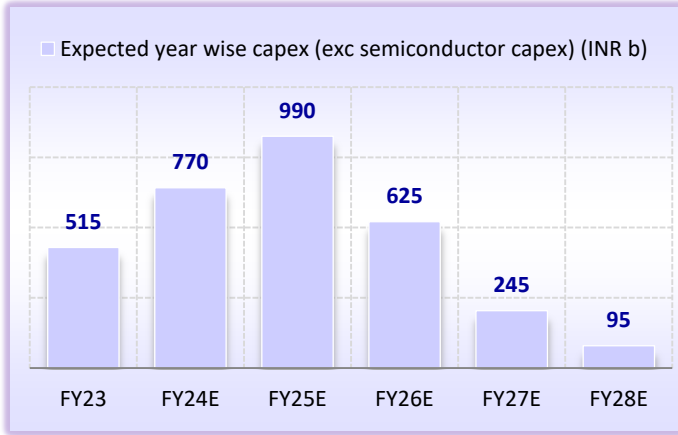
Spending on water is also ramping up from Centre and states for Jal Jeevan Mission (INR b)



Source: Budget documents, MOFSL

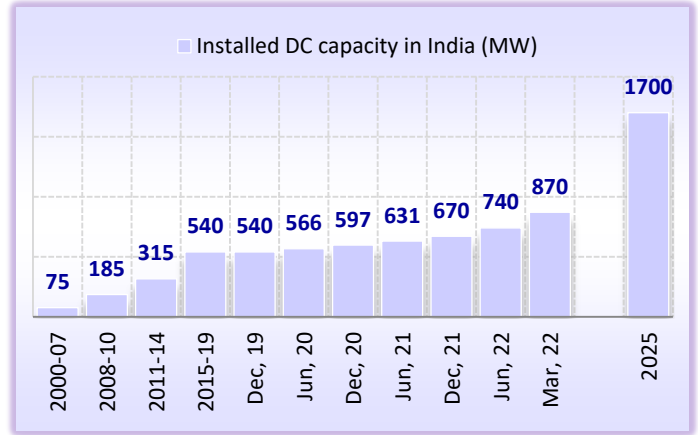
STORY IN CHARTS

PLI led capex will increase over next two years thereby aiding private capex



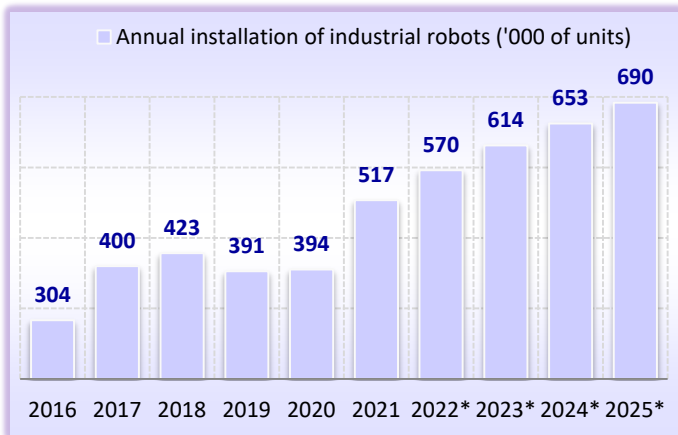
Source: MeITY, MOFSL

Data centre market is also witnessing increasing investments in ramping up capacity (MW)



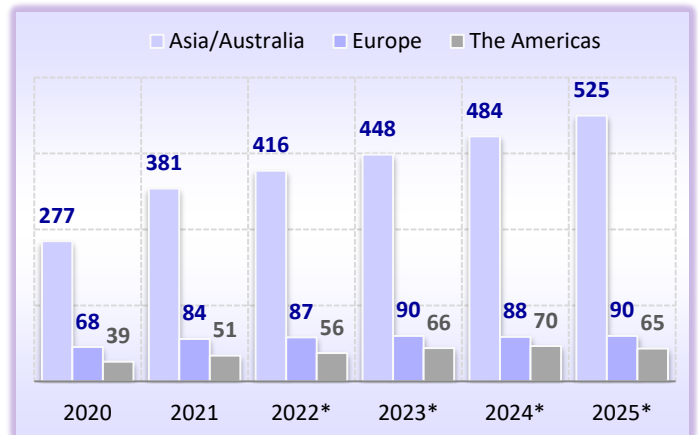
Source: Industry, MOFSL

Global installations of industrial robots 2016-2021 and 2022*-2025*



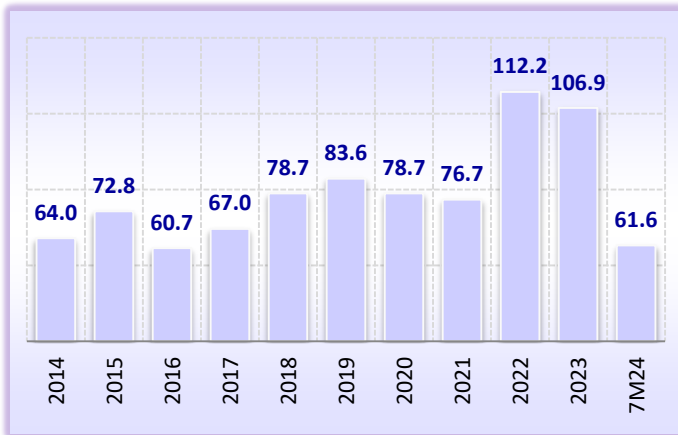
Source: IFR, MOFSL

Country wise annual installations of industrial robots 2016-2021 and 2022*-2025* ('000 of units)



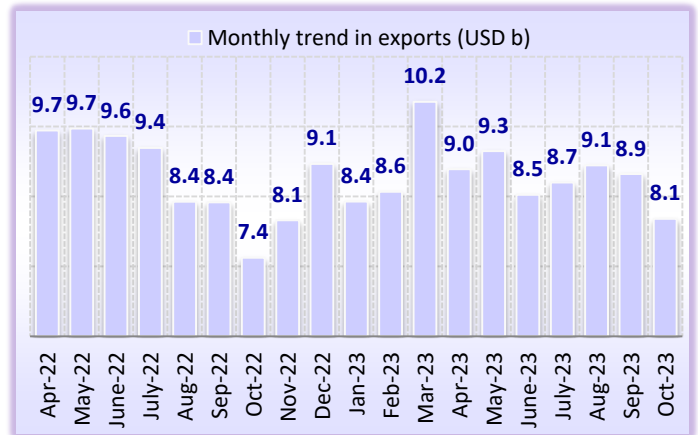
Source: IFR, MOFSL

Engineering exports from India have moved up sharply from FY22; FY24 may see some weakness (USD b)



Source: MOFSL

Monthly exports too have come down in last two months (USD b)



Source: MOFSL

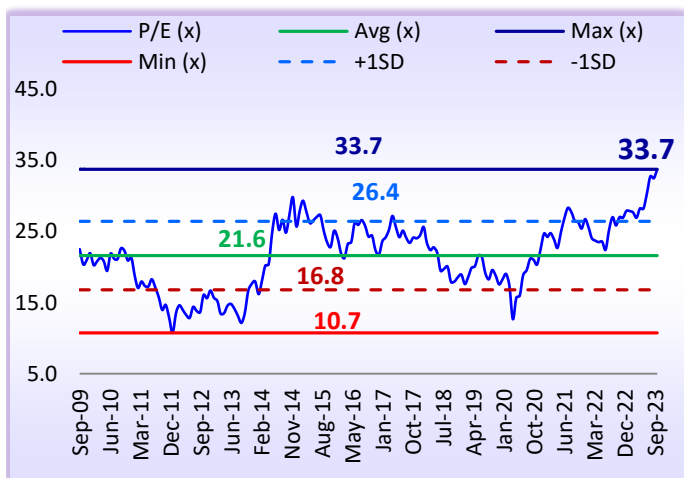
STORY IN CHARTS

Elections schedule in previous cycles didn't impact order inflows adversely in post-election year leaving aside the impact of Covid year in FY20 (INR b)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
L&T - Order inflows	925	1,125	1,367	1,146	1,201	1,274	1,449	1,455	1,330	1,444	1,724
YoY % in election years		21.7	21.5				13.8	0.5			
ABB (Calendar year)	67	79	81	125	58	67	70	59	77	100	124
YoY % in election years		17.7	2.4				3.6	-14.9			
Siemens (Sep ending fiscal)	110	103	101	121	135	127	132	115	145	196	205
YoY % in election years		-5.8	-2.1				3.9	-13.3			
Thermax				44	44	64	56	55	48	94	88
YoY % in election years							-11.7	-2.4			
KEC International (consolidated)	79	85	82	87	124	151	129	113	119	172	224
YoY % in election years		7.8	-3.2				-14.9	-11.8			
KPI (consolidated)	66	59	62	105	88	125	144	99	169	183	231
YoY % in election years		-11.6	5.7				15.4	-31.4			
BEL	55	50	53	178	169	103	234	132	155	194	179
YoY % in election years		-8.3	4.7				128.1	-43.7			

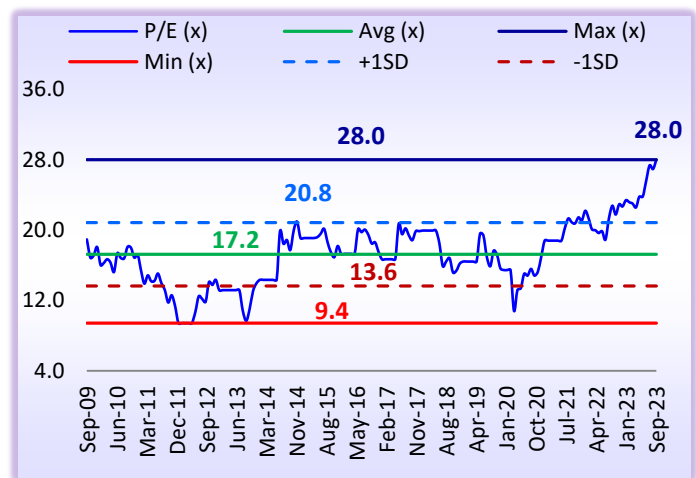
Source: Company, MOFSL

Sector valuations have moved up over last two year - 1 yr fwd P/E for BSE-Capital goods companies



Source: Bloomberg, MOFSL

Sector valuations have moved up over last two year - 2 yr fwd P/E for BSE-Capital goods companies

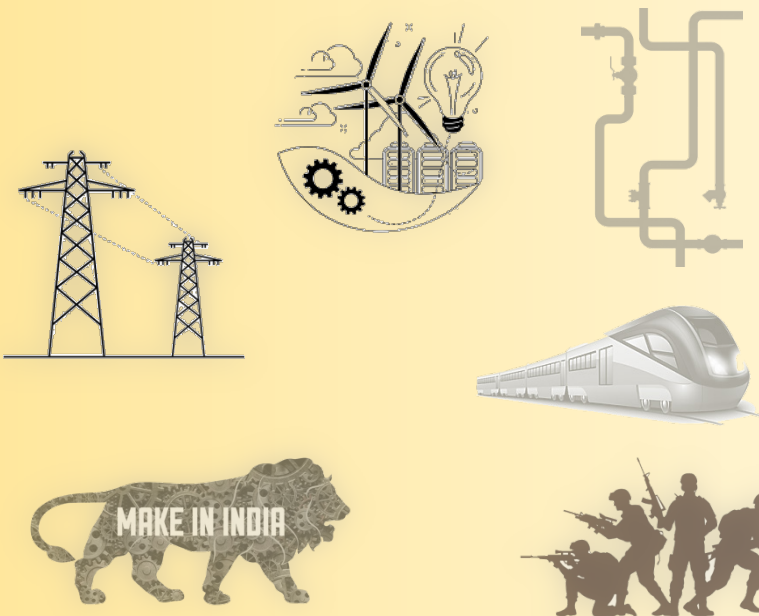


Source: Bloomberg, MOFSL

The capital goods sector has started benefitting from the government's initiatives

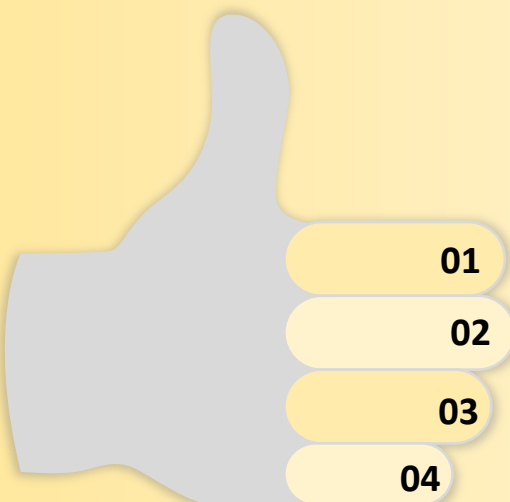


Government undertaking long-term capex across key area



Government has already set the ball rolling by undertaking long-term capex across key areas such as transmission, clean energy, railways, Make in India, PLI, defense indigenization, et al. until FY30, which provides a strong addressable market for capital goods companies.

We expect the uptick in capex to be driven by



1. Government spending across infrastructure segments such as transmission, railways, water, defense, etc.
2. Private capex for core sectors, PLI-led schemes, data center and EV/EV charging-led infrastructure
3. Increasing expenditure towards industrial automation and digitization
4. Sustainability-led capex.

Executive summary

There are enough levers in place for companies to benefit from the upcoming opportunities across segments over the long term

Expectations of sustained levels of high growth and margin improvement have already resulted in valuations re-rating for some of these names

We recommend a selective stance on the sector and recommend BUY on LT, ABB, SIEM, KKC, KPIL, KOEL, TRIV

Long-term structural tailwinds at play

We believe that there are enough levers in place for companies to benefit from the upcoming opportunities across segments over the long term despite near-term disruption due to elections. This provides visibility for healthy revenue CAGR. Strong demand and RM tailwinds are positive catalysts, some of which will have to be passed on by the companies. Near-term weakness in exports may weigh on revenue and margins of companies. However, higher oil prices and incremental spends from GCC nations are positives for EPC companies, which have presence in the MENA region.

Valuations for some stocks factor in some of these tailwinds

Stock valuations for some companies are already factoring in some of these tailwinds related to strong order inflows, revenue growth and margin improvement. Expectations of sustained levels of high growth and margin improvement have already resulted in valuations re-rating for some of these names. Correspondingly, some stocks are already baking in peak cycle earnings growth expectations and peak cycle valuation multiples, thereby leaving limited margin of safety.

Key risks and concerns

- a) **Slowdown in order inflows:** Order inflow momentum has remained strong for the capital goods companies until now. It has been to some extent also supported by up-fronting of order inflows before elections. Any prolonged slowdown even after elections would adversely impact growth assumptions.
- b) **Political risk:** Key risk to our assumptions for order inflows and revenues come from election schedule or change in government or different priorities of government.
- c) **Steep increase in raw material prices:** Corrections in raw material prices have supported margins for most of the companies. However, any adverse movement in raw material prices can hit gross margins.
- d) **Slowdown in exports and international revenue:** Geopolitical turmoil/ prolonged slowdown in Europe and the US would hurt demand growth as well as future investments. This can have an adverse impact on exports, which have remained strong for Cummins and have been on an uptrend for ABB and Siemens.

Select stocks would continue to outperform

We reinitiate coverage on the sector with a positive long-term bias. However, current valuations for a few of these names have limited risk-reward ratio. We thus recommend a selective stance on the sector and recommend BUY on L&T, ABB, Siemens, Cummins, Kalpataru Power International, Kirloskar Oil Engine, Triveni Turbine and Neutral stance on BEL, Thermax and KEC and SELL on Hitachi Energy. We are positive on the business models of these companies but would look for better entry points owing to unfavorable risk reward at current valuations.



L&T

L&T, a prominent player in India's capex cycle, is poised to experience accelerated growth over the next five years compared to the previous five year cycle.

- Over the last five years, L&T has focused on (1) large and mega -sized projects where competition is lesser, (2) diversified mix of projects with increased inflows from international geographies, (3) improving RoIC through a combination of margin improvement and efficient working capital management, (4) exiting non-core assets and optimizing capital allocation.
- The next three to five year journey looks promising and we expect (1) L&T to post 16%+ CAGR in core E&C revenue over FY23-26 on the back of strong OB (INR4.5t+; OB/Rev: 2.8x), (2) Core E&C earnings to compound at ~24% during the same timeframe, driven by revenue growth and margin improvement; (3) divestment of Nabha Power and potential divestment of Hyderabad Metro to gradually free up capital from non-core assets; (4) high likelihood of higher dividends / buybacks, potentially occurring every two years, thereby boosting RoEs.
- We reinitiate coverage on the stock with a BUY rating and a TP of INR3,660 on SOTP basis on two year forward earnings.



ABB India

ABB is a play on improving investments across energy efficiency, sustainability, government led infrastructure investments, capex revival led by PLI schemes as well as increasing spend towards automation and digitization

- The company has benefited from short-cycle orders, which has sustained the momentum in base orders translating into order inflow CAGR of 13% over CY2019-CY2022. During this period, EBITDA margin also improved 390bp.
- Driven by strong opportunity pipeline across data center and T&D (electrification), railways (electrification and mobility), and PLI-led capex (industrial automation and robotics) over the next five years, we expect ABB's revenue/EBITDA/PAT to report a CAGR of 23%/30%/36% over CY22-25.
- The stock is currently trading at 65X/54X P/E on CY24/25E. We value the stock on DCF basis at arrive at a TP of INR5,280 implying 65X P/E on CY25E earnings. This takes into account 21% decadal revenue and EBITDA CAGR each and 11% PAT margin over the same period in our DCF assumptions. We reinitiate coverage with a BUY rating.

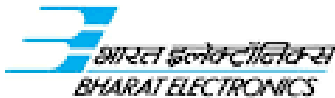


Siemens

Siemens has been a beneficiary of uptick in spending on railways as well as expected spend on T&D network by government. It is also benefiting from decarbonization related initiatives from corporates and uptick in investments in data centre, automation and digitization.

- With large order inflows coming in from electric locomotives and metro, order inflow CAGR stood at 14% over FY2019-FY2022. With an expected spend of INR2.4t in transmission and an additional INR10-11t in metros, RRTS, locomotives until FY30, coupled with INR400-450b investment in data centres over next three to four years, we expect the company to actively pursue opportunities within these segments.

- We believe that recent announcements related to purchase of 18% stake of Siemens Energy Global in the company by Siemens AG eases concerns related to problems being faced by Siemens Energy globally. Potential demerger and listing of Siemens India Energy segment opens avenues for value unlocking over next 2-3 years.
- We expect the company to clock revenue/EBITDA/PAT CAGR of 15%/17%/18% over FY22-25. The stock is currently trading at 58.4X/49.2X P/E on FY24/25E. We value it at INR4,460 based on 55X P/E on two year forward earnings and at 15% discount to ABB. We reinitiate coverage on Siemens with a BUY recommendation.



Bharat Electronics

Bharat Electronics (BEL) is well positioned to benefit from (1) growing defense expenditure by the government, (2) its focus on indigenization and presence in multiple segments, (3) strong manufacturing base, (4) strategic technology tie-ups and in-house R&D, (5) improving share of non-defense segments, and (6) focus on increasing exports.

- We expect a 15% CAGR in BEL's order inflows over FY23-26, resulting in a CAGR of 14%/13%/11% in revenue/ EBITDA/PAT of over the same period.
- We value the company at 28x two-year forward earnings at INR165 and reinitiate coverage on the stock with a NEUTRAL rating. Key risks to our estimates and rating would come from delays in the finalization of large tenders, margin pressure and higher working capital.



Thermax

Thermax is well prepared to be a partner for its customers in their energy transition journey.

- Over the years, it has reduced its dependence on traditional thermal power projects by increasing the share of green projects and is now building capabilities and expanding across biomass, waste to energy, solar and chemicals. It has signed technology tie ups for venturing into hydrogen energy projects and we also expect it to benefit with its product offerings for ultra-pure water needed for semiconductor manufacturing.
- In the near term, ordering activity is dominated mainly by base orders which has weakened yoy while large sized orders will get finalized in coming quarters. We expect margins to benefit from low raw material prices and easing supply chain issues.
- Over FY23-26, we expect Thermax to post a 14% CAGR in revenue on the back of a strong order book (INR103b; OB/Rev: 1.1x). We estimate a 21% CAGR in earnings, aided by revenue growth and margin improvement. We value Thermax at 38X two-year forward estimated earnings and add value from green solutions. We reinitiate coverage on Thermax with a Neutral rating and a TP of INR2,740 and would look for better entry points in the stock.



Cummins India

Cummins India has benefited from strong demand in the powergen and distribution segments and a revival in exports over the last two years.

- While the implementation timeline for pollution norms CPCB 4+ has been revised, the company is ready with both types of products, CPCB 2 and CPCB 4+, as it has control over its supply chain. Moreover, Cummins keeps developing new products for industrial, distribution and fit-for-market (FFM) products for export markets.
- We expect a 14% CAGR in revenues during FY2023-26, driven by faster growth in the powergen and distribution segments. Exports are expected to remain weak in the near term, which may weigh on margins. However, the company has levers to reduce costs for new gensets with more localization. We expect margin improvement of 50bps over FY2023-26, resulting in a 16% PAT CAGR over the same period.
- We value Cummins at 34X P/E on two-year forward earnings at INR2,250. Reinitiate with a BUY rating. Key risks include a sharper-than-expected slowdown in exports, sooner-than-expected transition toward clean sources of fuel and the company's inability to keep pace with new products.



Kirloskar Oil Engine

KOEL is benefiting from strong demand in the powergen, industrial, and distribution segments and is targeting to increase its exports from current levels.

- The company is already ready with products related to revised pollution norms for CPCB 4+ and has also introduced several fuel agnostic products. The company has a market leadership in the mid-kVA range and has also introduced new products in the 1,500 kVA range. With several new products and focus on increasing exports, distribution and aftermarket and higher market share in existing segments, company has lined out a plan to double its revenues in 3 years.
- We expect revenues to grow at a CAGR of 16% between FY2023-26E driven by faster growth in powergen/industrial/distribution segment while exports will gradually start inching up. We expect margin improvement of 180 bps over FY23-26E, resulting in 25% PAT CAGR over the same period.
- We value the company on SOTP methodology valuing core business at 18X P/E on two-year forward earnings. Initiate with a BUY rating with TP of INR710. Key risks to recommendation would come from sharper-than-expected slowdown in exports, slowdown in demand for powergen and industrial segments and higher commodity prices.



Triveni Turbine

Triveni Turbine (TRIV) is a market leader in the below-30MW domestic turbine market. TRIV has a market share of ~50-60% in the category and is supported by high demand from industrial capex in the domestic market.

- Over the years, the company has also intensified its presence in international markets and is benefitting from increasing investments in renewables and waste-to-energy as well as improved after-market demand. The company reported a revenue/EBITDA/PAT CAGR of 10%/11%/18% over FY19-23.

- We believe TRIV would continue to benefit from: 1) its market leadership in the turbine market below 30MW; 2) higher share of exports and aftermarket, which results in better margins than competitors; and 3) enhanced scope for API turbine of refineries.
- We expect TRIV's revenue/EBITDA/PAT to clock a CAGR of 31%/34%/32% over FY23-26. Backed by a comfortable negative working capital cycle, strong margins and low capex requirements, we expect OCF and FCF to report a CAGR of 39%/45% over the same period. We value the company at 39X two-year forward earnings to arrive at our TP of INR520. We initiate coverage on the stock with a BUY rating.



Hitachi Energy

Hitachi Energy, with its diverse product portfolio, is likely to be a key beneficiary of the expected spend in transmission, railways, data center, and EV.

- With a variety of technology-driven solutions addressing transmission, grid stability, railways, data centers, etc., the company has an edge over its peers.
- We expect the company's revenue/PAT to report a CAGR of 20%/70% over FY23-26. This would be led by order inflow growth of 7% and margin improvement of 475bp over the same period. We expect margin improvement to be driven by moderating supply chain issues and higher share of services and exports.
- We value the stock on DCF basis at INR4,150 implying a 41X P/E on two-year forward. This takes into account 17% decadal revenue growth and EBITDA margin improvement to 10% from current levels of 4.4%. We also bake in EBITDA margin to improve to 10% by FY26. We initiate coverage on the stock with a SELL rating as current valuations are already baking in potential positives from strong addressable market and margin improvement. We would look for better entry points in the stock.



KEC International

KEC is ideally positioned to capitalize on upcoming opportunities in the transmission and civil segment.

- Over FY21-23, the company has grown its order inflow/order book at a CAGR of 37%/26%, mainly driven by civil and Transmission & Distribution (T&D) sectors. Company remains focused on (1) maintaining its market share in domestic T&D projects and widening its presence in international T&D, (2) diversifying across various segments in civil projects, (3) concluding legacy projects, and (4) minimizing working capital and borrowings.
- Over FY23-26E, we expect (1) KEC to post 17% revenue CAGR, on the back of strong OB (INR313b; OB/Rev: 1.5x), (2) EBITDA to compound at ~40% during the same time period on margin improvement from the low base of FY23; (3) stable working capital cycle. We expect overall borrowings and interest expenses to remain high over FY23-26.
- We reinstate coverage on the stock with a Neutral rating and a TP of INR640 based on 16X two year forward earnings and would look for better price points.



Kalpataru projects international

Kalpataru Projects International Limited (KPIL) is benefiting from improved ordering in the T&D, Water, and B&F segments.

- It has reported a 36% CAGR in order inflows during FY20-23 driven by B&F and Civil, and followed by a revival in T&D. The company is already driving cost-optimization initiatives post-merger with JMC Projects (JMC) and it has aligned the interest rate of JMC with KPIL.
- We expect KPIL to: 1) maintain its market share in domestic T&D ordering, 2) scale up its presence in non-T&D segments across international markets, 3) focus on achieving 4.5-5.0% PBT margin over the next few years through interest cost savings and working capital management, and 4) improve its RoCE by monetizing non-core assets.
- Over FY23-26, we expect: a) KPIL to post 19% CAGR in revenue backed by strong order book (OB; INR470b; OB/Revenue: 2.5x), b) EBITDA to compound at ~23% during the same period led by margin improvement, and c) working capital cycle of 120 days. We expect limited reduction in borrowings and interest expenses over FY23-26 as the company is on a high-growth path, which requires continuous capex and working capital. We initiate coverage on KPIL with a BUY rating and a TP of INR820 (based on SoTP methodology and 13X two year forward earnings for core business). The stock trades at a sharp discount of 37% to its nearest peer KEC. Promoter pledge continues to remain a key overhang on the stock.

Exhibit 2: Valuation metrics for capital goods companies

Companies	CMP	TP	% upside	Rating	Mcap (INRb)	EPS (INR)			P/E (X)			RoE (%)			RoCE%		
						FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
L&T	3,184	3,660	15	Buy	4,485	98.1	121.9	147.2	32.5	26.1	21.6	15.1	17.6	18.7	7.0	8.1	8.8
ABB India	4,387	5,280	20	Buy	930	56.7	67.8	81.4	77.3	64.7	53.9	21.9	21.5	21.2	22.1	21.6	21.3
Siemens	3,753	4,460	19	Buy	1,337	64.2	76.4	90.6	58.4	49.2	41.4	16.4	17.2	18.0	16.3	17.1	17.9
Bharat Electronics	147	165	12	Neutral	1,078	4.7	5.1	5.7	31.1	28.9	26.0	22.1	20.8	20.4	23.7	22.3	21.8
Thermax	2,610	2,740	5	Neutral	311	51.8	61.0	72.1	50.4	42.8	36.2	14.4	15.2	15.9	12.6	13.1	13.7
Cummins India	1,920	2,250	17	Buy	532.3	45.7	54.6	64.3	42.0	35.2	29.9	22.5	24.4	25.9	10.2	12.1	14.7
Kirloskar Oil Engine	584	710	22	Buy	84.6	23.9	29.9	36.9	24.4	19.5	15.8	14.1	15.8	17.3	13.8	15.6	17.1
Triveni Turbine	430	520	21	Buy	136.7	7.9	10.6	14.0	54.4	40.5	30.7	29.6	31.8	33.1	29.7	31.9	33.2
Hitachi Energy	4,733	4,150	-12	Sell	200.6	28.4	74.5	109.4	166.8	63.5	43.3	9.0	19.1	21.9	10.1	18.8	21.3
KEC International	590	640	8	Neutral	151.6	16.9	30.0	43.6	35.0	19.7	13.5	10.9	17.1	21.0	12.4	15.0	17.6
Kalpataru Projects Int.	668	820	23	Buy	108.5	36.3	55.8	65.8	18.4	12.0	10.2	10.6	14.4	14.8	9.5	12.3	12.8

Source: Company, MOFSL

Stage is already set for a decadal growth opportunity

Capital goods sector has seen a healthy growth in inflows fueled by central government capex, state capex was muted while private capex was selective

Capital goods sector has seen a healthy growth in inflows fueled by government capex mainly in railways, metros, water, transmission as well as defense. With elections nearing in FY25, up-fronting of inflows was also seen in EPC companies. State government capex was muted but private sector capex was selective. Sustainability of short-cycle orders from private sector drove inflows of most of the product companies. Government has already set the ball rolling by undertaking long-term capex across key areas such as transmission, clean energy, railways, Make in India, defense indigenization, et al. until FY30, which provides a strong addressable market for capital goods companies. Correction in raw material prices provides tailwinds to margins. Export growth may get hit in the near term due to the ongoing weak global macros.

We highlight the key long-term growth themes of the sector below:

Capex growth to start improving

Centre and state capex put together was ~INR11t in FY22 and INR13.5t in FY23RE. This is projected to grow to INR17t in FY24

We look at the capex from all three entities – central government capex, state government capex and corporate capex of both private and PSU companies.

Government capex is already on an uptrend

Government has already set the ball rolling by undertaking long-term capex across key areas such as transmission, clean energy, railways, Make in India, defense indigenization, et al. until FY30, which provides a strong addressable market for capital goods companies. Center and state capex put together was ~INR11t in FY22 and INR13.5t in FY23RE. This is projected to grow to INR17t in FY24. Government's pace of capex has remained healthy at 47% of FY24BE in 1HFY24 led by higher spending on roads and railways. This is led by strong tax receipts in 1HFY24 with direct tax collections growing at 25% yoy and GST collections growing by 9% yoy in 1HFY24. State government capex was weak in most of the states till FY22 and is budgeted to grow in FY24.

Private sector capex is recovering selectively

While green shoots are visible we expect private capex to take some more time to revive

Revival in overall private capex is still slower than expectations but has seen an uptick across sectors such as cement, pharmaceuticals, chemicals, telecom, food & beverages, and metals & mining in FY23 based on our assessment of BSE500 companies. We see select pockets where opex-led spend towards greener sources of energy and sustainability is happening. We expect the private capex cycle to take some more time to revive. However, we see drivers for capex cycle in the form of: 1) deleveraged balance sheet and improving capacity utilization across key sectors, 2) PLI-led capex, which has so far remained below expectations, 3) increased spend towards digitization and automation, thus driving growth for data centers and 4) green energy-related capex such as EV, renewable energy, etc.

Exhibit 3: Government capex has been growing well while private capex is selective (INRt)

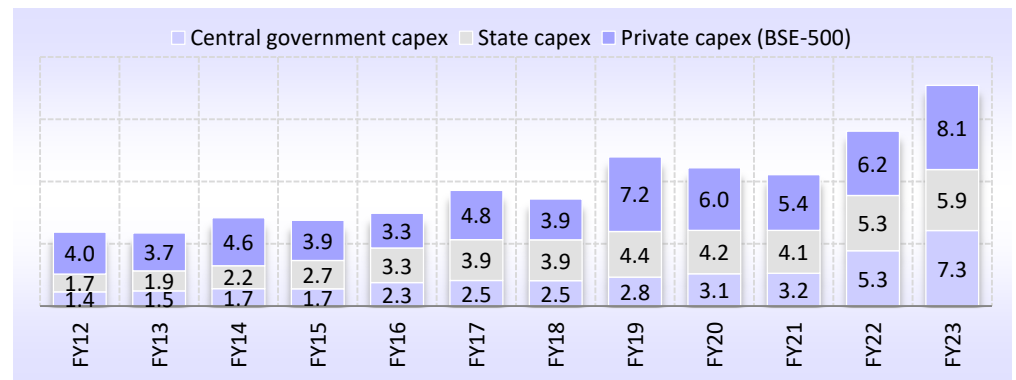
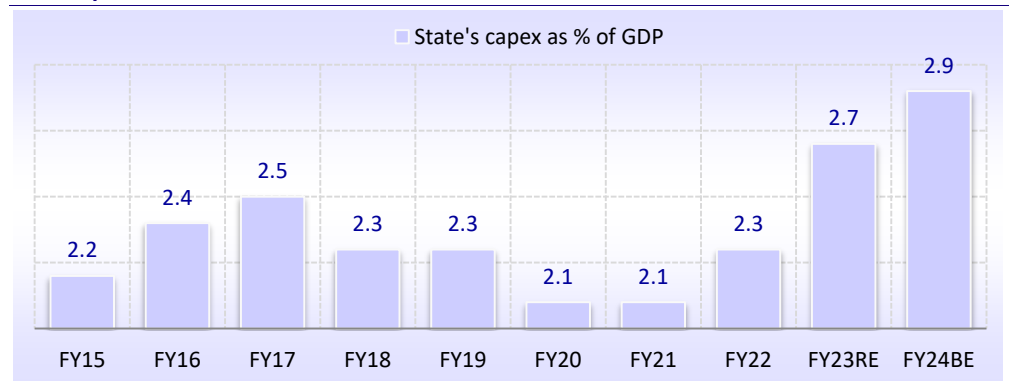


Exhibit 4: State capex has remained in the range of 2.1-2.3% of GDP and is budgeted to move up in FY2024E



Source: Budget documents, Capitaline, MOFSL

Exhibit 5: Government's overall tax collections are healthy so far in 1HFY24

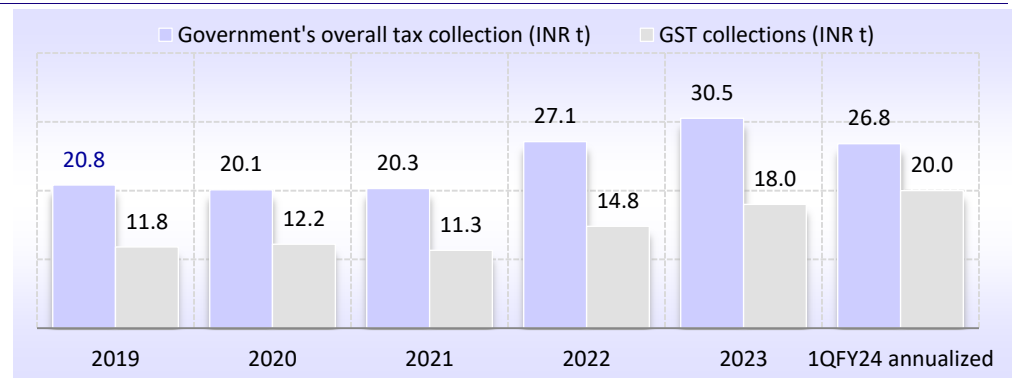
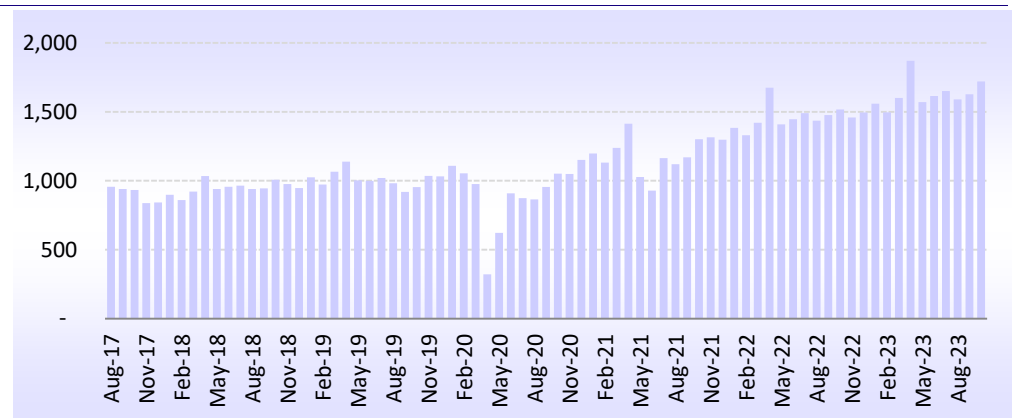


Exhibit 6: Monthly GST collections are also in line with full year target (INR b)



Source: Government documents, MOFSL

Key areas of investments

- We expect the uptick in capex to be driven by: 1) government spending across infrastructure segments such as transmission, railways, water, defense, etc., 2) private capex for core sectors, PLI-led schemes, data center and EV/EV charging-led infrastructure, 3) increasing expenditure towards industrial automation and digitization, and 4) sustainability-driven capex.
- Government has outlined various capex plans for transmission, railways, highways, water, and defense indigenization as well as several PLI schemes. Though we believe that these targets are aggressive as compared to past run-rates, even a 60-70% achievement ratio of the said targets can result in significant long-term opportunity for the sector. Several ministries have already kick-started the awarding process. Given the large size of investments required, this would also result in increased private sector participation in the upcoming projects.

Transmission line network worth INR2.4t will have to be set up before renewable energy capacity gets commissioned

Government-led capex is witnessing an uptick across:

Transmission: Current power deficit necessitates higher renewable power

Government of India has an ambitious target of reaching 537GW of renewable capacity (including hydro) by FY30 from an existing operational capacity of 166GW. To achieve this goal, transmission line network worth INR2.4t will have to be set up before renewable energy capacity gets commissioned. These will result in an opportunity of almost INR240b per year over and above the existing planned expansion of INR1.2t lined up by Inter State Transmission System (ISTS) until FY26 (~INR240b per year).

Based on current CEA's line-up of projects, an opportunity pipeline worth INR760b is expected to get finalized in the next 1-2 years, which would also result in ramping up of domestic T&D ordering.

Exhibit 7: Transmission line network worth INR2.4t will have to be set up before renewable energy capacity gets commissioned

Details	Capacity (GW)
RE capacity already commissioned	166
66.5 GW RE capacity to be integrated to ISTS network (8.8 GW already commissioned)	58
Additional RE capacity to be integrated to ISTS network (55 GW+181.5GW)	237
Margin already available in ISTS sub-stations which can be used for integration	34
Balance RE capacity from GEC-1 to be integrated to intra-state system	7
RE capacity from GEC-II to be integrated to intra-state system	19
Additional hydro capacity likely by FY2030	17
Total RE capacity targeted till FY2030	537

Source: Ministry of Power, MOFSL

Additionally, four HVDC projects are lined up for implementation apart from the Leh-Ladakh HVDC project, which has already been awarded to PGCIL. For the Leh-Ladakh project, The Union Cabinet, chaired by Prime Minister Narendra Modi, has given its approval for 13 gigawatt renewable energy project in Leh-Ladakh. The next project to be taken up for bidding will be the 800kV Bhadla-III – Fatehpur HVDC line and Khavda-Aurangabad HVDC line.

Exhibit 8: HVDC projects lined up for integration of additional RE capacity by FY2030

Sr no	Project name
1	800 kV Bhadla-III - Fatehpur HVDC line
2	350 kV Pang - Kaithal HVDC line
3	800 kV Barmer-II - Jabalpur HVDC line
4	800 kV Khavda - Aurangabad HVDC line

Source: CEA, MOFSL

Players active on the TBCB side are Power Grid, Adani Transmission, Sterlite Power, Renew Power and a few infrastructure companies. EPC market on transmission side has also been dominated by 4-5 players such as L&T, KPTL, KEC, and Tata Projects. The EPC market is now witnessing entry of newer players such as Trans Rail, Jyoti Structure and infrastructure companies.

Government has earmarked a record INR2.4t for railways

Railways: Focus on improving railway infrastructure**Intensified government interest on improving railway infrastructure**

The government is focusing on improving the railway infrastructure and it has implemented a range of measures to drive this transformation: a) increasing the budget allocation to INR2.4t for FY24E, b) introducing innovative wagon designs and ramping up locomotive demand, c) awarding more contracts for manufacturing high-end passenger trains, such as Vande Bharat, d) inviting private sector participation in wagon manufacturing and e) expanding the nationwide metro network in the country.

Tendering process underway for electric locomotives and Vande Bharat

The government has already awarded contracts for the following projects: a) Siemens has been awarded the tender for 1,200 units of 9000HP electric locomotives at ~USD3b, b) the government has also called for bids for 800 units of 12,000 HP electric locomotives – though the awarding of this project has been consistently postponed, c) the awarding process for 200 train-sets designed for the Vande Bharat sleeper-type train has been finalized and split between two consortiums: TMH+RVNL and Titagarh Wagons+BHEL at an estimated tender value of USD3.5b, d) the financial bids for 100 aluminum train-sets with a distributed power system have been opened. The fifth tender for 100 aluminum train-sets with a concentrated power system has currently been postponed.

Upcoming opportunities on locomotives and coaches

According to industry estimates, yearly locomotive production is expected to be ~1,290 and yearly train-set production is likely to be in the range of 4,200-6,400 over the next five years. This includes T-18 coaches, private tenders for Vande-Bharat trains as well as LHB coach production.

Exhibit 9: 5-year forecast of E-locomotive production

	FY23	FY24	FY25	FY26	FY27	FY28
IR Loco estimated production	1,190	1,190	1,120	1,050	1,010	990
Private - Alstom (Madhavpura)	100	100	100	100	100	100
Private - Siemens - 1,200 Locos(Dahod)	-	5	35	80	80	100
Private - 800 Locos - BLW	-	-	-	60	100	100
Total	1,290	1,295	1,255	1,290	1,290	1,290

Source: Indian Railways, Industry Estimates

Exhibit 10: 5-year forecast of trainset coach production

	FY23	FY24	FY25	FY26	FY27	FY28
IR LHB coach estimates	5,896	4,354	4,000	3,000	2,500	2,000
T-18 coaches by IR	250	1,072	500	500	500	500
Private - 200 VB trainsets	-	-	64	576	768	960
Private - 100 AL trains	-	-	32	240	320	400
Private - 100 AL trains - push pull	-	-	32	240	320	400
Total	6,146	5,426	4,628	4,556	4,408	4,260

Source: Indian Railways, Industry Estimates

This is in line with the IR plan for future trains. Another opportunity that is being lined up by IR is installation of Kavach alongside the entire railway network of nearly 68,500 route kilometer (rkm). With an average costing of nearly INR5m per rkm, a target market of INR340b over next five years opens up for players active in the space. So far, Kavach has been deployed on only 1,465 rkm and 121 locomotives.

Exhibit 11: Unit costing of Vande-Bharat train sets and key beneficiaries (INR m)

Component	Basic unit rate	Quantity	Total	Key players
Propulsion system inc traction converters, brake chopper resistors, traction motor, transformers, auxilliary convertors, pantographs,, RMPU's, lighting, assembled bogies	500	1	500	❖ Medha, Alstom, Siemens, BHEL, Titagarh, CG Power
Complete sheel kit per coach	3.5	16	56	❖ DTL, Pennar, Airflow, Universal, Chennai Radha, EC Blades
Turnkey furnishing	5	16	80	❖ BFG, MSL, HFL, Kineco, Airflow
Seat - Economy class	5	14	70	❖ Ster, Tata, Airflow, Advanced Silicones
Seat - Executive class	6	2	12	❖ Ster, Tata, Airflow, Advanced Silicones
Vacuum evacuation system	2.5	16	40	❖ EVAC, Glova, Oasis
Brake system	5	16	80	❖ Knorr Bremse, Wabtec
Nose Cone	1	2	2	❖ BFG, MSL, HFL, Kineco, Airflow
Gangway	2	2	4	❖ Hubner, Dellner
Misc- Mechanical	2	16	32	❖ Several players
Misc - Electrical	2.5	16	40	❖ Several players
Total			916	

Source: Industry, MOFSL

Demand for coaches and wagons to be driven by upcoming metro projects and freight wagon requirements

For the upcoming metro rail network of 1,194 km until FY32, nearly 4,800 coaches will be required that will translate into 480 coaches per year. With an average bid of ~INR100m per coach, this results in an addressable opportunity of INR48b yearly for key players. IR is also likely to finalize award for 60,000 freight wagons over the next 1-2 months. Assuming an average cost of INR4m per wagon, an addressable market

of INR250b over next five years (INR50b per year) will be available for wagon manufacturers. Thus, we believe that in order to participate in the upcoming opportunities for coaches and wagons, players will also have to ramp up capacities and government will also have to encourage foreign player participation in partnership with domestic players.

Exhibit 12: Metro rail planned network in the country till FY2032 (km)

City	Planned network (km)
Delhi and NCR	82
Mumbai	113
Bengaluru	106
Chennai	134
Gurugram	199
Kolkatta	44
Lucknow	85
Navi Mumbai	83
Bhopal	77
Hyderabad	63
Nagpur	48
Indore	57
Pune	31
Noida	15
Surat	23
Kochi	11
Jaipur	23
Total	1,194

Source: Industry, MOFSL

Exhibit 13: Recent bids for metro rail coaches (INR m)

Metro	No. of coaches	Awarding year	Bid per coach	Winning player
Bangalore Metro	318	2023	72.0	BEML
DMRC RS17	312	2022	76.6	Alstom
Chennai Metro	78	2022	121.4	Alstom
Agra - Kanpur	201	2020	82.1	Alstom
Mumbai line 4	234	2021	79.0	Cancelled by Alstom
Additional Bangalore Metro	216	2020	73.1	Earlier CRRC, now TRSL

Source: Industry Estimates, MOFSL

Key players in metro coaches are BEML, Alstom, Bombardier, Titagarh Firema and key players in metro coach components are Knorr Bremse, Faiveley Transport, ABB, Siemens, Sidwal, Mitsubishi Electric, Schunk, Dellner India, and Automator Alliance. Key players in wagon manufacturing are Texmaco, HEI, Titagarh, Jupiter Wagons, Braithwaite, SAIL RITES, Oriental Foundry, etc.

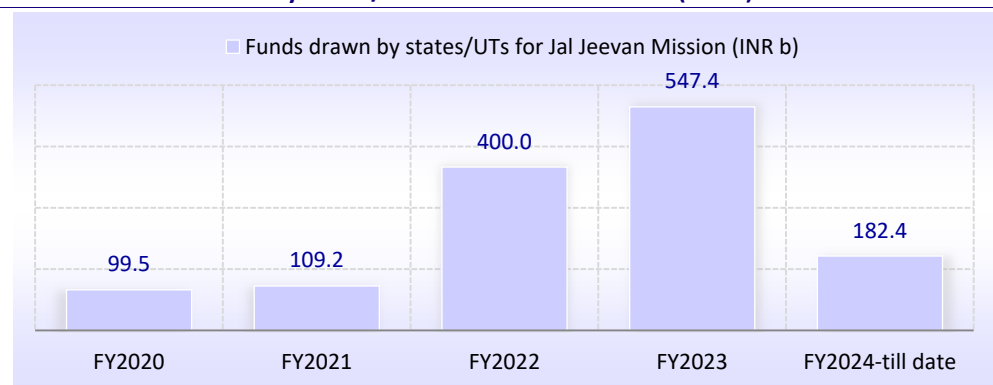
Out of and allocation of INR3.6t, INR1.4t has already been spent and we expect the balance to be spent in the next 1-2 years

Water: Spending on Jal Jeevan Mission to continue for another few years

Government launched Jal Jeevan Mission during FY20 at a total project cost of INR3.6t to provide tapped drinking water for all by FY24. An amount of ~INR1.4t has been spent over FY20-23 and we expect the remaining amount to be spent over the next 1-2 years, factoring in a one-year delay. Most of the EPC companies such as L&T, KEC, Kalpataru Projects International (JMC projects) were beneficiaries of the incremental spend towards JJM and we expect this to continue going forward also. We anticipate players like ABB and CG Power to benefit too. ABB's offerings include LV Switchgear & components, Automation & Instrumentation, Motors, Drives,

Digital solutions for treatment plants, pumping stations and lift irrigation for water-related projects.

Exhibit 14: Funds drawn by states/UTs for Jal Jeevan Mission (INR b)



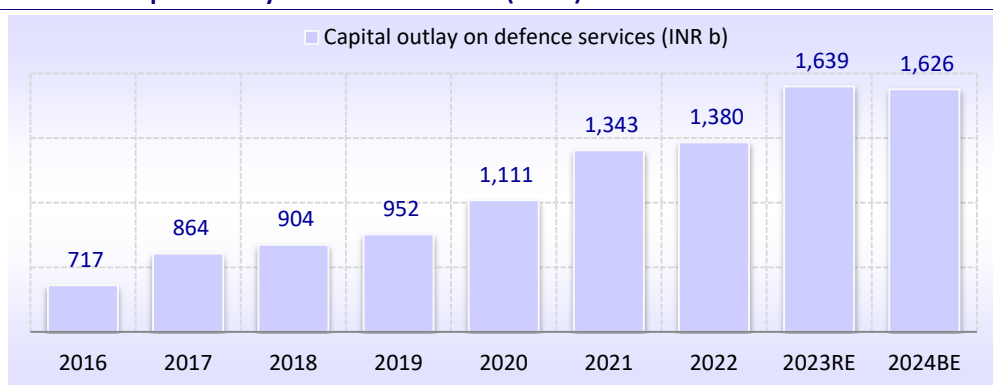
Source: Budget documents, MOFSL

With the four import embargo lists, MoD expects indigenization potential to be worth more than INR5t over the next five years

Defense: Focus on defense indigenization remains

Overall defense budget as a percentage of GDP has remained ~1.5% and government has made a budgetary allocation of INR1.6t for defense capital expenditure for FY24. In line with the self-reliant India initiative, the share of domestic capital procurement that was earmarked at 68% in 2022-23 has been enhanced to 75% of the capital acquisition budget of Defense Services for FY23-24. Over the last few years, to provide impetus to self-reliance in defense manufacturing, the government has modified and simplified the policies of private partnership and defense procurement through Defense Production and Export Promotion Policy (DPEPP 2022), Defense Acquisition procedure (DAP 2020), Strategic partnership model, reorganization of ordinance factories, defense production hubs and AGNIPATH scheme for recruitment of youth in the Armed Forces. The Ministry of Defense (MoD) also released import embargo lists for several items to be indigenized. With all four import embargo lists, MoD expects indigenization potential to be worth more than INR5t over the next five years.

Exhibit 15: Capital outlay on defence services (INR b)



Source: Budget documents, MOFSL

Exhibit 16: Details of Schemes accorded AoN/CNC Negotiated Cost for contracting during FY23-24 and FY24-25

S. No.	Scheme	Anticipated Cost (INR b)
1	❖ Fleet Support Ships/Fleet Tanker (FSS) - Sec A	170.0
2	❖ Cadet Training Ship - Sec B	30.7
3	❖ Procurement of Upgraded SRGM (R/o)	23.5
4	❖ Next Generation Offshore Patrol Vessels (NGOPVs)- Sec B	89.3
5	❖ Procurement of High Data Rate VLF-HF Receivers	2.6
6	❖ Lynx U-2 for 11 NGOPV & two WWR (R/O)	19.2
7	❖ SDR (Portables) Version -1 - MP Version -2- FP Version - 3- HH	2.7
8	❖ Modernisation of Naval Aircraft Yards (NAY)-Kochi and Goa on 'Turnkey' Basis	3.7
9	❖ Special Maintenance Tools and Special Test Equipment(SMT/STE) for shore based Repair Facility at NSRY(PB)and Shore Based Training Facility at INS Shivaji for Integrated Platform Management System(IPMS) Fitted Onboard LCU MK IV Ships	0.4
10	❖ Setting up of Naval Aircraft and Ship Instrumentation Including Telemetry (NASI)	2.5
11	❖ Upper Air Sounding System (UASS) - Make II	0.2
12	❖ Procurement of Bottom Opening Dumb Barges	0.6
13	❖ Implementation of ERP solution (AIIMS) for NAI organization	0.9
14	❖ Procurement of Integrated Platform Management System with Motion Control (IPMS-MC) Simulator in-house developed By WESEE For Project – 75 Submarines	1.1
15	❖ Universal Proximity and DA Fuze (with electronics adaptable to 76 mm to 127 mm ammunition) for 76/62 Gun Ammunition	0.2
16	❖ Digital Beam forming Based Satellite TV (DB2ST) - Make II	0.6
17	❖ Three Phase Static Inverter for ELTA MPR - Make II	0.1
18	❖ Next Generation Corvettes (NGC)	364.3
19	❖ Procurement of 500 Ton Self Propelled Water Barges (Karwar and Mumbai)	0.7
20	❖ 500 Ton Fuel Barge	1.7
21	❖ Procurement of Six Integrated Bridge System (IBS)	0.3
22	❖ AI in SCM & Logistics	0.0
23	❖ Procurement of Infantry Weapon Training Simulator (IWTS)	0.6
24	❖ Dornier MLU	22.0
25	❖ Procurement of Expendable Aerial Targets (EATs)	1.7
26	❖ DPR, Consultation for Contract Conclusion and Project Monitoring for Strategic Special Assets Facility (SSAF)	0.1
27	❖ Other Schemes (9 Nos)*	184.2
	Total	923.6

Source: Ministry of Defence, MOFSL

Private sector capex to increase from PLI-led schemes, Data centers, and EV charging

PLI scheme is likely to result in capex of ~INR4-5t over the next five years

PLI-led capex: Set to improve from current levels

Government had outlined incentives of INR2t across sectors under the PLI scheme. This is likely to result in capex of ~INR4-5t over the next five years across these sectors with asset turnover being different for every sector. The investments have to be carried out over a period of five years with corresponding PLI incentives for companies coming on achieving required sales and investment threshold limits year wise. So far, the capex has been lower as per the year-wise schedule and was hit by a range of issues related to supply chain disruption because of the Russia-Ukraine conflict, global demand slowdown (especially in mobile phones) as well as higher inflation. We expect gradual a pick-up in capex in related segments as these issues are ebbing gradually.

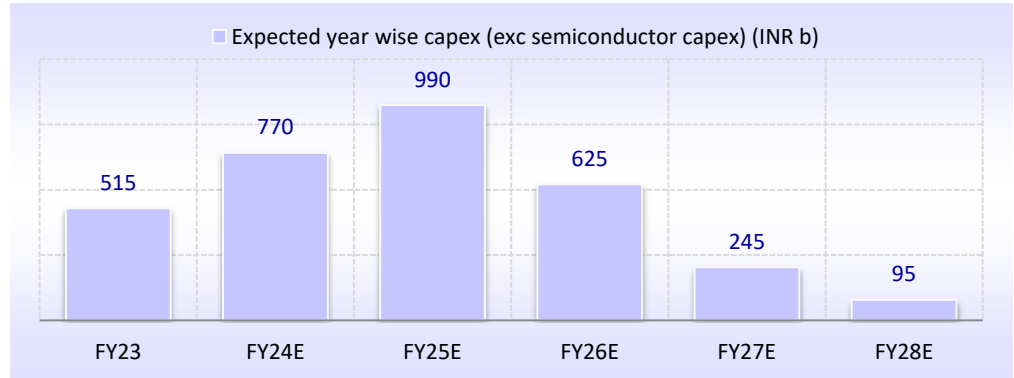
Exhibit 17: PLI incentives for different sectors (INR b)

Sector	Incentives outlay
Mobile phones	420
Advanced Chemistry cell batteries	181
Electronics and Tech products	50
Automobile and components	570
Phamaceuticals and drugs	150
Telecom and networking products	122
Textiles	107
Food products	109
High efficiency solar PV modules	45
White goods	62
Speciality steel	63
Solar modules	185
Total	2,064

Source: MeiTY, PIB

In FY23, PLI-led capex of INR512b came primarily from three segments – mobile, solar and pharma. Within pharma sector – 55 companies invested ~INR162b, three companies in high efficiency solar PV modules invested ~INR104b and mobile manufacturing firms invested INR51.2b. Other sectors such as automotive, advanced chemistry cell, specialty steel, etc. are yet to make meaningful investments that formed nearly 60% of total targeted PLI capex. ABB, Siemens, Thermax would have a role to play in PLI-led capex mainly through their automation and robotics-related offerings and presence in sectors such as auto and steel. ABB's offerings include LV & MV switchgear, building automation, switches, distribution boards, digital power train, and robots.

Exhibit 18: PLI-led yearly capex spend expectations excluding semiconductor capex (INR b)



Source: Industry, MOFSL

Data centre capacity is expected to reach 1,700-1,800 MW by FY25

Data center: Emerging as a big opportunity for players

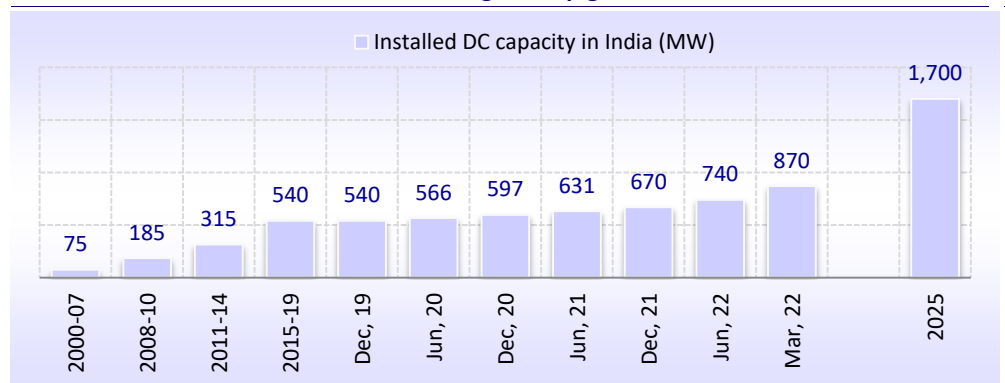
Demand for data center is growing at a fast pace

Demand for data center is driven by higher digitization due to Covid-19, government efforts, AI, IoT, and big data that have attracted considerable investments from local and foreign companies, including hyperscale operators, in the Indian data center sector. Further boost to data center demand in India would come from widespread adoption of 5G services. India’s current data center capacity stands at around 890 MW and is expected to reach 1,700-1,800 MW by FY25 as per CRISIL estimates. The value of the India data center market is expected to increase to USD10b by 2025 from USD4.35b in 2021, at a CAGR of 15% over FY22-25. Several government initiatives such as keeping 75% of the data inside the nation, “infrastructure status” to data centers, SEZ classification for cloud data centers in addition to free land, water, and power have resulted in increased announcements from players to set up data center capacity.

Incremental investments in data centers to increase capacity to 1,700 MW by CY2025

Our interactions with industry participants indicate incremental investment of USD5-6b over next three years as data center capacity moves to 1,700MW by CY25 from 890MW in CY22. Nearly 55-65% of total incremental capex will be spent on electrical and HVAC and cooling systems thereby yielding an addressable market of USD3-3.5b for product companies such as ABB, Siemens, Cummins, KOEL etc.

Exhibit 19: Data centre market is witnessing a sharp growth

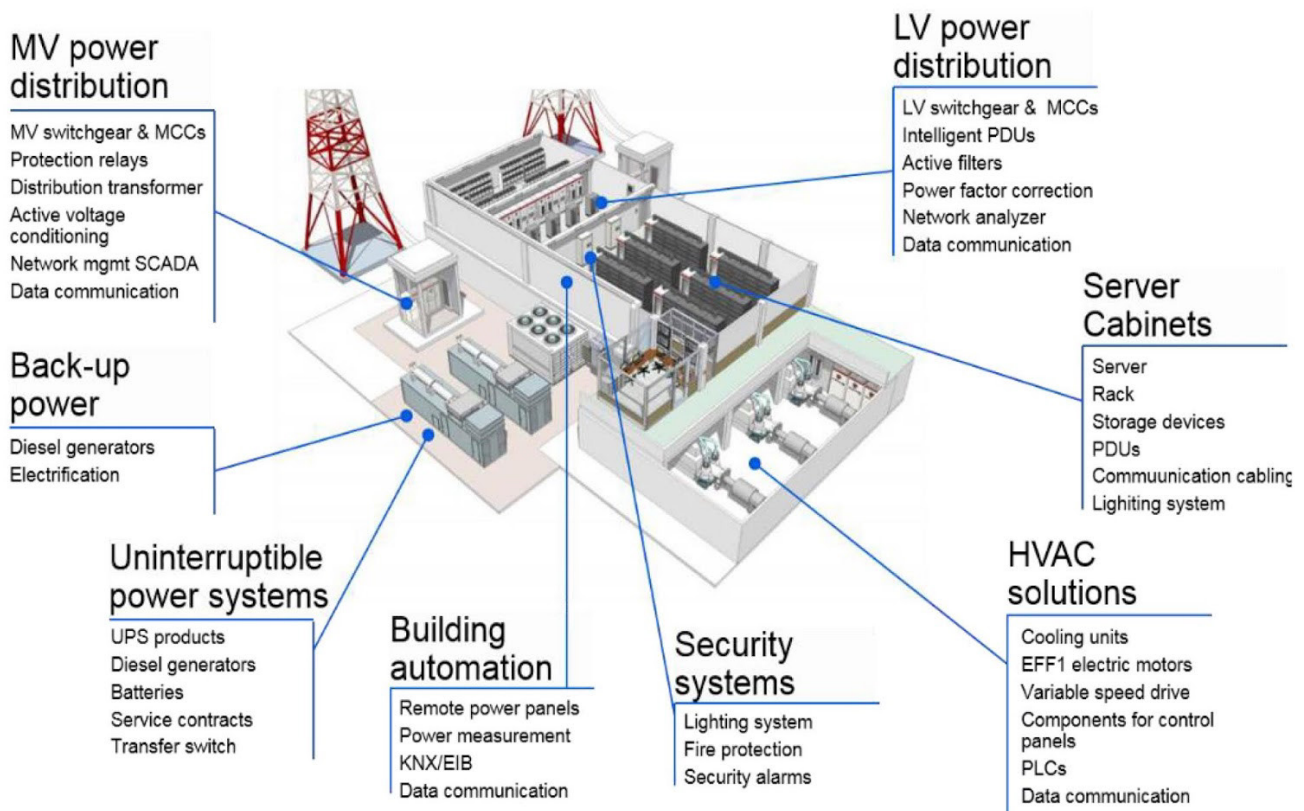


Source: Industry, CRISIL

Cost structure of a data center

On the cost structure, electrical systems, HVAC and cooling systems account for 55-65% of total costs, where the opportunities for most product companies like ABB, Siemens and Cummins are present. We expect an addressable opportunity of USD3-3.6b for these players on an incremental investment of USD5-6b in data center market by FY25. Given the ESG considerations for most of the key tenants, data center players are also expected to invest in green power to meet their power requirements.

Exhibit 20: ABB: Electrical Distribution System in a Data Center



According to ICRA, ~48,000 additional EV chargers at an investment of around INR140b will be installed over the next 3-4 years in India.

EV charging: Increased requirement for more EV chargers as EV demand improves

India needs about 400,000 charging stations to meet the requirements for the 2m EVs that are expected to come on roads by 2026, according to a Grant Thornton Bharat-FICCI report. Oil marketing companies have reportedly announced the setting up of 22,000 EV charging stations in prominent cities and on national highways across the country. Of the total, Indian Oil Corporation Limited will install 10,000 EV charging stations, Bharat Petroleum Corporation Limited will install 7,000 and the remaining 5,000 will be installed by HPCL. Private companies such as Tata Power, Fortum, ChargeGrid, Volttic, ABB and Delta have also contributed to setting up EV charging infrastructure in India. According to ICRA, ~48,000 additional EV chargers at an investment of around INR140b will be installed over the next 3-4 years in India.

Infrastructure is necessary to set up an EV Charging Station

- a) Installation of a transformer, substation equipment, and safety equipment.
- b) About 33/11 KV cables and associated equipment for line and meters.
- c) Civil works and installations.
- d) Land space for charging vehicles and entry or exit of vehicles.
- e) Installation of all the charger models being approved as per the local and international standards.

Exhibit 21: Infrastructural Costs for Setting Up EV Charging Stations

Requirement	Cost (INR)
Land lease at INR 50k/month	600,000
Electricity connection, transformers and energy meters	750,000
Civil Works	250,000
Maintenance & Technical Team	300,000
Brand Promotion & Marketing	50,000
Total	1,950,000

Source: Industry, MOFSL

Players such as ABB and Siemens will be able to target opportunities from the upcoming EV charging infrastructure. However, the Indian EV charging market is still at a nascent stage as compared to the global markets.

Industrial automation and digitization-led spend

Currently, nearly 23% of the operating budget of industries is spent on technology with aerospace, electronics, pharmaceuticals, automotive and industrials among the top 5 spenders

Increasing spends on industrial automation are likely in future

As per the survey conducted by Rockwell Automation across 1,353 global manufacturers on the state of smart manufacturing, nearly 97% respondents reported plans to use smart manufacturing technology in the coming years. Currently, nearly 23% of the operating budget of industries is spent on technology with aerospace, electronics, pharmaceuticals, automotive and industrials among the top 5 spenders; gradually SMEs will also start scaling up.

Exhibit 22: Outcome of survey by Rockwell Automation

Industry	% of operating budget spent on technology
Aerospace	34%
Electronics	25%
Life Sciences – Pharmaceuticals and Medical Devices	25%
Industrial Machinery	24%
Auto, Auto Tier Supplies, EV	23%
Home and Personal Care	22%
Food and Beverage	21%
Semiconductor	20%
Plastics / Rubber Manufacturing	20%
Material Handling	19%
Pulp and Paper	19%
Packaging	18%
Metals/Metal Fabricators/ Precision Metal forming	18%

Source: Rockwell Automation

Exhibit 23: Investment in Process automation and cloud/SaaS are delivering the highest returns, thereby will prompt more players to spend on process automation

Technology	Percentage (%)
Process Automation	63
Cloud/SaaS	63
Machine Integration	58
Industrial Internet of Things (IIoT)/Internet of Things (IoT)	55
Machine Learning/ Artificial Intelligence	53
Cameras/Scanners/Drones	52
5G	52
RPA (Robotic Process Automation)	47
Automated mobile robots and automated guided vehicles	47
3D printers/additive manufacturing	44
Wearables	44
Generative Design	43
Augmented Reality, Mixed Reality, Virtual Reality	43
Sensors/ RFID / GeoTagging	43
Blockchain	41
Voice Recognition/Natural Language Processing (NLP) technology	41
Cobots (Collaborative Robots)	40
Facial Recognition	39
Digital twins (i.e., digital replicas synchronized with physical assets)	38

Source: Rockwell Automation

Over next five years, nearly 40% of the total 1,353 respondents indicated that data analytics and increased automation will drive business outcomes going ahead.

Exhibit 24: Data analytics and increased automation will drive business outcomes going ahead as per the survey

Better use of data analytics	40%
Increased automation	40%
Adopting smart manufacturing software	36%
Adopting cloud technology	36%
ESG/sustainability program/policies	35%
Automated process enforcement	33%
Increased training and employee programs	32%
Increased use of Artificial Intelligence/Machine Learning	32%
Adopting supply chain planning software	31%
Leveraging new/emerging market opportunities	31%

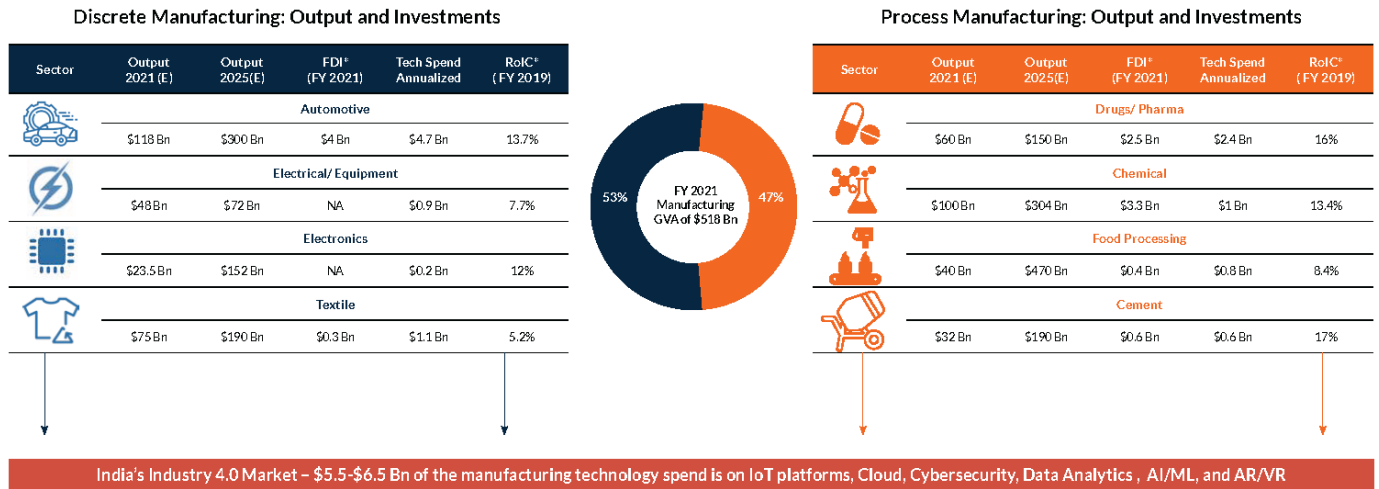
Source: Rockwell Automation

State of Industry 4.0 adoption in India...

Indian manufacturing sector is witnessing a push to adopt digital technologies to achieve the target of 25% contribution to GDP by FY26. This is aided by favorable government policies and thrust towards NIP implementation, ease of doing business, PLI scheme, focus on Atmanirbhar Bharat, and setting up of industrial corridors as well as global export hubs.

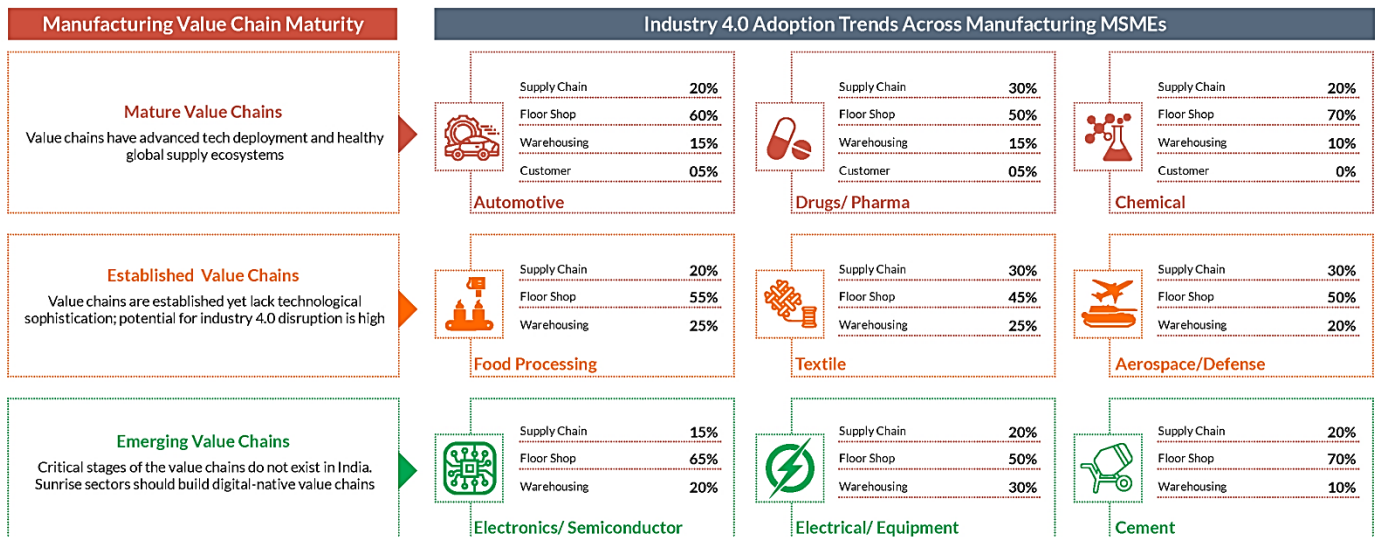
- a) Major Indian manufacturing sectors have collectively invested ~USD12b in technology, and have attracted nearly ~USD11b worth of FDI to enhance operational efficiencies and global competitiveness. Of the USD12b, nearly USD5.5-6.5b was spent on Industry 4.0 initiatives in FY21.
- b) Discrete manufacturers, led by Auto, Electricals and Electronics sectors, are the incumbents in Industry 4.0 spending, while process manufacturers such as Chemicals and Pharmaceuticals are investing more in process automation.
- c) Connected and mature value chains invest more in digitalization across the supply chain, vs. value chains that have just established or are still emerging.
- d) According to NASSCOM Survey and interviews with cross-sector manufacturers, companies plan to ramp up investments in emerging network technology, big data analytics, central and remote-controlled monitoring, and automation over the next 18-24 months.

Exhibit 25: Discrete manufacturers, led by Auto, Electricals and Electronics sectors, are the incumbents in Industry 4.0 spending while process manufacturing is ramping up on process automation



Source: NASSCOM, IBEF, InvestIndia, IEEMA, MOFSL

Exhibit 26: Connected and mature value chains invest in digitalization across the supply chain, compared with value chains that have just established or are still emerging, highlighting the network advantage



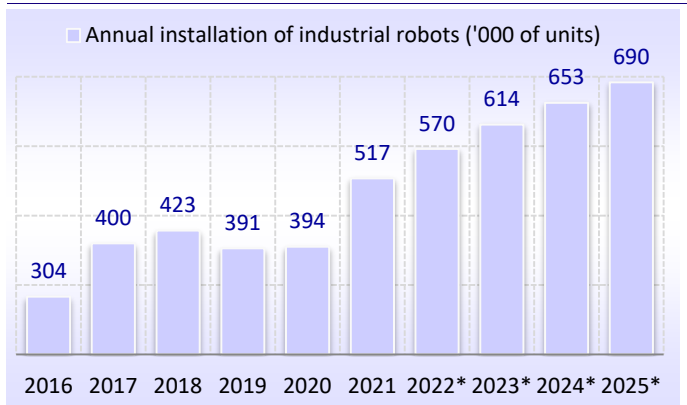
Source: Research Team Analysis | In Emerging value chains, Industry 4.0 investment at a stage reflects the spend by companies with visibility of that stage, however, does not suggest maturity in any way

Source: NASSCOM

...accompanied by higher usage of robotics

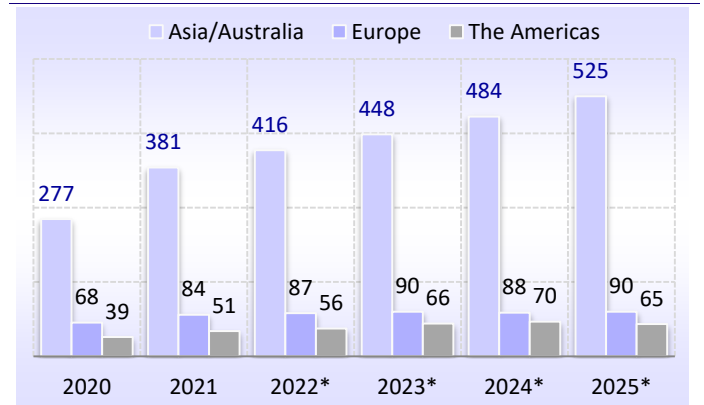
Robotics is a major and a very important component of Industrial Automation. As per IFR, world robotic installations in CY21 hit a record growth of 31% for industrial robots driven by healthy demand from electronics, automotive, metals & mining, plastic & chemicals and F&B followed by other smaller sectors. With Industry 4.0 in place, robotic process automation has already expanded in key areas such as healthcare, automobile, F&B, electronics, and warehousing logistics in India. This will gradually expand its footprint in other important industries as well. At the same time, Industry 5.0 is a more recent trend that emphasizes on immediate customer service, personalization, and the integration of humans with collaborative robots (cobots), to become more proactive in the new industrial automation model. Installation of cobots has also grown at a pace of 50% in CY21 as per IFR.

Exhibit 27: Global installations of industrial robots 2016-2021 and 2022*-2025*



Source: IFR, MOFSL

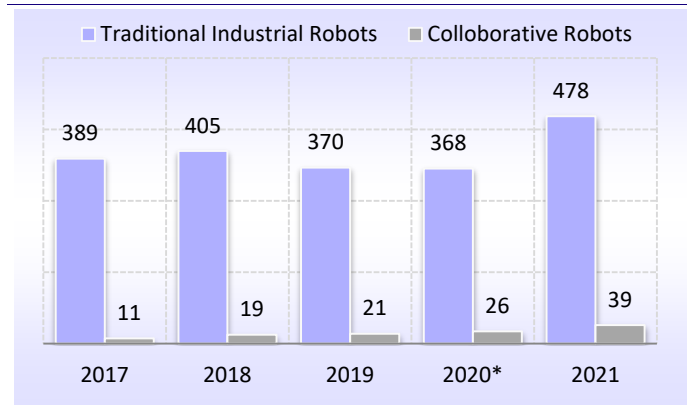
Exhibit 28: Country wise annual installations of industrial robots 2016-2021 and 2022*-2025* ('000 of units)



Source: IFR, MOFSL

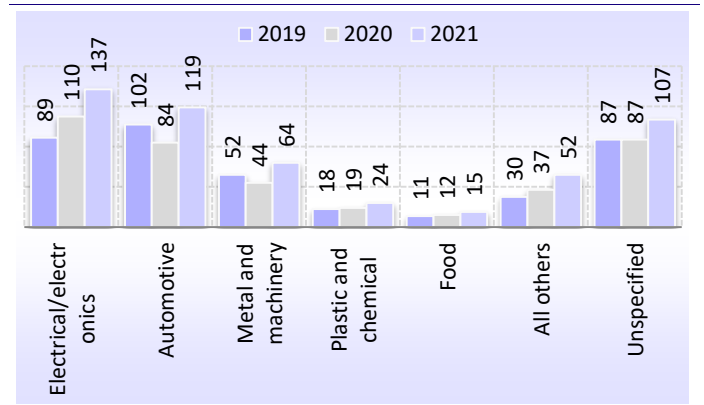
Over CY16-21, robotic installations have reported a CAGR of 11% and IFR expects it to grow at 8% over the next five years.

Exhibit 29: Overall installation of collaborative robots and traditional Industrial Robots is moving up ('000 of units)



Source: IFR, MOFSL

Exhibit 30: Annual installation of Traditional Industrial Robots across the world by customer industry ('000 of units)



Source: IFR, MOFSL

As per CRISIL estimates, India spent around INR5.7t on green investments in industrial and infrastructure categories

Sustainability-driven capex

- As per CRISIL estimates, India spent around INR5.7t on green investments in industrial and infrastructure categories. This amount is estimated to grow 4X by FY2030 in order to comply with the COP27 targets. Power would continue to account for larger chunk of investments and transport too has started picking up with investments seen in CNG infra and ethanol blending linked capex.
- Investments in power related to shift towards green energy will be more back-ended in nature while energy efficiency related investments will be more front-ended. On transportation, most investment spend will be balanced.

Exhibit 31: Green investments planned till 2030E (INR t)

	2015-22E	2023-2030P	Share of 2023-26: 2027-30
Power	6.4	24.1	40:60
Non-fossil fuel	5.3	17.8	37:63
Grid	0.2	3.9	25:75
Efficiency	0.9	2.4	75:25
Transport	0.4	3	47:53
Auto value chain	0.1	1.3	47:53
Infrastructure	NA	1.3	47:53
Optimization	0.3	0.3	67:33
Hydrogen	NA	2	35:65

Source: Industry, CRISIL

Investments in new technologies related to energy transition

Companies are incrementally investing in new technologies as well as facilities related to energy transition. We expect these investments towards hydrogen energy, renewables, railways, and pollution norms change to start yielding results over the next 3-5 years.

Exhibit 32: Investments towards automation and energy transition by various corporates

Companies	Investment towards automation and energy transition
L&T	❖ In line with its strategic road map Lakhya 2026, L&T intends to set up electrolyzer capacity of 500 MW by 2026 and 1 GW by 2028 with a targeted capital allocation of Rs11-12 bn. It had already entered into an MoU with Norway-based electrolyzer manufacturer HydrogenPro to set up a joint venture in India for gigawatt-scale manufacturing of alkaline water electrolyzers. The company also intends to go for advance chemical cell manufacturing with nearly INR31 bn capital allocation.
	❖ L&T also entered into MoU with Norway-based H2Carrier (H2C) to co-operate towards developing floating green ammonia projects for industrial-scale applications with an aim to decarbonise the global economy. H2C has proven expertise in developing and integrating Power-to-X (PtX) projects based on affordable, often stranded, non-commercial renewable power. Under the terms of the MoU, L&T will become a partner for EPCIC of the topsides for H2C's floating process plants.
ABB	❖ ABB India's Smart Power division expanded its manufacturing facility spanning over 8,400 square meter in Nelamangala Bengaluru, catering to the industry 5.0 with ABB cobots. The ABB Smart Power factory links equipment such as robots, motors, and drives to the Internet of Things (IoT).
	❖ ABB also expanded Digital Substation Products and Digital Systems factory in Vadodara, Gujarat. This new factory will meet the growing demand for a wide range of digital substation products and digital solutions in India and outside India
	❖ During last year, company also opened its New facility for R&D – ABB Innovation Center
Siemens	❖ Siemens is making significant strides in its commitment to Energy Efficiency Programs across various sectors, including as industrial, Food and Beverage, Hospitality, and Automotive industries. The company's focus primarily lies in manufacturing, where they have demonstrated reductions in carbon footprint and cost savings for their clients.
Cummins	❖ Cummins future plans include developing local 'fit-for-market' solutions to meet upcoming emission regulations and market needs on commercial off-highway and power generation segments
	❖ Focused engine development for the Power Generation segment for the upcoming emissions norms
	❖ Technological innovation to add value to products in the areas of alternate fuels, fuel cells, power electronics, hybrid engines and recycle / re-use
Thermax	❖ Thermax has been continuously investing in R&D and entered into various technology-related tie-ups in waste-to-energy, agro-based hybrid multi-fuel combustion, new waste heat recovery applications, electric boilers, coal gasification, green hydrogen, energy storage, thin film solar and other renewable areas.
	❖ Thermax signed an MoU with Fortescue for a green hydrogen manufacturing facility. It also wants to foray into electrolyser manufacturing
Hitachi Energy	❖ Hitachi has various product offerings which cater to green energy, renewable grid integration as well as supporting energy transition initiatives. These products include Green transformer, Dry transformer, Scott and V-connected transformer which use green fuels, STATCOM products for grid integration, e-Motion fleet etc
Kirloskar Oil Engine	❖ Company has introduced various models in compliance with CPCB 4+ norms
	❖ It has also introduced several new products such as Optiprime series and fuel agnostic gensets utilizing other fuels such as gas, hydrogen, ethanol, methanol

Source: Companies, MOFSL

Addressable market for companies and key beneficiaries

Exhibit 33: Opportunity pipeline till FY2030 and expected beneficiaries from the same

Segments	Description	Spending scenarios				Base case yearly capex opportunity	Key beneficiaries
		Investment planned	Bear case - 40%	Base case - 70%	Bull case - 100%		
Transmission	❖ As per MoP, transmission line network worth Rs2.4 tn will have to be set up before renewable energy of total capacity of 500 GW capacity gets commissioned	INR2.4t till 2031	INR960b	INR1.7t	INR2.4t	INR170b	❖ PGCIL, L&T, KEC, Kalpataru, Tata projects, GE T&D, Hitachi energy, ABB, Siemens, CG Power, Voltamp, TRIL, Bharat Bijlee
Railways	❖ Apart from the near term opportunity from metro projects, as per National Rail Plan, investment of Rs16.9 trn is needed to ramp up high speed rail network and increase coaches and locomotives capacity	INR16.9t till 2031	INR6.8t	INR11.8t	INR16.9t	INR1.18t	❖ L&T, KEC, Kalpataru, Siemens, ABB, CG Power, TD Power, Hitachi Energy, Medha, Stadler, RVNL, Titagarh Wagons, Jupiter Wagons
Defence	❖ With all four import embargo lists, MoD expects indigenisation potential worth more than Rs5 tn to happen over next 5 years.	INR5t till 2027	INR2t	INR3.5t	INR5t	INR700b	❖ BEL, HAL, BDL, L&T, Garden Reach, Mazgaon Dock, MTAR, Data Patterns, BEML, Bharat Forge
Water	❖ From the overall Jal Jeevan Mission cost of Rs3.6 trn, an amount nearly Rs1.4 tn has been spent from FY2020-23 and we expect the remaining amount to be spent over next 1-2 years factoring in a delay of a year	INR2.2t till 2025	INR880b	INR1.5t	INR2.2t	INR750b	❖ L&T, KEC, Kalpataru, KNR, PNC, Va Tech, NCC
PLI led capex	❖ Government had outlined incentives of Rs1.97 tn across 14 sectors under the PLI scheme. This is likely to result in capex of nearly Rs4-5 trn over next five years across these sectors with asset turnover being different for every sector	INR4.5t till 2027	INR2t	INR3t	INR4.5t	INR600b	❖ ABB, Siemens, L&T, KEC, Kalpataru, Dixon, Amber, PG Electroplast, Thermax, Isgec Heavy
Data centre	❖ Incremental investment of \$5bn-\$6bn over next 3 years is expected to happen in data centre market as capacity moves from 890MW in CY2022 to 1700MW by CY2025	INR415b till 2025	INR170b	INR290b	INR415b	INR140b	❖ Cummins, KOEL, ABB, Siemens, Hitachi Energy, Schneider, L&T, KEC, Kalpataru, Amber, Blue Star, Voltas
Green investments	❖ This would involve RE capacity additions, grid investments, battery charging infrastructure, smart metering, ethanol blending to name a few	INR22t till 2030	INR880b	INR15.4t	INR22t	INR1.5t	❖ Tata Power, NPTC, PGCIL, ABB, Siemens, Hitachi Energy, Genus Power, Praj Industries, Cummins, Thermax

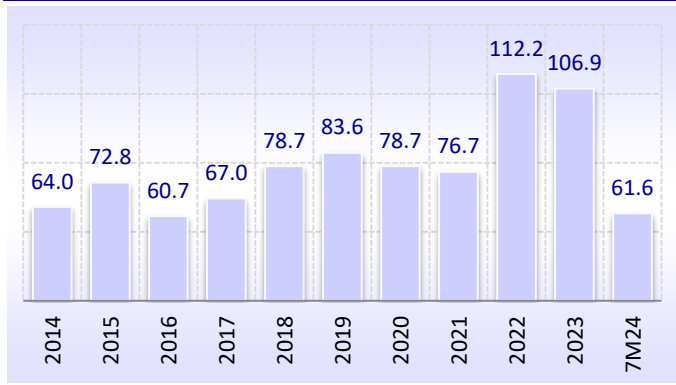
Source: Industry, MOFSL estimates

Export growth may remain weak in the short term

Engineering exports are weak in FY24 so far

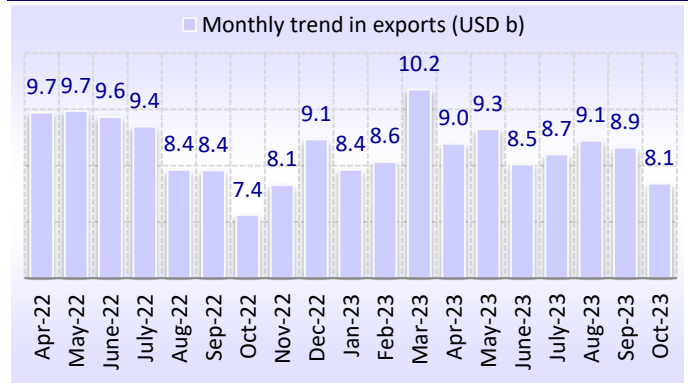
Overall exports of engineering goods from India were strong at USD112b in FY22 which declined to USD107b in FY23. This was hit by geopolitical crisis in the CIS region due to the Russia-Ukraine conflict, economic slowdown in North-East Asia (especially China), and downturn in Europe that resulted in lower shipment of engineering goods from India during FY23. Monthly exports also remained weak YoY till Oct,23.

Exhibit 34: Engineering exports from India (USD b)



Source: PIB

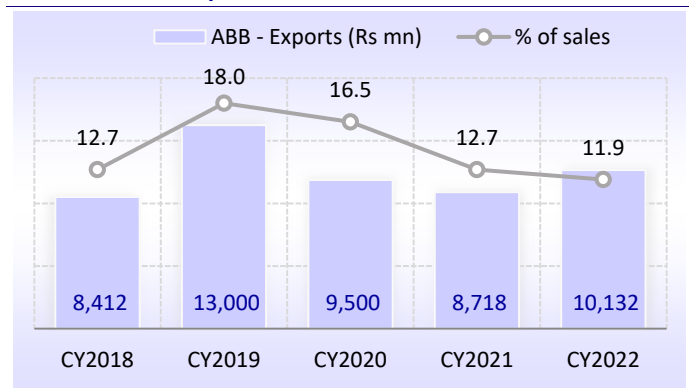
Exhibit 35: Monthly trend in exports (USD b)



Source: PIB

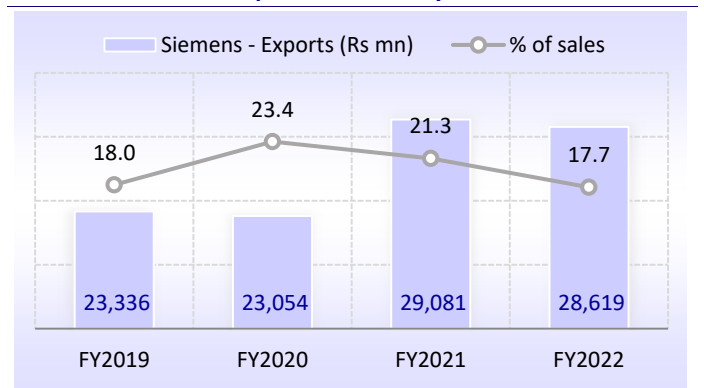
Exports formed nearly 27% of overall sales for Cummins while it is around 12%/18% for ABB/Siemens for CY22/FY22. Companies are well placed to capitalize on export demand through their offerings and presence across geographies. This has been reflected in the 5-7% export CAGR of ABB, Siemens and Cummins over the last four years. Cummins had been able to increase its exports through both LHP and HHP sales across geographies but has now mentioned that Europe, Africa, Asia Pacific, China, North America and Latin America are slowing down a bit. ABB has got a mandate from parent for additional export markets. Recent commentary by management indicated that domestic demand is stronger than export demand. Siemens is also focused on increasing exports. However, in near term, we do expect export demand to be weak for these players.

Exhibit 36: ABB export share is 11-12% of sales



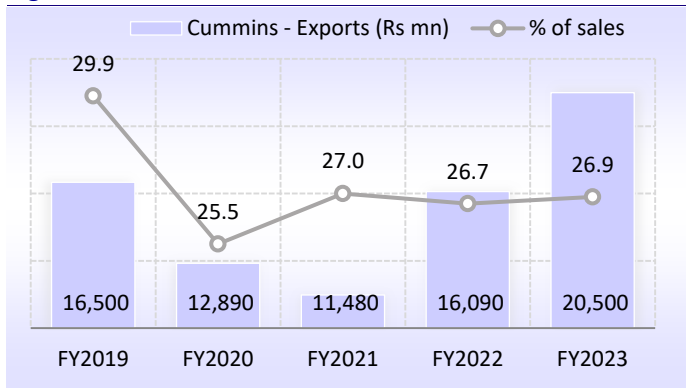
Source: Company, MOFSL

Exhibit 37: Siemens exports are broadly around 18% of sales



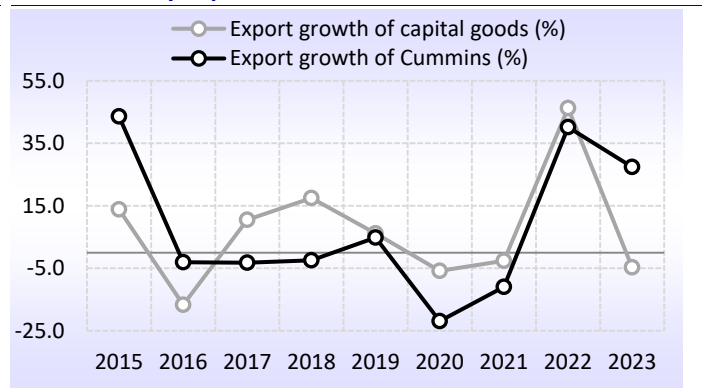
Source: Company, MOFSL

Exhibit 38: Cummins' share of exports to overall sales is higher than ABB and Siemens



Source: Company, MOFSL

Exhibit 39: Cummins export growth trend mirrors that of overall country exports



Source: Company, MOFSL

We thus believe that near term demand weakness from export geographies can impact revenues and margins. However, with improved product portfolio as well as mandate from global parent for exports, companies can overcome all the near-term challenges.

Near-term impact of the impending elections

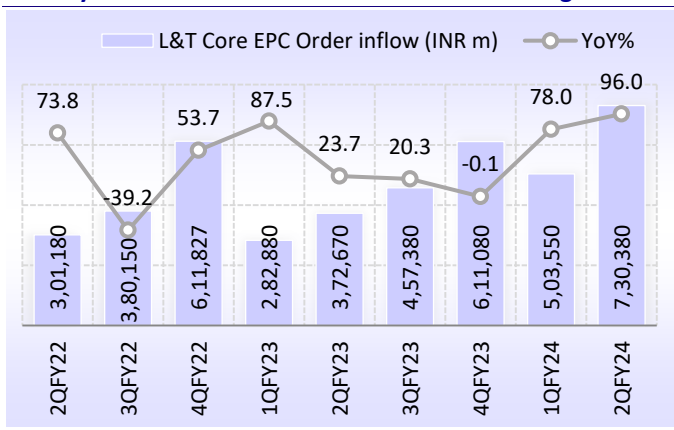
Continuity of inflows and revenue growth

Due to election schedule, we can see moderation in inflows and revenue growth over 4QFY24-1QFY25

Order inflows for the sector were robust during FY22 and FY23 and in 1HFY24, we have also seen up-fronting of inflows from government clients due to the imminent elections. However, there has seen some moderation in inflows for product companies owing to the high base of last year but the structural trend is positive from areas such as transmission, power, railways, PLI, defense, data center, energy efficiency, and renewables. Due to election schedule, we can see moderation in inflows and revenue growth over 4QFY24-1QFY25, similar to earlier election cycles. For players like L&T, this impact can be offset by increase in hydrocarbon capex particularly in GCC countries.

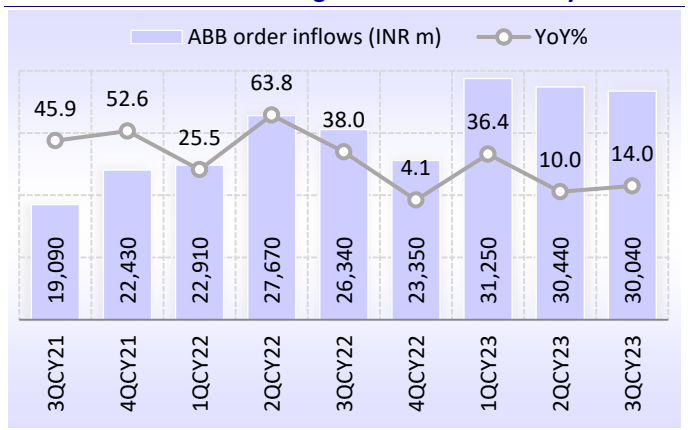
Order inflow growth has moderated yoy for most companies

Exhibit 40: L&T Core EPC order inflows are strong driven by healthy inflows from Middle-East and domestic region



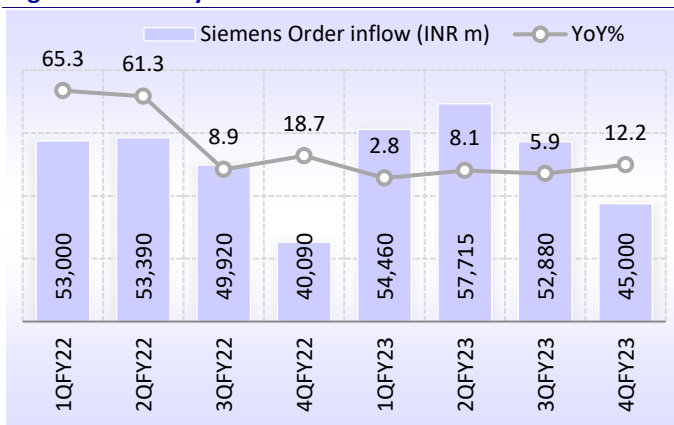
Source: Company, MOFSL

Exhibit 41: ABB India order inflows have seen moderation; however base order inflow growth remains healthy



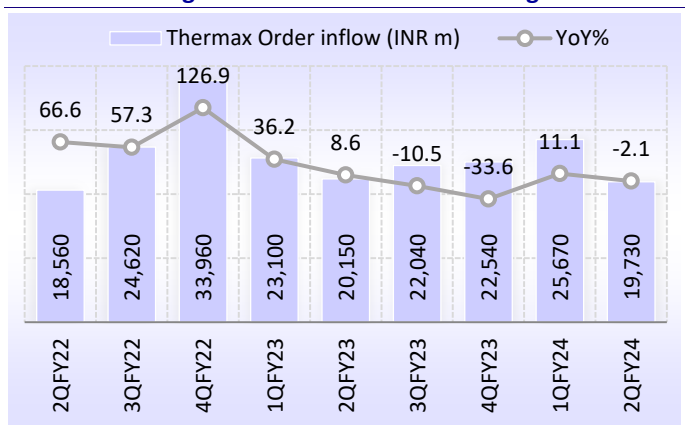
Source: Company, MOFSL

Exhibit 42: Siemens order inflows have moderated owing to high base of last year



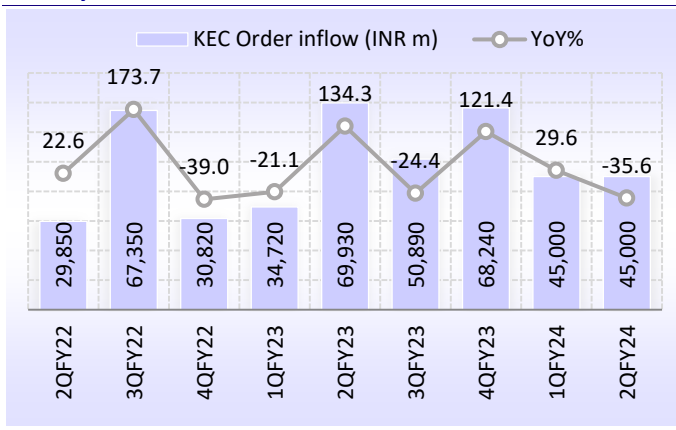
Source: Company, MOFSL

Exhibit 43: Thermax order inflows are driven more by base orders while large order inflows are still missing



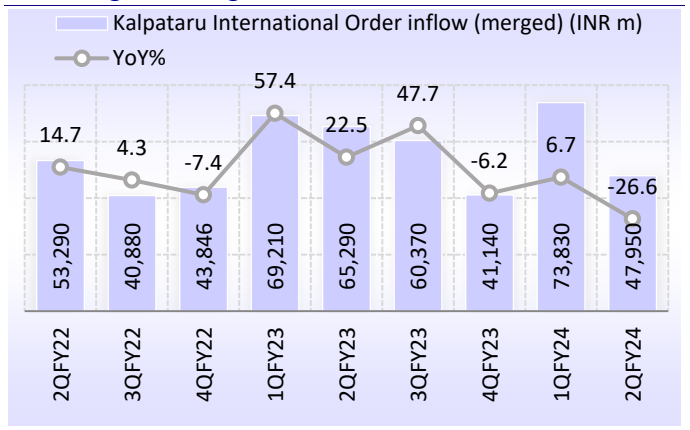
Source: Company, MOFSL

Exhibit 44: KEC International’s order inflows have remained healthy



Source: Company, MOFSL

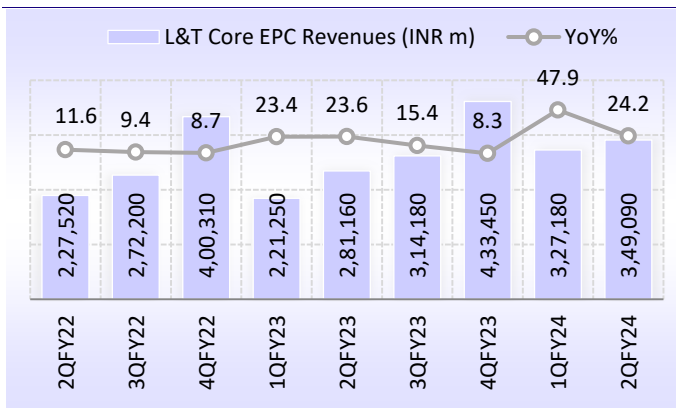
Exhibit 45: Kalpataru Projects International’s order inflows are strong across segments



Source: Company, MOFSL

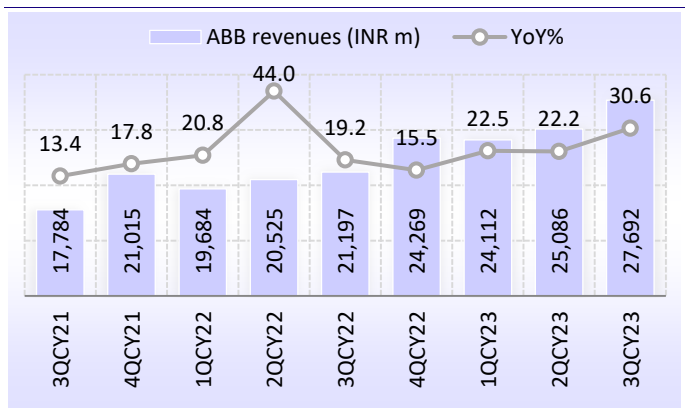
Revenues growth moderation was seen only in select companies

Exhibit 46: Revenue growth for L&T is driven by strong order book and inflows



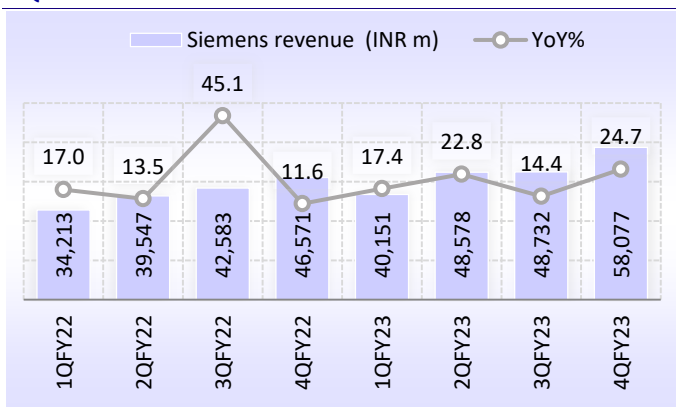
Source: Company, MOFSL

Exhibit 47: Revenue growth for ABB has remained strong in 9M CY23



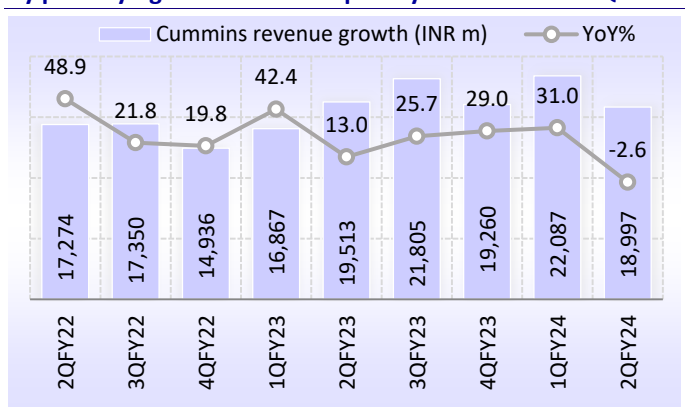
Source: Company, MOFSL

Exhibit 48: Siemens revenue growth has improved during 4QFY23



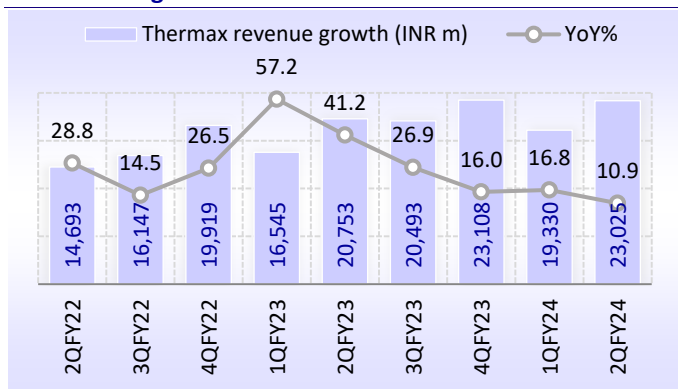
Source: Company, MOFSL

Exhibit 49: Cummins revenue growth in 1QFY24 was driven by pre-buying and then subsequently moderated in 2QFY24



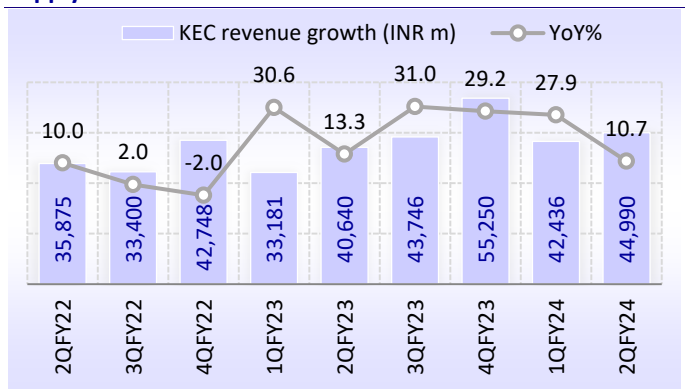
Source: Company, MOFSL

Exhibit 50: Thermax’s revenue growth moderated in 1HFY24 on lack of large sized inflows



Source: Company, MOFSL

Exhibit 51: KEC’s revenue growth moderation was due to supply chain issues



Source: Company, MOFSL

Election impact on inflows and revenues in a year post election

Exhibit 52: Election impact on yearly inflows for most companies (INR b)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
L&T - Order inflows	925	1,125	1,367	1,146	1,201	1,274	1,449	1,455	1,330	1,444	1,724
YoY % in election years		21.7	21.5				13.8	0.5			
ABB (Calendar year)	67	79	81	125	58	67	70	59	77	100	124
YoY % in election years		17.7	2.4				3.6	-14.9			
Siemens (Sep ending fiscal)	110	103	101	121	135	127	132	115	145	196	205
YoY % in election years		-5.8	-2.1				3.9	-13.3			
Thermax				44	44	64	56	55	48	94	88
YoY % in election years							-11.7	-2.4			
KEC International (consolidated)	79	85	82	87	124	151	129	113	119	172	224
YoY % in election years		7.8	-3.2				-14.9	-11.8			
KPTL (consolidated) - (a+b)	66	59	62	105	88	125	144	99	169	183	231
YoY % in election years		-11.6	5.7				15.4	-31.4			
BEL	55	50	53	178	169	103	234	132	155	194	179
YoY % in election years		-8.3	4.7				128.1	-43.7			

Source: Company

Exhibit 53: Revenue trend during election years (INR b)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
L&T - Revenue (Rs m)	681	721	729	803	814	947	1,089	1,096	935	1,080	1,251
YoY % in election years		5.9	1.1				15.0	0.6			
ABB (Calendar year)	76	76	80	85	60	66	72	58	69	85	107
YoY % in election years		-0.0	5.0				9.3	-20.4			
Siemens (Sep ending fiscal)	114	107	105	108	110	127	130	99	136	161	191
YoY % in election years		-6.1	-1.4				2.2	-24.1			
Thermax	55	51	54	51	45	45	60	57	48	61	81
YoY % in election years		-7.1	5.8				33.8	-4.0			
KEC International (consolidated)	70	79	85	85	86	101	110	120	131	137	173
YoY % in election years		13.2	7.2				9.4	8.8			
KPTL (consolidated) - (a+b)	59	67	68	67	72	85	104	116	114	124	143
YoY % in election years		14.2	1.6				22.0	12.0			
BEL	63	65	71	74	87	104	122	130	141	154	176
YoY % in election years		3.9	8.8				17.0	6.6			

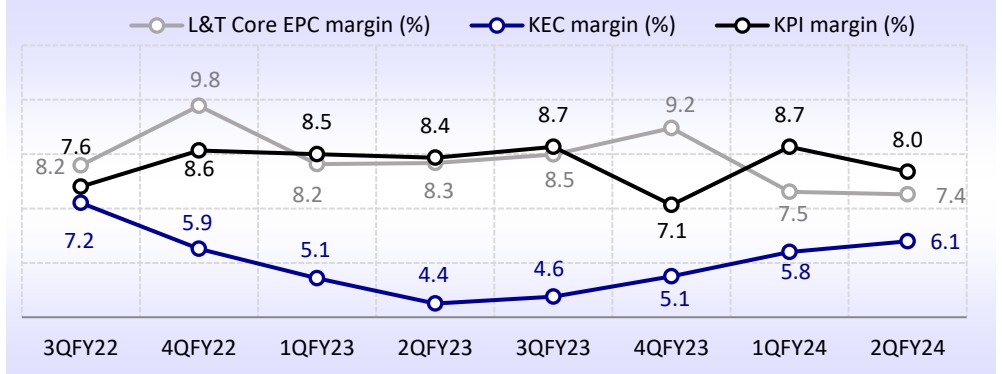
Source: Company, * For ABB and Siemens, full year revenues for 2023 are MOFSL estimates

Limited scope of further margin improvement

EPC companies: Increased competitive intensity and higher RM prices resulted in margin compression for EPC companies over FY20-23. We believe that margins will still take time to reach the double-digit mark, despite raw material price correction, due to the impact of legacy projects bid at higher commodity prices as well as continuous investments in technology, manpower and resources to build capabilities and expand geographical footprints.

Exhibit 54: EPC companies will take time to reach double digit margin level owing to legacy projects

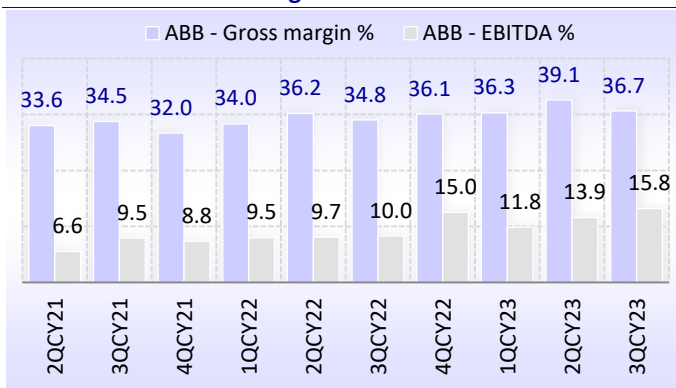
We see limited scope further margin in EPC and product companies



Source: Company

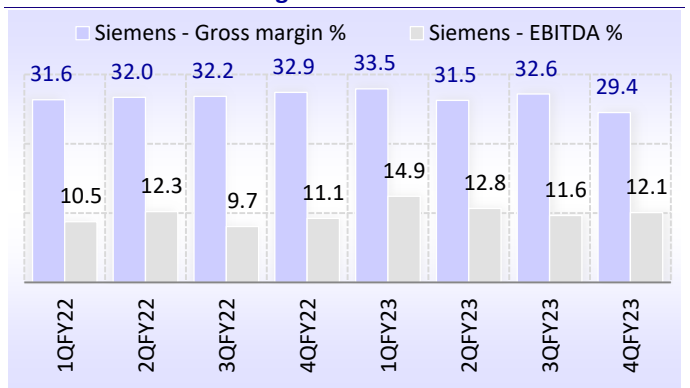
Product companies: Most of the product companies have been able to improve their margins from the pre-Covid levels on strong demand and ability to pass on raw material price hikes. Extent of improvement, however, has varied from player to player (ABB, Siemens, Cummins) on product mix, localization and technology fronts. We expect ABB to pass on RM price correction gains over coming quarters while Cummins' margins may get hit by postponement of CPCB 4+ transition. Siemens' margins have improved in 9MFY23 by 220bp but further improvement will be difficult owing to increased dependence on traded goods. Heightened competition and slowdown in exports may offset margin improvement from RM price correction.

Exhibit 55: ABB India margin trend



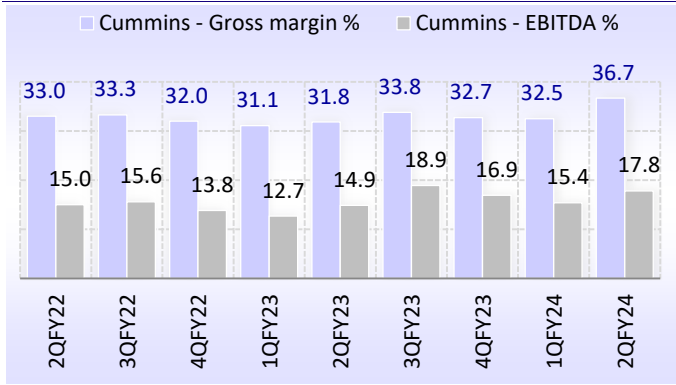
Source: Company, MOFSL

Exhibit 56: Siemens margin trend



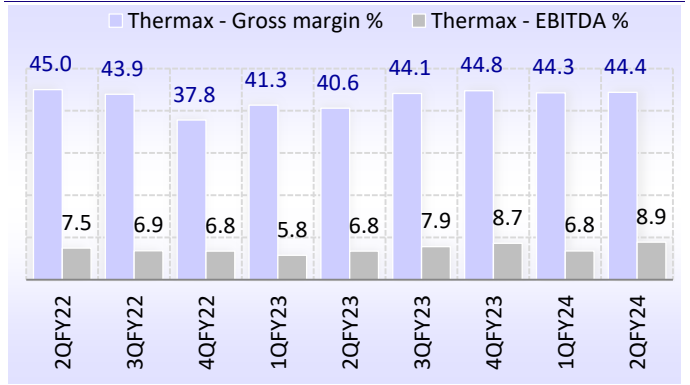
Source: Company, MOFSL

Exhibit 57: Cummins India margin trend



Source: Company, MOFSL

Exhibit 58: Thermax margin trend



Source: Company, MOFSL

Incremental benefit of indigenization: This benefit is yet to play out mainly for defense players. Change in revenue mix towards non-defense too can hurt the margin improvement trajectory.

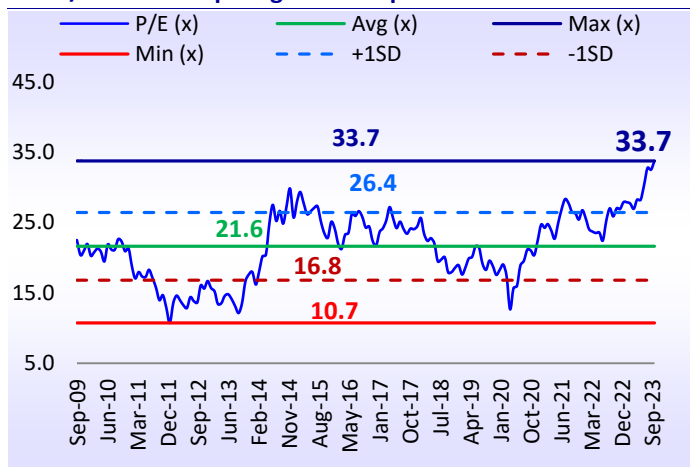
Margins in export business: Improving export trajectory has also aided margins as export business is generally a higher-margin business. Any slowdown in exports can hit margins too.

Valuations are factoring in some of the positives

We are selective in our approach and prefer companies where scope of earnings improvement is much higher in coming quarters despite stocks being at higher than historical valuations

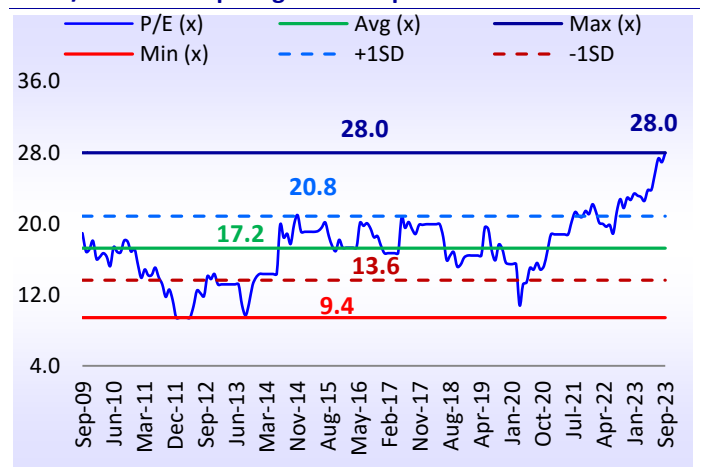
Overall capital goods sector valuation have moved up in recent quarters and is already trading above historical mean valuations. Some stocks are already baking in ‘peak cycle multiples and peak earnings growth expectations’, thereby leaving limited margin of safety from current levels. We are thus **selective in our approach and prefer companies where scope of earnings improvement is much higher in coming quarters despite stocks being at higher than historical valuations.**

Exhibit 59: Valuations have moved up over last two year - 1 yr fwd P/E for BSE-Capital goods companies



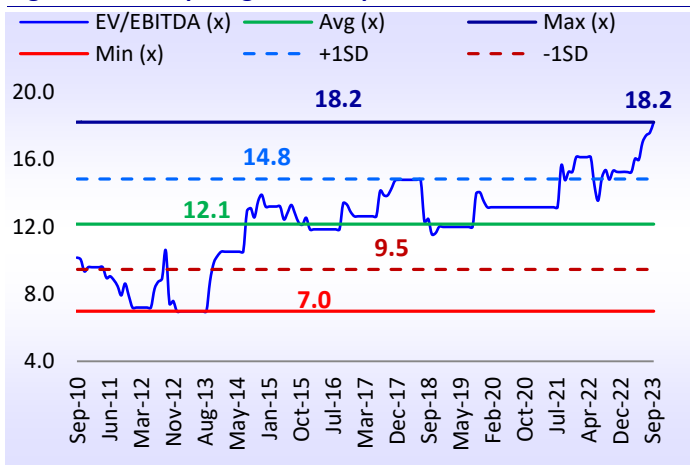
Source: Bloomberg, MOFSL

Exhibit 60: Valuations have moved up over last two year - 2 yr fwd P/E for BSE-Capital goods companies



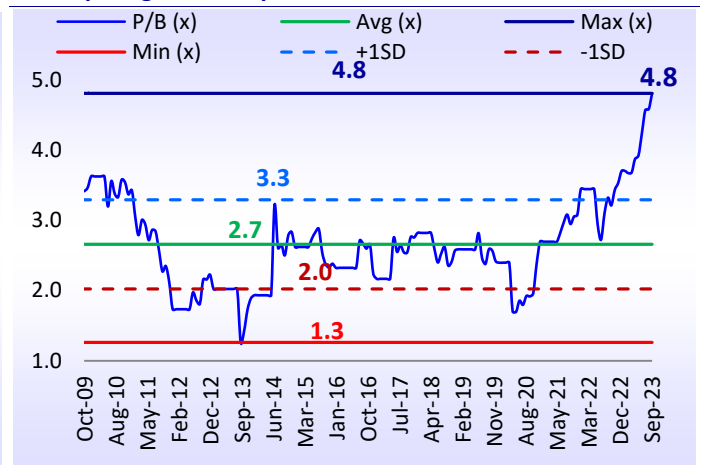
Source: Bloomberg, MOFSL

Exhibit 61: 2 year fwd EV/EBITDA is also above historical highs for BSE-Capital goods companies



Source: Bloomberg, MOFSL

Exhibit 62: 2 year fwd P/BV are also above historical highs for BSE-Capital goods companies



Source: Bloomberg, MOFSL

Companies covered in the report

L&T: Play on both domestic and international capex



Pg44

ABB: High quality player across government and private capex



Pg70

Siemens: Benefiting from railways, transmission and digitization capex



Pg91

Thermax: Play on private capex and green energy solutions



Pg113

Cummins: Well placed with new products



Pg134

Bharat Electronics: Play on defence indigenization



Pg154

KOEL: Ramping up portfolio across segments



Pg175

Triveni Turbine: Getting stronger in exports and after market



Pg200

KEC: Margins bottomed out



Pg219

KPI: Merger Synergies will start playing out



Pg239

Hitachi Energy: Tech-led play on T&D, railways, EV, data centre



Pg262

Larsen & Toubro

BSE SENSEX
67,481S&P CNX
20,268

CMP: INR3,184

TP: INR3,660 (+15%)

Buy

**LARSEN & TOUBRO**

Bloomberg	LT IN
Equity Shares (m)	1405
M.Cap.(INRb)/(USD\$b)	4485.4 / 53.8
52-Week Range (INR)	3198 / 2045
1, 6, 12 Rel. Per (%)	3/35/44
12M Avg Val (INR M)	5026
Free float (%)	100.0

Financials & Valuations (INR b)

Y/E Mar	2023	2024E	2025E
Sales	1,833.4	2,096.5	2,427.4
EBITDA margin	11.3	11.6	11.9
Adj. PAT	103.3	134.8	167.5
EPS (INR)	73.5	98.1	121.9
EPS Gr. (%)	20.5	33.4	24.3
BV/Sh. (INR)	635.5	647.5	734.2

Ratios

RoE (%)	12.0	15.1	17.6
RoCE (%)	5.8	7.0	8.1
Payout (%)	29.3	28.9	28.9

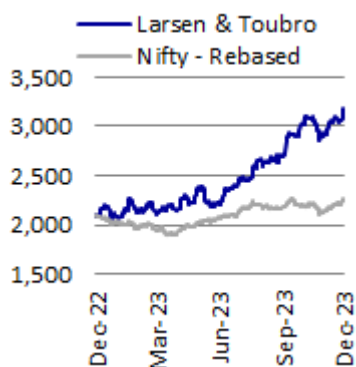
Valuations

P/E (x)	43.4	32.5	26.2
P/BV (x)	5.0	4.9	4.3
EV/EBITDA (x)	23.7	20.4	16.9
EV/Sales (x)	2.9	2.6	2.2

Shareholding pattern (%)

As On	Sep-23	Jun-23	Sep-22
Promoter	0.0	0.0	0.0
DII	37.1	37.9	40.3
FII	26.6	26.2	23.1
Others	36.3	35.9	36.6

FII Includes depository receipts

Stock's performance (one-year)**Play on both domestic and international capex**

L&T, a prominent player in India's capex cycle, is poised to experience accelerated growth over the next five years compared to the previous five year cycle. Over the last five years, L&T has focused on (1) large and mega - sized projects where competition is lesser, (2) diversified mix of projects with increased inflows from international geographies, (3) improving RoIC through a combination of margin improvement and efficient working capital management, (4) exiting non-core assets and optimizing capital allocation.

The next three to five year journey looks promising and we expect (1) L&T to post 16%+CAGR in core E&C revenue over FY23-26 on the back of strong OB (INR4.5t+; OB/Rev: 2.6x), (2) Core E&C earnings to compound at ~24% during the same timeframe, driven by revenue growth and margin improvement; (3) divestment of Nabha Power and potential divestment of Hyderabad Metro to gradually free up capital from non-core assets; (4) high likelihood of higher dividends / buybacks, potentially occurring every two years, thereby boosting RoEs. We reinitiate coverage on the stock with a BUY rating and a TP of INR3,660.

Long term capex cycle is visible over next decade

L&T is currently witnessing capex recovery across both its domestic and international segment. Domestic capex is primarily led by the central government, boosted by improved tax collections, and is spread across water, urban infra, transmission, railways, defence, and renewable energy. This is coupled with improved spending in the Middle East across hydrocarbon, transmission, and urban infra. State spending is selective, and capex tailwinds are visible within the private sector, though broad based revival is still some time away. Energy transition-related investment is driving capex across both domestic as well as international segments. Therefore, we believe that all the components of capex are coming together for the next decade, which bodes positively for L&T. We expect its order inflows to grow at a CAGR of 13.5% over the next decade, compared to the 8% seen in the past decade.

How has L&T differentiated itself

L&T has fared better than other players in maintaining its profitability over the last three years by focusing on (1) executing larger-sized projects, (2) increasing exposure to high margin defence segment, (3) improving RoIC, driven largely by working capital reduction, despite margins being lower than double-digit levels, (4) investing in new energy initiatives, (5) efficiently allocating capital and distributing surplus cash to shareholders. We expect these initiatives to reflect in margin and RoIC improvement over FY23-26E.

Infrastructure and hydrocarbon to remain key growth drivers for L&T

The infrastructure segment continues to remain a dominant segment for L&T and has a prospect pipeline of INR5t. Within the energy segment, international hydrocarbon is the growth driver, where order inflows have moved up sharply, particularly from the Middle East and has a strong prospect pipeline of INR3t. The company is cautiously bidding for thermal power projects. The defence segment, which is part of hi-tech energy, is still small with a prospect pipeline of INR200b, but will grow at a fast pace.

New energy investments will play out gradually

L&T has made initial investments in hydrogen, electrolyzers, and data centre as per its strategic growth plan Lakshya 2026. It has entered into an MoU with IOCL and Renew power to develop green power along with manufacturing electrolyzers. It had already entered into an MoU with Norway-based electrolyzer manufacturer HydrogenPro to set up a joint venture in India for gigawatt-scale manufacturing of alkaline water electrolyzers. L&T also entered into MoU with Norway-based H2Carrier (H2C) to co-operate toward developing floating green ammonia projects for industrial scale applications with an aim to decarbonise the global economy. These investments will play out gradually as market for hydrogen develops.

Improving prospect pipeline and control over working capital to drive 24% PAT CAGR over three years

We expect revenue/EBITDA/PAT CAGR of 16%/21%/24% over FY23-26 for L&T core EPC division. This is driven by (1) order inflow growth of 17% over the same period, led by prospect pipeline of INR8.8t and L&T's market share of 15%, (2) gradual recovery in core EPC EBITDA margin to 9.3%/9.7% by FY25/26, albeit still less than the double-digit mark, which the company used to register during pre-Covid time, (3) control over working capital and NWC at 18% of sales.

Valuation and recommendation

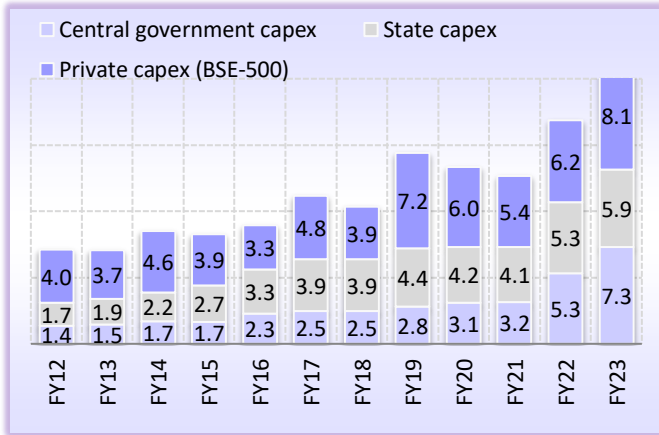
We value L&T on SOTP methodology, ascribing 26X P/E to the core business, where we expect revenue, EBITDA, and PAT CAGR of 16%/21%/24% over FY23-26E. We value investments in listed subsidiaries at market price and with a 25% holding company discount. Additionally, we ascribe a 1X/(-0.3X) P/BV to investments in power and Hyderabad metro and arrive at a TP of INR3,660. We recommend a BUY rating on the stock.

Key risks

Slowdown in order inflows, political risk in terms of change in government post elections, sharp rise in commodity prices, higher crude prices, lower-than-expected monsoon and consequently higher inflation, increase in receivables and working capital, increased competition are a few downside risks to our estimates.

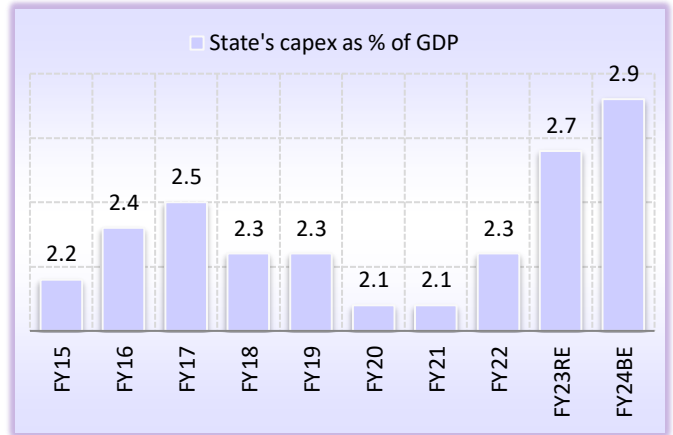
STORY IN CHARTS

Capex recovery over last few years was driven by central government (INR t)



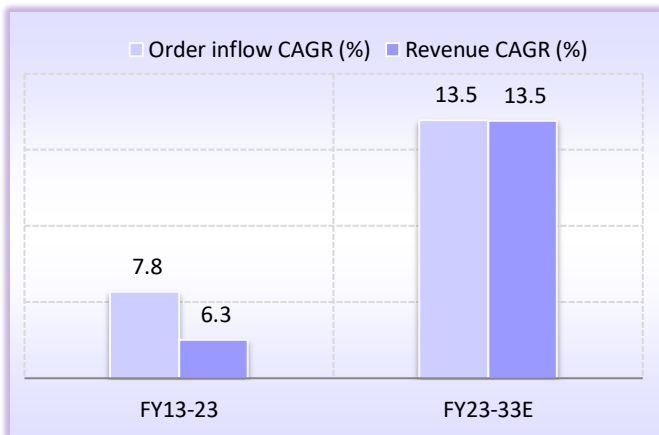
Source: Budget documents, Capitaline

State Government capex as a % of GDP is projected to grow in coming years



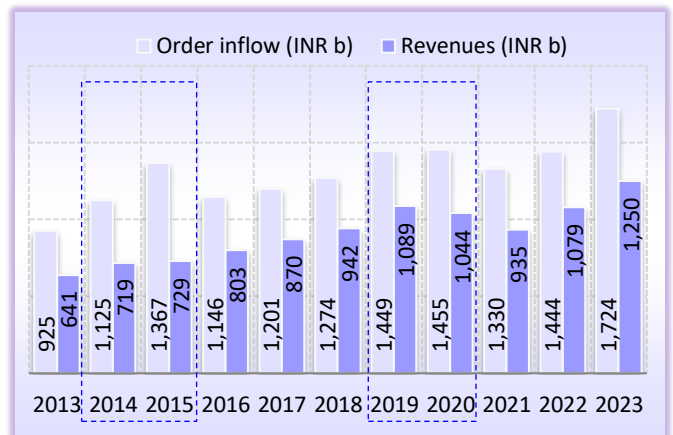
Source: Company, MOFSL

We expect order inflow and revenue CAGR over next decade to be better than last decade



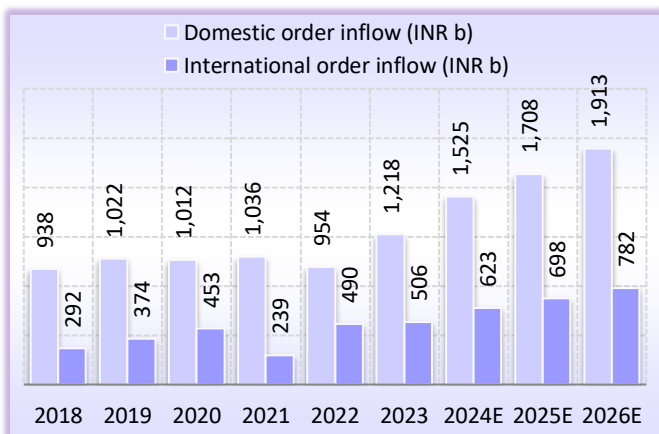
Source: Company, MOFSL Estimates

Historical data suggests that elections didn't have a major impact on inflows in following year after elections



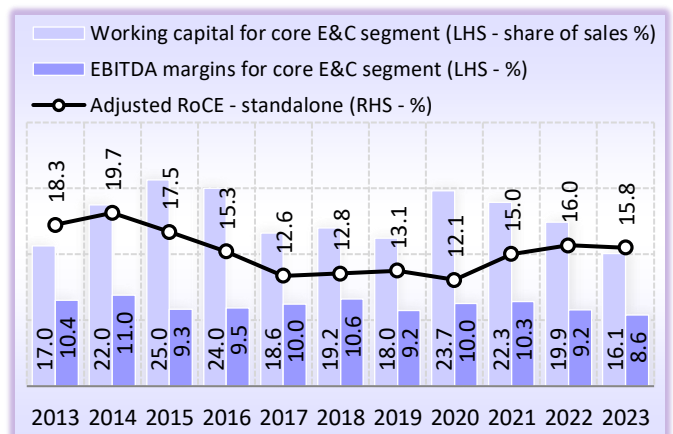
Source: Company, MOFSL Estimates

We expect order inflows to grow at a CAGR of 17% over FY23-26



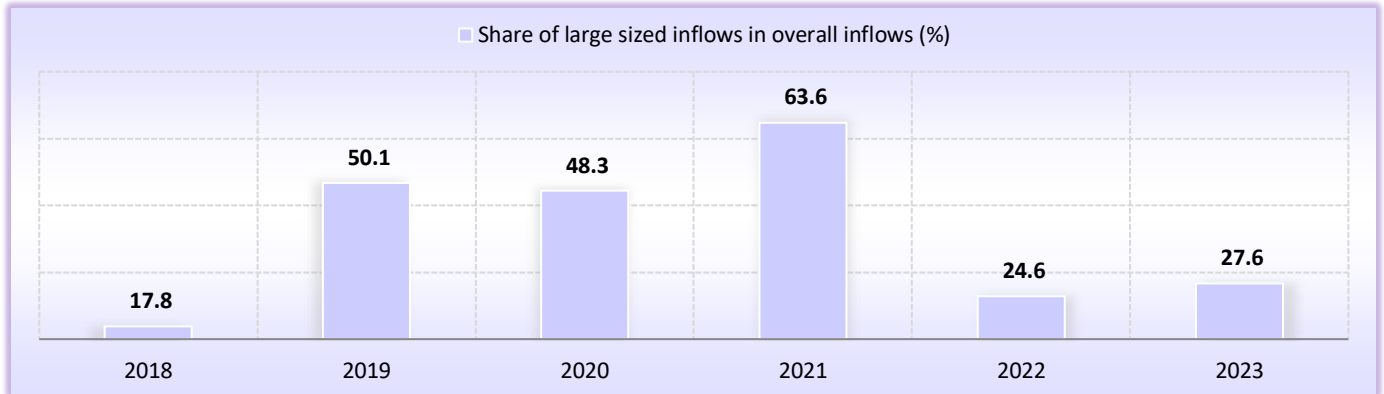
Source: Company, MOFSL

Return profile has improved despite margin pressure due to focus on working capital reduction



Source: Company, MOFSL

Share of large sized projects (>INR25 b) in overall inflows has remained above 25% since 2019



Source: Company, MOFSL

Initiatives for new energy transition

In line with its strategic road map Lakshya 2026, L&T intends to set up electrolyzer capacity of 500 MW by 2026 and 1 GW by 2028 with a targeted capital allocation of Rs11-12 bn. It had already entered into an MoU with Norway-based electrolyzer manufacturer HydrogenPro to set up a joint venture in India for gigawatt-scale manufacturing of alkaline water electrolyzers. It also entered into an Electrolyzer Manufacturing Binding Agreement with McPhy Energy a France-based leading electrolyzer technology and manufacturing company, for a long-term partnership to explore the opportunities unfolding in the emerging Green Hydrogen market. The company also intends to go for advance chemical cell manufacturing with nearly INR31b capital allocation.

L&T also entered into MoU with Norway-based H2Carrier (H2C) to co-operate towards developing floating green ammonia projects for industrial-scale applications with an aim to decarbonise the global economy. H2C has proven expertise in developing and integrating Power-to-X (PtX) projects based on affordable, often stranded, non-commercial renewable power. Under the terms of the MoU, L&T will become a partner for EPCIC of the topsides for H2C’s floating process plants.

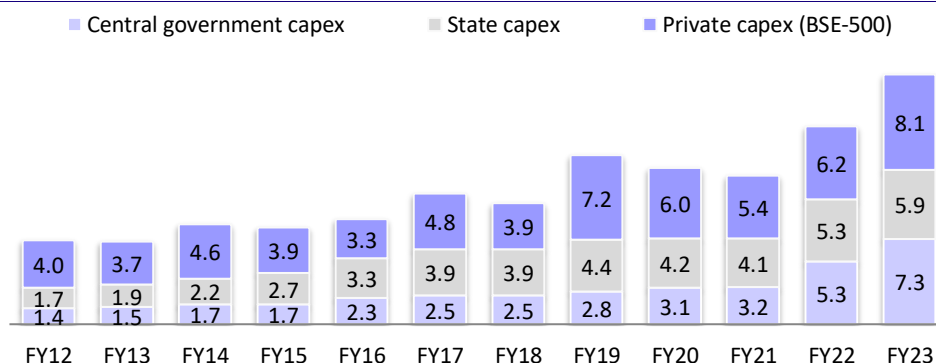
What has changed now – Both domestic and international fronts active; potential near-term election-related risks

Domestic capex is primarily led by the central government, owing to improved tax collections. This investment is diversified across various sectors including water, urban infra, transmission, railways, defence, and renewable energy. Additionally, there has been increased expenditure in the Middle East, particularly in hydrocarbon, energy transition, transmission, and urban infrastructure projects. We expect the central government’s capex trend to continue and support from the state government will likely follow selectively post elections. Moreover, we do see tailwinds for private sector capex recovery. Given significant spending on refinery, new energy and new city driven capex in key Middle Eastern regions, we expect international order inflows to remain robust as long as oil prices stay within the range of \$70-90 per barrel.

Central and State government capex: The government has already set the ball rolling for long-term capex drivers across key areas such as transmission, clean energy, railways, Make in India, defence indigenization till FY2030, providing a strong addressable market for capital goods companies. The Centre and state capex combined stood at INR11t in FY22 and INR13.5t in FY23RE. This is projected to grow to INR17t in FY24E. The state government capex was weak in most states.

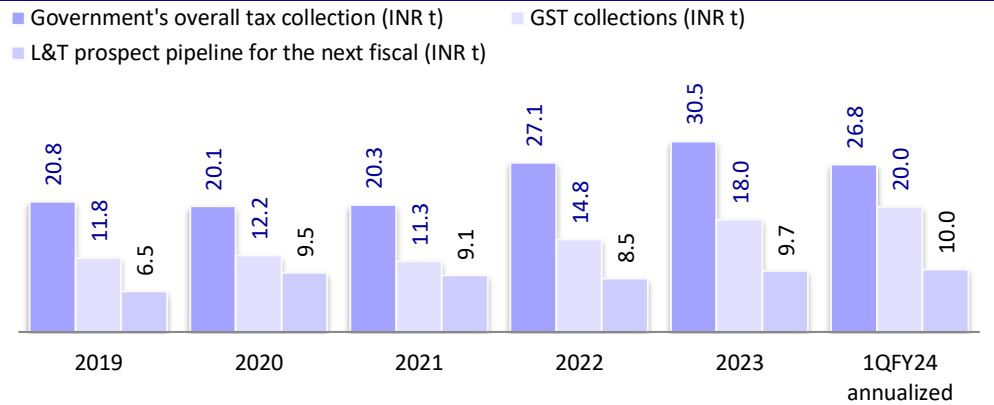
Private and PSU capex: Revival in overall private capex is still lower than expectations and is very selective across sectors such as cement, pharmaceuticals, food and beverages, telecom, metals and mining. We see specific instances where opex is being directed toward more sustainable energy resources, signaling a shift toward greener practices. We expect the private capex cycle to take some time to regain momentum and accelerate. However, we see positive drivers for capex cycle from (1) Deleveraged balance sheet and increasing capacity utilization across main sectors, (2) PLI-led capex, which has so far remained below expectations, (3) increased spend towards digitization and automation, driving growth for data centres and (4) Green energy-related capex such as EV and renewable energy.

Exhibit 63: Government capex has been growing well while private capex is selective and has started growing from FY22 (INR t)



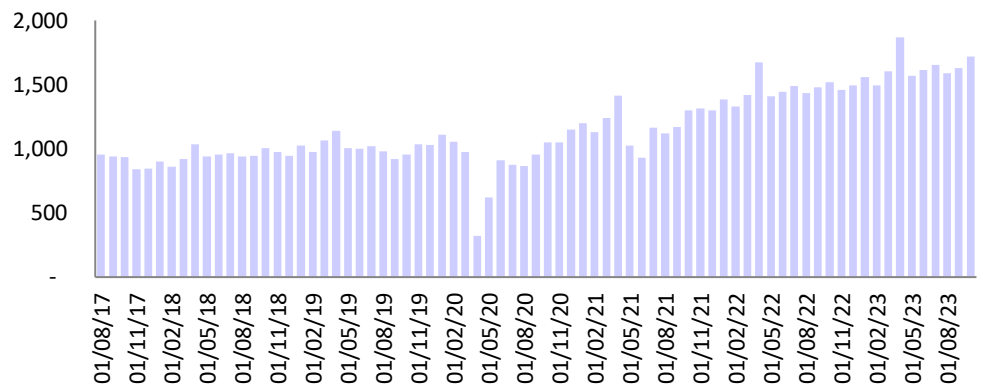
Source: Budget documents, Capitaline

Exhibit 64: Buoyant tax collections bode well for L&T



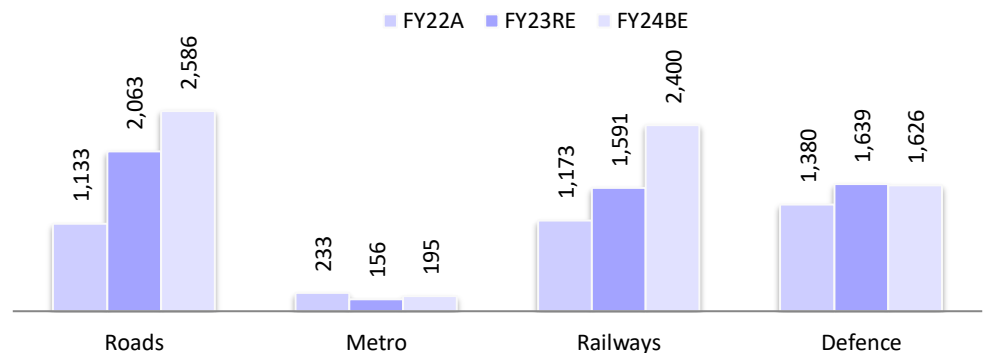
Source: Company, MOFSL

Exhibit 65: Monthly GST collection trend (INR b)



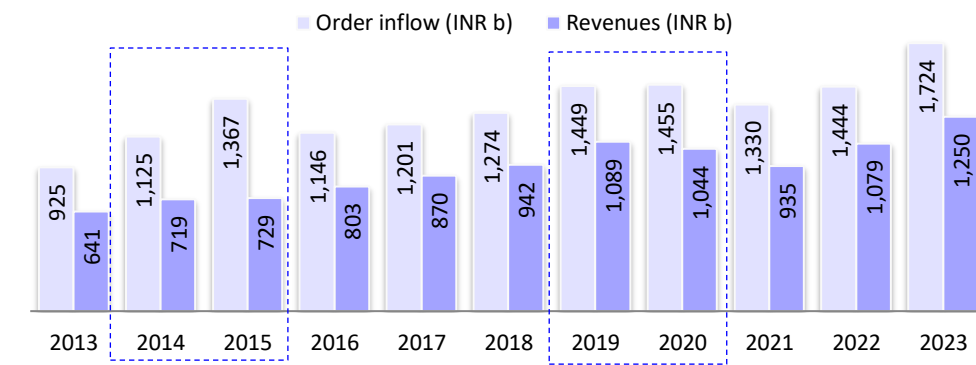
Source: Company, MOFSL

Exhibit 66: Higher budgetary allocation for roads, metro, railways, defence to augur well for L&T (INR b)



Source: Budget documents, MOFSL

Exhibit 67: Election didn't have a major impact on inflows, execution was a bit soft in following year after elections

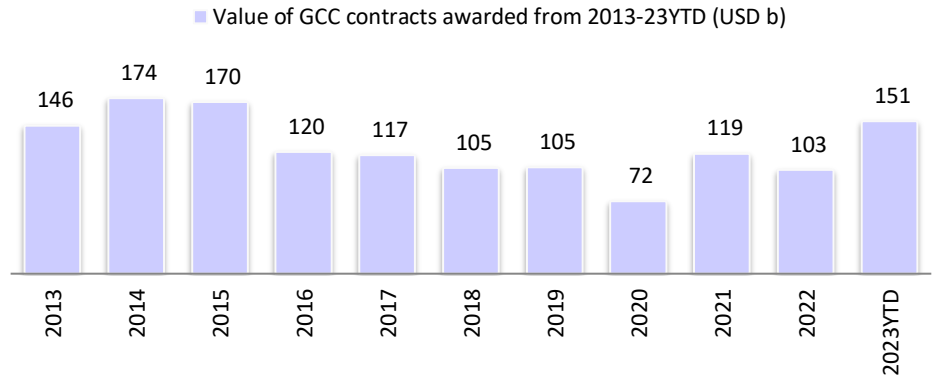


Source: Company, MOFSL

Capex across key nations in GCC: Investments in various sectors, including hydrocarbons, renewables, and infrastructure, have witnessed significant growth in the GCC region. Region has seen project awards of USD150b in YTD CY23 as compared to USD103b in CY22. Kingdom of Saudi Arabia (KSA) and UAE have dominated these project awards. Various Giga projects have been announced in Saudi region such as Neom city, Amaala red sea luxury coastal resort project, Jeddah Central Urban revival project, King Salman Park Foundation, Riyadh city project, Qiddiya entertainment city, Diriyah Gate residential and retail destination, New Murabba downtown development etc which we believe will keep awarding activity strong in coming years. Total value of such contracts is expected to be around USD884b and so far from 2018-YTD23, awards worth USD60b have been awarded.

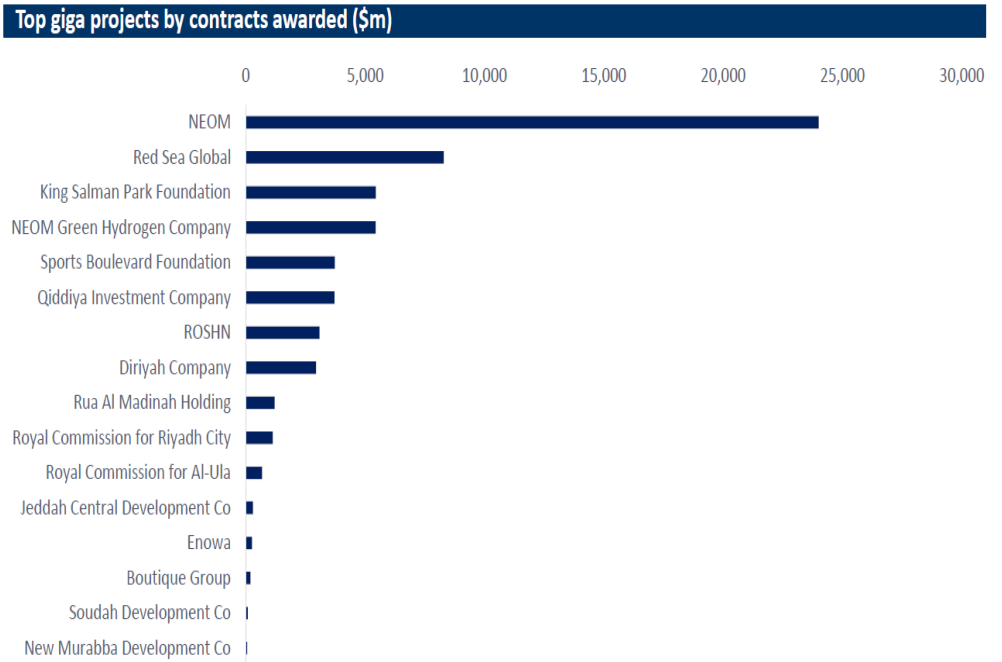
Saudi Aramco, in particular, is actively working to enhance its capacity by adding 1 million barrels per day (mb/d) to achieve a production level of 13 mb/d by 2027, with a strong focus on its offshore fields. Other big projects include the development of the Jafurah onshore unconventional gas field and the expansion of Aramco's Master Gas System. Saudi Aramco plans to increase its total capital expenditure to between USD45b and USD55b in 2023 (compared to USD 38b in 2022) and increase it further over the next several years. Nearly 60% of capital expenditure is earmarked for the upstream. In line with global sustainability efforts, Saudi Aramco has also made a commitment to achieve net-zero emissions by 2050. This aligns with the Kingdom's broader goal of reaching net-zero emissions on a national scale by 2060. As a result of this commitment, we can anticipate an uptick in investments in renewable projects. L&T has benefited from order inflows from Saudi Aramco and we expect it to benefit further from incremental capex from Saudi Aramco. Along with this, we do expect L&T to benefit from spending on NEOM city project too, which could range from USD500b to USD1t.

Exhibit 68: With higher oil prices, spending across GCC region has moved up in last two years. Within the value of GCC contracts awarded from 2013-23YTD, KSA and UAE dominated most of the awards (USD b)



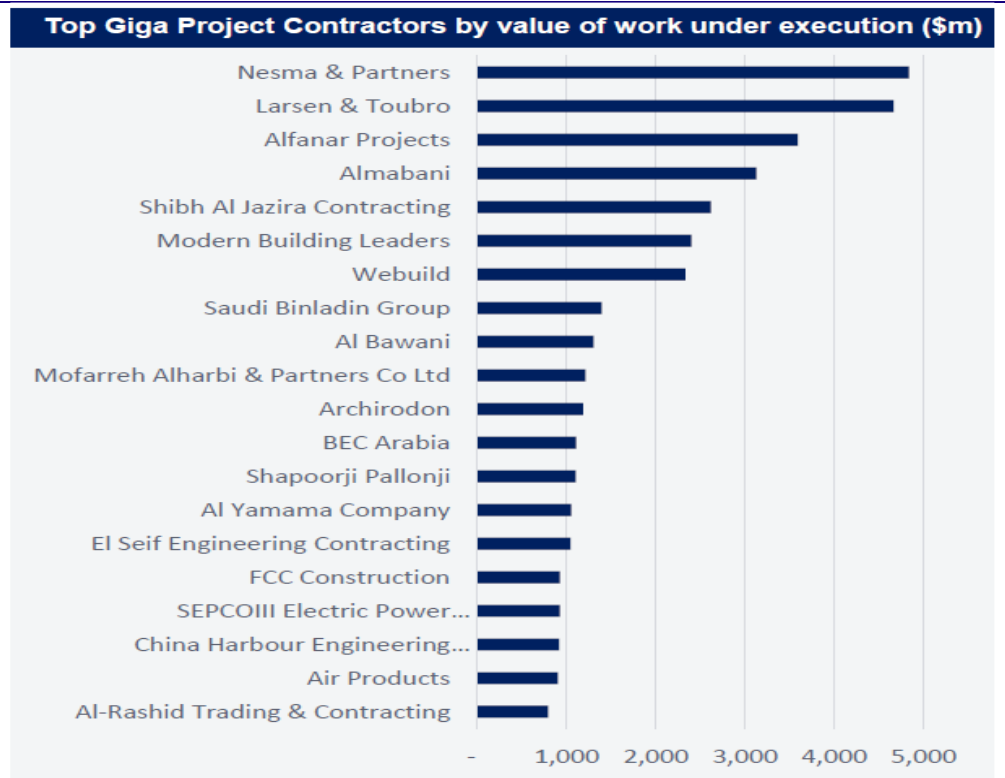
Source: MEED, MOFSL

Exhibit 69: Top giga projects contribute USD884b in capex which are under construction and awarding of USD60b has already happened



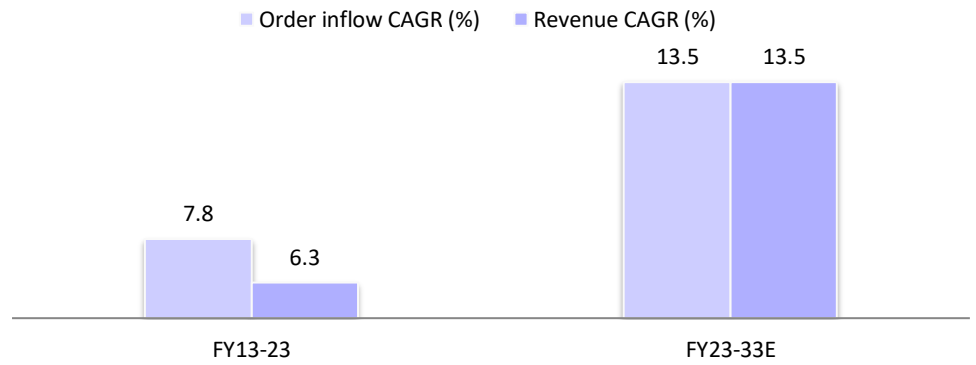
Source: MEED, MOFSL

Exhibit 70: L&T has emerged as one of the top contractors and has competed well with global players



Source: MEED, MOFSL

Exhibit 71: We thus expect order inflow and revenue CAGR for L&T over next decade to be better than last decade



Source: Company, MOFSL

L&T's unique differentiation strategy

Focus on large-sized projects: Despite facing heightened competition from other EPC players, L&T has intensified its efforts to secure large-sized order inflows across various sectors including metro, RRTS, transmission, water and defence, over the next few years. Share of large sized projects in overall inflows has remained well above 25% since 2019 and company has won 3-4 mega projects every year.

For example, in the recent tenders of Mumbai-Ahmedabad high speed bullet train project, L&T has emerged as the preferred bidder for package C-3 for INR 157b. The company is now doing four packages of the same – C-3, C-4, C-5 and C-6 along with Sabarmati Depot project (D2), constituting 92% of the mainline project. It has also grown its base in transmission (international) and water segment. The company has significantly expanded its presence in the international transmission and water segments. Notably, it recently secured a substantial project valued at INR240b for Saudi Aramco's Jafurah unconventional gas development initiative. Additionally, the company has been awarded a second contract for the construction of gas compression units, amounting to INR83b. Along with this, we also expect company to grow its defense segment. It is prequalified to manufacture several products listed under import embargoes, further enhancing its prospects in this sector.

Exhibit 72: Large sized projects (>INR25b) in overall inflows have remained above 25% since 2019

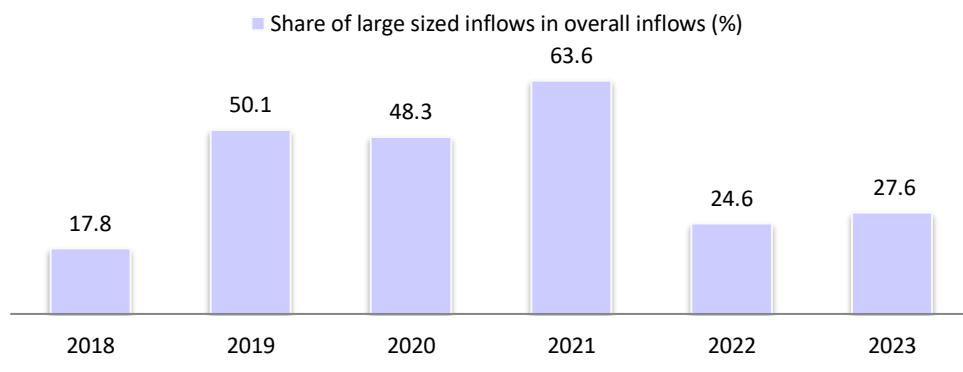


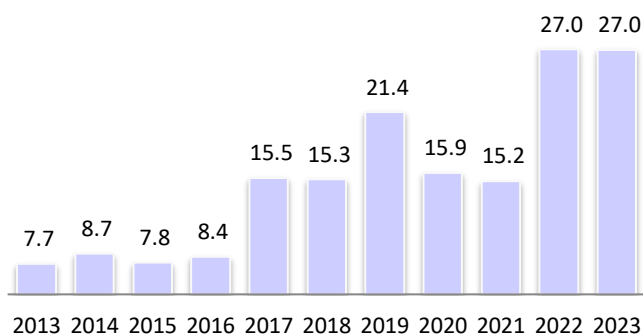
Exhibit 73: Share of mega projects across diverse sectors has increased in last 4 years for L&T

Year	Customer	Region	Sector	Order size (distributed, INR b)
2020	SJVN Thermal	Domestic	Power	70.0
2020	Saudi Aramco	International	Hydrocarbon	70.0
2020	Navi Mumbai International Airport Pvt Ltd	Domestic	Infrastructure	60.0
2020	CIDCO	Domestic	Infrastructure	60.0
2020	HPCL	Domestic	Hydrocarbon	70.0
2021	NHSRCL	Domestic	Infrastructure	249.9
2021	NHSRCL	Domestic	Infrastructure	70.0
2021	HPCL	Domestic	Hydrocarbon	70.0
2021	HPCL	Domestic	Hydrocarbon	70.0
2021	RVNL	Domestic	Infrastructure	70.0
2021	ACWA Power	International	Infrastructure	60.0
2022	Overseas Client	International	Hydrocarbon	70.0
2023	ArcelorMittal Nippon Steel India	Domestic	Infrastructure	70.0
2023	NEOM Green Hydrogen Company	International	Infrastructure	230.7
2023	Government of MP	Domestic	Infrastructure	60.0
2023	Overseas Client	International	Hydrocarbon	60.0
2023	Saudi Aramco	International	Hydrocarbon	70.0
2024	NHSRCL	Domestic	Infrastructure	70.0
2024	MMRDA	Domestic	Infrastructure	70.0
2024	Saudi Aramco	International	Hydrocarbon	83.0
2024	Saudi Aramco	International	Hydrocarbon	240.7

Source: Company, MOFSL

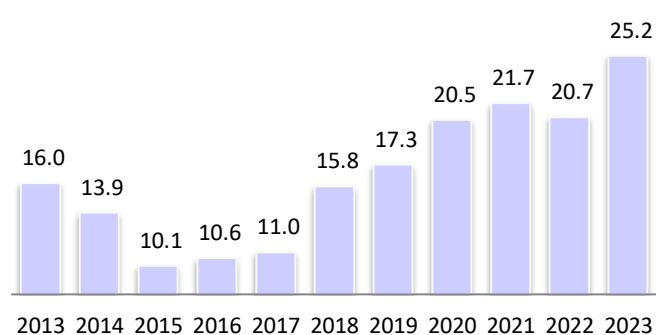
Diversified mix to hedge against slowdown in any segment: During FY23, L&T's 25.2% of overall revenues and 27% of overall order inflows came from the energy segment (largely hydrocarbon) and the hi-tech segment (largely defense). Share of inflows from hydrocarbon has increased to 38% in 1HFY24, which hedges the company against any near-term slowdown in order inflows and execution due to election schedule.

Exhibit 74: Share of hydrocarbon and defence put together in order inflows has increased since FY22



Source: Company, MOFSL

Exhibit 75: Share of hydrocarbon and defence in revenues has also increased from FY23



Source: Company, MOFSL

Capital allocation: From FY16-23, L&T has distributed a major part of its FCF to its shareholders in the form of dividends and special dividends and would continue to do so on dividends and share buybacks. The company has reduced exposure toward non-core assets by divesting its 51% stake in IDPL at an enterprise value of INR27b

and is looking to exit Nabha Power and Hyderabad metro. The incremental loss funding support is currently only for the Hyderabad metro rail project. This funding will continue until debt reduces in the project, with support from the state government and ToD sales.

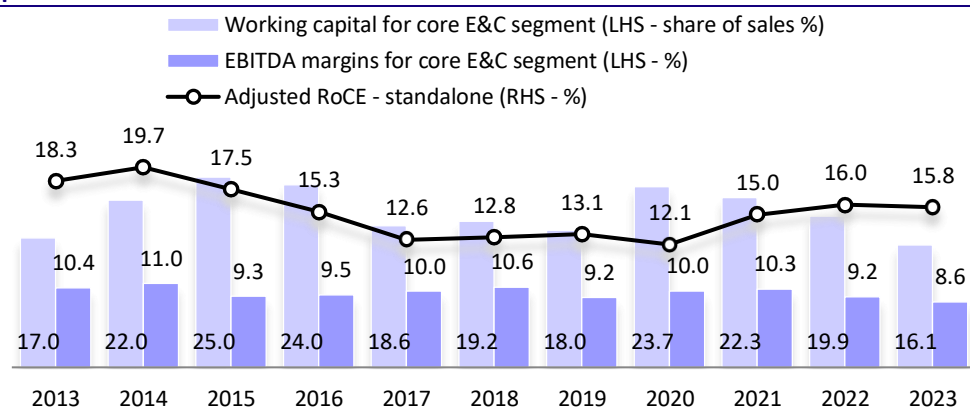
Exhibit 76: L&T has paid all of its FCF generation to shareholders and company's investments in subsidiaries were limited over FY2016-23

	2010-15	2016-23
Free cash flow generation	90	290
Payout to shareholders (includes dividend tax)	63	218
Net investments in subsidiaries	107	8
L&A given to subsidiaries	13	20
Dividend income	36	126

Source: Company, MOFSL

Focus on improving return metrics: In FY23, L&T successfully reduced its overall WC as percentage of sales to 16%, led by its emphasis on efficient collections. Despite margins being lower than the pre-Covid double-digit mark, this focus resulted in an improvement in its RoCE to 15%. Thus, we believe that sustaining the WC within the range of 16-18% of net sales will continue to drive RoCE/RoIC improvements, even if margins remain below the double-digit mark of 10%.

Exhibit 77: Return profile has improved despite margin pressure due to focus on working capital reduction



Source: Company, MOFSL

Growth drivers for L&T

We expect infrastructure (metros, high speed rail, railways, water, transmission, airport), international hydrocarbon and defence to drive overall inflow growth for the company over FY23-26E. Notably, the company boasts a robust pipeline valued at INR8.8t for rem-FY24E, and we expect it to grow further with improved government tax collections and increased capex across the GCC region.

Infrastructure: L&T has an overall prospect pipeline of INR8.8t for rem-FY24E and the infrastructure segment contributes nearly INR5.1t. This is spread across heavy civil infra (13%), water and effluent treatment (20%), transportation infrastructure (26%), Power T&D (13%), buildings and factories (18%), minerals and metals (10%).

- We expect heavy civil and transportation infrastructure segment to benefit from ongoing investments in urban infra, particularly metros and high-speed rail projects where L&T has a healthy market share.
- Spending on Jal Jeevan-related projects has remained strong at INR1.4t so far from the overall budgeted project cost target of INR3.6 t and we expect L&T's water and effluent treatment segment to benefit from the remaining spend on Jal Jeevan projects as well as state irrigation projects.
- The mix of inflows from international and domestic transmission projects stood at nearly 70:30 for overall transmission-related inflows in FY23 and with improving pipeline across domestic T&D projects, we expect L&T to get 15-20% share of overall domestic T&D tendering.

Energy: As per the new classification, the energy segment comprises hydrocarbon and power. The company has a prospect pipeline of INR3t in the energy segment.

- L&T has witnessed a sharp increase in international hydrocarbon inflows to INR225/187b for FY22/23 as compared to INR75/29b seen during FY20/21. This improved further to INR474b in 1HFY24. This is driven by a sharp uptick in capex toward hydrocarbon by the GCC nations.
- The company is maintaining a disciplined approach for thermal power projects despite it being a largely two player market between BHEL and L&T. The company believes that bids for thermal power projects remain highly competitive, primarily due to the significant under-utilization of capacity that industry players are currently experiencing. It sees a prospect pipeline of 4.5-5GW from thermal power projects during next one year.

Hi-tech manufacturing: In line with its strategic road map Lakhya 2026, L&T intends to set up electrolyzer capacity of 500 MW by 2026 and 1 GW by 2028 with a targeted capital allocation of Rs11-12 bn. It had already entered into an MoU with several players to explore production of green hydrogen, electrolyzers, green ammonia.

Exhibit 78: L&T new energy initiatives to yield benefits in long term

Segment	New energy initiatives
Electrolyser	❖ In line with its strategic road map Lakhya 2026, L&T intends to set up electrolyzer capacity of 500 MW by 2026 and 1 GW by 2028 with a targeted capital allocation of Rs11-12 bn. It had already entered into an MoU with Norway-based electrolyzer manufacturer HydrogenPro to set up a joint venture in India for gigawatt-scale manufacturing of alkaline water electrolyzers. The company also intends to go for advance chemical cell manufacturing with nearly INR31b capital allocation.
Green ammonia	❖ L&T also entered into MoU with Norway-based H2Carrier (H2C) to co-operate towards developing floating green ammonia projects for industrial-scale applications with an aim to decarbonise the global economy. H2C has proven expertise in developing and integrating Power-to-X (PtX) projects based on affordable, often stranded, non-commercial renewable power. Under the terms of the MoU, L&T will become a partner for EPCIC of the topsides for H2C's floating process plants.
Green Hydrogen	❖ L&T also entered into an Electrolyzer Manufacturing Binding Agreement with McPhy Energy, a France-based leading electrolyzer technology and manufacturing company, for a long-term partnership to explore the opportunities unfolding in the emerging Green Hydrogen market.
Green hydrogen and electrolyser	❖ L&T also signed a JV with IOCL and Renew Power to develop nascent green hydrogen and electrolyzers

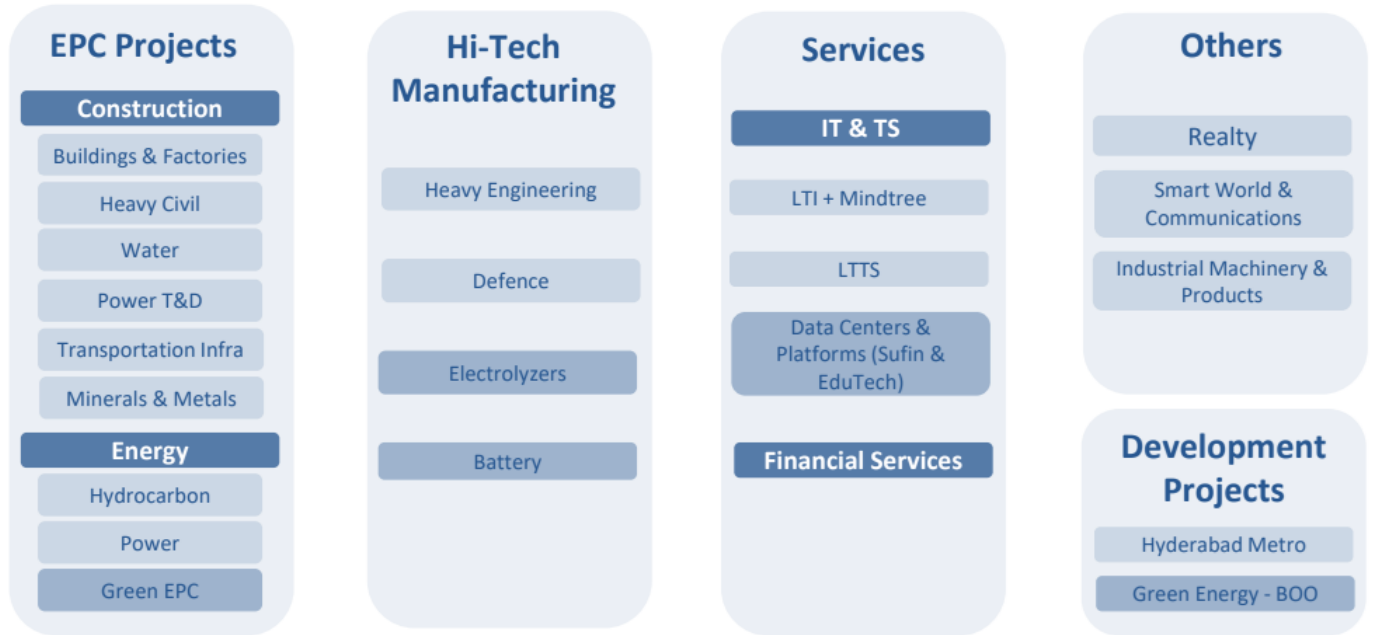
Source: Company, MOFSL

The defense segment has now crossed the inflection point and is witnessing improved order inflows, which stood at INR120b in FY23. For L&T, defense prospect pipeline stands at INR200b, which still does not include the large-sized order of INR450b from P75I submarine, where the company has already submitted its bid. We expect the share of revenues from defense to gradually inch up to 4-5% of overall sales over the next two years.

Lakshya targets

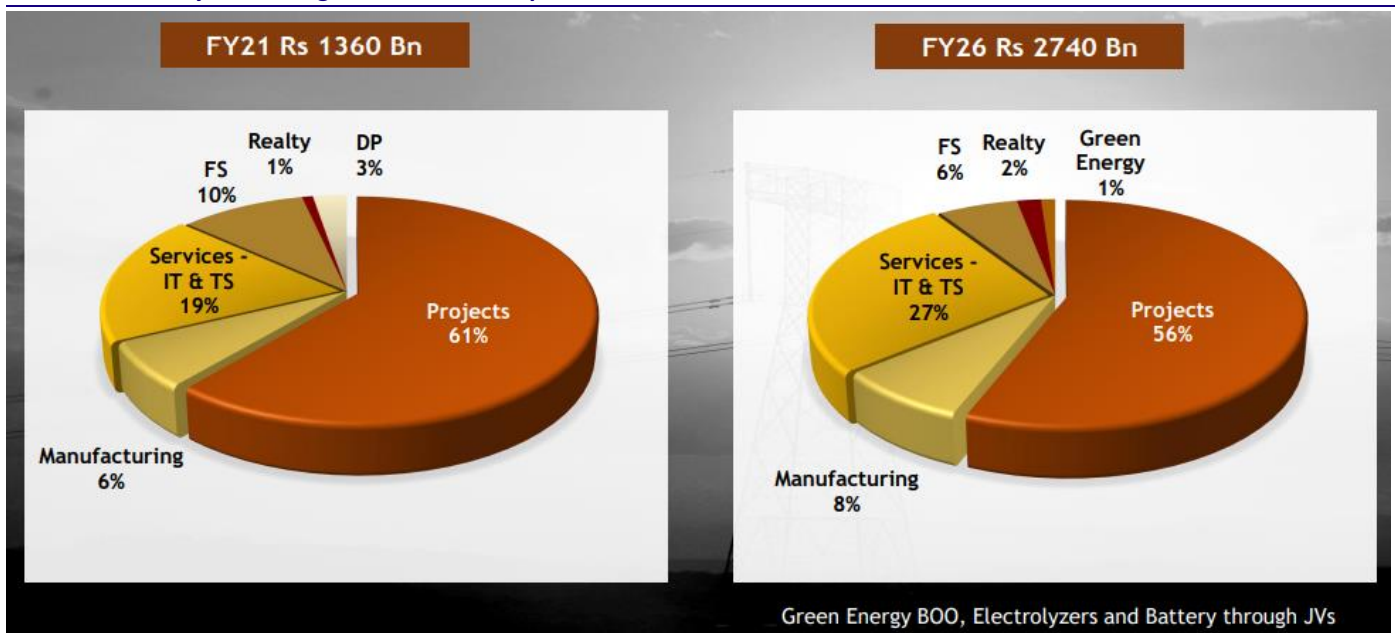
L&T has come up with a strategic road map Lakshya 2026 to identify future growth areas across projects (construction, hydrocarbon, power, green EPC), hi-tech manufacturing focusing on defense, heavy engineering, electrolyzers, and battery manufacturing and services, focusing on existing companies along with investments in data center and platforms. With focus on sustainable growth, L&T expects to clock a revenue CAGR of 15% over FY21-26 and targets 18%+ RoE by FY26.

Exhibit 79: Lakshya 2026 targets: Emerging Business Portfolio



Source: Company, MOFSL

Exhibit 80: Lakshya 2026 targets: Revenue Composition



Source: Company, MOFSL

Monetization plans for Hyderabad metro and Nabha power

In FY22, L&T successfully refinanced the Hyderabad metro, leading to an annual interest cost saving of INR3b. Hyderabad metro's ridership has steadily increased and currently stands at 4.62 lakh passenger per day. The company needs 14 lakh pax per day to reach the break-even point at PBT level. The state government has already approved funding assistance of INR30b in the form of soft loans and also granted approval for monetization of ToD rights. The company aims to reduce the current debt of INR 130b at Hyderabad Metro. This reduction can be achieved through state government assistance (INR30b) and monetization of ToD rights (INR20b), totaling approximately INR55-60b over the next two years.

Key financials of Hyderabad Metro

Exhibit 81: Income Statement (INR m)

Y/E March	FY20	FY21	FY22	FY23
Total Income from Operations	13,597	3,477	4,569	6,979
Change (%)		-74.4	31.4	52.8
EBITDA	2,952	-821	185	2,665
Margin (%)	21.7	-23.6	4.0	38.2
Depreciation	1,456	2,985	3,066	3,144
EBIT	1,497	-3,806	-2,882	-479
Int. and Finance Charges	5,428	14,245	14,766	12,734
Other Income	109	383	185	53
PBT bef. EO Exp.	-3,822	-17,668	-17,462	-13,159
EO Items	0	0	0	0
PBT after EO Exp.	-3,822	-17,668	-17,462	-13,159
Total Tax	0	0	-3.6	0
Tax Rate (%)	-3,822	-17,668	-17,459	-13,159
Minority Interest				
Reported PAT	-3,822	-17,668	-17,459	-13,159
Adjusted PAT	-3,822	-17,668	-17,459	-13,159
Change (%)		362.3	-1.2	-24.6
Margin (%)	-28.1	-508.1	-382.1	-188.6

E: MOFSL est.

Net debt (INR m)

Y/E March	FY20	FY21	FY22	FY23
Gross Debt	1,40,672	1,67,039	1,76,408	1,71,251
Cash	2,537	1,590	1,113	88
Net Debt	1,38,134	1,65,449	1,75,295	1,71,163

Free Cash Flow Statement (INR m)

Y/E March	FY20	FY21	FY22	FY23
Cash Flow from Operations	27	75	6,726	2,385
Capital Expenditure	-15,411	-3,245	-1,987	-22
Free Cash Flow	-15,384	-3,170	4,738	2,363

Key financials of Nabha Power plant

Exhibit 82: Income Statement (INR m)

Y/E March	FY21	FY22	FY23
Total Income from Operations	33,911	41,289	45,699
Change (%)	-10.0	21.8	10.7
EBITDA	6,346	6,568	8,266
Margin (%)	18.7	15.9	18.1
Depreciation	17	31	27
EBIT	6,329	6,538	8,239
Int. and Finance Charges	4,909	3,705	4,228
Other Income	218	186	325
PBT bef. EO Exp.	1,639	3,018	4,336
EO Items	-1,206		
PBT after EO Exp.	2,845	3,018	4,336
Total Tax	0	0	0
Tax Rate (%)	0	0	0
Minority Interest	0	0	0
Reported PAT	2,845	3,018	4,336
Adjusted PAT	2,845	3,018	4,336
Change (%)	17.1	6.1	43.7
Margin (%)	8.4	7.3	9.5

Net debt (INR m)

Y/E March	FY21	FY22	FY23
Gross Debt	67,696	53,411	48,948
Cash	5,275	647	3,027
Net Debt	62,421	52,763	45,921

Free Cash Flow Statement (INR m)

Y/E March	FY21	FY22	FY23
CF From Operations	13,209	8,275	6,411
Capital Expenditure	851	1,490	2,225
Free Cash Flow	12,358	6,784	4,186

Source: Company, MOFSL

ESG

As part of the Lakshya 2026 plan, the company re-evaluated shareholder value creation, defined social obligations and framed sustainability goals. In line with L&T's sustainability vision for a better world, the company aims to achieve Carbon Neutrality by 2040 and Water Neutrality by 2035. The company has set interim targets for carbon neutrality, water neutrality, and other areas based on its Net Zero strategy. These targets are part of the current Lakshya 2026 strategy plan and include (1) Emissions intensity reduction by 25% (2) Renewable (% of electricity consumption) of 50%, (3) Energy intensity reduction by 11%, (4) Wastewater recycling efficiency at 75%.

Exhibit 83: L&T's ESG matrix

Environment	
Energy	
Energy consumption intensity	9,882GJ/ INR b
Sourcing from renewables	9.60%
Emissions	
GHG emission intensity	889tCO ₂ e/INR b
Carbon sequestration potential from tree plantation	141,300 Emissions tCO ₂ e
Water	
Water consumption intensity	10,155kL/ INR b
Wastewater recycling efficiency	68%
Material Management	
Recycled and eco-friendly material used	24%
Green Business	
Revenue from Green Business	37%
Social	
Health and Safety	
Safety training man hours 6	6.9 Mn
LTIFR ¹	0.06
Human Rights	
Own locations assessed on and complied with Human Rights requirements	100%
Workforce Skilling and Talent Management	
Employees	28,000+
workers trained on skill upgradation	45,000+
Attrition rate	13.90%
Diversity and Inclusion	
Diversity	7.10%
Women in senior management	89
Social Impact	
CSR beneficiaries	1.5 Mn
MSME suppliers	10,736
Governance	
Governance & Ethics	
New joinees trained on CoC	100%
Customer Centricity	
Customer satisfaction score out of 10	9.2
Data Privacy & Cyber Security	
Sustainable Supply Chain	
Sustainable sourcing from suppliers by value	40%
Of input material sourced from neighbouring districts	7%
Brand Management	3 rd among 'World's Top 200 Environmental Firms ranked by ENR for 2022

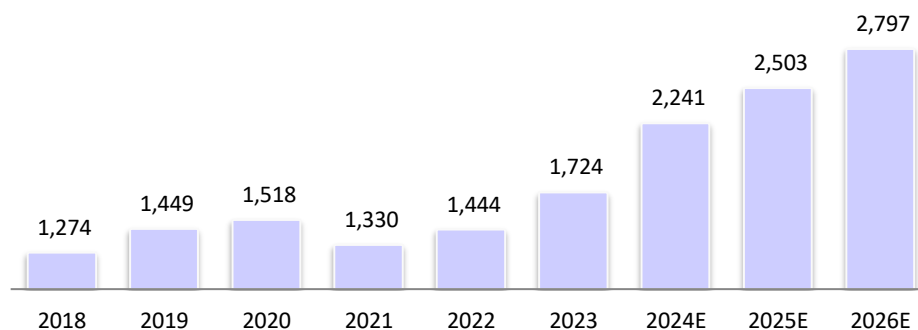
Source: Company, MOFSL

Financial outlook

We expect revenue/EBITDA/PAT CAGR of 16%/21%/24% over FY23-26E for L&T core EPC division. This will be driven by -

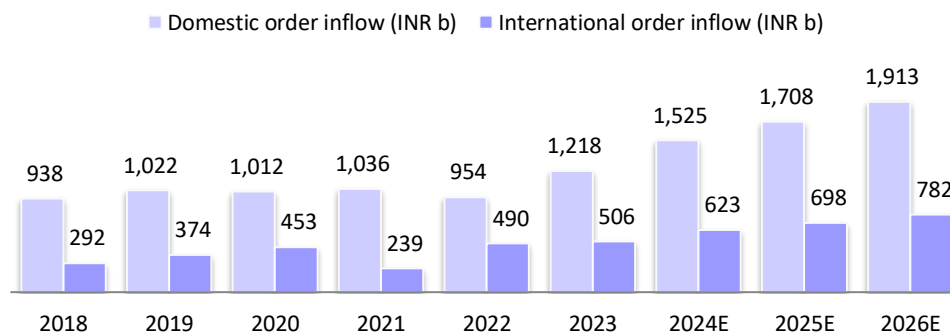
- Order inflow growth of 17% over the same period, led by a prospective pipeline of INR8.8t and L&T's market share of 15%. We expect order inflow of INR2.2/2.5/2.8 t for FY24/25/26E. Our estimates bake in moderation in order inflow during 4QFY24-1QFY25 due to election schedule.
- Gradual recovery in core EPC EBITDA margin by 50/40 bp to 9.3%/9.7% by FY25/26, albeit still less than the double digit mark which company used to register during pre-Covid times. Increased competition, pending claims from clients, and cost overruns in certain fixed price contracts have resulted in 60 bp decline in margins for FY23. Decline in RM prices will be positive for 65% of order book, which is variable in nature.
- L&T has demonstrated adept control over working capital, maintaining Net Working Capital (NWC) as a percentage of sales at 16.7%. This control was achieved through effective management of capital employed in projects and manufacturing, improved customer advances, and more efficient debtor collections. Through a strategic combination of revenue growth and reduced capital intensity, L&T managed to improve its NWC to 16% of net sales in FY23 despite lower margins. We believe that it will continue to maintain its focus on lower capital deployment and maintain NWC at its current levels of 17-18%.

Exhibit 84: Overall order inflow trend (INR b)



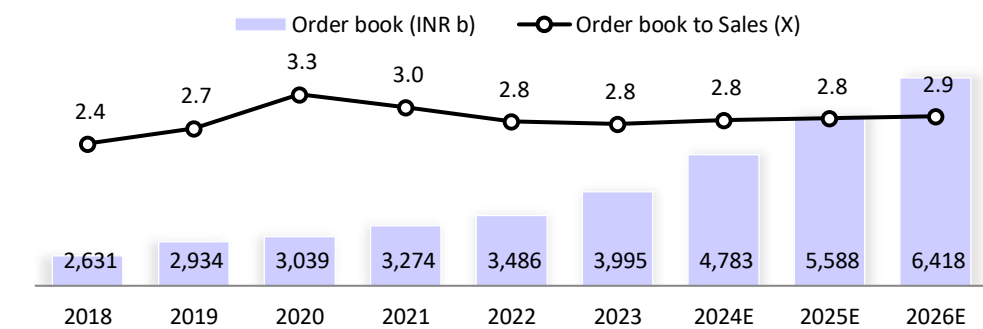
Source: Company, MOFSL

Exhibit 85: Geography-wise order inflow trend



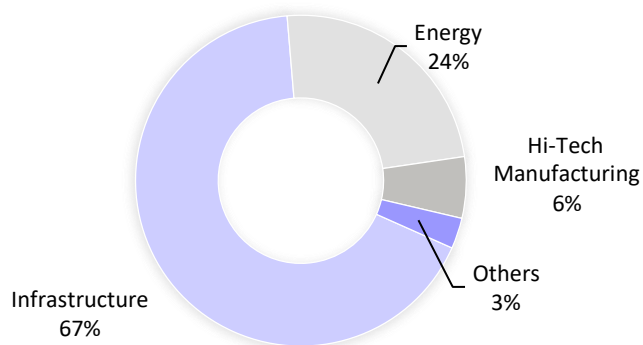
Source: Company, MOFSL

Exhibit 86: Robust tendering pipeline to support order book growth



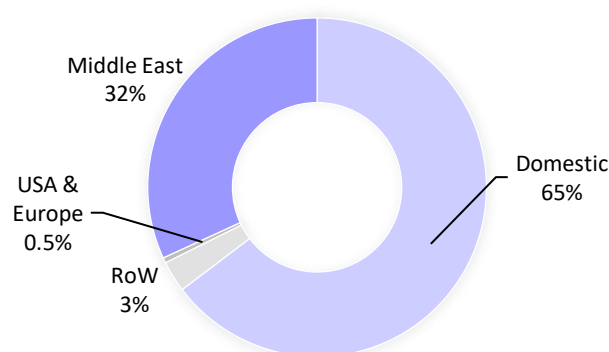
Source: Company, MOFSL

Exhibit 87: Segmental order book breakup – INR4.5t



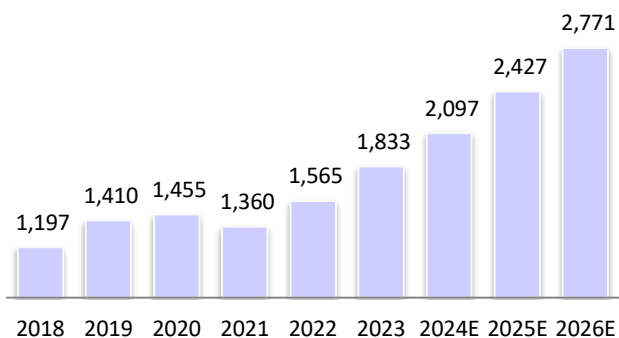
Source: Company, MOFSL

Exhibit 88: Geographical order book breakup – INR4.5t



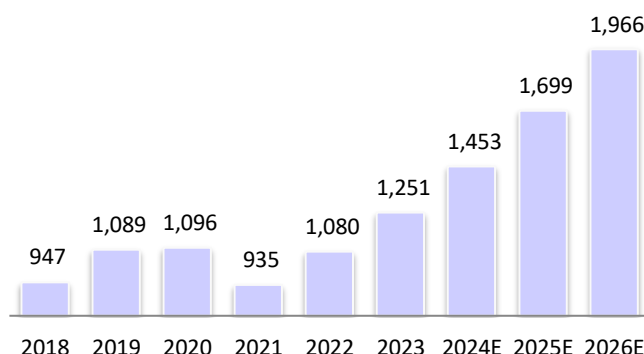
Source: Company, MOFSL

Exhibit 89: Consolidated revenue trend (INR b)



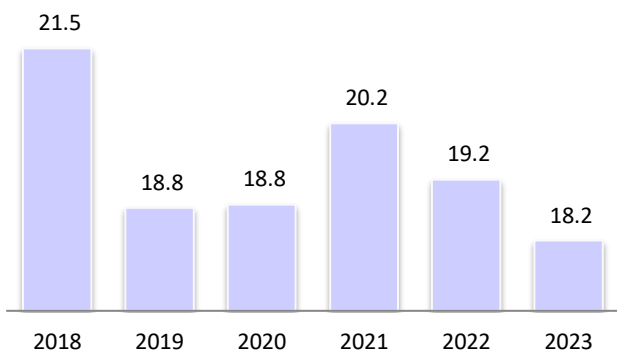
Source: Company, MOFSL

Exhibit 90: Core E&C revenue trend (INR b)



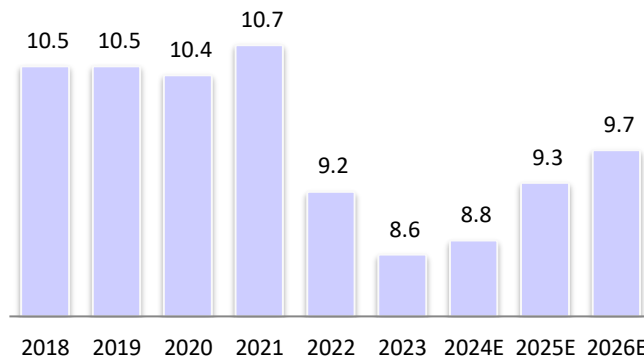
Source: Company, MOFSL

Exhibit 91: Standalone gross margin trend (%)



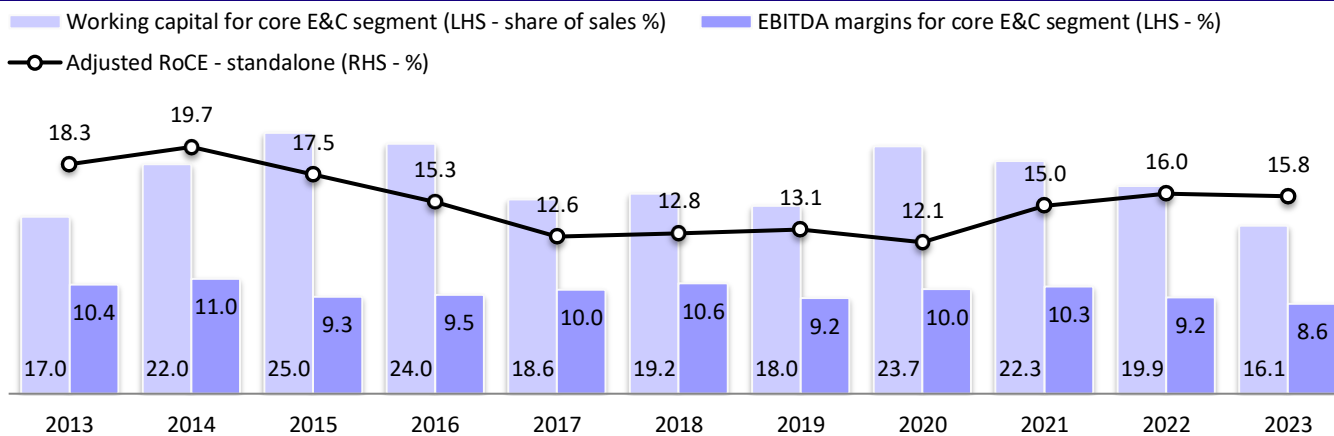
Source: Company, MOFSL

Exhibit 92: E&C EBITDA margin to improve as legacy projects get completed (%)



Source: Company, MOFSL

Exhibit 93: Working capital and RoCE trend



Source: Company, MOFSL

Valuation and recommendation

- We value L&T using a SOTP methodology, ascribing a 26X P/E based valuation for the core business. We expect revenue, EBITDA and PAT CAGR of 16%/21%/24% over FY23-26E.
- We value investments in listed subsidiaries at market price and with a 25% holding company discount.
- We ascribe a 1X/(-0.3X) P/BV to investments in power and Hyderabad metro and arrive at a TP of INR3,660 on two year forward estimates.
- We recommend a BUY rating on the stock.

Exhibit 94: L&T- SOTP based target price (INR/share)

	Earnings/Book (FY24) (INR m)	Target multiple (X)	Value (INR b)	Valuation basis	Stake (%)	Value (INR b)	Base case	
							March-25 (INR)	March-26 (INR)
Core E&C business (consolidated)	82,217	26	2,175	P/E	100.0	2,175	2,063	2,503
L&T Finance Holdings			423	(at MOFSL TP)	66.0	279	233	268
LTI-Mindtree			1,583	(at MOFSL TP)	68.6	1,086	909	1,045
L&T Technology Services			552	(at MOFSL TP)	73.8	407	341	392
IDPL- Roads, Transmission	24,000	1.2	29	Based on deal	51.0	15	12	14
Hyderabad Metro	24,390	(0.3)	-7	P/B	100.0	-7	-6	-7
Power development	26,000	1.0	26	P/B	100.0	26	22	25
Total subsidiaries				25% holding co. disc.		1,354	1,133	1,303
Grand total							3,196	3,806
Two-year forward fair value (INR/share)							3,660	

Source: Company, MOFSL

Exhibit 95: Implied reverse valuation

	Earnings/Book (INR m)	Target multiple (X)	Value (INR b)	Valuation basis	Stake (%)	Value (INR b)
L&T's market cap			4,484			4,484
L&T Finance Holdings			423	(at MOFSL TP)	66.0	279
LTI-Mindtree			1,583	(at MOFSL TP)	68.6	1,086
L&T Technology Services			552	(at MOFSL TP)	73.8	407
IDPL- Roads, Transmission	24,000	1.2	29	P/B	51.0	15
Hyderabad Metro	24,390	(0.8)	-19	P/B	100.0	-19
Power development	26,000	1.0	26	P/B	100.0	26
Total subsidiaries				25% holding co. disc.		1,345
Implied value of core business						3,139
Core earnings of core business for Dec, 25E						124
Implied P/E for core business for Dec, 25E						25

Source: Company, MOFSL

Exhibit 96: Sensitivity analysis - Base case, bull case and bear case valuation

	Bear case	Base case	Bull case	Rationale
Core business multiple - X	18	26	28	❖ Current valuations are closer to bull case valuations for L&T
Core business valuation - Dec, 25 earnings (INR b)	2,015	3,289	3,557	❖ We take 10% sensitivity of earnings
Subsidiary valuation after 25% holdco discount - INR b	1,710	1,710	1,710	❖ We assume similar subsidiary valuations in all cases
Total (INR b)	3,725	5,000	5,541	
Valuation per share (INR)	2,715	3,660	4,035	

Source: Company, MOFSL

SWOT analysis

- ❖ Diversified order book
- ❖ Focus on large sized projects
- ❖ Better control over collections
- ❖ Technically qualified for various projects
- ❖ Highly Skilled Workforce
- ❖ Focus on sustainability

S

STRENGTH



- ❖ Dependent on labor availability
- ❖ Exposure to non-core assets
- ❖ Uncertainty of how new-age biz will play out
- ❖ Dependence on several state governments

W

WEAKNESS



- ❖ New segments such as hydrogen, electrolyzers, data centre, batteries
- ❖ New geographies or increasing scope of work in existing geographies
- ❖ Increasing scope of work in existing geographies
- ❖ Capital allocation across high growth areas

O

OPPORTUNITY



- ❖ Increased Competition
- ❖ Delays in payments from clients
- ❖ Geopolitical war in key operating countries
- ❖ Very high crude oil prices
- ❖ Slowdown in capex momentum
- ❖ Commodity risk

T

THREATS



Exhibit 97: Management profile



S. N. Subrahmanyam
CEO & Managing Director



R. Shankar Raman
Whole-time Director &
Chief Financial Officer



Subramanian Sarma
Whole-Time Director &
Sr. Executive Vice President
(Energy)



M. V. Satish
Whole-time Director &
Sr. Executive Vice President
(Buildings)



S. V. Desai
Whole-Time Director &
Sr. Executive Vice President
(Civil Infrastructure)



T. Madhava Das
Whole-Time Director &
Sr. Executive Vice President
(Utilities)



Anil V. Parab
Whole-Time Director &
Sr. Executive Vice President
(Heavy Engineering and L&T Valves)



Shrikant Joshi
CEO & Managing Director
L&T Realty Limited



D. K. Sen
Advisor to the CEO & MD
(Development Projects, Minerals & Metals,
L&T Special Steels & Heavy Forgings and L&T Aviation)



J. D. Patil
Advisor to the CEO & MD
(Defence & Smart Technologies)

Source: Company, MOFSL

Key risks

Slowdown in order inflows, sharp rise in commodity prices, higher crude prices, lower-than-expected monsoon and consequently higher inflation, increase in receivables and working capital, increased competition are a few downside risks to our estimates.

Financials and valuation

Consolidated - Income Statement						(INR Million)		
Y/E March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Total Income from Operations	14,10,071	14,54,523	13,59,790	15,65,212	18,33,407	20,96,541	24,27,430	27,70,633
Change (%)	17.8	3.2	-6.5	15.1	17.1	14.4	15.8	14.1
Raw Materials	9,92,811	9,73,625	8,67,009	9,97,385	11,65,934	13,33,271	15,43,697	17,61,953
Gross Profit	4,17,260	4,80,898	4,92,781	5,67,827	6,67,473	7,63,269	8,83,734	10,08,680
Employees Cost	1,81,006	2,31,140	2,47,620	2,97,313	3,72,358	4,25,800	4,93,002	5,62,706
Other Expenses	73,007	86,468	88,920	88,341	87,493	94,907	1,00,792	1,13,277
Total Expenditure	12,46,824	12,91,232	12,03,549	13,83,039	16,25,785	18,53,978	21,37,491	24,37,935
% of Sales	88.4	88.8	88.5	88.4	88.7	88.4	88.1	88.0
EBITDA	1,63,247	1,63,291	1,56,241	1,82,173	2,07,621	2,42,563	2,89,939	3,32,698
Margin (%)	11.6	11.2	11.5	11.6	11.3	11.6	11.9	12.0
Depreciation	20,840	24,623	29,042	29,480	35,023	37,920	41,255	41,584
EBIT	1,42,407	1,38,668	1,27,199	1,52,694	1,72,599	2,04,642	2,48,684	2,91,114
Int. and Finance Charges	18,060	27,967	39,134	31,257	32,072	32,360	33,049	32,095
Other Income	18,515	23,609	34,294	22,671	29,292	36,276	40,578	42,569
PBT bef. EO Exp.	1,42,862	1,34,310	1,22,358	1,44,107	1,69,819	2,08,559	2,56,212	3,01,589
EO Items								
PBT after EO Exp.	1,42,862	1,34,310	1,22,358	1,44,107	1,69,819	2,08,559	2,56,212	3,01,589
Total Tax	43,433	32,632	40,593	42,166	44,930	51,242	63,599	71,695
Tax Rate (%)	30.4	24.3	33.2	29.3	26.5	24.6	24.8	23.8
Minority Interest	13,115	13,452	13,617	17,499	20,599	23,182	26,485	27,974
Reported PAT	86,104	88,946	68,292	85,724	1,03,348	1,34,767	1,67,480	2,02,272
Adjusted PAT	86,313.8	88,226.1	68,148.5	84,441.9	1,04,290.3	1,34,134.9	1,66,127.7	2,01,920.0
Change (%)	12.3	2.2	-22.8	23.9	23.5	28.6	23.9	21.5
Margin (%)	6.1	6.1	5.0	5.4	5.7	6.4	6.8	7.3

Consolidated - Balance Sheet						(INR Million)		
Y/E March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Equity Share Capital	2,806	2,808	2,809	2,810	2,811	2,749	2,749	2,749
Total Reserves	6,20,943	6,64,424	7,55,876	8,21,267	8,90,449	8,87,161	10,06,277	11,50,138
Net Worth	6,23,748	6,67,232	7,58,685	8,24,077	8,93,260	8,89,909	10,09,026	11,52,887
Minority Interest	68,261	95,208	1,20,515	1,29,661	1,42,422	1,63,785	1,88,353	2,16,606
Total Loans	12,55,552	14,10,071	13,46,291	12,55,080	12,06,504	12,38,303	12,71,641	13,05,141
Deferred Tax Liabilities	-31,078	-23,935	-15,183	-18,008	-33,544	-33,544	-33,544	-33,544
Other liabilities*	32	19,842	0	0	2,730	2,730	2,730	2,730
Capital Employed	19,16,515	21,68,418	22,10,308	21,90,810	22,11,372	22,61,183	24,38,206	26,43,819
Gross Block	2,42,857	4,97,473	5,70,322	5,31,013	5,94,017	6,38,932	6,97,114	7,60,548
Less: Accum. Deprn.	73,464	98,086	1,27,128	1,32,585	1,67,607	2,05,528	2,46,783	2,88,366
Net Fixed Assets	1,69,394	3,99,387	4,43,193	4,27,368	4,26,410	4,33,404	4,50,332	4,72,182
Capital WIP	1,39,269	76,783	5,034	20,006	40,544	21,937	21,937	21,937
Total Investments	2,53,748	2,37,622	3,96,266	3,96,034	4,47,983	4,47,983	4,47,983	4,47,983
Curr. Assets, Loans&Adv.	21,94,740	23,29,144	22,41,241	23,27,883	23,48,744	25,57,868	29,01,471	32,79,700
Inventory	64,139	57,467	58,205	59,433	68,288	78,089	90,413	1,03,196
Account Receivables	3,70,382	4,07,315	4,22,298	4,61,389	4,47,315	4,82,795	5,58,993	6,38,026
Cash and Bank Balance	1,17,262	1,51,178	1,62,415	1,89,532	2,25,196	2,37,824	3,12,350	4,10,447
Loans and Advances	10,59,590	10,61,171	9,90,912	9,55,424	8,88,851	9,36,861	9,87,635	10,41,340
Others	5,83,367	6,52,013	6,07,412	6,62,105	7,19,094	8,22,300	9,52,081	10,86,691
Curr. Liability & Prov.	8,40,637	8,74,518	8,75,427	9,80,481	10,52,310	12,00,010	13,83,518	15,77,983
Other Current Liabilities	8,04,690	8,39,923	8,37,703	9,38,744	10,08,678	11,50,254	13,26,153	15,12,556
Provisions	35,947	34,595	37,725	41,737	43,632	49,756	57,364	65,427
Net Current Assets	13,54,104	14,54,626	13,65,814	13,47,402	12,96,435	13,57,858	15,17,954	17,01,717
Misc Expenditure	0	0	0	0	0	0	0	0
Appl. of Funds	19,16,515	21,68,418	22,10,308	21,90,810	22,11,372	22,61,183	24,38,206	26,43,819

E: MOFSL Estimates; *deferred payment liabilities and liabilities for assets held for sale

Financials and valuation

Ratios

Y/E March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Basic (INR)								
EPS	62.8	64.2	49.6	61.4	75.9	97.6	120.9	146.9
Cash EPS	78.0	82.1	70.7	82.9	101.4	125.2	150.9	177.2
BV/Share	453.8	485.5	552.0	599.6	649.9	647.5	734.2	838.8
DPS	16.3	18.0	36.0	22.0	22.0	28.3	35.2	42.5
Payout (%)	31.0	33.1	86.2	35.3	29.3	28.9	28.9	28.9
Valuation (x)								
P/E	49.5	48.5	62.7	50.6	41.0	31.9	25.7	21.2
Cash P/E	39.9	37.9	44.0	37.5	30.7	24.9	20.6	17.6
P/BV	6.9	6.4	5.6	5.2	4.8	4.8	4.2	3.7
EV/Sales	3.8	3.8	4.0	3.4	2.9	2.5	2.2	1.9
EV/EBITDA	33.2	33.9	34.9	29.3	25.3	21.8	18.1	15.5
Dividend Yield (%)	0.5	0.6	1.2	0.7	0.7	0.9	1.1	1.4
FCF per share	-59.6	24.7	159.5	117.3	138.7	94.5	71.3	92.3
Return Ratios (%)								
RoE	14.6	13.7	9.6	10.7	12.1	15.0	17.5	18.7
RoCE	6.4	6.2	5.2	5.9	7.1	8.6	9.9	10.7
RoIC	7.4	6.8	5.1	6.7	8.2	10.1	11.7	13.0
Working Capital Ratios								
Fixed Asset Turnover (x)	5.8	2.9	2.4	2.9	3.1	3.3	3.5	3.6
Asset Turnover (x)	0.7	0.7	0.6	0.7	0.8	0.9	1.0	1.0
Inventory (Days)	17	14	16	14	14	14	14	14
Debtor (Days)	96	102	113	108	89	84	84	84
Creditor (Days)	0	0	0	0	0	0	0	0
Leverage Ratio (x)								
Current Ratio	2.6	2.7	2.6	2.4	2.2	2.1	2.1	2.1
Interest Cover Ratio	7.9	5.0	3.3	4.9	5.4	6.3	7.5	9.1
Net Debt/Equity	1.4	1.5	1.0	0.8	0.6	0.6	0.5	0.4

Consolidated - Cash Flow Statement

(INR Million)

Y/E March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
OP/(Loss) before Tax	1,42,862	1,43,142	2,30,263	1,44,107	1,49,638	1,86,009	2,31,080	2,73,966
Depreciation	20,840	24,623	29,042	29,480	35,023	37,920	41,255	41,584
Interest & Finance Charges	9,055	19,669	25,358	20,721	32,072	32,360	33,049	32,095
Direct Taxes Paid	-45,816	-40,465	-34,710	-45,521	-60,466	-51,242	-63,599	-71,695
(Inc)/Dec in WC	-1,62,473	-77,838	99,702	47,566	86,631	-48,796	-85,569	-85,666
CF from Operations	-35,532	69,131	3,49,655	1,96,352	2,42,897	1,56,252	1,56,215	1,90,283
Others	-11,636	-2,192	-1,21,213	-4,717	0	0	0	0
CF from Operating incl EO	-47,169	66,939	2,28,441	1,91,636	2,42,897	1,56,252	1,56,215	1,90,283
(Inc)/Dec in FA	-34,746	-32,994	-9,223	-30,399	-52,225	-26,308	-58,183	-63,434
Free Cash Flow	-81,915	33,944	2,19,218	1,61,237	1,90,673	1,29,944	98,033	1,26,849
(Pur)/Sale of Investments	-42,420	38,802	-1,75,595	-24,225	-51,949	0	0	0
Others	-32,828	-88,371	1,30,530	17,947	-2,378	0	0	0
CF from Investments	-1,09,994	-82,563	-54,289	-36,677	-1,06,552	-26,308	-58,183	-63,434
Issue of Shares	113	176	159	110	-5,289	-99,200	0	0
Inc/(Dec) in Debt	1,81,743	1,38,176	-87,325	-84,131	-45,846	31,798	33,339	33,500
Interest Paid	-29,824	-28,522	-33,213	-33,751	-32,072	-32,360	-33,049	-32,095
Dividend Paid	-26,471	-45,513	-40,325	-25,284	-30,237	-38,917	-48,364	-58,411
Others	28,849	-601	7,960	-8,758	12,761	21,363	24,568	28,253
CF from Fin. Activity	1,54,410	63,716	-1,52,744	-1,51,815	-1,00,682	-1,17,316	-23,507	-28,753
Inc/Dec of Cash	-2,753	48,092	21,409	3,144	35,664	12,628	74,526	98,097
Opening Balance	80,325	1,17,262	1,51,178	1,62,415	1,89,532	2,25,196	2,37,824	3,12,350
Othr bank balances	39,690	-14,176	-10,172	23,973	1	0	0	0
Closing Balance	1,17,262	1,51,178	1,62,415	1,89,532	2,25,196	2,37,824	3,12,350	4,10,447

ABB India

BSE SENSEX
67,481S&P CNX
20,268

CMP: INR4,387

TP: INR5,280 (+20%)

Buy



Bloomberg	ABB IN
Equity Shares (m)	212
M.Cap.(INRb)/(USDb)	929.7 / 11.2
52-Week Range (INR)	4678 / 2637
1, 6, 12 Rel. Per (%)	1/2/39
12M Avg Val (INR M)	1128
Free float (%)	25.0

Financials & Valuations (INR b)

Y/E Dec	2022	2023E	2024E
Sales	85.7	108.8	134.7
EBITDA margin	11.2	13.1	13.0
Adj. PAT	6.9	12.0	14.4
EPS (INR)	32.4	56.7	67.8
EPS Gr. (%)	66.9	75.2	19.5
BV/Sh. (INR)	233.1	284.8	346.6
Ratios	-	-	-
RoE (%)	15.3	21.9	21.5
RoCE (%)	15.5	22.1	21.6
Payout (%)	38.6	26.5	26.6
Valuations	-	-	-
P/E (x)	135.4	77.3	64.7
P/BV (x)	18.8	15.4	12.7
EV/EBITDA (x)	92.9	62.1	50.0
EV/Sales (x)	10.5	8.2	6.5

Shareholding pattern (%)

As On	Sep-23	Jun-23	Sep-22
Promoter	75.0	75.0	75.0
DII	7.4	8.1	11.9
FII	10.2	9.5	5.4
Others	7.5	7.5	7.7

FII Includes depository receipts

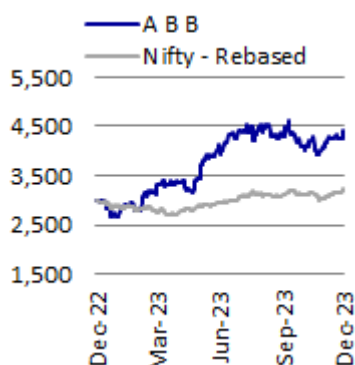
Stock's performance (one-year)**High quality player across government and private capex**

ABB is a play on improving investments across energy efficiency, sustainability, government led infrastructure investments, capex revival led by PLI schemes as well as increasing spend towards automation and digitization. The company has benefited from short-cycle orders, which has sustained the momentum in base orders translating into order inflow CAGR of 13% over CY2019-CY2022. During this period, EBITDA margin also improved 390bp. Driven by strong opportunity pipeline across data center and T&D (electrification), railways (electrification and mobility), and PLI-led capex (industrial automation and robotics) over the next five years, we expect ABB's revenue/EBITDA/PAT to report a CAGR of 23%/30%/36% over CY22-25. The stock is currently trading at 65X/54X P/E on CY24/25E. We value the stock at INR5,280 based on DCF methodology implying 65X P/E on CY25E earnings. This takes into account 21% decadal revenue and EBITDA CAGR each and 11% PAT margin over the same period in our DCF assumptions. We reinitiate coverage with a BUY rating.

Robust opportunity pipeline across segments

ABB is capitalizing on growth opportunities through its four segments - electrification, motion, process automation and robotics. We expect it to benefit from increasing investments across: 1) electrification driven by T&D & renewable power (INR2.4t), data center (INR400-500b), and EV charging (INR140b); 2) motion and mobility led by planned investments of government across metro, high-speed rail and RRTS (INR5-6t); 3) industrial automation driven by a surge in investments towards smart manufacturing led by PLI (INR4t); and (4) robotics, by FY30. With these investments, we expect ABB's yearly addressable market to expand to nearly INR1.7-1.8t from INR1t currently. This would be split across electrification (30-35%), motion (30-35%), process automation (15-20%) and robotics (the rest 5-10%). With division-level segmentation, the company remains focused on targeting 20+ market segments from its wide portfolio of 18 divisions and even penetrating further in Tier 4 and Tier 5 cities. We expect an order inflow growth of 20% over CY22-CY25.

Strategic priorities aligned with market growth

ABB's strategic priorities to capitalize on the growth momentum in Indian market include: 1) systematic capital allocation (both organic and for acquisitions), aligned with its purpose; 2) increased exposure to high-growth, profitable markets that are benefiting from key global trends; and 3) embedding sustainability in all processes and across value chain. With these priorities in mind, ABB has identified areas and market segments of growth. ABB has aligned 18 divisions to cater to the demand from 23 market segments.

Wide portfolio of offerings

ABB has a wide portfolio of offerings across areas such as : 1) grid automation and sub-station management; 2) solutions across infrastructure segments; 3) data center power distribution and automation & server solutions; 4) circuit breakers, safety controllers, control and signaling for railways; 5) power distribution equipment for oil and gas; 6) water and waste management, electrical and automation for F&B; and 7) EV chargers, electrical distribution solutions, battery energy storage systems, and prefabricated solutions for electric vehicles. Along with these, there are several other portfolio offerings to cater to other areas.

Expanding in high-growth areas

ABB is expanding across high-growth electrification and motion segment for both domestic as well as export requirements. The company is also spending more money on productivity measures of existing shop floors by automating them. It has also invested in a large GIS factory as the market is shifting towards GIS switch gear on medium voltage side.

Margins trajectory to be led by higher share of high-growth segments

ABB's business mix is spread across domestic (85%) and exports (15%). On the domestic business mix, nearly 50-55% comes from core sectors like cement, steel etc. while the remaining 40-45% mix comes from new high-growth sectors. Within this, ABB has a dominant position in electrification and motion and is able to command premium pricing. We expect ABB to balance the mix in favor of high-growth and high-margin sectors over a period of time to maintain double-digit PAT margin trajectory. However, we do expect moderation in margins from the highs of 4QCY22-1QCY23.

Intensifying focus on improving exports and services

ABB India has been given a mandate to tap additional export markets from the parent group. This is a positive development for ABB India to increase exports to geographies like North America, South America and the Middle East. The company has ramped up capacities too to cater to incremental demand from both domestic and export markets. Currently, export growth is slower than domestic market growth. However, exports have better margins than domestic. Services segment, though smaller, is also a high-margin segment and has the potential to grow 6-7% annually.

Financials

We expect ABB's order inflows to report a 20% CAGR over CY22-25. This would result in a 23% revenue CAGR over CY22-25E. We expect gross margin to range around 35.4-35.6% similar to the levels seen in CY22 and CY23, despite lower RM prices as we expect the net impact of passing on lower RM prices to end users and revenue mix in favour of higher margin segments. We expect ABB's EBITDA margin to be 13%/13.2% for CY24/25. We expect ABB's healthy cash position of INR31.5b and operating cash flows of INR34.7b over CY23-25 would take care of the next three years of capex of INR11b.

Valuation and recommendation

We expect ABB to report a revenue/EBITDA/PAT CAGR of 23%/30%/36% over CY22-25. The stock is currently trading at 65X/54X P/E on CY24/25E. We value the stock at INR5,280 based on DCF methodology implying 65X P/E. This takes into account 21% decadal revenue and EBITDA CAGR each and 11% PAT margin over the same period in our DCF assumptions. We reinitiate coverage with a **BUY** rating.

Key risks and concerns

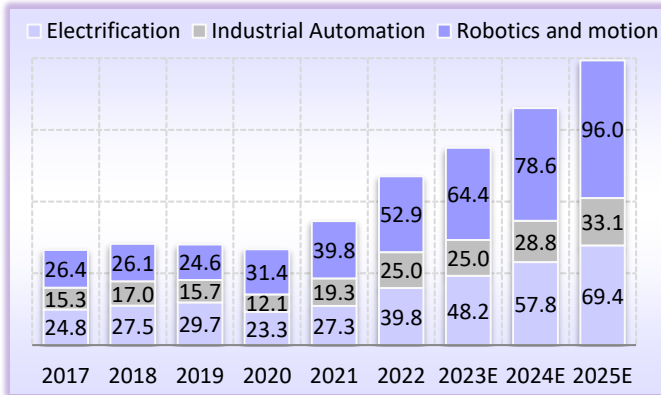
Global geopolitical and macro factors: The continuing tight crude prices, supply chain issues, shifting global trade balance and currency volatility as well as inflationary conditions (especially core inflation) will be the key monitorables. ABB India will continue to deploy its experience of navigating such markets by leveraging global parentage, diversified supply chains, early planning, and hedging tools.

Slowdown in domestic order inflows: Delays in 1) decision making from key clients and 2) spending for government projects can impact domestic order inflows adversely on both base orders as well as large orders. ABB is trying to mitigate this risk by diversifying across divisions and market segments.

Pricing pressure across segments: Intensified competition and lower-than-expected demand can hurt pricing power of ABB and consequently impact its margins adversely. The company is trying to mitigate this risk by diversifying across high-growth and high-margin segments as well as focusing on increasing exports and services.

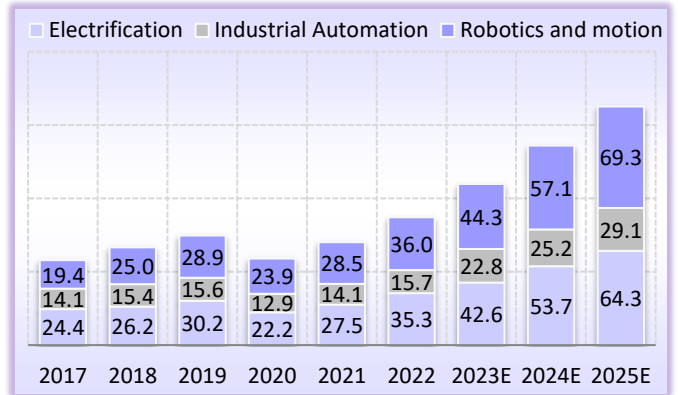
STORY IN CHARTS

We expect order inflows to grow at a CAGR of 20% between CY22-25 (INR b)



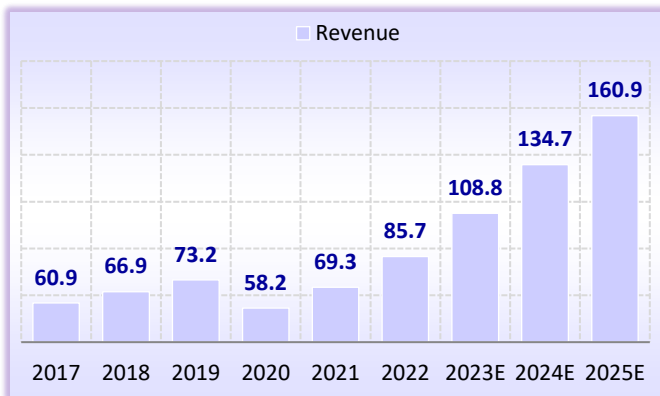
Source: Company, MOFSL

We expect electrification and motion to account for a higher share of revenues by CY25 (INR b)



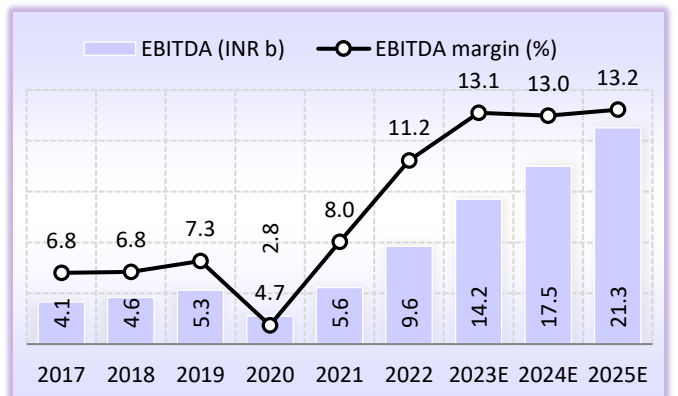
Source: Company, MOFSL

We expect revenues to grow at a CAGR of 23% between CY22-25 (INR b)



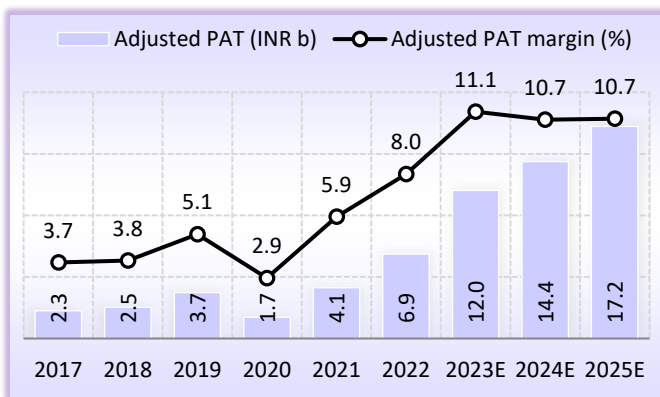
Source: Company, MOFSL

We expect healthy margins led by favourable product mix (%)



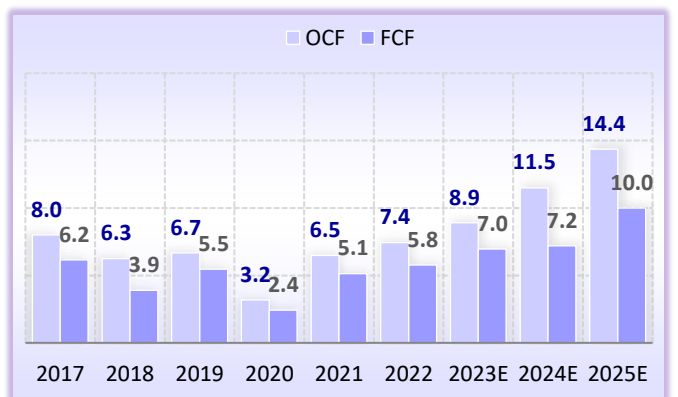
Source: Company, MOFSL

We expect PAT to grow at a CAGR of 36% over CY22-25 (INR b)



Source: Company, MOFSL

We expect OCF & FCF to remain strong over CY23-25 for ABB (INR b)



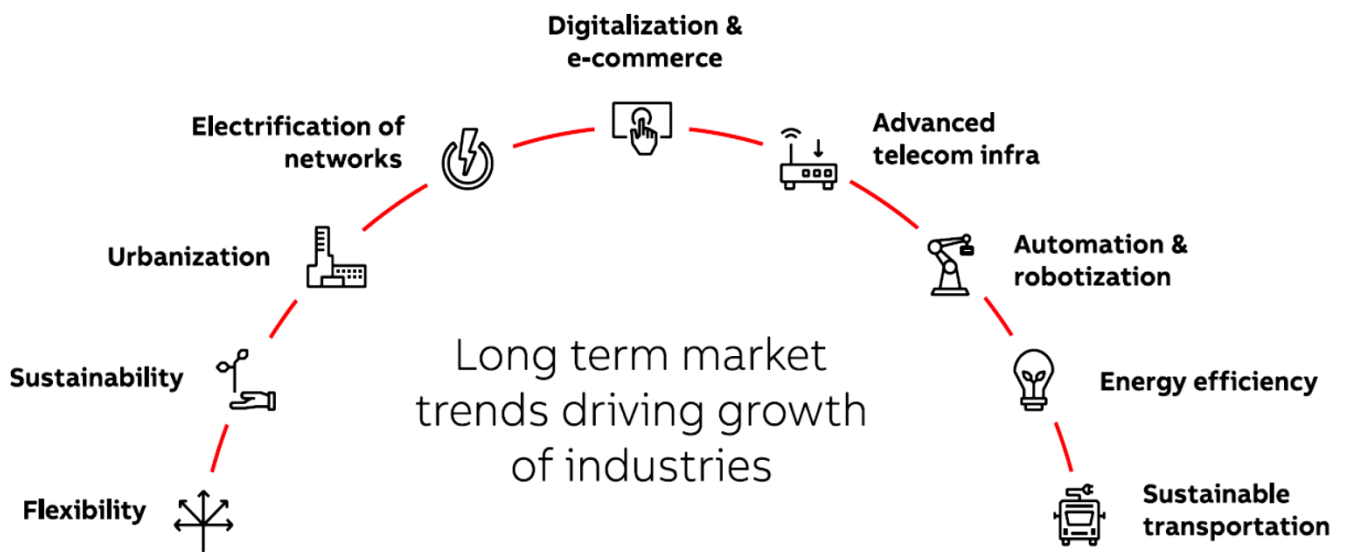
Source: Company, MOFSL

Key investment argument

Beneficiary of a strong long-term opportunity pipeline

ABB is a play on increasing investments across: 1) electrification driven by T&D & renewable power (INR2.4t), data center (INR400-500b), and EV charging (INR140b); 2) motion and mobility led by planned investments of government across metro, high- speed rail and RRTS (INR5-6t); 3) industrial automation driven by a surge in investments towards smart manufacturing led by PLI (INR4t); and (4) robotics. With division-level segmentation, the company remains focused on targeting 20+ market segments from its wide portfolio of 18 divisions and even penetrating further in Tier 4 and Tier 5 cities.

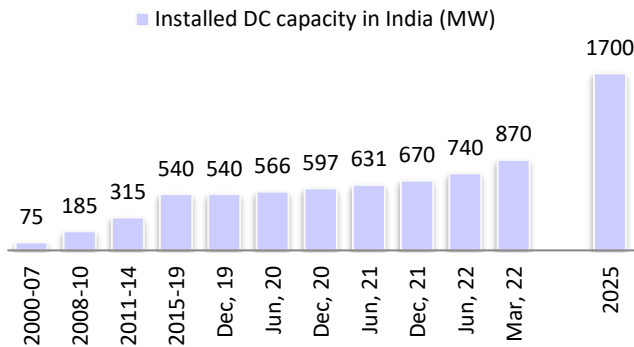
Exhibit 98: ABB has identified long term market growth trends and is focusing on these segments



Source: Company, MOFSL

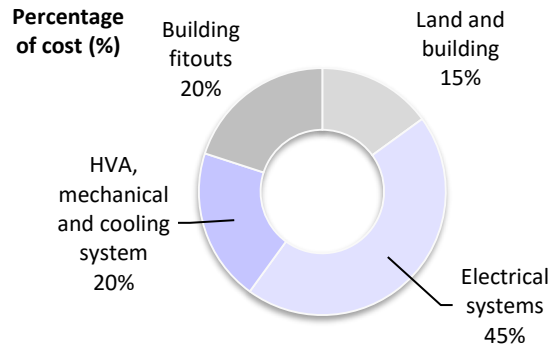
Management is upbeat about the sustainability of strong inflows as it remains optimistic about large-sized order inflows from sectors such as metals, cement, oil & gas, railways, and metro, as well as healthy order pipelines from data centers, F&B, and renewables. ABB has been a beneficiary of short-cycle orders that have sustained momentum in base orders, translating into an order inflow CAGR of 13% over CY19-22. We expect a much higher order inflow CAGR of 20% over CY22-26 driven by large addressable opportunities from its key segments. We highlight below the key areas where we expect ABB to benefit from incremental investments:

Exhibit 99: Data centre market is witnessing sharp growth where ABB has a strong positioning



Source: Industry, MOFSL

Exhibit 100: ABB has an addressable market of 45-50% of overall data centre cost



Source: Industry, MOFSL

Exhibit 101: ABB can target opportunities across substation management, renewable integration, smart sensors and system automation from transmission line capex worth INR2.4t

Details	Capacity (GW)
RE capacity already commissioned	166
66.5 GW RE capacity to be integrated to ISTS network (8.8 GW already commissioned)	58
Additional RE capacity to be integrated to ISTS network (55 GW+181.5GW)	237
Margin already available in ISTS sub-stations which can be used for integration	34
Balance RE capacity from GEC-1 to be integrated to intra-state system	7
RE capacity from GEC-II to be integrated to intra-state system	19
Additional hydro capacity likely by FY2030	17
Total RE capacity targeted till FY2030	537

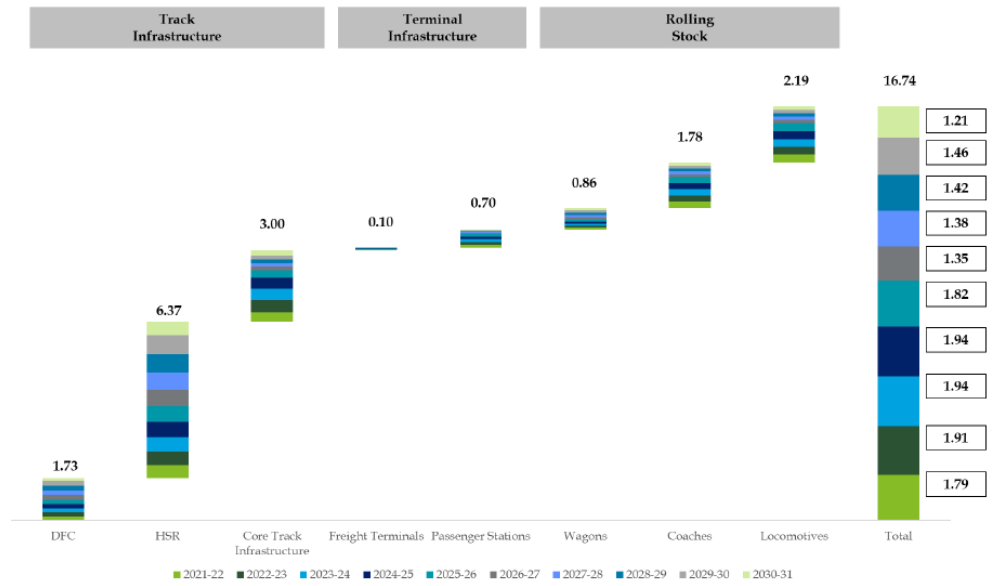
Source: Ministry of Power,, MOFSL

Exhibit 102: HVDC projects lined up for integration of additional RE capacity by FY2030

Sr no	Project name
1	800 kV Bhadla-III - Fatehpur HVDC line
2	350 kV Pang - Kaithal HVDC line
3	800 kV Barmer-II - Jabalpur HVDC line
4	800 kV Khavda - Aurangabad HVDC line

Source: CEA, MOFSL

Exhibit 103: Annual Capital Expenditure Requirements till 2031 by Indian Railways across DFC, High Speed Rail, Track infrastructure, stations, wagons, coaches, locomotives (INR t)



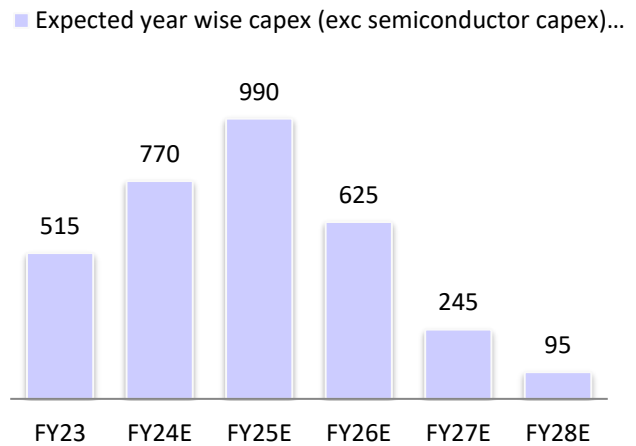
Source: National Rail Plan, MOFSL

Exhibit 104: PLI incentives across sectors will aid capex recovery in coming years

Sector	Incentives outlay
Mobile phones	420
Advanced Chemistry cell batteries	181
Electronics and Tech products	50
Automobile and components	570
Pharmaceuticals and drugs	150
Telecom and networking products	122
Textiles	107
Food products	109
High efficiency solar PV modules	45
White goods	62
Speciality steel	63
Solar modules	185
Total	2,064

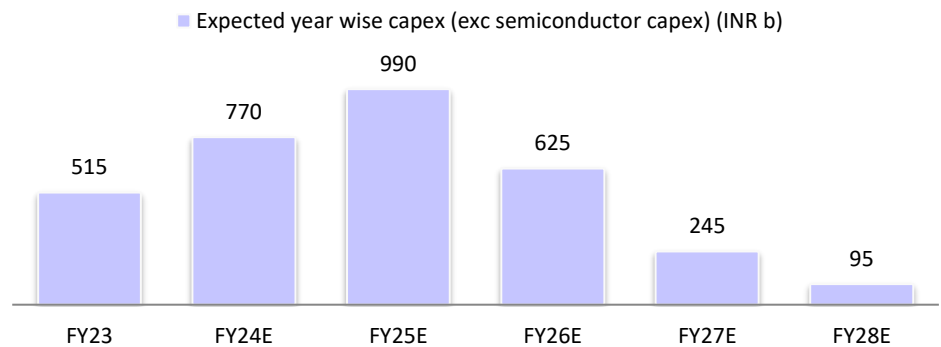
Source: MeITY, MOFSL

Exhibit 105: PLI yearly capex expectations excluding semiconductor capex in coming years



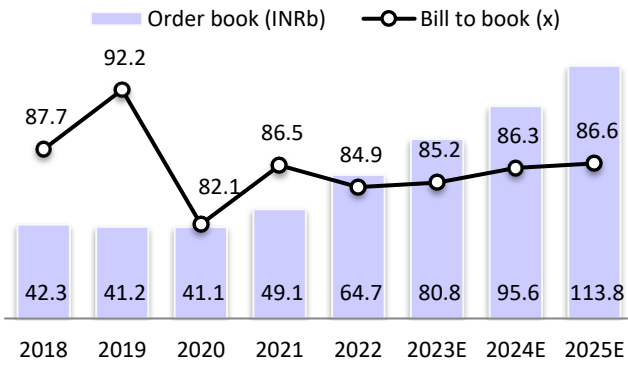
Source: MeITY, MOFSL

Exhibit 106: PLI-led yearly capex spend expectations excluding semiconductor capex (INR b)



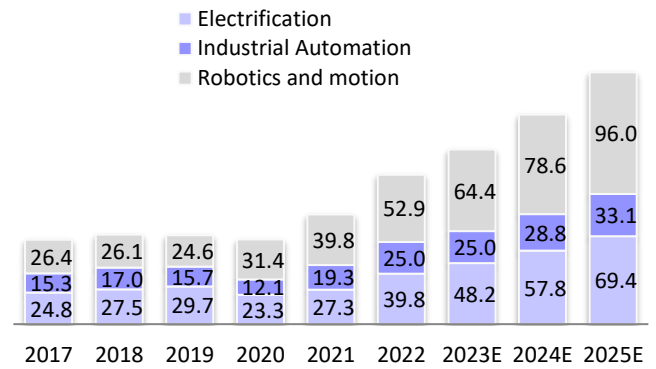
Source: Industry, MOFSL

Exhibit 107: ABB's order book has grown fast over last two years



Source: Company, MOFSL

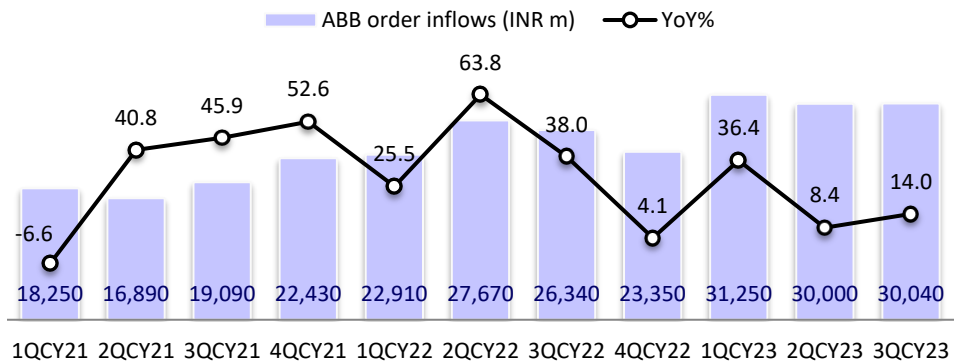
Exhibit 108: Revival in inflows was seen across segments (INR b)



Source: Company, MOFSL

Order inflow growth for ABB during 2QCY23 moderated to 10% primarily on the high base of last year. However, inflow growth stood at 22% for 1HCY23. Going forward, we expect order inflow growth of ~20% based on the mix of core and high-growth sectors targeted by the company.

Exhibit 109: Quarterly order inflow trend (INR b)



Source: Company, MOFSL

Wide portfolio of offerings across segments

ABB has a wide portfolio of offerings across segments ranging from Grid, data centre, railways, F&B, infrastructure, EV, electronics.

Exhibit 110: Portfolio of ABB's offerings

Areas	Offerings
Grid	❖ Grid automation and substation management, renewable integration, smart sensors, system automation
Infrastructure	❖ Solutions across water, airport, land, telecom, ports and shipyards
Data centre	❖ Intelligent grid connection, data centre power distribution, power protection, data centre smart automation, data centre colling system, pre-fabricated data centre solutions, life cycle management solutions, server room solutions
Railways	❖ Rolling stock (circuit breaker, safety controllers, electronic relays, connectors, wiring ducts, plugs and sockets), electrification, control and signaling, passenger station, tunnels
Oil and gas	❖ Power distribution equipment (medium voltage switch gear, MV outdoor products, MV switchgear and motor control, electrical system integration), low voltage power distribution, motor control and protection, cable protection system, explosion proof lighting
F&B	❖ Solutions across water and waste management, electrical distribution, power intake
EV	❖ EV chargers, electrical distribution solutions, battery energy storage systems, prefabricated solutions
Water	❖ ABB's offerings include LV Switchgear & components, Automation & Instrumentation, Motors, Drives, Digital solutions for treatment plants, pumping stations and lift irrigation.
Electronics	❖ ABB's offerings include LV & MV Switchgear, Building Automation, Switches, Distribution Boards, Digital Power Train, Robots

Source: Company, MOFSL

Well placed to benefit from energy efficiency initiatives across user industries

Energy efficiency is gradually becoming a key pillar of government infrastructure programs and the government will begin incentivizing the adoption of latest technologies to achieve this objective. ABB released a ten-point action plan last year to assist companies in adapting and improving energy efficiency initiatives. ABB, through each of the ten action plans, aims to meet its investment needs. ABB is focusing on energy-saving projects in several industry categories such as chemical, oil and gas, steel, aluminum, and cement. One significant oil & gas business, for example, is investing 40% of its cash flows in energy transition to reduce fossil fuel production by 40% from present levels and supplement it with renewables.

Exhibit 111: Cost savings is the key determinant for investing in energy efficiency

	Argentina	Brazil	China	Germany	India	Indonesia	Italy	Malaysia	Mexico	Spain	Sweden	UK	US
Cost savings	50%	71%	47%	58%	50%	72%	65%	70%	51%	51%	54%	63%	70%
Corporate sustainability commitment	50%	69%	68%	51%	49%	75%	53%	56%	67%	49%	48%	49%	50%
Increased competitiveness	50%	30%	60%	46%	45%	55%	38%	51%	46%	45%	44%	37%	43%
Improving brand reputation	43%	43%	41%	38%	51%	28%	36%	39%	32%	31%	42%	42%	46%
Pressure from regulators	20%	10%	30%	21%	15%	16%	17%	22%	12%	16%	14%	22%	18%
Pressure from investors	7%	9%	21%	16%	19%	8%	13%	12%	5%	15%	24%	22%	14%
Pressure from customers	7%	5%	19%	20%	19%	6%	8%	11%	6%	14%	19%	20%	13%

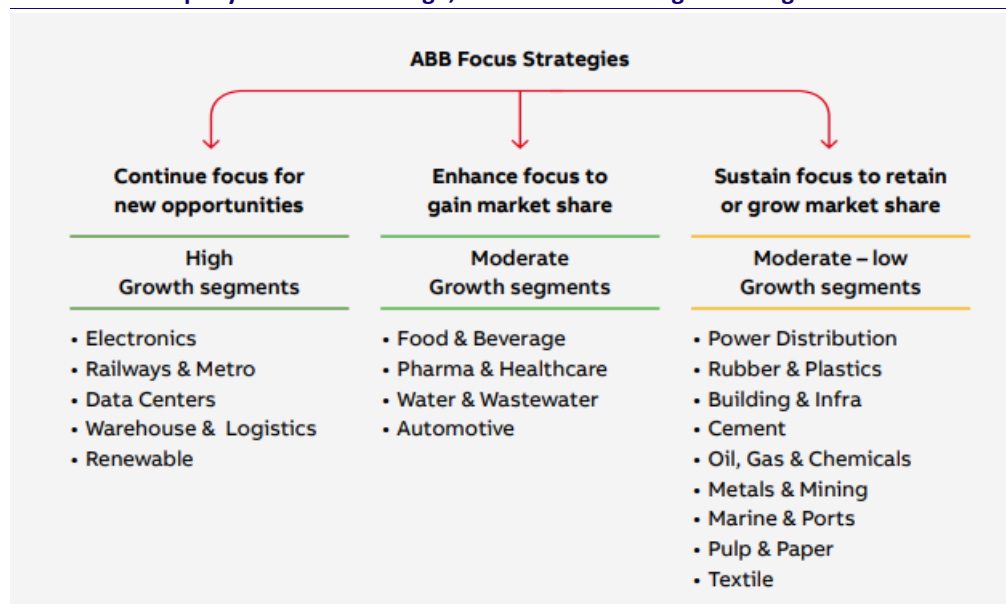
Source: ABB Survey Report: Accelerating ambition How global industry is speeding

Targeting growth areas through various market segments

ABB's strategic priorities to capitalize on the growth momentum in Indian market include: 1) systematic capital allocation (both organic and for acquisitions), aligned with its purpose; 2) increase of exposure to high-growth, profitable markets that are benefiting from key global trends; and 3) embedding sustainability in all processes

and across value chain. With these priorities in mind, ABB has identified areas and market segments of growth. ABB will continue to focus on high-growth segments such as Renewables, Data Centers, Buildings, e-mobility, Rail, Infrastructure, and Food & Beverages along with emerging segments such as Green hydrogen. Management will maintain its focus and continued emphasis on customer proximity through customized webinars, industrial hubs and customer connect programs that we believe will enhance business growth further.

Exhibit 112: Company has identified high, moderate and low growth segments

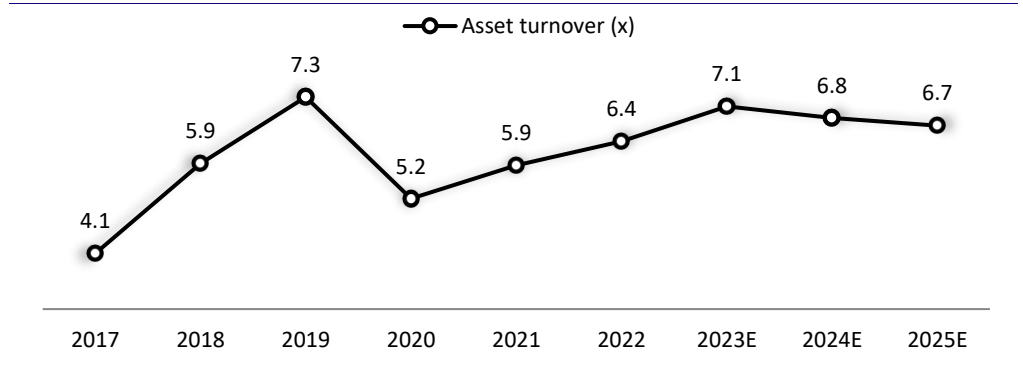


Source: Company, MOFSL

Expansion across facilities

- Last year, ABB India's Smart Power division expanded its production plant in Nelamangala Bengaluru to over 8,400 sqm, serving to industry 5.0 using ABB cobots. The ABB Smart Power factory links equipment such as robots, motors, and drives to the Internet of Things (IoT). The connected factory software highlights process optimization opportunities to maximize productivity and efficiency. This resulted in enhanced productivity of 40% in the same space, with an energy efficiency of 15%.
- ABB India also inaugurated its expanded Digital Substation Products and Digital Systems factory in Vadodara, Gujarat. This new factory will meet the growing demand for a wide range of digital sub-station products and digital solutions in India and in more than 50 countries.
- ABB also opened its first smart instrumentation factory in Bengaluru. The new plant will manufacture field devices such as pressure and temperature transmitters, IP converters and electromagnetic flow-meters for a wide variety of industries, including power, oil, and gas, pharmaceutical, water, et al.
- The company is also spending more money on productivity measures of existing shop floors by automating them. It has also invested in a large GIS factory as the market is shifting towards GIS switch gear on medium voltage side.
- During the year, it also opened its new R&D facility – ABB Innovation Center.
- These facilities will help the company target domestic as well as export-related opportunities.

Exhibit 113: Asset turnover trend



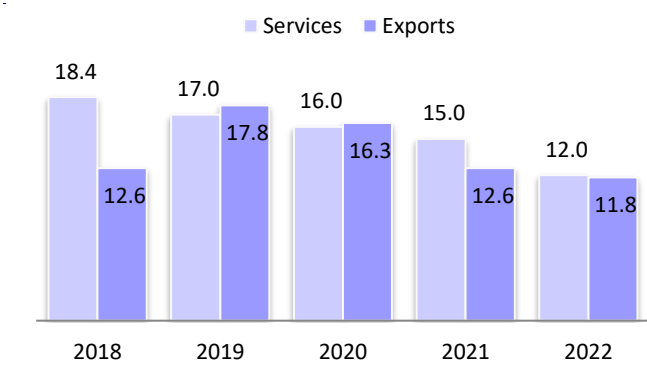
Source: Company, MOFSL

Intensifying focus on improving exports and services

ABB’s exports for CY22 stood at INR10b and were up 16% YoY as ABB India has been given a mandate to tap additional export markets by the parent group. This is a positive development for ABB India to raise exports to geographies like North America, South America and the Middle East. The company has ramped up capacities too to cater to incremental demand from both domestic and export markets. Electrification division reported an all-time high export level with significant orders from Brazil, UAE, Oman, and other countries. Motion segment too witnessed strong growth in exports for large motors and generators.

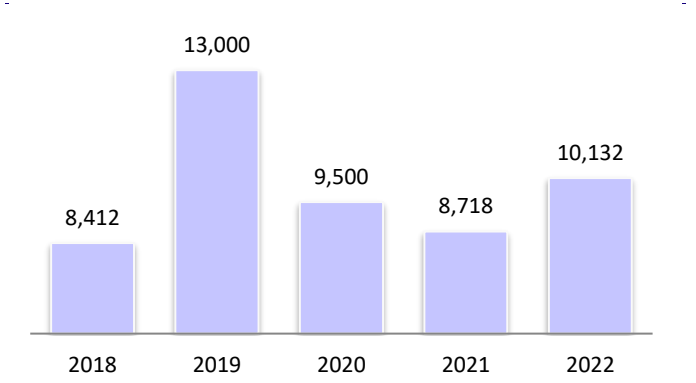
However, the current geopolitical situation may hit export growth of the company in the near term. ABB is experiencing a much faster growth in domestic markets as compared to export markets. Management expects exports to remain around 12-15% of overall sales.

Exhibit 114: Share of exports and services in overall revenue (%)



Source: Company, MOFSL

Exhibit 115: Export revenue trend (INR m)



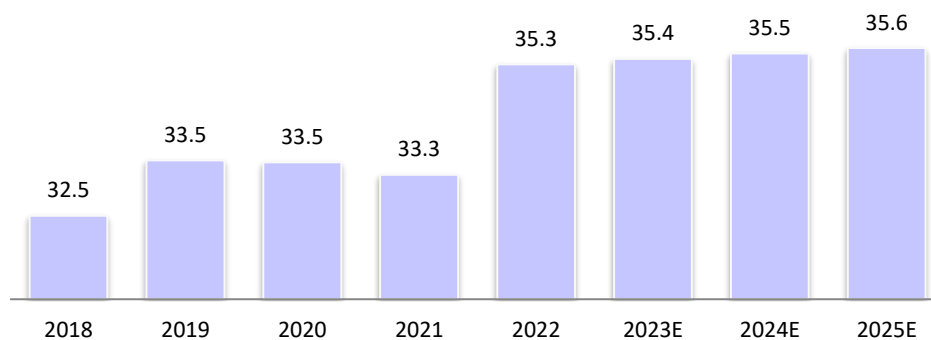
Source: Company, MOFSL

Margin levers for future

ABB was able to expand its EBITDA margin during CY22 and further in 1HCY23 due to better pricing driven by strong demand, improved product mix, and higher localization. This resulted in gross margin improvement and customer preference for quality products and better brands led to improved operating leverage. We expect that some of the margin improvements caused by price increases would be reversed in the next quarters due to RM price correction, while demand drivers across its

categories would persist in the medium to long term. Improved operating leverage across new facilities will also contribute to margin expansion.

Exhibit 116: Gross margin trend (%)



Source: Company, MOFSL

Exhibit 117: There is still a scope of margin improvement versus parent entity which can be achieved via higher localization (Segment wise margins % - Parent vs ABB India)

	2019	2020	2021	2022
Electrification				
Parent (A)	13.3%	14.1%	16.1%	16.5%
ABB India (B)	9.8%	4.1%	11.1%	13.8%
Net margin difference (A-B)	3.5%	10.0%	5.0%	2.7%
Motion				
Parent (A)	16.6%	16.8%	17.1%	17.3%
ABB India (B)	9.2%	5.3%	12.5%	12.3%
Net margin difference (A-B)	7.4%	11.5%	4.6%	5.0%
Process Automation				
Parent (A)	11.7%	7.8%	12.8%	14.0%
ABB India (B)	6.1%	-5.4%	9.1%	12.8%
Net margin difference (A-B)	5.6%	13.2%	3.7%	1.2%
Robotics and Discrete Automation				
Parent (A)	11.9%	8.2%	10.8%	10.7%
ABB India (B)	8.8%	3.2%	7.9%	12.5%
Net margin difference (A-B)	3.1%	5.0%	2.9%	-1.8%

Source: Company, MOFSL

ABB India also pays higher royalty and technology fee to the parent – at 8% of sales – as against its MNC peers. The company has already made a representation in the past to the parent group for reducing these costs over time, which if approved will aid margins further. Along with this, the company also has a scope to align its margins with ABB global across its segments. ABB India sees this as an opportunity to improve its margins in electrification and motion while margins may remain weak in process automation due to higher competition.

Exhibit 118: Yearly outgo to parent remains high at around 7.8-8% of net sales (INR m)

INR m	2017	2018	2019	2020	2021	2022
Royalty and technology fees	1,568	1,745	2,145	1,726	1,987	2,582
IT fees	1,229	1,934	2,079	1,833	1,830	2,027
Trademark fees	652	682	807	609	722	973
Group management fees	1,010	873	859	695	982	1,114
Total	4,459	5,234	5,890	4,863	5,521	6,696
As a % of revenue	7.3	7.8	8.1	8.4	8.0	7.8

Source: Company, MOFSL

Exhibit 119: ABB India technology absorption will also help margins

Details of technology	Year of import	Technology absorbed or not
Formula Air ACBs - the new Mid-High variant of ACBs	2020	Yes
E9 ACBs new voltage variant up to 900VAC	2020	Yes
Xtmax MCCBs LIG variant	2020	Yes
7.2 kV / 36 KV Generator circuit breaker	2021	Yes
VCB for ARC furnace application	2021	Yes
Digital Solutions for Switchgear	2021	Yes
NMK 710 slip ring machine along with brush lifting device & NXR series motors for US LSU	2021	Yes
Product updates in Emax2.0	2022	Yes
Launched Xt5 and Xt6 MCCBs	2022	Yes
Online Quality Control System (QCS) and Offline Quality Measurement systems (LnW) for Paper	2022	Yes

Source: Company, MOFSL

Exhibit 120: Impact of forex on margin was only around 60bps in last two years

INR m	2020	2021	2022
Revenue	58,210	69,340	85,675
EBITDA	2,759	5,567	9,619
Reported EBITDA margin	4.7	8.0	11.2
Forex in EBITDA (INR m)	-48	-406	488
As % of sales	-0.1	-0.6	0.6
EBITDA margin net of forex	4.7	7.4	11.8

Source: Company, MOFSL

ABB's sustainability initiatives

The ABB Group's sustainability strategy 2030 is focused on balancing the needs of society, the environment and the economy to create success for all its stakeholders. The company has set major sustainability targets and strives to achieve all targets by 2030. Its goal and targets are mainly categorized under three main buckets:

- Enable a low carbon economy by achieving Carbon neutrality in own operations and supporting customers in reducing annual CO₂e emissions by >100 Mt. It also focuses on reducing supply chain emissions.
- To preserve resources, 80% of ABB's products and solutions are covered by the circularity approach. It focuses on zero waste to landfill along with Supplier sustainability framework
- To promote social progress by focusing on zero harm to the company's people and contractors along with comprehensive diversity & inclusion framework. It also has a Top-tier employee engagement score in the industry.

Exhibit 121: ABB sustainability initiatives

Sustainability goals and targets

The ABB Group sustainability strategy 2030 is focused on balancing the needs of society, the environment and the economy to create success for all its stakeholders. Main sustainability targets have been set and the Company strives to achieve all targets by 2030. Its goal and targets are mainly under three main groupings:

- I. To enable a low carbon economy**
 1. Carbon neutrality in own operations
 2. Support customers in reducing annual CO₂e emissions by >100 Mt
 3. Supply chain emission reduction

- II. To preserve resources**
 1. 80 percent of ABB products and solutions covered by circularity approach
 2. Zero waste to landfill
 3. Supplier sustainability framework

- III. To promote social progress**
 1. Zero harm to the Company’s people and contractors
 2. Comprehensive Diversity & Inclusion framework; 25 percent women among ABB leaders
 3. Top-tier employee engagement score in the industry
 4. Impactful support for community-building initiatives

Source: Company

Exhibit 122: Sustainability - key focus areas

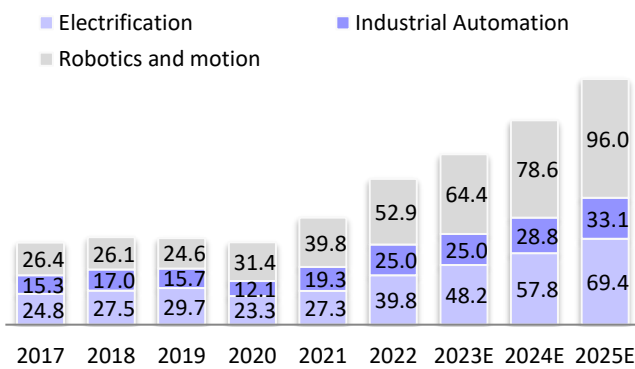


Source: Company

Financial outlook

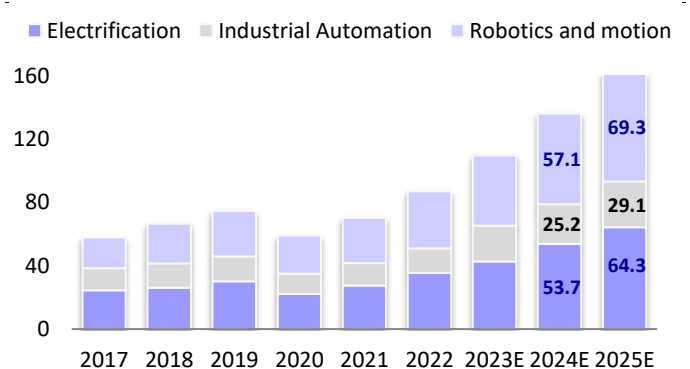
We expect ABB’s order inflows to grow at 20% CAGR over CY22-25. This would result in a 23% revenue CAGR over CY22-25E. We expect gross margins to range around 35-36% similar to the levels of CY2022 and CY2023 despite lower RM prices as we expect the net impact of passing on lower RM prices to end users, revenue mix in favour of higher margin segments. We estimate ABB’s EBITDA margin to be 13%/13.2% for CY24/25. We anticipate ABB’s healthy cash position of INR31.5b and operating cash flows of INR34.7b over CY23-25 would take care of the next three years of capex of INR11b.

Exhibit 123: We expect order inflows to grow at a CAGR of 20% over CY22-25 (INR b)



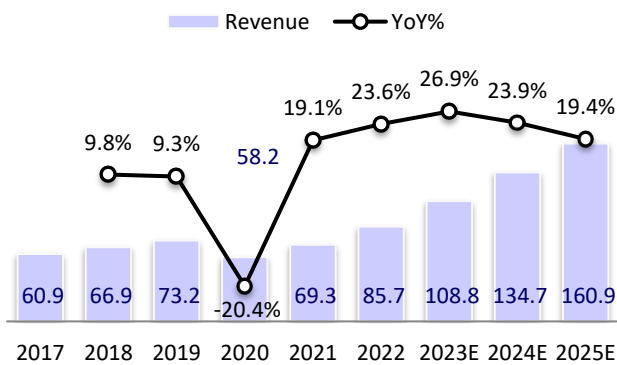
Source: Company, MOFSL

Exhibit 124: We expect revenues to grow at a CAGR of 23% over CY22-25 (INR b)



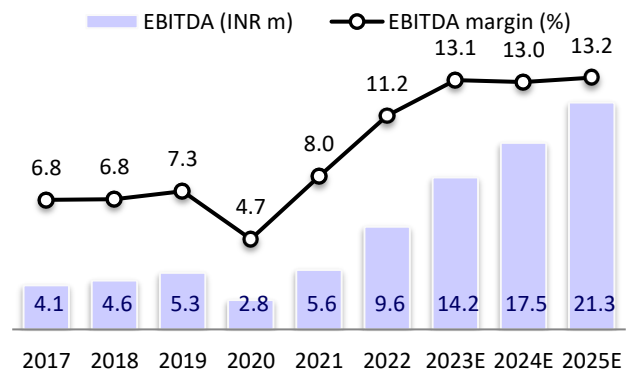
Source: Company, MOFSL

Exhibit 125: Overall revenue trend (INR b)



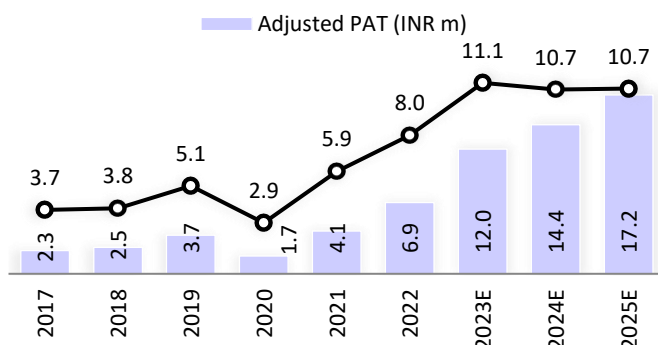
Source: Company, MOFSL

Exhibit 126: EBITDA and margin trend (INR b, %)



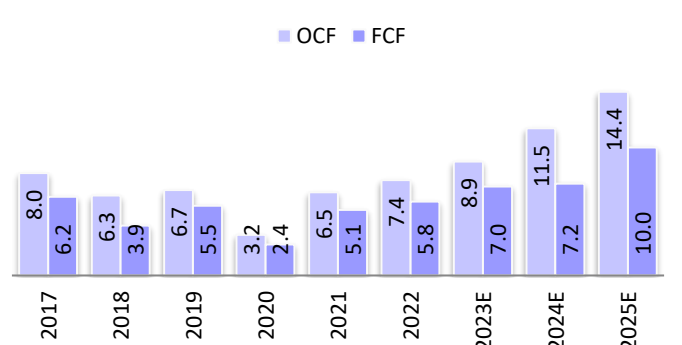
Source: Company, MOFSL

Exhibit 127: PAT growth to be driven by improved revenues and margin improvement (INR b)



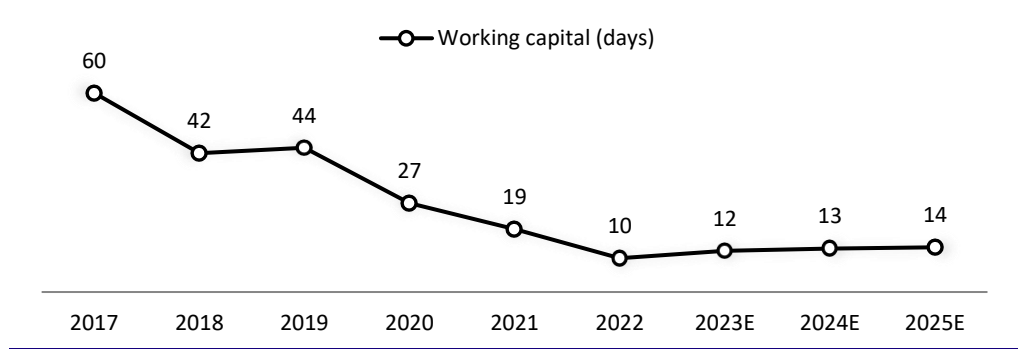
Source: Company, MOFSL

Exhibit 128: We expect OCF and FCF to remain strong on stable working capital cycle (INR b)



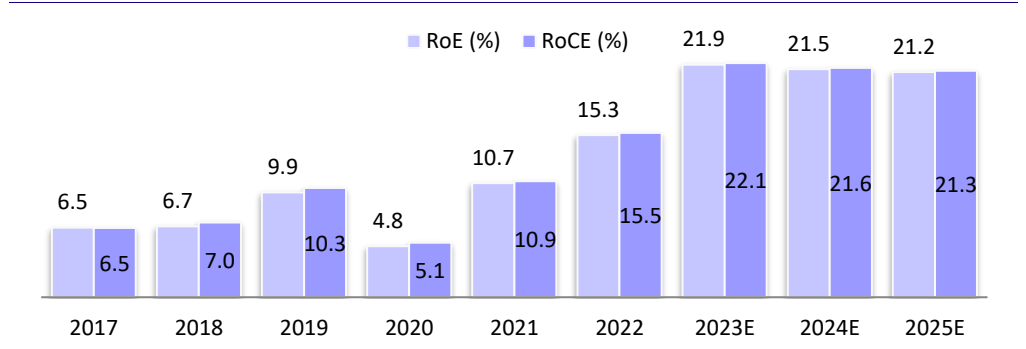
Source: Company, MOFSL

Exhibit 129: Working capital days



Source: Company, MOFSL

Exhibit 130: RoE and RoCE trend

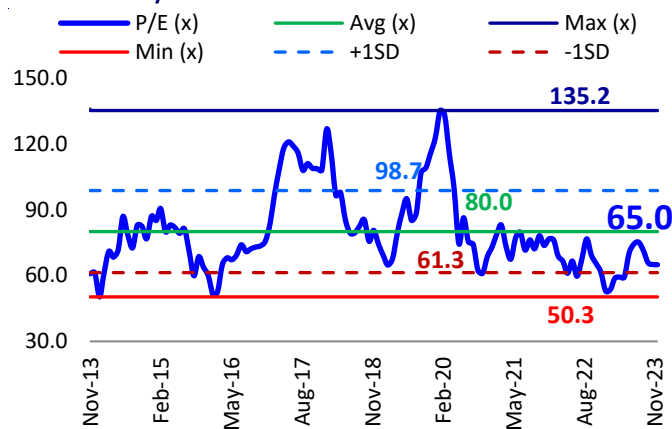


Source: Company, MOFSL

Valuation and recommendation

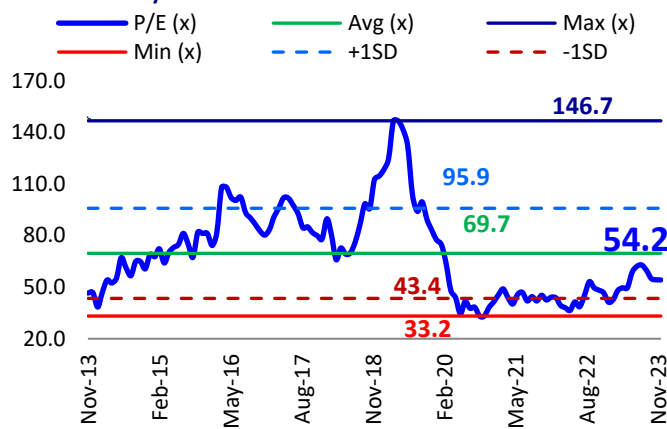
We expect ABB to report a revenue/EBITDA/PAT CAGR of 23%/30%/36% over CY22-25. The stock is currently trading at 65X/54X P/E on CY24/25E. We value the stock at 65X P/E on CY25E earnings taking into account 21% decadal revenue and EBITDA CAGR each and 11% PAT margin over the same period in our DCF assumptions. We arrive at a Fair Value of INR5,280 and reinitiate coverage with a **BUY** rating.

Exhibit 131: 1-yr forward PE valuation band



Source: Bloomberg, MOFSL

Exhibit 132: 2-yr forward PE valuation band



Source: Bloomberg, MOFSL

Exhibit 133: Sensitivity analysis - Bear/Base/Bull case valuations

	Bear case	Base case	Bull case
2 year forward EPS (INR)	73	81	89
Valuation multiple (x)	50	65	75
Target Price (INR/share)	3,670	5,280	6,720

Source: MOFSL

Key risks and concerns

Global geopolitical and macro factors: The continuing tight crude prices, supply chain issues, shifting global trade balance and currency volatility as well as inflationary conditions (especially core inflation) will be the key monitorables. ABB India’s management, as earlier, will continue to deploy its experience of navigating such markets by leveraging global parentage, diversified supply chains, early planning, and hedging tools.

Slowdown in domestic order inflows: Delays in 1) decision making from key clients and 2) spending for government projects can impact domestic order inflows adversely on both base orders as well as large orders. ABB is trying to mitigate this risk by diversifying across divisions and market segments.

Pricing pressure across segments: Intensified competition and lower-than-expected demand can hurt pricing power of ABB and consequently impact its margins adversely. The company is trying to mitigate this risk by diversifying across high-growth and high-margin segments as well as focusing on increasing exports and services.

SWOT analysis

- ❖ Diversified segmental presence
- ❖ Strong technological prowess
- ❖ Strong brand
- ❖ Ability to benefit from increasing spend towards automation, electrification and motion

S

STRENGTH



- ❖ Dependence on parent for technology
- ❖ High payout to parent for royalty and tech fee

W

WEAKNESS



- ❖ Increased penetration into Tier 3 and Tier 4 cities
- ❖ Growing addressable market across key areas
- ❖ Support from parent entity in increasing exports

O

OPPORTUNITY



- ❖ Increased competition from smaller players in automation and robotics
- ❖ Pricing risk on entry of bigger players in motors business
- ❖ Limited availability of skilled employees

T

THREATS



Management profile



Mr. Sanjeev Sharma - Group Managing Director

Sanjeev Sharma is the Country Managing Director of ABB India Ltd. Sanjeev is an electrical and telecommunications engineer and with various management degrees. Sanjeev has spent close to 30 years at ABB, having worked in different roles including business operations, sales and marketing, strategy and product management across Europe, South East Asia and India.



Mr. TK Sridhar - Group Chief Financial Officer

TK Sridhar is the Chief Financial Officer of ABB India, a Finance & Accounts Expert with 30+ years of global experience. He held P&L accountability, mitigated risks, controlled costs, and established governance framework of multi-million programs & projects. Deft at USA/Indian GAAP & IFRS and Sarbanes Oxley Act; and also has expertise in establishing internal financial controls and managing statutory & internal audits.



Mr. Sanjeev Arora (President – Motion)

Sanjeev Arora is the President – Motion India. He has done integrated course under Senior Management Development Program, with learning on various aspects of business from Financial, Products Portfolio Management to M&A's etc



Mr. Kiran Dutt (President – Electrification)

Kiran Dutt joined ABB in 2004 and has over 25 years' experience. In his role, Kiran leads the ABB Electrification business for India, Sri Lanka, and Bangladesh. He is responsible for growing market coverage and channel penetration and working closely with the broader Electrification Regional Global Markets organization of Asia Pacific & India.



Mr. G Balaji (Head of Energy Division Process Automation)

G Balaji is head of Energy Industries division in Industrial Automation, ABB India. He is also member of Country Management Committee that shapes critical management strategy. Balaji is an engineer in instrumentation and control. In his role as the head of Energy Industries, Balaji is driving digital transformation for many customers through co-innovation and co-creation with the customers.



Ms. Subrata Kamrakar (President – Robotics & Discrete Automation)

Subrata Kamrakar President - Head of Robotics & Discrete Automation Business, India at ABB India Ltd. Over 27 + years of experience in the field of Robotics, Instrumentation, Design, Simulation, Artificial intelligence & Digital engineering.

Financials and valuation

Standalone - Income Statement

(INR Million)

Y/E March	CY20	CY21	CY22	CY23E	CY24E	CY25E	CY26E
Total Income from Operations	58,210	69,340	85,675	1,08,756	1,34,701	1,60,880	1,93,623
Change (%)	-20.4	19.1	23.6	26.9	23.9	19.4	20.4
Raw Materials	38,705	46,263	55,426	70,249	86,873	1,03,596	1,24,487
Employee Cost	5,680	5,882	6,353	7,417	9,064	10,734	12,714
Other Expenses	11,066	11,627	14,277	16,846	21,269	25,280	30,527
Total Expenditure	55,450	63,773	76,057	94,513	1,17,206	1,39,610	1,67,728
% of Sales	95.3	92.0	88.8	86.9	87.0	86.8	86.6
EBITDA	2,759	5,567	9,619	14,243	17,495	21,271	25,895
Margin (%)	4.7	8.0	11.2	13.1	13.0	13.2	13.4
Depreciation	1,204	1,027	1,047	1,142	1,275	1,574	1,923
EBIT	1,556	4,540	8,572	13,102	16,220	19,696	23,972
Int. and Finance Charges	169	107	131	112	113	114	115
Other Income	1,069	1,596	1,795	3,083	3,107	3,467	4,080
PBT bef. EO Exp.	2,456	6,029	10,235	16,074	19,214	23,049	27,937
EO Items							
PBT after EO Exp.	2,456	6,029	10,235	16,074	19,214	23,049	27,937
Total Tax	739	1,918	3,372	4,051	4,842	5,808	7,040
Tax Rate (%)	30.1	31.8	32.9	25.2	25.2	25.2	25.2
Minority Interest							
Reported PAT	1,716	4,112	6,863	12,023	14,372	17,241	20,897
Adjusted PAT	1,716	4,112	6,863	12,023	14,372	17,241	20,897
Change (%)	-53.9	139.5	66.9	75.2	19.5	20.0	21.2
Margin (%)	2.9	5.9	8.0	11.1	10.7	10.7	10.8

Standalone - Balance Sheet

(INR Million)

Y/E March	CY20	CY21	CY22	CY23E	CY24E	CY25E	CY26E
Equity Share Capital	424	424	424	424	424	424	424
Total Reserves	35,640	40,028	48,970	59,927	73,020	88,726	1,07,780
Net Worth	36,064	40,452	49,394	60,351	73,444	89,149	1,08,204
Minority Interest							
Total Loans	0	0	0	0	0	0	0
Deferred Tax Liabilities	-1,172	-939	-898	-898	-898	-898	-898
Capital Employed	34,892	39,513	48,496	59,453	72,545	88,251	1,07,305
Gross Block	11,150	11,764	13,432	15,363	19,681	24,038	29,488
Less: Accum. Deprn.	3,469	3,741	4,586	5,728	7,003	8,578	10,501
Net Fixed Assets	7,681	8,024	8,846	9,635	12,678	15,460	18,987
Goodwill on Consolidation	146	146	146	146	146	146	146
Capital WIP	749	769	693	693	693	693	693
Total Investments	1	0	4,932	4,932	4,932	4,932	4,932
Curr. Assets, Loans&Adv.	60,016	70,248	77,668	98,232	1,20,919	1,46,613	1,78,078
Inventory	8,408	10,091	14,207	15,799	19,593	23,338	28,039
Account Receivables	26,419	25,604	24,451	32,589	40,364	48,209	58,020
Cash and Bank Balance	22,066	26,877	31,491	40,361	49,260	61,083	75,195
Loans and Advances	292	796	921	1,105	1,326	1,591	1,910
Other Current Asset	2,832	6,880	6,599	8,377	10,375	12,392	14,914
Curr. Liability & Prov.	33,701	39,781	43,788	54,185	66,822	79,592	95,529
Other Current Liabilities	30,801	36,436	39,956	49,321	60,798	72,397	86,869
Provisions	2,901	3,345	3,832	4,864	6,024	7,195	8,660
Net Current Assets	26,315	30,467	33,880	44,047	54,097	67,021	82,548
Misc Expenditure	0	107	0	0	0	0	0
Appl. of Funds	34,892	39,513	48,496	59,453	72,545	88,251	1,07,305

Financials and valuation

Ratios

Y/E March	CY20	CY21	CY22	CY23E	CY24E	CY25E	CY26E
Basic (INR)							
EPS	8.1	19.4	32.4	56.7	67.8	81.4	98.6
Cash EPS	13.8	24.2	37.3	62.1	73.8	88.8	107.7
BV/Share	170.2	190.9	233.1	284.8	346.6	420.7	510.6
DPS	7.4	8.9	10.7	12.8	15.4	18.5	22.2
Payout (%)	107.3	53.8	38.6	26.5	26.6	26.6	26.3
Valuation (x)							
P/E	545.7	227.8	136.5	77.9	65.2	54.3	44.8
Cash P/E	320.8	182.3	118.4	71.1	59.9	49.8	41.0
P/BV	26.0	23.2	19.0	15.5	12.8	10.5	8.7
EV/Sales	15.7	13.1	10.6	8.2	6.6	5.4	4.4
EV/EBITDA	331.4	163.4	94.1	62.9	50.7	41.2	33.3
Dividend Yield (%)	0.2	0.2	0.2	0.3	0.3	0.4	0.5
FCF per share	11.5	24.2	26.7	32.9	33.9	47.2	56.6
Return Ratios (%)							
RoE	4.8	10.7	15.3	21.9	21.5	21.2	21.2
RoCE	5.1	10.9	15.5	22.1	21.6	21.3	21.3
RoIC	7.3	25.9	49.4	78.9	77.9	75.2	74.7
Working Capital Ratios							
Fixed Asset Turnover (x)	5.2	5.9	6.4	7.1	6.8	6.7	6.6
Asset Turnover (x)	1.7	1.8	1.8	1.8	1.9	1.8	1.8
Inventory (Days)	53	53	61	53	53	53	53
Debtor (Days)	166	135	104	109	109	109	109
Creditor (Days)	0	0	0	0	0	0	0
Leverage Ratio (x)							
Current Ratio	1.8	1.8	1.8	1.8	1.8	1.8	1.9
Interest Cover Ratio	9.2	42.4	65.4	117.5	143.9	172.7	207.8
Net Debt/Equity	-0.6	-0.7	-0.7	-0.8	-0.7	-0.7	-0.7

Standalone - Cashflow Statement

(INR Million)

Y/E March	CY20	CY21	CY22	CY23E	CY24E	CY25E	CY26E
OP/(Loss) before Tax	2,894	7,072	13,503	16,074	19,214	23,049	27,937
Depreciation	1,204	1,027	1,047	1,142	1,275	1,574	1,923
Interest & Finance Charges	-509	-579	-1,137	-2,972	-2,994	-3,353	-3,965
Direct Taxes Paid	-1,033	-1,131	-2,467	-4,051	-4,842	-5,808	-7,040
(Inc)/Dec in WC	-130	1,015	-194	-1,297	-1,151	-1,101	-1,415
CF from Operations	2,427	7,405	10,752	8,896	11,503	14,361	17,440
Others	755	-912	-3,427	0	0	0	0
CF from Operating incl EO	3,182	6,492	7,326	8,896	11,503	14,361	17,440
(Inc)/Dec in FA	-747	-1,358	-1,660	-1,932	-4,318	-4,356	-5,450
Free Cash Flow	2,435	5,134	5,666	6,964	7,185	10,004	11,990
(Pur)/Sale of Investments	3,476	0	19,741	0	0	0	0
Others	1,695	950	180	0	0	0	0
CF from Investments	4,424	-409	18,262	-1,932	-4,318	-4,356	-5,450
Issue of Shares	0	0	0	0	0	0	0
Inc/(Dec) in Debt	-337	-124	0	0	0	0	0
Interest Paid	-169	-85	-300	2,972	2,994	3,353	3,965
Dividend Paid	-1,017	-1,060	-1,102	-1,066	-1,279	-1,535	-1,842
Others							
CF from Fin. Activity	-1,523	-1,268	-1,402	1,906	1,715	1,818	2,123
Inc/Dec of Cash	6,084	4,815	24,186	8,870	8,899	11,822	14,112
Opening Balance	15,976	22,066	26,877	31,491	40,361	49,260	61,083
Other Bank Balances	6	-4	-19,573				
Closing Balance	22,066	26,877	31,491	40,361	49,260	61,083	75,195

Siemens

BSE SENSEX
67,481S&P CNX
20,268

CMP: INR3,753

TP: INR4,460 (+19%)

Buy

SIEMENS

Bloomberg	SIEM IN
Equity Shares (m)	356
M.Cap.(INRb)/(USD\$b)	1336.6 / 16
52-Week Range (INR)	4069 / 2726
1, 6, 12 Rel. Per (%)	6/-3/28
12M Avg Val (INR M)	1399
Free float (%)	25.0

Financials & Valuations (INR b)

Y/E Sep	2023	2024E	2025E
Sales	195.5	223.7	259.6
EBITDA margin	12.7	12.9	13.1
Adj. PAT	19.6	22.9	27.2
EPS (INR)	55.1	64.2	76.4
EPS Gr. (%)	55.5	16.6	18.8
BV/Sh. (INR)	367.6	415.1	471.6

Ratios

RoE (%)	15.9	16.4	17.2
RoCE (%)	15.7	16.3	17.1
Payout (%)	18.2	26.1	26.1

Valuations

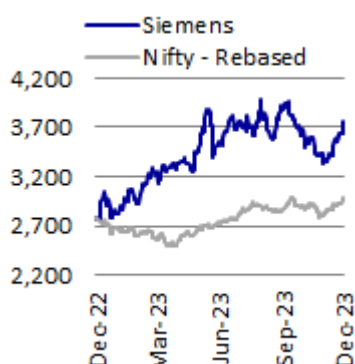
P/E (x)	68.1	58.4	49.2
P/BV (x)	10.2	9.0	8.0
EV/EBITDA (x)	50.7	42.7	35.8
EV/Sales (x)	6.4	5.5	4.7

Shareholding pattern (%)

As On	Sep-23	Jun-23	Sep-22
Promoter	75.0	75.0	75.0
DII	7.6	8.0	9.5
FII	7.9	7.6	6.0
Others	9.4	9.4	9.4

FII Includes depository receipts

Stock's performance (one-year)



Benefiting from railways, transmission and digitization capex

Siemens has been a beneficiary of uptick in spending on railways as well as expected spend on T&D network by government. It is also benefiting from decarbonisation related initiatives from corporates and uptick in investments in data centre, automation and digitisation. With large order inflows coming in from electric locomotives and metro, order inflow CAGR stood at 14% over FY2019-FY2022. With an expected spend of INR2.4t in transmission and an additional INR10-11t in metros, RRTS, locomotives until FY30, coupled with INR400-450b investment in data centres over next three to four years, we expect the company to actively pursue opportunities within these segments. We believe that recent announcements related to purchase of 18% stake of Siemens Energy in the company by Siemens AG eases concerns related to problems being faced by Siemens Energy globally. Potential demerger and listing of Siemen's India Energy segment opens avenues for value unlocking over next 2-3 years. We expect the company to clock revenue/EBITDA/PAT CAGR of 15%/17%/18% over FY23-26. The stock is currently trading at 58.4X/49.2X P/E on FY24/25E. We value it at INR4,460 based on 55X P/E on two year forward earnings and at 15% discount to ABB. We reinitiate coverage on Siemens with a BUY recommendation.

Improving macros across key segments to benefit Siemens

Siemens is a key beneficiary of uptick in railways, transmission, data centre and digitization related investments with its product offerings. We expect (1) Improving spend across railways particularly in locomotives, Vande Bharat trains, metros and high speed rail with an overall addressable market of INR10-11t till FY31 to benefit its mobility segment, (2) Expected spend of INR2.4t on transmission network till FY30 and increasing demand of industrial decarbonisation solutions to benefit its energy segment, (3) High growth in Data centre, smart metering, e-mobility to reflect in improved inflows for smart infrastructure and (4) Increasing spend towards energy efficiency and digitization to positively benefit its digital industries segment.

How is Siemens changing

Siemens has strengthened its position in key segments such as 1) Energy segment with key project wins in transmission and expectations of getting a share from upcoming HVDC projects, 2) Mobility segment with large order win of 9000 HP locomotives and 3) consolidating position in Smart Infrastructure with acquisition of C&S electric. These segments will aid revenue growth CAGR of the company. However, scope of sharp margin improvement in these segments may be limited due to lower margins on transmission business as well as on the locomotive order in initial phase. Increasing share of O&M and increased localization in other segments can provide positive margin levers.

Moving toward digital transformation

During last year, company launched an open digital business platform Siemens Xcelerator, consisting of three main elements - portfolio, ecosystem and marketplace. Its portfolio consists of Siemens's existing products for customers to start with, future products as well as products of other partner vendors so that customers have a wide range to choose from. Through this platform, company is able to provide verticalized, tailor-made solutions for customers.

Financials to gradually reflect execution of recent inflows and localization initiatives

Despite strong order inflow growth of 14% over FY2019-FY2022 for Siemens, revenue growth didn't align with inflow growth due to advance bookings of orders, supply chain issues in procuring imported content as well as delays in project execution due to higher RM prices. With the resolution of supply chain and RM challenges, we expect revenue/EBITDA/PAT CAGR of 15%/17%/18% over FY23-26E for Siemens. These positive trends are underpinned by a robust order book and an expected margin improvement of 60bps over the same period. We anticipate that Siemens's increased dependence on traded goods will limit significant improvements in gross and EBITDA margins.

Valuation and view

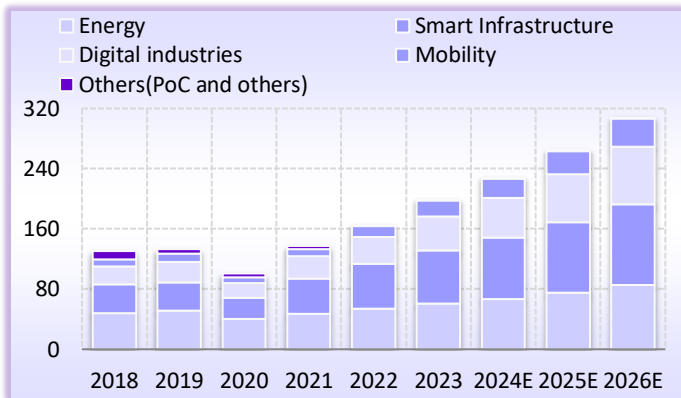
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Key risks and concerns

- Slowdown in order inflows from key government-focused segments such as transmission and railways owing to election schedule
- Aggression in bids to procure large-sized projects to adversely impact margins
- Related-party transactions with parent group entities at lower than market valuations to weigh on stock performance

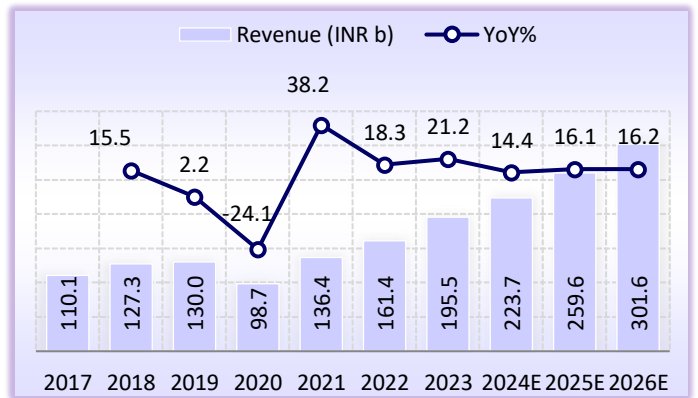
STORY IN CHARTS

Segmental revenue breakup (INR b)



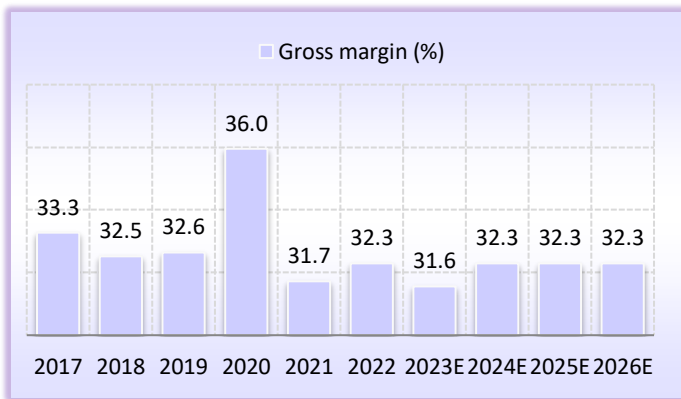
Source: Company, MOFSL

We expect revenue CAGR of 15% over FY23-26 (%)



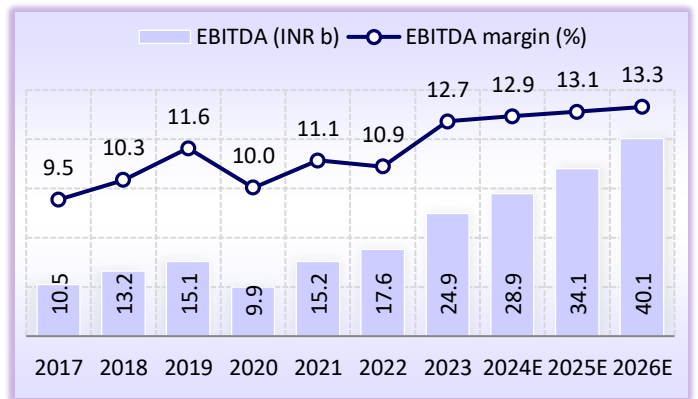
Source: Company, MOFSL

We expect gross margin to improve slightly to 32.3%



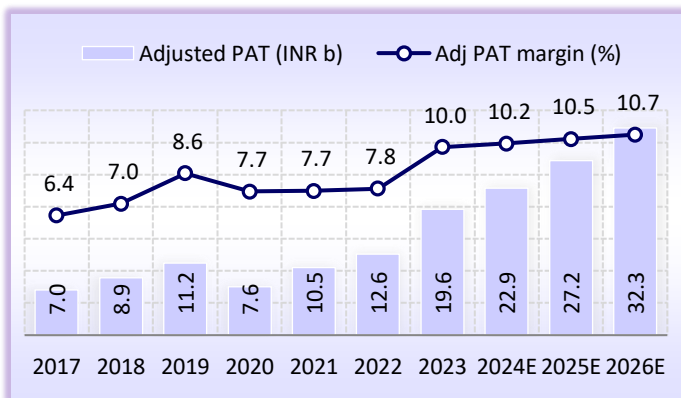
Source: Company, MOFSL

We expect EBITDA margin to remain around 13-13.3%



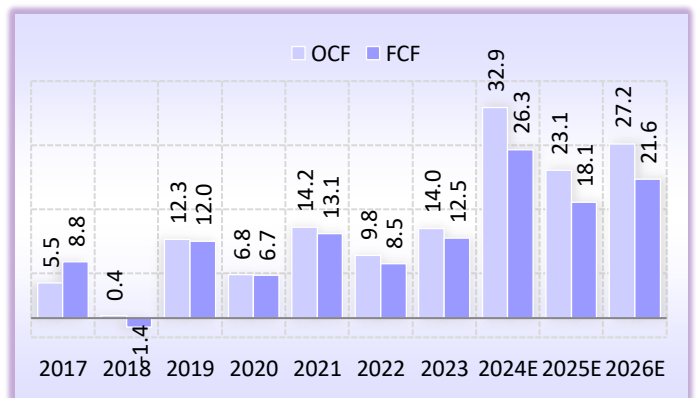
Source: Company, MOFSL

We expect PAT to reflect improvement in EBITDA margin



Source: Company, MOFSL

We expect OCF & FCF to start improving from FY24 (INR b)



Source: Company, MOFSL

Key beneficiary of uptick in transmission and mobility segment inflows

Siemens Limited operates in sectors that are directly linked to the economic and industrial growth of India – manufacturing, infrastructure, transportation, and energy. It is benefiting from an uptick in spending in key market segments such as data centre, automotive, chemical, transmission, building, e-mobility, pharma, railways, and intralogistics.

Exhibit 133: Siemens offerings across different areas

Grid	❖ Smart communication, digital substation, substation automation, grid security, microgrids, LV and MV power distribution
Data centre	❖ Data center management, automation and control, power distribution, fire safety and security
Railways	❖ Intelligent mobility, components for urban transport vehicles, trains and locomotives, rail infrastructure and rail systems
Oil and gas	❖ Low voltage converters, MV converters, LV motors, MV motors, DC motors, motion control motors, fire safety
F&B	❖ Building automation systems, smart buildings

Source: Company, MOFSL

We highlight below the key growth areas for Siemens over the medium to long term:

Energy segment growth to be driven by T&D spend

During recent announcements related to purchase of Siemens Energy 18% stake in Siemens India by Siemens AG, company has also proposed demerger and potential listing of energy segment into a separate company by 2025. This will pave way for potential unlocking of value via separate listing the way it had happened for ABB and Hitachi Energy in past.

Siemens was able to grow inflows by 22% yoy in FY2022 for energy segment. With its portfolio of offerings in T&D and experience in executing HVDC projects, we expect energy segment to benefit from government's plan to set up 500 GW of renewable capacity and corresponding transmission network. We also expect at least 1-2 HVDC projects to get finalized during the year including Leh-Ladakh which is already awarded to PGCIL and other HVDC projects such as Khavda and Bhadla-Fatehpur to get finalized soon. We expect Siemens to get a share of such projects. Company is also a beneficiary of increasing demand of industrial decarbonization solutions – waste heat recovery, biomass, modernization & upgrade.

Exhibit 134: CEA near term pipeline of INR762b to benefit Siemens' energy segment

Transmission Scheme	Mode of implementation	Tentative Implementation timeframe	Survey Agency	BPC	Est Cost (INR b)
❖ Augmentation of transformation capacity by 1x1500 MVA (3rd), 765/400 kV ICT at Maheshwaram (PG) substation in Telangana	RTM	21 months		POWERGRID	1.2
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (7 GW): Part E1	RTM	24 months		Adani Transmission	2.2
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (7 GW): Part E3	RTM	24 months		POWERGRID	2.2
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (7 GW): Part E4	RTM	24 months		POWERGRID	2.4
❖ Western Region network expansion scheme in Kallam area in Maharashtra	TBCB	18 months	RECPDCL	RECPDCL	1.6
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (7 GW): Part A	TBCB	24 months from SPV Transfer	RECPDCL	RECPDCL	40.9
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (7 GW): Part B	TBCB	24 months from SPV Transfer	PFCCCL	PFCCCL	47.7
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (7 GW): Part C	TBCB	24months from SPV Transfer	RECPDCL	RECPDCL	53.4
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (7 GW): Part D	TBCB	24 months from SPV Transfer	PFCCCL	PFCCCL	34.6
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (7 GW): Part E2	TBCB	21 months SPV Transfer	RECPDCL	RECPDCL	7.0
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (8GW): Part A	TBCB	48 months for Bipole-1 and 54 months for Bipole -2 from SPV Transfer	RECPDCL	RECPDCL	248.2
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-V (8 GW): Part C	TBCB	48 months from SPV Transfer	PFCCCL	PFCCCL	120.0
❖ Transmission system for evacuation of power from Rajasthan REZ Ph-IV (Part-2:5.5 GW) (Jaisalmer/Barmer Complex): Part A	TBCB	24 months from SPV Transfer	RECPDCL	RECPDCL	22.1
❖ Transmission system for evacuation of power from Rajasthan REZ Ph-IV (Part-2 :5.5 GW) (Jaisalmer/Barmer Complex): Part B	TBCB	24 months from SPV Transfer	PFCCCL	PFCCCL	32.8
❖ Transmission system for evacuation of power from Rajasthan REZ Ph- IV (Part-2:5.5 GW)(Jaisalmer/Barmer Complex): Part C	TBCB	24 months from SPV Transfer	CTUIL	RECPDC L	27.1
❖ Transmission system for evacuation of power from Rajasthan REZ Ph- IV (Part-2:5.5 GW) (Jaisalmer/Barmer Complex): Part D	TBCB	24 months from SPV Transfer	CTUIL	PFCCCL	22.3
❖ Transmission system for evacuation of power from Rajasthan REZ Ph- IV (Part-2 :5.5 GW)(Jaisalmer/Barmer Complex): Part E	TBCB	24 months from SPV Transfer	RECPDCL	RECPDCL	32.5
❖ Transmission system for evacuation of power from Rajasthan REZ Ph- IV (Part-2:5.5GW) (Jaisalmer/Barmer Complex): Part F (By clubbing Part F1 & F2)	TBCB	24 months from SPV Transfer	PFCCCL	PFCCCL	27.4
❖ Transmission system for evacuation of power from Rajasthan REZ Ph- IV (Part-2:5.5 GW) (Jaisalmer/Barmer Complex): Part H1	TBCB	24 months from SPV Transfer	RECPDCL	RECPDCL	36.7
Total					762.0

Exhibit 135: Transmission line network worth INR2.4t will have to be set up before renewable energy capacity gets commissioned

Details	Capacity (GW)
RE capacity already commissioned	166
66.5 GW RE capacity to be integrated to ISTS network (8.8 GW already commissioned)	58
Additional RE capacity to be integrated to ISTS network (55 GW+181.5GW)	237
Margin already available in ISTS sub-stations which can be used for integration	34
Balance RE capacity from GEC-1 to be integrated to intra-state system	7
RE capacity from GEC-II to be integrated to intra-state system	19
Additional hydro capacity likely by FY2030	17
Total RE capacity targeted till FY2030	537

Source: Ministry of Power, MOFSL

Exhibit 136: HVDC projects lined up for integration of additional RE capacity by FY2030

Sr no	Project name
1	800 kV Bhadla-III - Fatehpur HVDC line
2	350 kV Pang - Kaithal HVDC line
3	800 kV Barmer-II - Jabalpur HVDC line
4	800 kV Khavda - Aurangabad HVDC line

Source: CEA, MOFSL

Mobility segment is benefiting from an uptick in spending from railways

The company's mobility business offers a range of hardware and software solutions for rail traffic automation, high-speed trains, commuter trains, locomotives, trainsets for intercity travel, urban public vehicles, such as metro, light rail, and electrification systems, intelligent traffic systems, parking and tolling solutions, as well as remote services. . In the mobility segment, company is already carrying out contracts for electrical and mechanical system works, signalling and telecommunication work for various metro projects as well as train control management system, electrics and electronic interlocking systems for nine Vande Bharat Express trainsets.

Electric locomotive order: Siemens Mobility has received an order for 1,200 locomotives of 9,000 horsepower (HP) from Indian Railways worth EUR3b, excluding taxes and price variation. Siemens Mobility will design, manufacture, commission, and test the locomotives. Deliveries are planned over an eleven-year period, and the contract includes 35 years of full-service maintenance. The locomotives will be assembled in the Indian Railways factory in Dahod, in the state of Gujarat, India. Maintenance will be performed in four Indian Railways depots located in Visakhapatnam, Raipur, Kharagpur, and Pune. The locomotive assembly and maintenance operations will be carried out collaboratively with Indian Railways' staff.

With the project delivery spanning over 11 years, incremental yearly revenue contribution will be lower for Siemens. However, the O&M period of 24 years provides a sustainable revenue visibility and qualifies the company for other such bids. As per the company management, overall bid including the maintenance period takes into account sufficient cushion to make double-digit margins.

Exhibit 137: Siemens' bid was significantly below the L2 bidder

	Total order (INR b)	Per locomotive (INR m)
Indian Railways estimate	200.0	166.7
Alstom bid	234.0	195.0
Siemens bid	132.0	110.0
Differential versus IR (%)	-34.0	-34.0
Differential versus Alstom (%)	-43.6	-43.6

Source: Industry

Exhibit 138: Details of 1200*9000 HP electric locomotive order awarded to Siemens at USD3b

Delivery schedule	No. of locos
1st year - 2023-24	5
2nd year - 2024-25	35
3rd year - 2025-26	80
4th year - 2026-27	80
5th year - 2027-28	100
6th year - 2028-29	100
7th year - 2029-30	160
8th year - 2030-31	160
9th year - 2031-32	160
10th year - 2032-33	160
11th year - 2033-34	160

Source: Industry, Indian Railways, MOFSL

With upcoming opportunity pipeline of INR10-11t from various routes planned under metro, high speed rail as well as RRTS projects, we expect Siemens to continue to benefit.

Exhibit 139: Metro rail planned network in the country till FY2032 (km)

City	Planned network (km)
Delhi and NCR	82
Mumbai	113
Bengaluru	106
Chennai	134
Gurugram	199
Kolkata	44
Lucknow	85
Navi Mumbai	83
Bhopal	77
Hyderabad	63
Nagpur	48
Indore	57
Pune	31
Noida	15
Surat	23
Kochi	11
Jaipur	23
Total	1,194

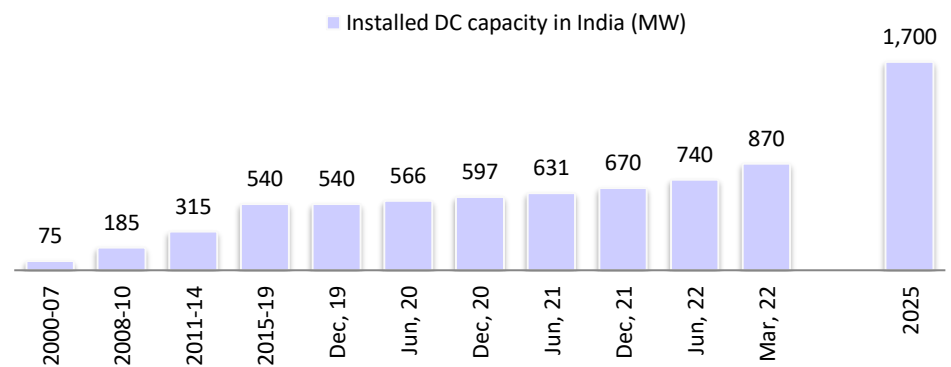
Source: Industry, MOFSL

Smart infrastructure and digital industries segments are well positioned to tap upcoming opportunities from data centre and digitization

India’s data centre capacity is expected to grow to 1700-1800 MW which will require an investment of nearly \$5 b over next 3-4 years. Siemens can target nearly 45% of the cost of setting up of data centre and can cater to building management software (BMS), energy and power management software (EPMS) and Space Cooling Optimisation (WSCO) technology etc. The Government of India’s push towards self-reliance (Atmanirbhar Bharat), Make in India, Production-linked Incentive schemes and investments by the private sector will further accelerate push towards digitalization and automation where Siemens has different product offerings. Siemens already has a good exposure towards Sugar, Petrochemical Steel, Water, Food and Beverage and Chemicals business.

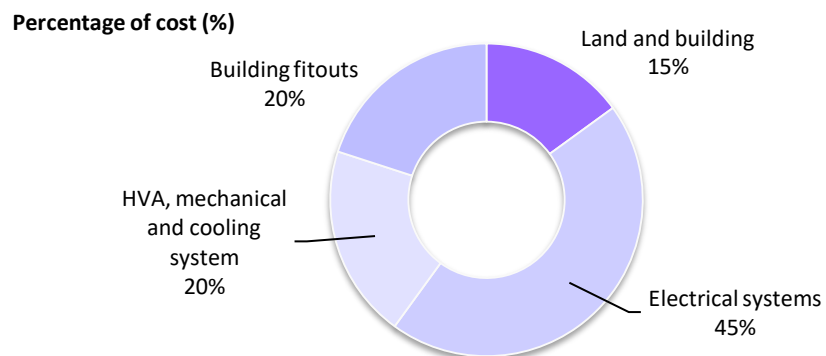
Siemens recent transaction proposal to sell LV motors and geared motors business to Siemens AG for INR22 b at a multiple of 2.1X EV/Sales and 15.5X EV/EBITDA was not approved by minority shareholders. The company’s primary objective was to divest predominantly commoditized business of LV motors. However, the deal faced resistance from shareholders primarily due to the perceived low valuations and concerns about the timing of the transaction. Shareholders were apprehensive of the deal, particularly in light of low valuations and when other industry players, such as CG Power and ABB India, are expanding their capacities in the motors segment.

Exhibit 140: Data centre market is witnessing a sharp growth



Source: Industry, CRISIL

Exhibit 141: We expect Siemens to have an addressable market of 45% of data centre cost




Source: Industry, MOFSL

Moving toward digital transformation

- In the past year, the company launched Siemens Xcelerator, an open digital business platform consisting of three key components - portfolio, ecosystem and marketplace. Its portfolio consists of Siemens's existing products, enabling customers to initiate its digital transformational journey. Additionally, it includes forthcoming products and offerings from partner vendors, so that customers have a diverse array of options to choose from.
- The company has created Xcelerator like an ecosystem of partners where it has System Integrators, Service Providers, IT Companies who can collaborate within themselves, who can collaborate together with the company as well and who can use the products and solutions that are available to design tailor-made solutions for customers specific to their needs, including co-creation with customers.
- It is like a marketplace, which is evolving with use-cases specific to each market vertical that the company operates in and demonstrates the benefits and the impact of digitalization solutions.
- As this platform is interoperable, flexible, open and available as-a-service, the company was able to provide customized solutions for its clients.

Exhibit 142: Xcelerator: IoT-enabled offerings

Xcelerator – Siemens is the partner of choice in digital transformation



A comprehensive, curated **portfolio** that includes digital and IoT-enabled offerings from Siemens and certified partners

A continuously growing, powerful **ecosystem** of partners

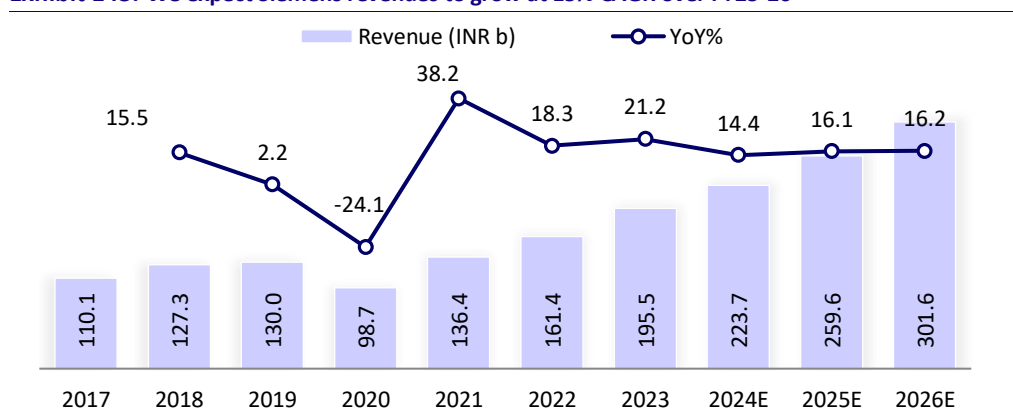
An evolving **marketplace** that enables education, exploration, exchange & transaction within a community of customers, partners & experts

Source: Company, MOFSL

Revenue growth yet to catch with the pace of order inflows

- Despite strong order inflow growth of 14% over FY19-FY22 for Siemens, revenue growth did not align with inflow growth. Firstly, it is attributable to advance order bookings by clients to some extent in order to overcome supply chain issues, which prevailed during the last two years. This resulted in a much higher order inflow growth.
- Secondly, revenue growth in energy segment was impacted by delays in delivery of products due to sharp volatility seen in commodity prices as well as project cycle. Same was the case with mobility segment as deliveries were linked to project cycle.
- Thirdly, delays in supplies of imported content or semiconductor availability adversely impacted Smart infrastructure and Digital industries segment. Majority of revenue slowdown impact was seen in digital industries as the company is not localized in this segment.
- We believe that supply chain issues are largely behind and revenue growth uptick will start getting reflected from FY2024 onwards. However, large sized inflows received by Siemens during FY2023 will start getting reflected in revenues only from FY2025.

Exhibit 143: We expect Siemens revenues to grow at 15% CAGR over FY23-26



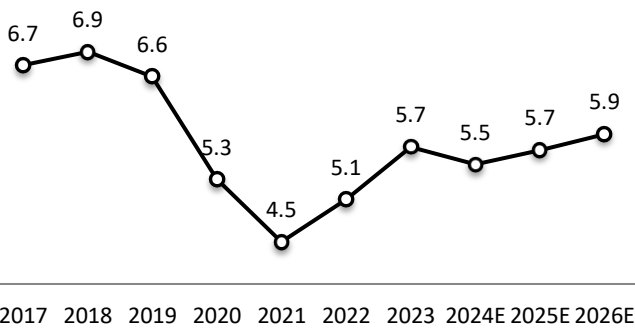
Source: Company, MOFSL

Capex to increase from current levels

Siemens capex have remained relatively low in recent years, and in the most recent year, they were even lower than the depreciation expense. The company relies more on traded goods and has not localized to the same extent as some of its industry peers.

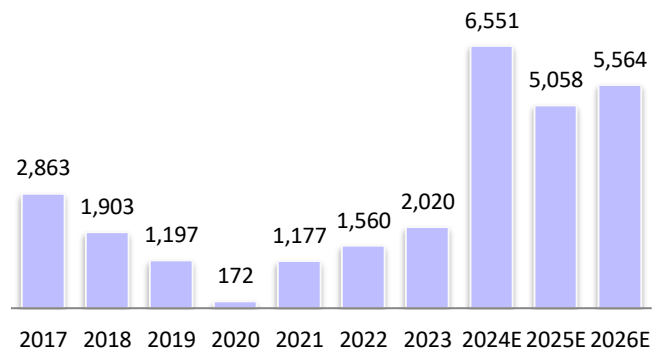
During the year, the company opened a Bogey Factory in Aurangabad for Metros and is also getting into the Electrification of Locomotive business as well. The company has already embarked on component manufacturing for traction components at its Nasik factory. Henceforth, it will further expand its portfolio to cater to and localize the mobility business, particularly in light of the recent significant order for 9,000HP electric locomotives.

Exhibit 144: Asset turnover (x)



Source: Company, MOFSL

Exhibit 145: We expect capex to increase for mobility and transformers (INR m)



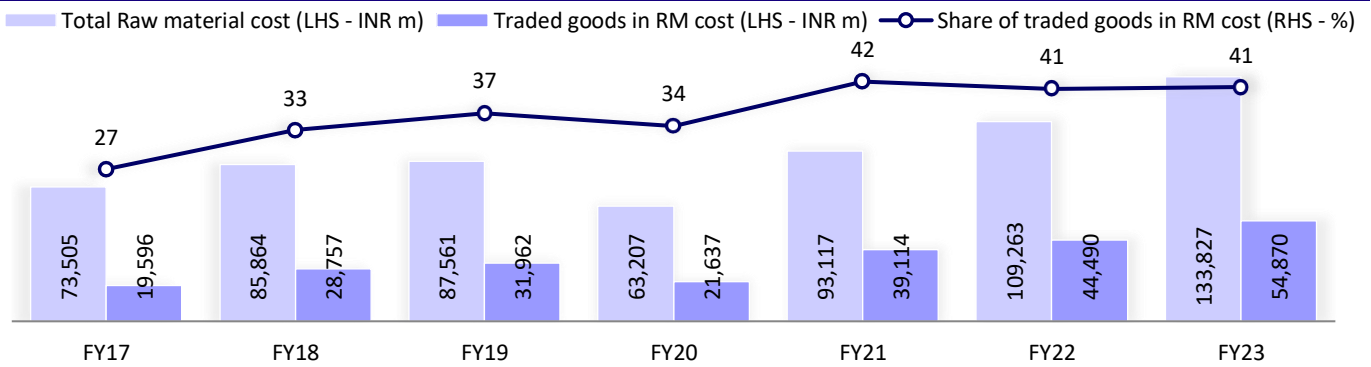
Source: Company, MOFSL

Margin recovery to be limited

Siemens has higher proportion of services and exports as compared to ABB and has higher margins than ABB during the period FY15-21.

However, Siemens continues to rely on related parties for large procurement of traded goods, including imports for its digital industries, which has consistently remained at 24-30% of its sales over the past four years. Additionally, a significant portion of its business is project-based, necessitating the use of traded goods. Furthermore, the company is also expanding the bogey factory to fulfil the recent locomotive order, and would continue to depend on traded components and materials. Consequently, we believe that Siemens will maintain a substantial reliance on traded goods in the foreseeable future. This dependence may limit the extent of margin improvement for the company.

Exhibit 146: Share of traded goods remains high in RM cost for Siemens



Siemens is actively seeking higher growth across segments, which will necessitate investments to further enhance capabilities, hardware as well as manpower. Hence, we expect EBITDA growth from current levels to be limited. Gross margin of Siemens has improved in FY22 and FY23 on improved product mix and decline in RM prices coupled with selective price hikes taken by the company.

Exhibit 147: EBITDA & gross margin trend

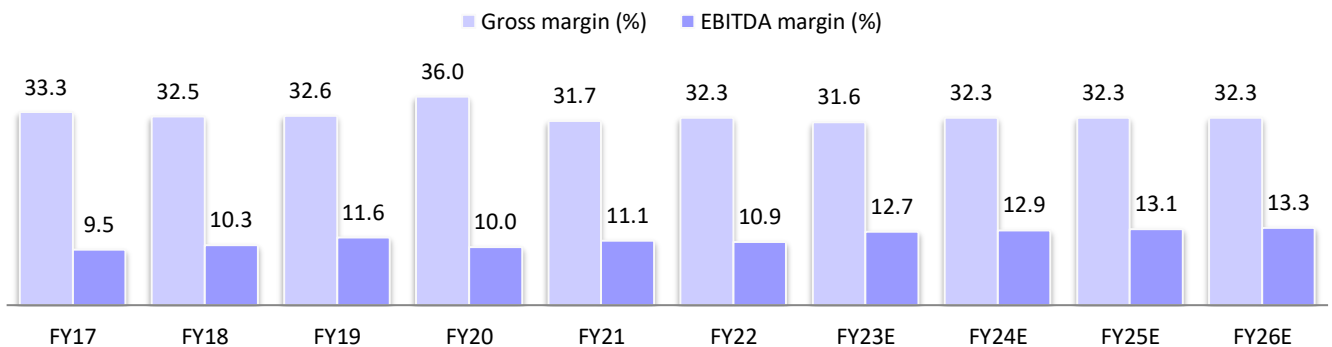


Exhibit 148: Siemens margin comparison across segments with relevant players

EBIT margin (%)	FY21	FY22	FY23	Comments
Siemens - energy segment	12.5	10.5	11.3	❖ We expect 40 bps improvement in Siemens energy segment margins which is still lower than other players like ABB and Triveni Turbine. Company competes with Triveni Turbine in turbine market and with T&D players in transmission segment. Triveni Turbines margins are higher due to higher share of after market and exports. Margins of GE T&D and Hitachi Energy are expected to improve in coming quarters.
ABB - electrification segment**	4.1	11.1	13.8	
Triveni Turbine	21.0	19.1	18.7	
GE T&D	8.6	-2.9	4.0	
Hitachi Energy	7.3	6.4	5.3	
Siemens - smart infrastructure	5.4	6.5	10.5	❖ We expect Siemens to get synergies from C&S acquisition and higher exports and bake in margin improvement
ABB - electrification segment**	4.1	11.1	13.8	
Siemens - Mobility	12.1	8.6	5.4	❖ Siemens mobility segment margin may remain weak in near term as company would need dependence on traded goods as it ramps up on locomotive order
ABB - motion	5.3	12.5	12.3	
Siemens - Digital industries	7.7	10.0	13.7	❖ We already bake in margin improvement in Siemens in line with other players
ABB - Industrial Automation	-5.4	9.1	12.8	
Honeywell Automation	19.5	14.8	15.1	

Notes: FY23 numbers for Siemens are our estimates; ** ABB financials are for Calendar year CY20-CY22; Source: Company, MOFSL

Exhibit 149: Segment-wise EBIT margin comparison - Siemens AG vs Siemens Ltd

Digital Industries	2019	2020	2021	2022	2023
Siemens AG (A)	17.90%	21.70%	20.30%	19.90%	22.60%
Siemens Ltd (B)	6.13%	5.95%	7.69%	9.98%	13.69%
Net margin difference (A-B)	11.8%	15.7%	12.6%	9.9%	8.9%
Smart Infra					
Siemens AG (A)	10.0%	9.1%	11.5%	12.8%	15.4%
Siemens Ltd (B)	9.5%	3.7%	5.4%	6.5%	10.5%
Net margin difference (A-B)	0.52%	5.43%	6.05%	6.34%	4.87%
Mobility					
Siemens AG (A)	11.0%	9.1%	9.2%	8.2%	8.4%
Siemens Ltd (B)	10.1%	11.3%	12.1%	8.6%	5.4%
Net margin difference (A-B)	0.9%	-2.2%	-2.9%	-0.4%	3.0%

Source: Company, MOFSL

Royalty and IT fee to parent much lower than peers

Royalty and IT fee for Siemens is much lower than ABB. However, its share of traded goods remains high as company depends on procurement from parent for raw material.

Exhibit 150: Annual payout to parent has remained between 1.1-1.6% of sales

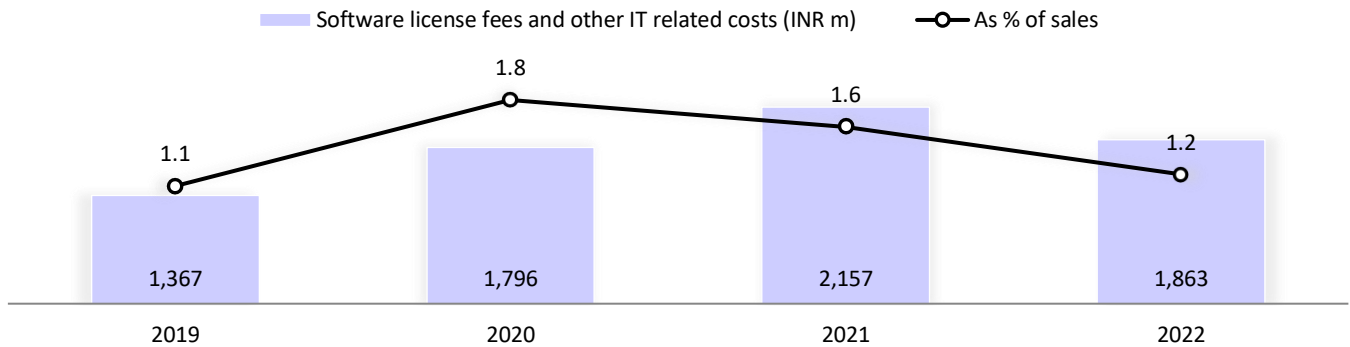


Exhibit 151: Technology absorption

Details of technology	Year of import	Technology absorbed or not
Contact Blade Assembly Automation (Includes Scara & 6-axis Robot)	2021	Yes
Test fixtures for XTRI products	2022	No
Train control management system	2022	No
Integration of 9000HP locomotive upgradation kit	2021	Yes
End of Train and Head of Train Device	2020	No
Point Machine S700 K and External Lock device	2020	No
Axle counters for Rail automation	2019	No
Knowhow of the Vehicle Control Software for Locomotive Control System	2019	Yes
Integrated Traction Converter for E-Loco	2019	Yes
Resin Impregnated Synthetic Bushings (For Power Transformer and Reactors) up-to 420kV	2021	No
Localization of 8DQ16 GIS Interrupter Unit	2022	Yes
Variable Shunt reactor	2019	No
Synthetic Ester Oil Transformer	2020	No

Source: Company, MOFSL

Sustainability initiatives

Siemens is making significant strides in its commitment to Energy Efficiency Programs across various sectors, including as industrial, Food and Beverage, Hospitality, and Automotive industries. The company's focus primarily lies in manufacturing, where they have demonstrated reductions in carbon footprint and cost savings for their clients. The company operates across 23 different market verticals, boasting a deep understanding of manufacturing processes, automation, and the integration of digitization to enhance productivity. Furthermore, Siemens has begun to forge collaborations in the field of Electrical Mobility.

Exhibit 152: Sustainability framework of Siemens

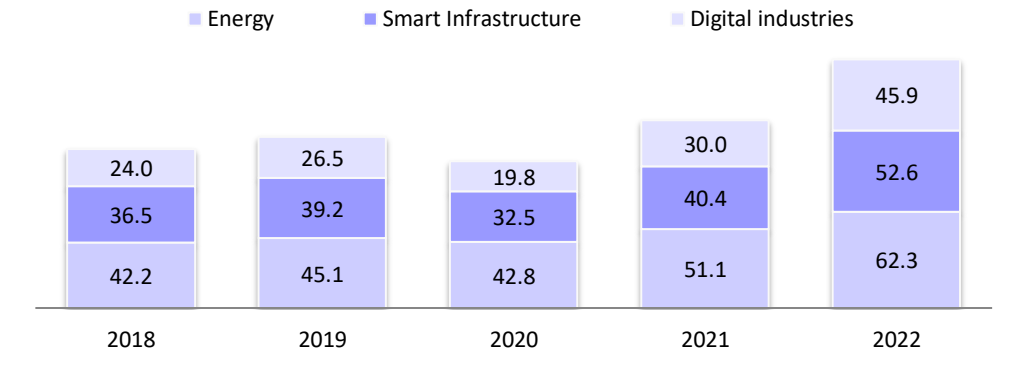


Source: Company

Financial outlook

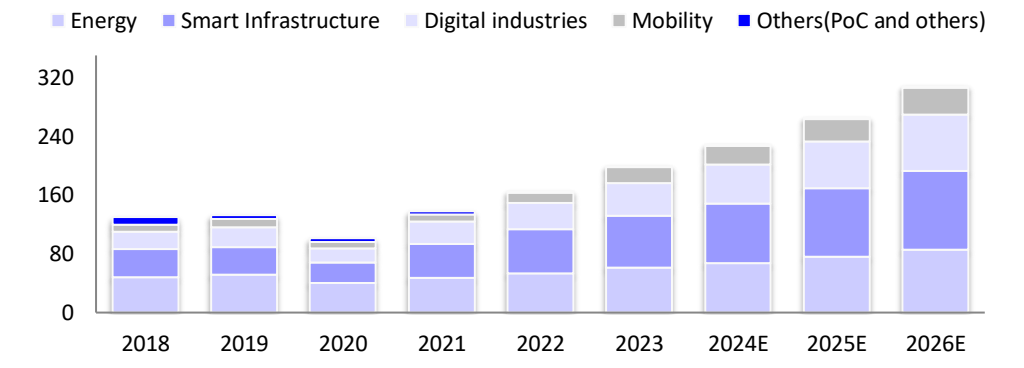
We expect the company to clock a revenue CAGR of 15% over FY23-26E, driven by 12%/15%/20%/19% CAGR in energy/smart infrastructure/mobility/digital industries. Over FY23-26E, we expect a 60-bp increase in margins due to improved pricing and low RM cost. We expect EBITDA/PAT CAGR of 17%/18% over the same period.

Exhibit 153: Order inflow breakup (INR b)



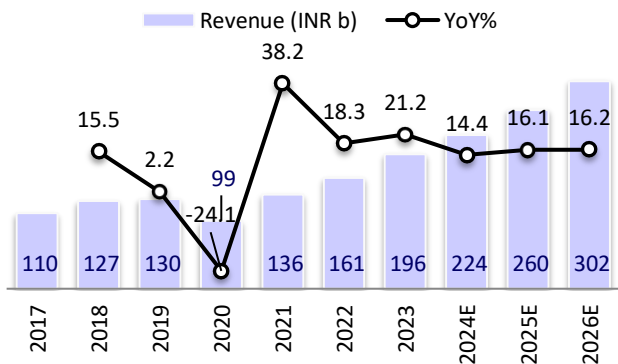
Source: Company, MOFSL

Exhibit 154: Segment-wise revenue breakup (INR b)



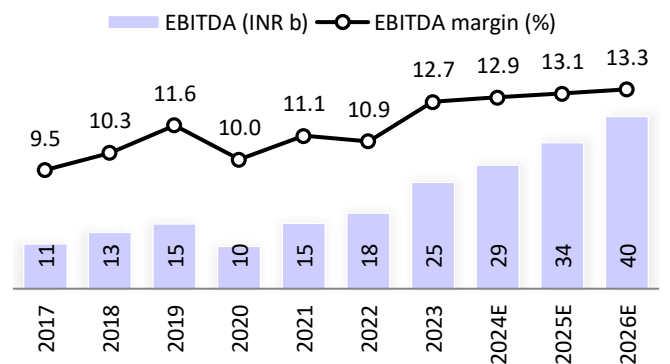
Source: Company, MOFSL

Exhibit 155: We expect revenue CAGR of 15% over FY23-26



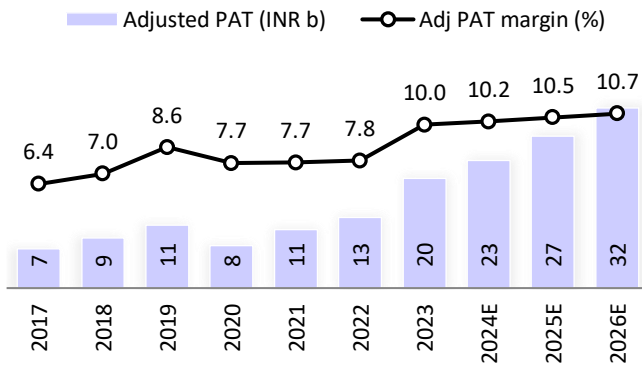
Source: Company, MOFSL

Exhibit 156: We expect EBITDA margin to be around 13.3%



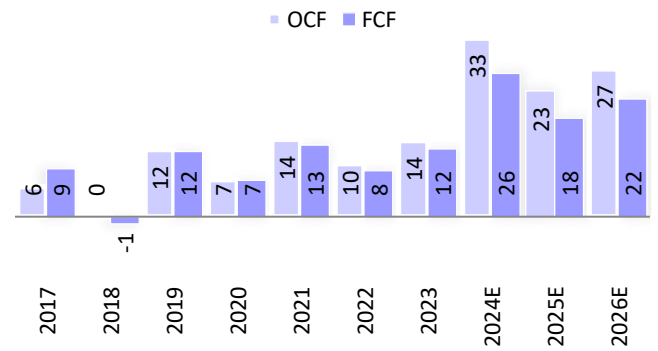
Source: Company, MOFSL

Exhibit 157: We expect PAT to reflect improvement in EBITDA margin



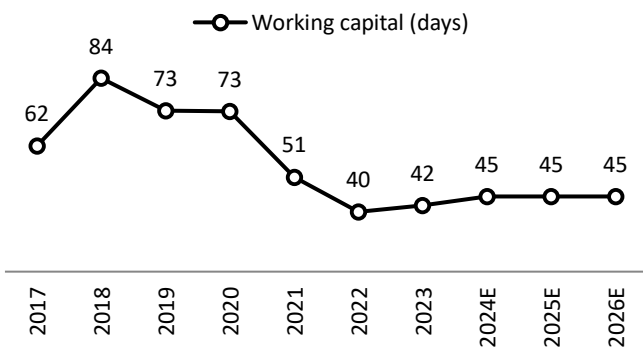
Source: Company, MOFSL

Exhibit 158: We expect OCF & FCF to start improving from FY24 (INR b)



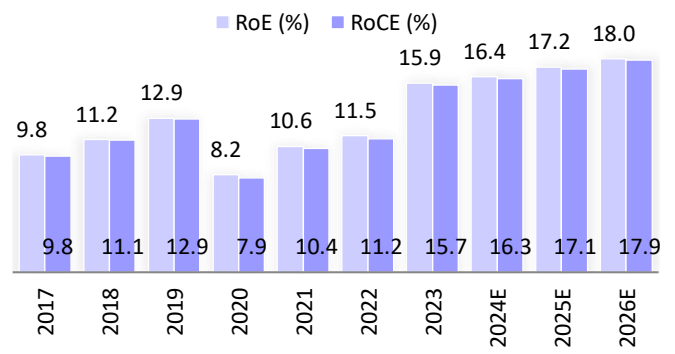
Source: Company, MOFSL

Exhibit 159: We expect higher working capital to bake in project based nature of projects (days)



Source: Company, MOFSL

Exhibit 160: We expect RoE and RoCE improvement to be led by improved PAT



Source: Company, MOFSL

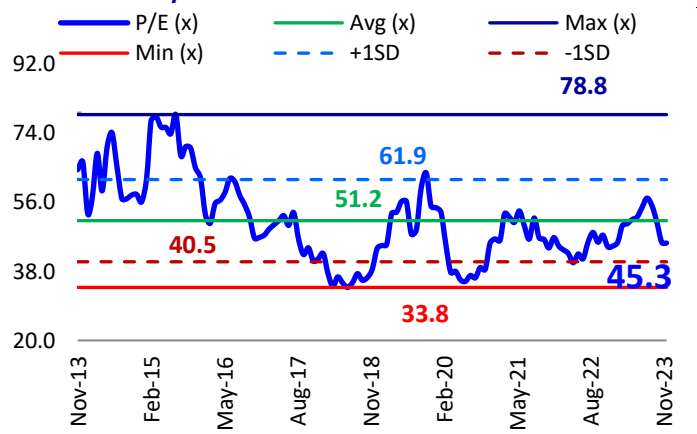
Key risks and concerns

- Slowdown in order inflows from key government focused segments such as transmission and railways, owing to election schedule
- Aggression in bids to procure large-sized projects to impact margins
- Related-party transactions with parent group entities at lower than market valuations to weigh on stock performance

Valuation and recommendation

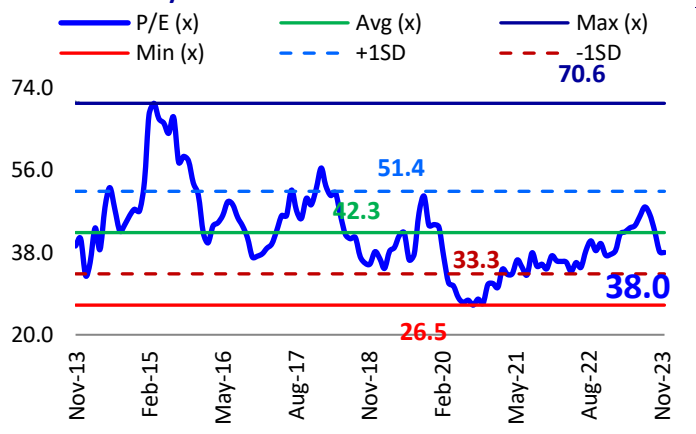
We expect the company to clock revenue/EBITDA/PAT CAGR of 15%/17%/18% over FY23-26. The stock is currently trading at 58.4X/49.2X P/E on FY24/25E. We value it at INR4,460 based on 55X P/E on two year forward earnings and at 15% discount to ABB. We reinitiate coverage on Siemens with a BUY recommendation.

Exhibit 161: 1-year forward PE band



Source: Bloomberg, MOFSL

Exhibit 162: 2-year forward PE band



Source: Bloomberg, MOFSL

Exhibit 163: Sensitivity analysis - Bear/Base/Bull case valuations

	Bear case	Base case	Bull case
2 year forward EPS (INR)	72	80	88
Valuation multiple (x)	50	55	60
Target Price (INR/share)	3,600	4,460	5,280

Source: MOFSL

SWOT analysis

- ❖ Focus on fast-growing segments
- ❖ Wide range of portfolio offerings
- ❖ Strong prowess in technology

- ❖ Track record of hiving off businesses to parent at unfavourable terms for minority shareholders
- ❖ High payout to parent in the form of software license fees

- ❖ Healthy visibility from target markets
- ❖ Potential to scale up exports due to parent's global footprint
- ❖ Global emphasis on decarbonisation

- ❖ Increased competition
- ❖ Commodity inflation
- ❖ Geopolitical tensions
- ❖ Policy instability



Management profile



Mr. Sunil Mathur (Group CEO & Director)

Sunil Mathur is the Managing Director and Chief Executive Officer of Siemens Limited, India since 2014. Sunil Mathur has been with Siemens for over 30 years, He is currently a Member of the Global Leadership Team of Siemens and a Member of the Board of Siemens Healthcare Private Limited in India, Chairman of the Board of Siemens Gamesa Renewable Energy Private Limited in India and Chairman of C&S Electric Limited.



Dr. Daniel Spindler (Group CFO)

Dr. Daniel Spindler is the Executive Director and Chief Financial Officer of Siemens Limited, India. Dr. Daniel Spindler, holds Business Administration and Conferral of a doctorate from University of Regensburg, Germany. He has been associated with Siemens for over 20 years during which he has held various management positions.

Financials and valuation

Consolidated - Income Statement							(INR Million)
Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Total Income from Operations	98,694	1,36,392	1,61,378	1,95,538	2,23,663	2,59,640	3,01,609
Change (%)	-24.1	38.2	18.3	21.2	14.4	16.1	16.2
Raw Materials	63,207	93,117	1,09,263	1,33,827	1,51,434	1,75,793	2,04,208
Gross Profit	35,487	43,275	52,115	61,711	72,229	83,848	97,401
Employee Cost	15,404	16,917	18,057	20,130	25,026	29,052	33,748
Other Expenses	10,180	11,173	16,485	16,710	18,284	20,743	23,512
Total Expenditure	88,791	1,21,207	1,43,805	1,70,667	1,94,744	2,25,588	2,61,468
% of Sales	90.0	88.9	89.1	87.3	87.1	86.9	86.7
EBITDA	9,903	15,185	17,573	24,871	28,919	34,052	40,141
Growth (%)	-34.5	53.3	15.7	41.5	16.3	17.7	17.9
Margin (%)	10.0	11.1	10.9	12.7	12.9	13.1	13.3
Depreciation	2,504	3,005	3,171	3,208	3,338	3,571	3,844
EBIT	7,399	12,180	14,402	21,663	25,581	30,481	36,297
Int. and Finance Charges	292	246	363	228	228	228	228
Other Income	3,099	2,265	3,078	4,962	5,430	6,331	7,365
PBT bef. EO Exp.	10,206	14,199	17,117	26,397	30,784	36,583	43,434
EO Items							
PBT after EO Exp.	10,206	14,199	17,117	26,397	30,784	36,583	43,434
Total Tax	2,632	3,698	4,498	6,778	7,904	9,394	11,153
Tax Rate (%)	25.8	26.0	26.3	25.7	25.7	25.7	25.7
Minority Interest							
Reported PAT	7,574	10,501	12,619	19,619	22,880	27,190	32,282
Adjusted PAT	7,574	10,501	12,619	19,619	22,880	27,190	32,282
Change (%)	-32.6	38.6	20.2	55.5	16.6	18.8	18.7
Margin (%)	7.7	7.7	7.8	10.0	10.2	10.5	10.7

Consolidated - Balance Sheet							(INR Million)
Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Equity Share Capital	712	712	712	712	712	712	712
Eq. Share Warrants & App. Money							
Preference Capital							
Total Reserves	94,028	1,02,778	1,15,390	1,30,159	1,47,067	1,67,160	1,91,016
Net Worth	94,740	1,03,490	1,16,102	1,30,871	1,47,779	1,67,872	1,91,728
Minority Interest	0	81	76	86	86	86	86
Total Loans	0	25	0	0	0	0	0
Deferred Tax Liabilities	-2,481	-473	-975	-1,627	-1,627	-1,627	-1,627
Capital Employed	92,259	1,03,123	1,15,203	1,29,330	1,46,238	1,66,331	1,90,187
Gross Block	20,443	30,118	31,906	34,198	40,684	45,742	51,305
Less: Accum. Deprn.	8,792	10,774	13,945	17,153	20,426	23,997	27,841
Net Fixed Assets	11,651	19,344	17,961	17,045	20,258	21,745	23,464
Goodwill on Consolidation	0	11,732	12,354	12,686	12,686	12,686	12,686
Capital WIP	880	350	517	501	501	501	501
Total Investments	550	972	766	667	1,304	1,304	1,304
Curr. Assets, Loans&Adv.	1,35,169	1,46,705	1,68,323	1,89,753	2,45,426	2,85,660	3,33,041
Inventory	11,064	17,969	21,650	25,052	30,639	35,567	41,316
Account Receivables	45,170	51,061	56,544	65,223	79,661	92,475	1,07,422
Cash and Bank Balance	55,517	51,591	65,841	76,507	1,01,424	1,18,494	1,38,855
Loans and Advances	7,782	8,185	7,113	7,288	12,256	14,227	16,527
Other Current Assets	15,636	17,899	17,175	15,683	21,447	24,897	28,921
Curr. Liability & Prov.	59,929	75,980	84,912	90,812	1,33,427	1,55,054	1,80,299
Other Current Liabilities	47,978	62,899	75,013	74,646	98,044	1,13,815	1,32,212
Provisions	11,951	13,081	9,899	16,166	35,383	41,239	48,087
Net Current Assets	75,240	70,725	83,411	98,941	1,11,999	1,30,606	1,52,742
Misc Expenditure	3,938	0	194	-510	-510	-510	-510
Appl. of Funds	92,259	1,03,123	1,15,203	1,29,330	1,46,238	1,66,331	1,90,187

Financials and valuation

Ratios

Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Basic (INR)							
EPS	21.3	29.5	35.4	55.1	64.2	76.4	90.6
Change (%)	-32.6	38.6	20.2	55.5	16.6	18.8	18.7
Cash EPS	28.3	37.9	44.3	64.1	73.6	86.4	101.4
BV/Share	266.0	290.6	326.0	367.5	415.0	471.4	538.4
DPS	7.0	8.0	10.0	10.0	16.8	19.9	23.7
Payout (%)	39.7	32.7	28.2	18.2	26.1	26.1	26.1
Valuation (x)							
P/E	176.5	127.3	105.9	68.1	58.4	49.2	41.4
Cash P/E	132.6	99.0	84.6	58.5	51.0	43.4	37.0
P/BV	14.1	12.9	11.5	10.2	9.0	8.0	7.0
EV/Sales	13.0	9.4	7.9	6.4	5.5	4.7	4.0
EV/EBITDA	129.3	84.6	72.3	50.6	42.7	35.8	29.8
Dividend Yield (%)	0.2	0.2	0.3	0.3	0.4	0.5	0.6
FCF per share	18.7	36.9	23.8	35.0	73.9	50.7	60.8
Return Ratios (%)							
RoE	8.2	10.6	11.5	15.9	16.4	17.2	18.0
RoCE	8.4	10.8	11.7	16.0	16.5	17.3	18.0
RoIC	15.0	21.1	21.6	32.3	40.2	50.9	56.5
Working Capital Ratios							
Fixed Asset Turnover (x)	4.8	4.5	5.1	5.7	5.5	5.7	5.9
Asset Turnover (x)	1.1	1.3	1.4	1.5	1.5	1.6	1.6
Inventory (Days)	41	48	49	47	50	50	50
Debtor (Days)	167	137	128	122	130	130	130
Creditor (Days)	0	0	0	0	0	0	0
Leverage Ratio (x)							
Current Ratio	2.3	1.9	2.0	2.1	1.8	1.8	1.8
Interest Cover Ratio	25.3	49.5	39.7	95.0	112.2	133.7	159.2
Net Debt/Equity	-0.6	-0.5	-0.6	-0.6	-0.7	-0.7	-0.7

Consolidated - Cash flow Statement

(INR Million)

Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
OP/(Loss) before Tax	10,193	15,058	20,817	26,397	30,784	36,583	43,434
Depreciation	2,504	3,005	3,171	3,208	3,338	3,571	3,844
Interest & Finance Charges	292	246	363	228	228	228	228
Direct Taxes Paid	-2,942	-3,735	-5,215	-8,033	-7,904	-9,394	-11,153
(Inc)/Dec in WC	-1,426	2,339	-3,619	-4,371	11,859	-1,537	-1,776
CF from Operations	8,621	16,913	15,517	17,429	38,305	29,453	34,578
Others	-1,856	-2,692	-5,732	-3,429	-5,430	-6,331	-7,365
CF from Operating incl EO	6,765	14,221	9,785	14,000	32,874	23,122	27,213
(Inc)/Dec in FA	-98	-1,074	-1,313	-1,545	-6,551	-5,058	-5,564
Free Cash Flow	6,667	13,147	8,472	12,455	26,323	18,064	21,649
(Pur)/Sale of Investments	-3,938	-13,623	4,419	-2,159	-637	0	0
Others	8,387	-9,196	-3,459	-4,765	5,430	6,331	7,365
CF from Investments	4,351	-23,893	-353	-8,469	-1,758	1,273	1,802
Issue of Shares							
Inc/(Dec) in Debt	-714	-2,385	-825	-893	0	0	0
Interest Paid	-128	-140	-248	-45	-228	-228	-228
Dividend Paid	-3,005	-2,493	-2,849	-3,561	-5,972	-7,097	-8,425
Others	0		0	0	0	0	0
CF from Fin. Activity	-3,847	-5,018	-3,922	-4,499	-6,200	-7,325	-8,653
Inc/Dec of Cash	7,269	-14,690	5,510	1,032	24,917	17,070	20,361
Opening Balance	48,913	55,517	51,591	65,841	76,507	1,01,424	1,18,494
Closing Balance	55,517	51,591	65,841	76,507	1,01,424	1,18,494	1,38,855

Thermax

BSE SENSEX
67,481S&P CNX
20,268

CMP: INR2,610

TP: INR2,740 (+5%)

Neutral



Bloomberg	TMX IN
Equity Shares (m)	113
M.Cap.(INRb)/(USDb)	311 / 3.7
52-Week Range (INR)	3230 / 1830
1, 6, 12 Rel. Per (%)	-16/1/19
12M Avg Val (INR M)	164
Free float (%)	38.0

Financials & Valuations (INR b)

Y/E Mar	2023	2024E	2025E
Sales	80.9	93.5	105.4
EBITDA margin	7.4	8.3	9.1
Adj. PAT	4.5	5.8	6.9
EPS (INR)	40.0	51.8	61.0
EPS Gr. (%)	44.4	29.4	17.7
BV/Sh. (INR)	343.4	378.8	425.8

Ratios

RoE (%)	12.3	14.4	15.2
RoCE (%)	11.2	12.6	13.1
Payout (%)	25.0	23.2	23.0

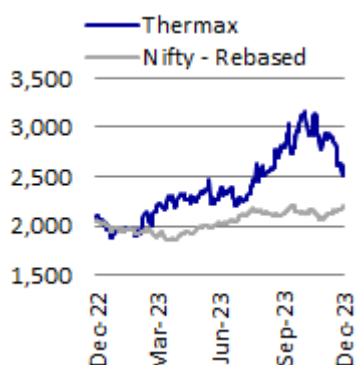
Valuations

P/E (x)	65.2	50.3	42.8
P/BV (x)	7.6	6.9	6.1
EV/EBITDA (x)	45.9	35.6	28.8
EV/Sales (x)	3.4	3.0	2.6

Shareholding pattern (%)

As On	Sep-23	Jun-23	Sep-22
Promoter	62.0	62.0	62.0
DII	15.5	15.5	15.3
FII	18.0	17.8	17.8
Others	4.5	4.7	4.8

FII Includes depository receipts

Stock's performance (one-year)**Play on private capex and green energy solutions****Long term play on private capex and energy transition**

Thermax is well prepared to be a partner for its customers in their energy transition journey. Over the years, it has reduced its dependence on traditional thermal power projects by increasing the share of green projects and is now building capabilities and expanding across biomass, waste to energy, solar and chemicals. It has signed technology tie ups for venturing into hydrogen energy projects and we also expect it to benefit with its product offerings for ultra-pure water needed for semiconductor manufacturing. In the near term, ordering activity is dominated mainly by base orders which has weakened yoy while large sized orders will get finalized in coming quarters. We expect margins to benefit from low raw material prices and easing supply chain issues. Over FY23-26, we expect Thermax to post a 14% CAGR in revenue on the back of a strong order book (INR103b; OB/Rev: 1.1x). We estimate a 21% CAGR in earnings, aided by revenue growth and margin improvement. We value Thermax at 38X two-year forward estimated earnings and add value from green solutions. We reinitiate coverage on Thermax with a Neutral rating and a TP of INR2,740 and would look for better entry points in the stock.

Opex and green solutions to drive growth

Thermax has been able to grow its base orders in healthy double digits over FY21-23. Sectors such as refinery & petrochemicals, food & beverages, metal/steel, sugar, distillery, power, and chemicals mainly contributed to the company's order book in FY23. Base orders of company have been moderating from last few quarters while large orders are expected to be finalized after 2-3 quarters due to delays in finalization from clients in both domestic and export markets. Thermax has built capabilities across waste-to-energy, solar, coal gasification, carbon capture, desalination, etc. to effectively offer energy transition solutions to customers. Its current order book of INR103b is dominated by green orders and it is also building its solar and bio-CNG portfolio.

Reorganization of business helps to target specific segments

In line with its strategic focus areas, Thermax has reclassified its business segments into new categories: Industrial Products, Industrial Infra, Chemical and Green Solutions. Through these segments, we expect company to (1) increase the scope of green energy, (2) grow products and services portfolio and (3) focus on internationalization for growth. We expect a CAGR of 15%/14% in order inflows/revenues over FY23-26. Low raw material prices, expected improvement in international subsidiaries and easing supply chain issues should help the company improve margins across segments.

Continuous investment in R&D and JVs for technology

Thermax has been continuously investing in R&D and entered into various technology-related tie-ups in waste-to-energy, agro-based hybrid multi-fuel combustion, new waste heat recovery applications, electric boilers, coal gasification, green hydrogen, energy storage, thin film solar and other renewable areas. Its key partnerships include Babcock & Wilcox (boilers), USA; Balcke-Duerr GMBH, Germany (dry electrostatic precipitators, regenerative air gas heaters and pulse jet bag filters); Lambion Energy Solutions, Germany (grate technologies); Marsulex Environment Technologies, USA (wet and semi-dry flue gas de-sulphurization technology); Power Roll (developing unique, low-cost and lightweight, flexible solar films); HZI Steinmüller (municipal solid waste fired waste to energy boilers); ExactSpace Technologies (AI solutions to decarbonize industrial plants and eliminate unplanned failures); and Everenviro Resource Management (to set-up bio-CNG turnkey projects). These partnerships have allowed the company to enter new areas related to energy transition.

Entering into hydrogen; set to benefit from semiconductor expansion

Thermax signed an MoU with Fortescue for a green hydrogen manufacturing facility. It also wants to foray into electrolyser manufacturing. The company will also keenly eye EPC and BoP opportunities in hydrogen projects or take up these projects on the BOT basis. Moreover, it is also looking for opportunities in the ultrapure water (UPW) space amid growing demand due largely to growth of the semiconductor industry. Thermax's products such as desalination plants, effluent treatment products and Tulsion UPW resins are ready for any opportunity in the semiconductor industry.

We expect 21% PAT CAGR over 3 years

We expect a CAGR of 14%/23%/21% in revenue/EBITDA/PAT over FY23-26. Growth will be driven by 1) 15% growth in order inflows, 2) a gradual recovery in EBIT margin of the industrial product/chemical divisions to 9.5%/18% by FY26, and 3) control over working capital and NWC at 6 days.

Valuation and view

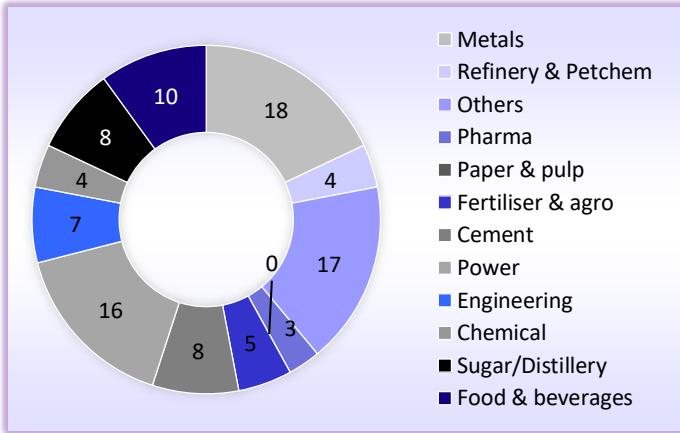
We value the company at 38X two year forward estimated earnings and add value of investments in green solutions at 1.5x P/BV and arrive at a TP of INR2,740. We reinstate coverage on Thermax with a Neutral rating as our TP already bakes in 15%/14% CAGR in order inflows and revenues and 200 bps margin improvement over FY23-26. Our valuation multiple is ahead of average P/E of last two years as it bakes in higher earnings CAGR of 21% over FY23-26.

Key risks

Slowdown in order inflows, sharp rise in commodity prices, slower-than-expected revival in private sector capex, increased competition are key risks to our estimates.

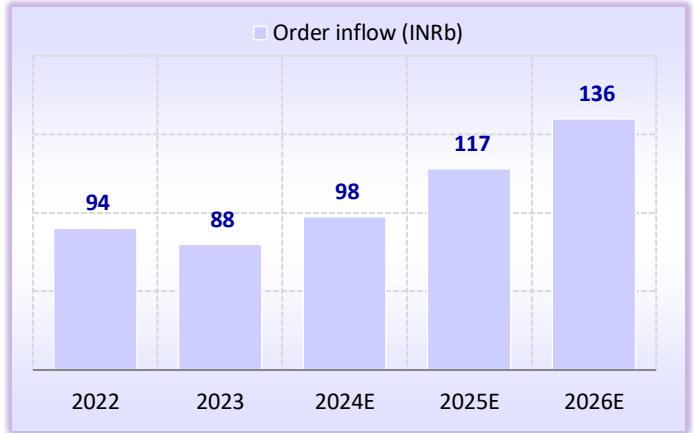
STORY IN CHARTS

Order inflow is diversified across segments for Thermax for 2QFY24 (%)



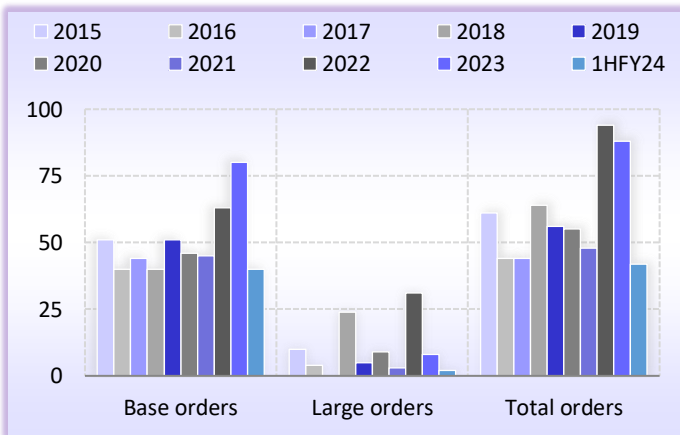
Source: Company, MOFSL

We expect order inflow to start growing from FY25. We bake in 15% CAGR in order inflows (INR b)



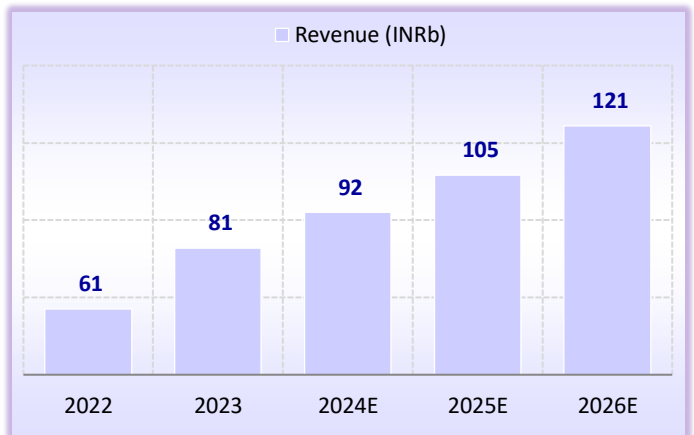
Source: Company, MOFSL

Large order inflows have weakened for Thermax over last few quarters (INR b)



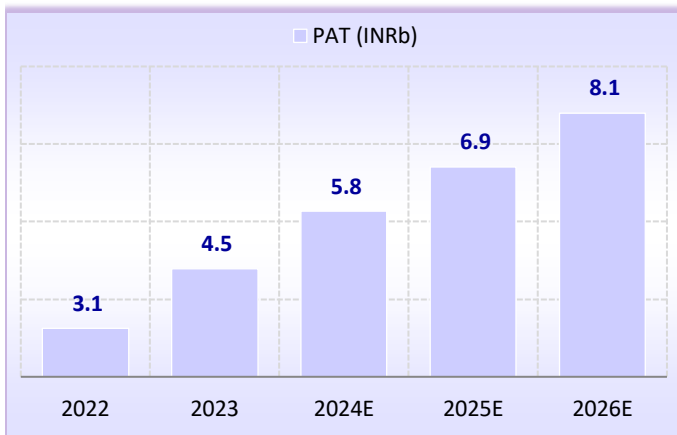
Source: Company, MOFSL

We expect revenue to grow at a CAGR of 14% over FY23-26 (INR b)



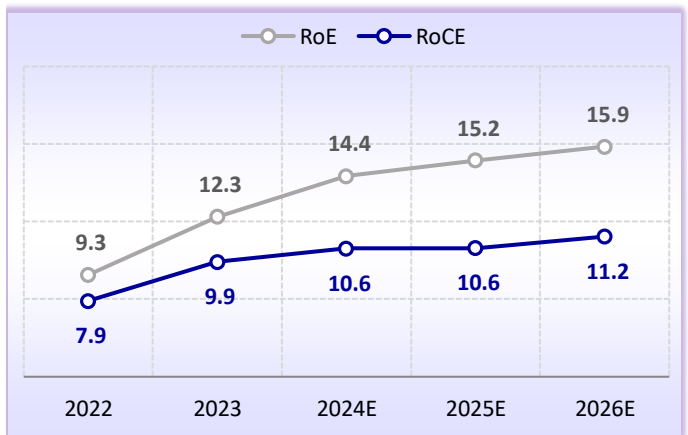
Source: Company, MOFSL

We expect PAT CAGR of 21% over FY23-26E (INR b)



Source: Company, MOFSL

Return ratios will start improving on better margins (%)

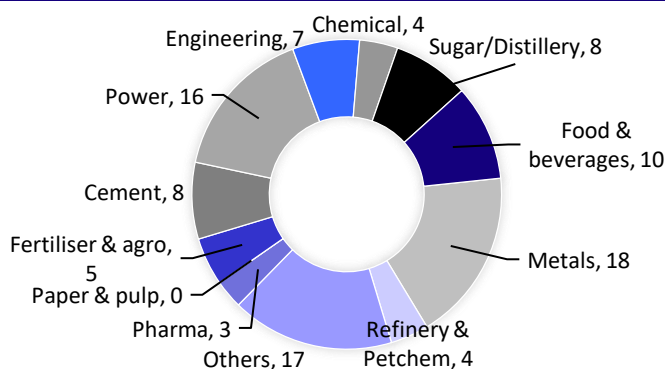


Source: Company, MOFSL

Select private capex and shift towards clean energy drove growth in base order inflows

Thermax has been able to grow its base orders in healthy double digits between FY21-23. Sectors such as refinery & petrochemicals, food & beverages, metal/steel, sugar/distillery, power and chemicals mainly contributed to Thermax's order book in FY23. This growth has moderated due to delays in finalization of projects in refinery while momentum has remained strong in waste to energy, bio fuel, cement and metals and mining. Our assessment indicates that expected spend on waste heat recovery plant, biomass, bio CNG, waste to energy, bio ethanol, ZLD etc is likely to result in a strong addressable market where Thermax can target to potentially win orders worth INR23-24b on yearly basis based on 2-15% market share across segments over and above the traditional base orders.

Exhibit 163: Order inflow breakup of INR19.7b as on Sep 2023



Source: Company, MOFSL

Exhibit 164: Opportunity potential from waste heat recovery, bio fuel, waste to energy, ZLD etc for Thermax - (INRb)

	Expected market opportunity	Yearly market	Thermax's yearly inflow potential	Comments
Waste heat recovery				
Cement (@7-8MW per MT)	INR140b over next 3 years	47	7.0	With cement capacity addition of 200MT over next 3 years, investment in WHR can be around INR140 b at INR100m per MW. We assume a high double digit market share for Thermax.
Steel (@10-15MW per MT)	INR36b over next 3 years	12	1.8	With steel capacity addition of 30MT over next 3 years, investment in WHR can be around INR36b at INR100m per MW. We assume a high double digit market share for Thermax.
Biomass	INR1.54t over next 8-10 years	154	3.1	The government plans to setup 5,000 CBG plants across India with an estimated capex potential of INR1.5t. We assume low single digit market share for Thermax as of now.
Bio cng	INR2t over next 7 years	286	2.9	According to MoPNG, India will see an investment of INR2t in setting up 5000 CBG plants in the country. Thermax currently has a low single digit market share in this and it plans to scale it up in future
Bio ethanol	INR140b over next 5 years	28	3.4	Oil Marketing Companies are in the process of setting up 12, 2G biorefineries with an investment of INR140b. We assume mid-teens market share of Thermax in this.
Zero Liquid discharge	INR216b over 7 years	31	4.6	India's wastewater treatment plants market stood at USD2.6b in 2020 and is projected to reach USD5.3b by 2027 owing to increasing demand for municipal water and sewage water treatment plants across the country. We assume mid-teens market share of Thermax in this.
Total			22.7	

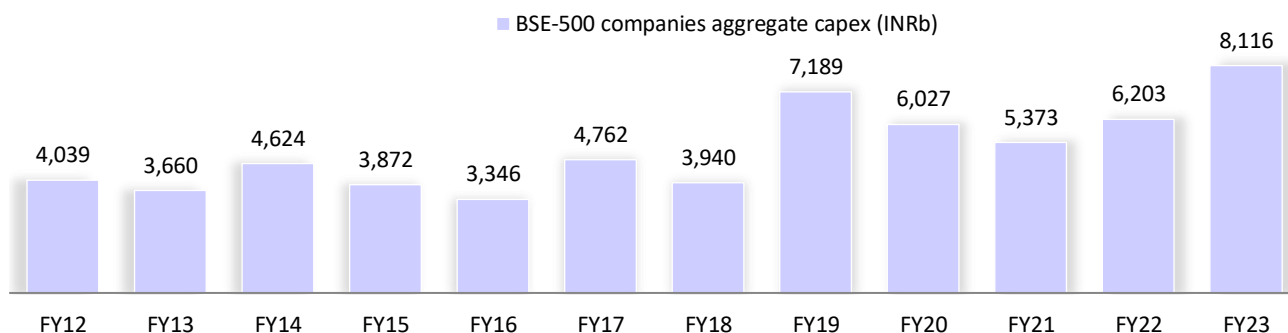
Source: MOFSL

...while large orders are yet to see a pick up

Our analysis of capex of BSE-500 companies indicates that private capex had declined from FY19-21 and grew at a CAGR of 23% between FY21-23. Thermax’s order inflow grew at a CAGR of 35% during the same FY21-23 period. Capex across key sectors in our coverage universe too remained flat from FY19-22 and grew by 27% in FY23. This is likely to move up further by 10% yoy in FY24, with relatively lesser growth expected in oil and gas and chemicals in FY24. This has impacted growth of large order inflows for Thermax in FY24. With large scale capex plans being announced by HPCL, Ultratech Cements, metal companies, we would gradually start witnessing large order inflow revival for Thermax too.

We expect that it will take another 2-3 quarters for the large order pipeline to get finalised. Large orders are also lacking from export geographies for Thermax which may remain weak in near term due to inventory de-stocking, lack of demand as well as geopolitical turmoil seen in key developed and developing markets.

Exhibit 165: Aggregate capex trend of BSE500 companies indicates uptick from FY22 onwards



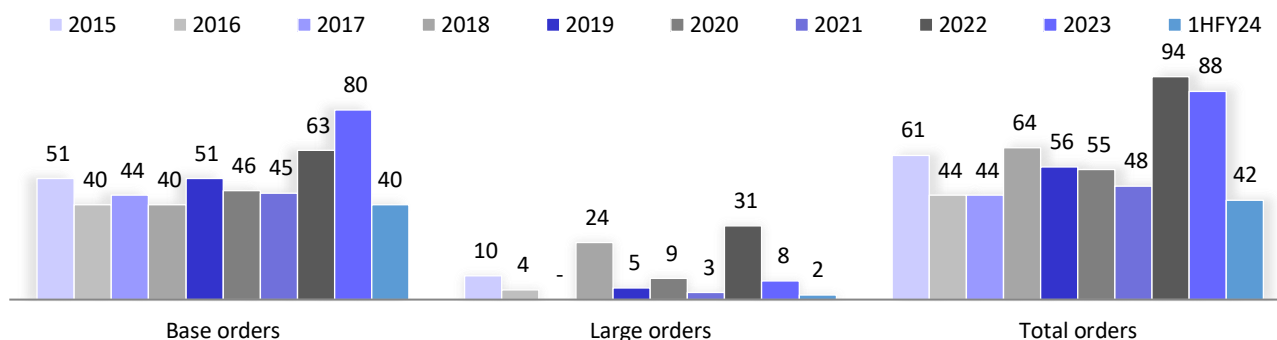
Source: Capitaline, MOFSL

Exhibit 166: Capex across key sectors has started improving - (INR b)

Capex across key sectors under coverage universe	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Automobile	573	533	368	378	449	600	624	699
Cement	106	130	104	188	247	274	251	281
Chemical	11	17	10	21	28	34	30	34
Metals and mining	530	563	493	620	839	998	919	1,030
Oil and Gas	1,625	1,660	1,717	1,671	2,058	2,196	1,743	1,952
Pharmaceuticals	200	98	151	182	261	202	145	162
FMCG	21	22	45	28	45	41	29	33
Total across these key sectors	3,067	3,022	2,888	3,088	3,927	4,344	3,741	4,190

Source: MOFSL

Exhibit 167: Base and large order trend (INR b)



Source: Company, MOFSL

Growth strategies of Thermax

Thermax is focusing more on bio-mass, chemicals and waste to energy related projects and is not keen in going back to thermal power projects. Thermax intends to grow via three strategies: 1) increasing the scope of green energy, 2) growing products and services portfolio, and 3) focus on internationalization.

Exhibit 168: Key focus areas where the company wants to grow

Increase the share of green offerings	Grow products and services portfolio	Internationalisation
❖ Build-own-operate (BOO) model for utility delivery services	❖ Industrial products (heating, cooling, water and waste solutions and air pollution control)	❖ Grow market share in International business
❖ New renewable energy solutions	❖ Chemical portfolio	❖ Increase Exports
❖ Waste to energy solutions	❖ Services	
❖ Water recycling and zero liquid discharge (ZLD)	❖ Digital solutions	
❖ Solutions for particulate and gaseous emissions		
❖ Gasification (coal/biomass to chemical)		
❖ Green hydrogen		

Source: Company, MOFSL

Exhibit 169: New product launches

Business Segments	Launch of Products Supporting the Strategy	Key Highlights
Industrial Products	Process Heating	Process Heating
	❖ Thermotron™, an innovative electric boiler that helps meet sustainability goals by accelerating industrial decarbonisation. Steam can be generated from electricity in this compact unit for industrial processes, resulting in 99% efficiency.	❖ Thermotron™ is generating a buzz across a wide range of industries, including breweries, food processing, pharmaceuticals, FMCG conglomerates, petrochemicals, dairy, edible oil, and hotels & hospitality. These industries are intrigued by the electric process heating technology, which simplifies operations and promotes sustainability in industry
	❖ Aquanexa E Series, an advanced heat pump that caters to the hot water needs of various commercial segments	❖ Aquanexa is rapidly gaining popularity among hotels, hospitals, hostels, and commercial spaces. This is primarily attributed to its seamless installation process and the fact that its hot water generator produces zero local emissions, makes it an environmentally-friendly choice
	Absorption Cooling and Heating	Absorption Cooling and Heating
	❖ Xtra Performance Series of VAM	❖ Xtra Performance Series of VAM is relatively more productive by 15% to 18% and reduces LiBr consumption by 14%
	❖ Developed a multi-effect low steam pressure chiller to cater to low-pressure steam, which can be extracted across a range of processes and used for chilling needs	❖ Recorded 17% growth in value-added spares business
	Water and Waste Solutions	Water and Waste Solutions
	❖ A new modularised UF system E-Flow (Application: pre-treatment to RO or post-treatment to STP)	❖ Received an order for four units, which are currently under assembly
Industrial Infra	Projects and Energy Solutions	Projects and Energy Solutions
	❖ Entered into a technology partnership with Covacsis	❖ Partnered with Covacsis, engaged in providing products and solutions to Industrial IoT, Industry 4.0, smart manufacturing and digital manufacturing space
	Boiler & Heater (TBWES)	Boiler & Heater (TBWES)
	❖ Flexisource™, a solution that can combust several types of waste fuels, providing higher fuel flexibility to customers	❖ Booked several orders in FY 2022-23 ranging from steam generation of 20 TPH to 70 TPH at high-pressure temperature cycles
Green Solutions	Build-Own-Operate Solutions (TOESL)	Build-Own-Operate Solutions (TOESL)
	❖ Portfolio diversification and backward integration	❖ Focussed on bio-CNG and water & wastewater treatment solutions under the build-own-operate model

Source: Company, MOFSL

Exhibit 170: Focus on internationalization – key orders received from international markets across business segments

Business Segments	Key Highlights
Industrial Products	Process Heating
	❖ A 12 TPH oil & gas fired boiler was supplied for an FMCG giant in Bangladesh
	❖ Order for 4 nos. oil & gas fired 25 TPH steam boilers from an oil & gas major in the Middle East
	❖ Order for biomass-fired 34 TPH & 10 TPH steam boilers, and 8 Mn kCal/hr for edible oil major in Indonesia
	❖ Order for a 22 TPH biomass-fired steam boiler for a food major for their plant in Sri Lanka
	❖ Order for 25 TPH biomass-fired steam boiler for edible oil major in Nigeria
	Absorption Cooling and Heating
	❖ Received major orders from the hospitality sectors in Puerto Rico and Caribbean nations; these are expected to grow the absorption chiller business
	❖ Received an order for eight multi-energy chillers, which is expected to be commissioned in Q3FY24
	❖ Increased focus on new markets such as Korea, Taiwan and select African nations
	Air Pollution Control
	❖ Facilitated strategic penetration in the cement market in Thailand
	❖ Received a maiden order for a submerged arc furnace in Oman
	❖ Received an FGD order from a French process engineering company for a leading oil refinery in Kuwait
❖ Established a strong presence in APC business, with several references in South East Asia, given its expertise in project execution and increased enforcement of air pollution norms	
❖ Received orders from new markets in Turkey, Germany, Greece, Brazil and the United States	
Water and Waste Solutions	
❖ Received a maiden EPC order in East Africa for the largest edible oil refinery	
❖ Received an order for the first pharma-grade plant in South East Asia for a Philippines-based pharmaceutical company, with pre-treatment and three units of RO-CDI	
Industrial Infra	Projects and Energy Solutions
	❖ The contracted base of the EPC power plant reached 3,560 MW, of which 443 MW are overseas
	❖ Received an order for plant performance evaluation from a Thailand-based customer
Green Solutions	Build-Own-Operate Solutions (TOESL)
	❖ Ensured targeted efforts in select SEA and African countries to offer utilities under the build-own operate model
Chemicals	❖ Partnered with ChemPoint to expand Thermax's ion exchange resin business in North America

Source: Company, MOFSL

Reclassification of business in line with growth plans

In line with its key strategic areas, Thermax has reclassified its business segments to new categories: Industrial Products, Industrial Infra, Green Solutions and Chemical. Both industrial products and industrial Infra are predominantly green, while the Green Solutions business provides 100% sustainable offerings on ownership basis. Orders received during FY23 will provide growth drivers for individual segments.

Exhibit 171: Key Business Updates Supporting the Strategy

Business Segments	Major Orders Received in FY 2022-23	
Industrial Products	Process Heating	
	❖ First-of-its-kind biomass fired energy plant with 36 MW capacity, with 100% flue gas recirculation for a new particle board plant, and flexibility to operate in nine load combinations	
	❖ Large capacity biomass-fired reciprocating grate thermal oil heater (8 Mn kCal/hr) for a major polyester film manufacturer	
	❖ Rice straw briquette-fired boiler (25 TPH) for an FMCG major	
	❖ Coffee waste-fired boiler (45 TPH) for a coffee manufacturer	
	Absorption Cooling and Heating	
	❖ 4 x 1000 TR hot water absorption chillers commissioned for a synthetic textile manufacturer in western India, to be utilised for process air cooling. The hot water extracted from the continuous polymerisation process resulted in ~2 MW power saving for the customer	
	Air Pollution Control	
	❖ Received highest-ever order for ESP upgradation	
	❖ Received largest cement APC package (integrated plant - 4 nos., grinding units - 7 nos., total 31 equipment)	
Industrial Products	Water and Waste Solutions	
	❖ Offered complete water reuse and zero liquid discharge (ZLD) project to an F&B company with 50 KLD MEE, and a textile major with 113 KLD MEE, to help them meet their ESG goals	
	❖ Commissioned the first pre-fabricated MEE as part of the ETP-ZLD solutions for the F&B industry	
	❖ Initiated first ETP augmentation in leading petrochemicals, followed by recycling for an oil & gas major	
	❖ Revamped and enhanced the capacity of seawater reverse osmosis plant (SWRO) at a chemical giant, and installation of energy recovery device (ERD) achieving 60% power savings	
	Industrial Infra	Projects and Energy Solutions
		❖ Received multiple orders for cogeneration plants from the distillery segment
		❖ Received a major order for the mechanical balance of plant works for a gas-based power plant from an Indian conglomerate
	Green Solutions	Renewable Energy Solutions (First Energy Private Limited)
Build-Own-Operate Solutions (TOESL)		
❖ Successfully executed a large 33 TPH biomass cogeneration plant for an aluminium major in Karnataka		
❖ Commissioned biomass boiler plants for steam supply to a pharmaceutical major, a zero liquid discharge plant for a steel major and two solar PV plants for power supply to two chemical companies		
	❖ Developed a biomass fuel supply chain with a total capacity of 1,870 tonnes per day (TPD), of which 870 TPD was supplied to plant sites. The total fuel supplied was over 290k tonnes.	

Source: Company, MOFSL

Green solutions business will require investments and may be return dilutive in initial years

Thermax has created two entities, Thermax Onsite Energy Services Limited (TOESL) and First Energy Private Limited (FEPL). It is carrying out projects in these entities under the build-own-operate model. TOESL and FEPL together would require additional investments of INR5-6b as equity and INR15-20b as project-level debt to expand their project portfolio and scope of offerings over the next 12-18 months. Beyond these investments and the said time frame, the company would seek to bring in external partners for these projects.

TOESL

It carries out projects in biomass gasification and bio-CNG solutions under the build-own-operate model for a concession period of 10 years and is looking to expand the revenue run rate from the current INR1.5b to INR5-5.5b over the next few years. It has now ventured into international geographies such as Indonesia and Sri Lanka. TOESL is in process of commissioning a pilot plant in collaboration with EverEnviro Resource Management Pvt. Ltd, and two other customer projects in northern India are under execution.

TOESL helps to facilitate circularity and reduce carbon footprint for its clients and uses all major field stocks, like rice straw, press mud and organic municipal waste to generate biogas. TOESL's profitability came down significantly in the last two years due to additional costs and higher prices of RM such as bio mass, which has grown 3x in the two years. ROCE was also impacted by fall in profitability and an increase in capital WIP. The company targets IRR of 20% from the projects in TOESL.

Exhibit 172: TOESL key financials

INR m	FY21	FY22	FY23
Revenue	1,274	2,180	3,482
Expenditure	1,040	1,974	3,213
EBITDA	235	206	269
EBITDA %	18.4	9.4	7.7
Depreciation	4.9	4.5	7.2
EBIT	230	201	262
Interest	18	22	52
PBT	212	179	210
Tax	40	48	50
Tax%	18.9	26.9	23.8
PAT	172	131	160
Share capital	423	723	723
Reserves	531	663	819
Networth	954	1,386	1,542
Debt	117	578	909
Total liabilities	1,071	1,964	2,451
Net block	17	68	68
Cash and inv in subsidiary	327	328	341
Net WC and other assets	727	1,568	2,043
Total assets	1,071	1,964	2,451
RoE	18.0	9.5	10.4
RoCE	17.4	7.5	8.1

Source: Company, MOFSL

FEPL

First Energy focuses on supporting the energy transition journey of its commercial and industrial customers by helping them move from the present fossil-based power generation to renewable-based power generation. FEPL aims to offer bespoke solutions, moving up the value chain from providing traditional solar mounted solutions to hybrid solutions that can deliver uninterrupted clean power on a daily basis as per the customer's requirements. FEPL's portfolio of projects differs from TOESL's due to the longer concession period of 25 years and would require higher investments compared to TOESL.

It has concluded captive renewable power projects of 180 MW for some major industrial consumers in Maharashtra, Gujarat and Tamil Nadu, and has also set up a wind-solar hybrid project for captive users. FEPL is also exploring the possibility of connecting large power projects with the central transmission utility (CTU). The company's focus is on B2B industrial customers and it plans to set up 1,000 MW of captive solar for C&I customers over five years.

Exhibit 173: FEPL consolidated financials

INR m	FY21	FY22	FY23
Revenue	28	266	193
Expenditure	17	252	347
EBITDA	10	13	-154
EBITDA %	36.6	5.0	-79.5
Depreciation	15	2	16
EBIT	-5	11	-170
Interest	17	1	35
PBT	-21	10	-205
Tax		-	4
Tax%	-	-	2.1
PAT	-21	10	-209
Share capital	135	395	1,534
Reserves	-340	-67	-336
Networth	-205	327	1,198
Debt	195	41	5,994
Total liabilities	-10	368	7,193
Net block	2	338	5,018
Cash	108	393	1,234
Net WC and other assets	-120	-362	940
Total assets	-10	368	7,193
RoE	10.4	3.0	-17.4
RoCE	48.2	2.9	-2.3

Source: Company, MOFSL

Working on several technologies including Hydrogen

MOU with Fortescue Future Industries (FFI) for green hydrogen manufacturing facility

- Thermax signed an MoU with FFI for a green hydrogen manufacturing facility and it also wants to get into electrolyser manufacturing. The company will also keenly eye EPC and BoP opportunities in hydrogen projects or take up these projects on BOT basis. However, since the ecosystem for hydrogen energy is not yet fully developed in the country, it will take time for these developments to reach fruition. In the meantime, the company is preparing itself with the right technology.

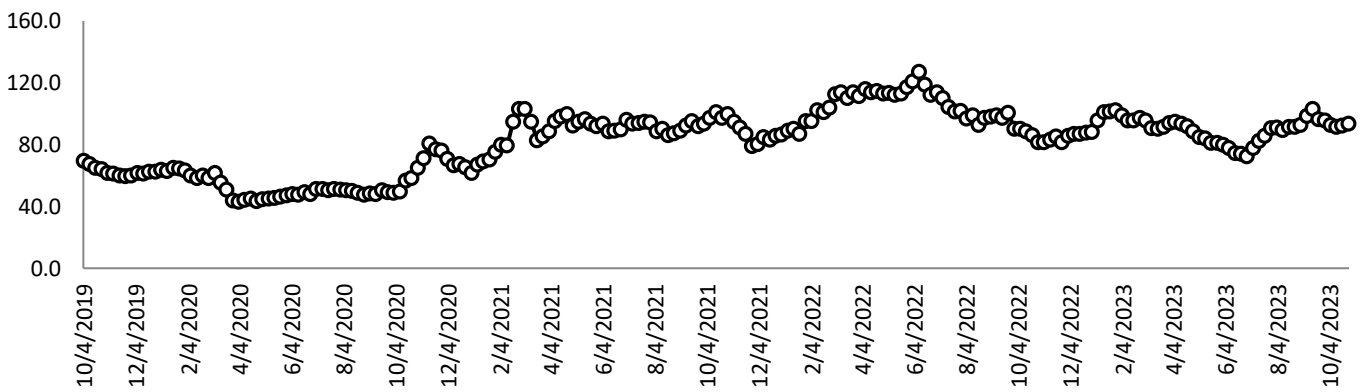
Technology-related tie-ups in other industries

- It has also continuously invested in technologies via R&D and JVs such as waste-to-energy, agro-based hybrid multi fuel combustion, new waste heat recovery applications, electric boilers, coal gasification, green hydrogen, energy storage, thin film solar and other renewable areas. Its key partnerships over years include Babcock & Wilcox, USA (boilers), Balcke-Duerr GMBH, Germany (dry electrostatic precipitators, regenerative air gas heaters and pulse jet bag filters), Lambion Energy Solutions, Germany (grate technologies) and Marsulex Environment Technologies, USA (wet and semi-dry flue gas de-sulphurization technology), Power Roll (developing unique, low-cost and lightweight, flexible solar films), HZI Steinmüller (municipal solid waste fired waste to energy boilers), ExactSpace Technologies (AI solutions to decarbonize industrial plants and eliminate unplanned failures) and Everenviro Resource Management (to set-up bio-CNG turnkey projects). These partnerships have allowed the company to enter new areas related to energy transition.

Chemical segment to benefit from improved supply-chain dynamics and lower RM costs

Thermax is recognized as Asia’s leading manufacturer and exporter of ion exchange resins and is a pioneer in water and wastewater treatment chemicals. It also manufactures construction and oil-field chemicals. With these specialty chemicals and its strong dealer network, it serves a number of industrial sectors and customers globally.

Exhibit 174: Styrene price have come off from the peak seen in June, 2022 (INR/kg)



Source: Company

Margins have scope of improvement in energy and chemicals segments in near term

- **Industrial products.** The industrial products division clocked margins of 6.4% in FY23. Margins in this segment were impacted by higher prices of commodities, such as lithium bromide which is used in absorption chillers. International subsidiaries have been a drag on the overall performance, but their profitability has now started improving. The company expects to improve margins in most of the key sub-segments such as cooling, heating, water and enviro, steam and international subsidiaries.
- **Industrial infra.** Margins in the industrial infra segment could see volatility owing to the pending execution of FGD projects worth INR6b/INR8b expected in FY24/FY25. These projects, along with other government projects, have seen delays and cost overruns. On these projects, company has already taken a hit on account of higher costs and under recovery of revenues. However, with improvement expected in revenues from these FGD projects, margins will get an operating leverage benefit.
- **Green solutions.** Higher raw material prices have affected margins of TOESL and FEPL for the near term, but these costs are passed through over the contract tenure.
- **Chemical.** Chemical segment margins have remained volatile over FY20-23 and ranged from highs of 30% to lows of 3% due to a sharp increase in styrene and ethylene dichloride as well as higher freight costs. Supply chain disruptions due to the Russia-Ukraine conflict resulted in higher freight costs, which the company could not pass on due to the fixed-price nature of contracts. Thermax has now renegotiated some contracts amid commodity price fluctuations and removed freight as a part of the mix. Additionally, lower RM prices will also aid margins for this segment going forward.
- **Higher proportion of services.** The services segment currently contributes to nearly 15-30% of overall business for Thermax and has more than 10% PAT margin. The company aims to increase the share of services in total revenue to boost margins.

Improving performance of subsidiaries

Performance of the company's international subsidiaries has been a drag on its overall profitability for the last few years due to a weak performance of Danstoker and PT Indonesia. The company has started witnessing an increase in order enquiries for both subsidiaries, particularly for green orders from European and South East Asian markets. Losses from these subsidiaries came down in FY23.

Exhibit 175: Losses from key subsidiaries have started coming down

INR m	2016	2017	2018	2019	2020	2021	2022	2023
Danstoker	32	79	-152	-295	-97	-89	71	-8
Boilerworks	1	-26	1	-192	-108	1,465	-11	-2
Indonesia	-58	-76	-125	-2	-54	-144	-113	-102
First Energy	NA	-50	-81	-54	-105	-21	10	-155
TOESL	35	117	139	159	142	151	131	160

Source: Company, MOFSL

Financial outlook

We expect a CAGR of 14%/23%/21% in revenue/EBITDA/PAT over FY2023-26. Growth will be driven by 1) 15% growth in order inflows over the same period, 2) a gradual recovery EBIT margin of the industrial product/chemical divisions to 9.5%/18% by FY26, and 3) control over working capital and NWC at 6 days.

Exhibit 176: We expect revenue CAGR of 14% over FY23-26E driven by order inflow CAGR of 15% over the same period

	2022	2023	2024E	2025E	2026E
Industry Products					
Revenue	25,757	33,375	41,506	49,467	58,026
Growth (%)		29.6	24.4	19.2	17.3
Order inflow	28,910	41,720	46,726	55,137	65,062
Growth (%)	(22.4)	44.3	12.0	18.0	18.0
Order backlog	20,014	28,420	35,324	42,677	51,397
Growth (%)	(46.2)	42.0	24.3	20.8	20.4
EBIT	1,815	2,739	3,736	4,699	5,512
EBIT Margin (%)	7.0	8.2	9.0	9.5	9.5
Industrial Infra					
Revenue	29,879	39,280	41,917	44,280	49,017
Growth (%)		31.5	6.7	5.6	10.7
Order inflow	58,220	37,790	39,691	46,824	52,924
Growth (%)	816.9	(35.1)	10.0	14.0	14.0
Order backlog	63,717	63,080	60,854	63,398	67,306
Growth (%)	345.3	(1.0)	(3.5)	4.2	6.2
EBIT	1,310	2,168	2,313	2,665	2,950
EBIT Margin (%)	4.4	5.5	5.5	6.0	6.0
Green Solutions					
Revenue	2,168	3,627	4,472	5,170	5,570
Growth (%)		67.3	20.0	20.0	20.0
Order inflow	1,270	1,950	3,900	5,070	6,338
Growth (%)		53.5	100.0	30.0	25.0
Order backlog	2,970	4,930	4,358	4,258	5,026
Growth (%)		66.0	(11.6)	(2.3)	18.0
EBIT	161	150	340	414	446
EBIT Margin (%)	7.4	4.1	7.6	8.0	8.0
Chemical segment					
Revenue	5,385	6,728	8,052	9,296	11,366
Growth (%)	25.4	24.9	20.0	20.0	20.0
Order inflow	5,690	6,430	8,038	9,645	11,574
Growth (%)	33.9	13.0	25.0	20.0	20.0
Order backlog	1,282	1,090	1,076	1,425	1,633
Growth (%)	62.3	(15.0)	(1.3)	32.4	14.6
EBIT	624	865	1,449	1,673	2,046
EBIT Margin (%)	11.6	12.8	18.0	18.0	18.0
Intersegmental					
Revenue	-1,906	-2,113	-2,470	-2,782	-3,197
Sum of Segments					
Revenues	61,283	80,898	93,477	105,431	120,782
Growth (%)	27.9	32.0	15.5	12.8	14.6
EBIT	4,353	6,227	8,481	10,132	11,919
Margin (%)	7.1	7.7	9.1	9.6	9.9
Growth (%)	25.0	43.1	36.2	19.5	17.6
Order inflow	94,090	87,890	98,355	116,676	135,898
Growth (%)	96.7	(6.6)	11.9	18.6	16.5

Source: Company, MOFSL

Exhibit 177: Order inflow is diversified across segments for Thermax for 2QFY24 (%)

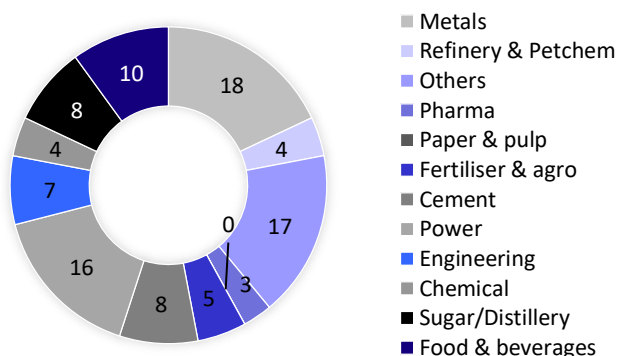


Exhibit 178: We expect order inflow to start growing from FY25 (INR b)

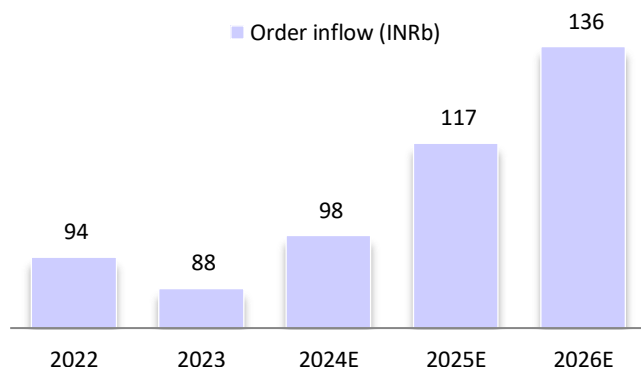


Exhibit 179: Revenue to grow at CAGR of 14% over FY23-26 (INR b)

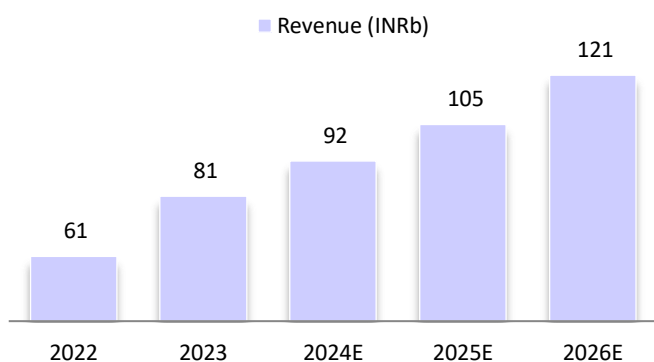


Exhibit 180: EBITDA margin to improve on better gross margins

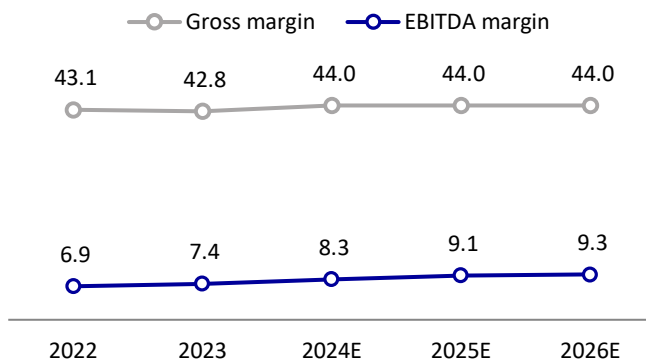


Exhibit 181: We expect PAT CAGR of 21% over FY23-26

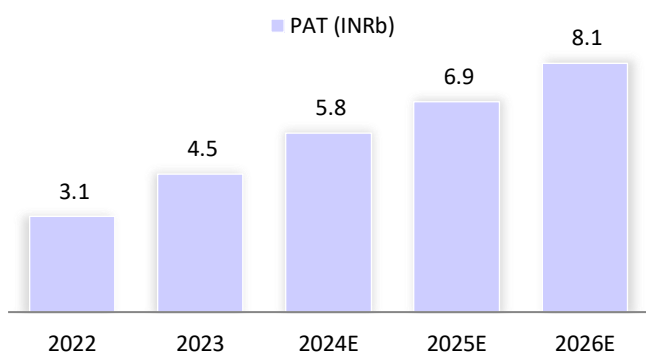


Exhibit 182: NWC days to remain comfortable

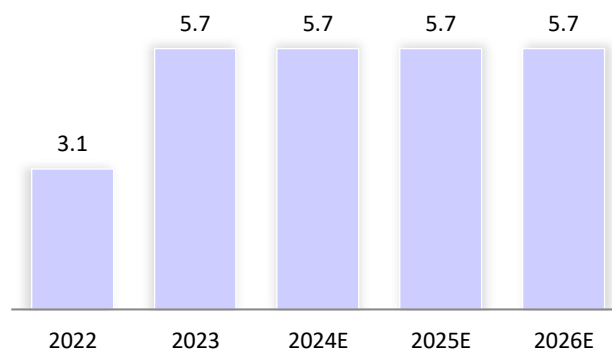


Exhibit 183: FCF to start improving from FY25 (INR b)

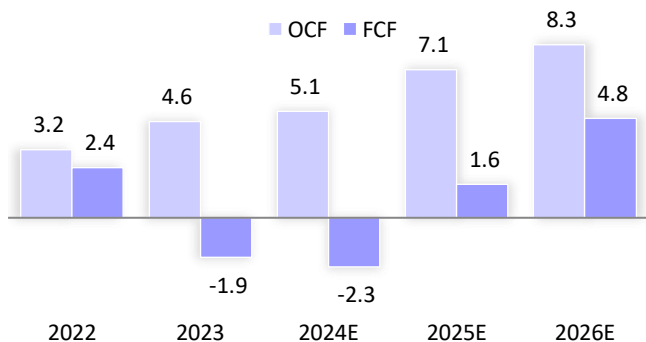
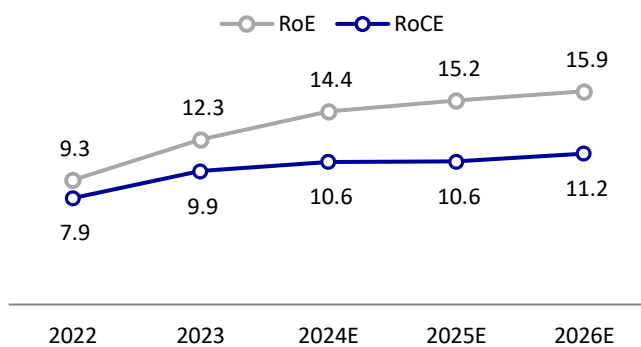


Exhibit 184: Return ratios



Source: Company, MOFSL

Source: Company, MOFSL

SWOT analysis

- ❖ Company has presence which extends to over 90 countries
- ❖ Thermax provides exhaustive product mix options to its customers
- ❖ Thermax's Rapid technological innovations boost industrial productivity and expand product and service offerings.

S
STRENGTH



- ❖ Moderation in large order pipeline
- ❖ Pivot towards green business contingent upon favourable regulatory environment

W
WEAKNESS



- ❖ Growth in industries like food, pharma, chemicals, cement, and steel, given the encouraging policies and macro-economic factor
- ❖ Clean energy focus is shifting energy mix, driving greenfield projects and brownfield replacements.
- ❖ Government is pushing local manufacturing under the 'Make in India'

O
OPPORTUNITY



- ❖ Reduced product launch cycles in Capital Goods increase competitive pressure on Thermax.
- ❖ Thermax dependency on single source vendors for critical products
- ❖ Impact of commodity price increase

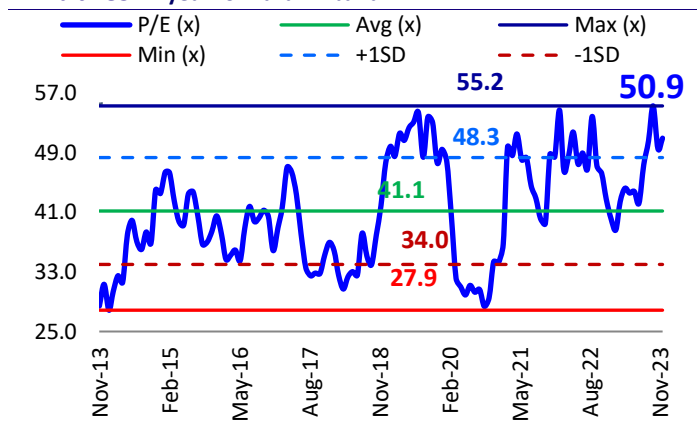
T
THREATS



Valuation and recommendation

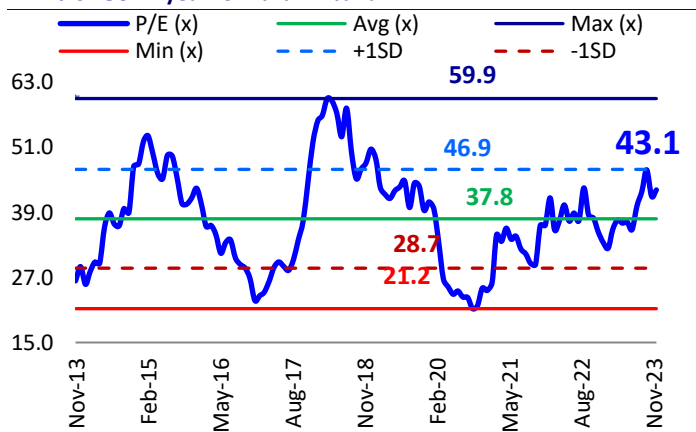
We value the company at 38X two year forward estimated earnings and add value of investments in green solutions at 1.5X P/BV and arrive at a TP of INR2,740. We reinitiate coverage on Thermax with a Neutral rating as our TP already bakes in 15%/14% CAGR in order inflows and revenues and 200 bps margin improvement over FY23-26. Our valuation multiple is ahead of last two year average P/E multiple as it bakes in higher earnings CAGR of 21% over FY23-26.

Exhibit 185: 1-year forward PE band



Source: Bloomberg, MOFSL

Exhibit 186: 2-year forward PE band



Source: Bloomberg, MOFSL

Exhibit 187: Sensitivity analysis - Bear/Base/Bull case

	Bear case	Base case	Bull case
Core business EPS (INR)	62	69	76
Valuation multiple (x)	34	38	42
BVPS of Green Solutions	71	107	178
Target Price (INR/share)	2,182	2,740	3,365

Source: MOFSL

Key risks and concerns

Slowdown in order inflows, sharp rise in commodity prices, slower than expected revival in private sector capex, increased competition are among the risks to our estimates.

Management profile



Ashish Bhandari
Managing Director and CEO



Amit Sethi
Executive Vice President
and Chief Digital and
Information Officer



B.C. Mahesh
Executive Vice President
and BU Head - Industrial
Products



Dinesh Mandhana
Executive Vice President
and BU Head - Chemical



Hemant Mohgaonkar
Executive Vice President
and BU Head - New Energy



Jasmeet Bhatia
Executive Vice President
and Chief Human
Resources Officer



Kirtiraj Jilkar
Executive Vice President
and BU Head - Projects &
Energy Solutions



Dr. Mahesh Murthy
Executive Vice President
and Chief Technology
Officer



Pravin Karve
President - TBWES and P&ES



Rajendran Arunachalam
Executive Vice President
and Group Chief Financial
Officer



Shokhar Kashalikar
Executive Vice President
and Chief Executive Officer
- TBWES

Note: The profiles of the Executive Council have been placed in an alphabetical order.

Financials and valuation

Consolidated - Income Statement

(INR Million)

Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Total Income from Operations	57,313	47,913	61,283	80,898	93,477	1,05,431	1,20,782
Change (%)	-4.0	-16.4	27.9	32.0	15.5	12.8	14.6
Raw Materials	30,857	25,386	34,850	46,247	52,316	59,006	67,598
Gross Profit	26,456	22,526	26,433	34,651	41,161	46,425	53,184
Employee Cost	7,990	7,588	8,129	9,542	11,288	12,225	14,079
Other Expenses	14,404	11,387	14,090	19,134	22,109	24,620	27,843
Total Expenditure	53,251	44,361	57,070	74,923	85,713	95,851	1,09,519
% of Sales	92.9	92.6	93.1	92.6	91.7	90.9	90.7
EBITDA	4,062	3,552	4,214	5,976	7,764	9,580	11,263
Margin (%)	7.1	7.4	6.9	7.4	8.3	9.1	9.3
Depreciation	1,166	1,146	1,132	1,169	1,221	1,424	1,604
EBIT	2,896	2,406	3,081	4,807	6,543	8,156	9,659
Int. and Finance Charges	150	206	252	376	672	945	1,058
Other Income	1,000	1,077	1,270	1,602	1,938	1,976	2,260
PBT bef. EO Exp.	3,745	3,277	4,100	6,033	7,808	9,187	10,861
EO Items							
PBT after EO Exp.	3,745	3,277	4,100	6,033	7,808	9,187	10,861
Total Tax	1,621	686	978	1,524	1,972	2,320	2,743
Tax Rate (%)	43.3	20.9	23.9	25.3	25.3	25.3	25.3
Preference Dividend	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Minority Interest	0	0	0	0	0	0	0
Reported PAT	2,125	2,591	3,122	4,509	5,836	6,867	8,118
Adjusted PAT	2,125	2,591	3,122	4,509	5,836	6,867	8,118
Change (%)	-48.8	22.0	20.5	44.4	29.4	17.7	18.2
Margin (%)	3.7	5.4	5.1	5.6	6.2	6.5	6.7

Consolidated - Balance Sheet

(INR Million)

Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Equity Share Capital	225	225	225	225	225	225	225
Total Reserves	30,054	32,289	34,700	38,446	42,424	47,715	54,143
Net Worth	30,279	32,514	34,925	38,671	42,649	47,940	54,369
Minority Interest	0	0	0	22	0	0	0
Total Loans	2,115	3,051	3,554	8,105	11,105	14,105	14,105
Deferred Tax Liabilities	-1,504	-1,540	-1,271	-1,057	-1,057	-1,057	-1,057
Capital Employed	30,891	34,024	37,208	45,741	52,698	60,988	67,417
Gross Block	19,779	20,168	20,442	22,145	29,145	34,145	37,145
Less: Accum. Deprn.	7,073	7,777	8,525	9,694	10,915	12,339	13,943
Net Fixed Assets	12,706	12,390	11,917	12,451	18,230	21,806	23,202
Goodwill on Consolidation							
Capital WIP	553	242	474	4,338	4,771	5,249	5,773
Total Investments	9,105	2,375	14,765	16,370	16,370	16,370	16,370
Curr. Assets, Loans&Adv.	35,864	48,452	46,153	54,141	61,347	71,725	84,120
Inventory	4,546	4,047	7,270	7,556	8,731	9,848	11,282
Account Receivables	14,785	13,380	15,972	18,766	21,683	24,456	28,017
Cash and Bank Balance	4,761	19,392	9,535	11,316	11,863	15,914	20,181
Loans and Advances	923	943	1,087	1,476	1,705	1,923	2,204
Other Current Assets	10,849	10,690	12,288	15,027	17,364	19,584	22,436
Curr. Liability & Prov.	27,336	29,434	36,101	41,559	48,021	54,162	62,049
Account Payables							
Other Current Liabilities	25,433	27,224	33,709	39,128	45,212	50,994	58,419
Provisions	1,903	2,210	2,392	2,431	2,809	3,168	3,630
Net Current Assets	8,528	19,018	10,051	12,581	13,326	17,563	22,071
Misc Expenditure	0	0	0	0	0	0	0
Appl. of Funds	30,891	34,024	37,208	45,741	52,698	60,988	67,417

Financials and valuation

Ratios

Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Basic (INR)							
EPS	18.9	23.0	27.7	40.0	51.8	61.0	72.1
Cash EPS	29.2	33.2	37.8	50.4	62.7	73.6	86.3
BV/Share	268.9	288.8	310.2	343.4	378.8	425.8	482.8
DPS	7.0	7.0	9.0	10.0	12.0	14.0	15.0
Payout (%)	44.7	36.6	32.5	25.0	23.2	23.0	20.8
Valuation (x)							
P/E	138.3	113.4	94.1	65.2	50.3	42.8	36.2
Cash P/E	89.3	78.6	69.1	51.8	41.6	35.4	30.2
P/BV	9.7	9.0	8.4	7.6	6.9	6.1	5.4
EV/Sales	5.1	5.8	4.7	3.6	3.1	2.8	2.4
EV/EBITDA	71.7	78.1	68.3	48.6	37.8	30.5	25.6
Dividend Yield (%)	0.3	0.3	0.3	0.4	0.5	0.5	0.6
FCF per share	24.7	60.9	21.4	-16.9	-20.8	14.2	42.2
Return Ratios (%)							
RoE	7.0	8.3	9.3	12.3	14.4	15.2	15.9
RoCE	6.8	8.1	9.0	11.2	12.6	13.1	13.7
RoIC	9.6	13.4	19.2	27.5	29.3	28.3	29.7
Working Capital Ratios							
Fixed Asset Turnover (x)	2.9	2.4	3.0	3.7	3.2	3.1	3.3
Asset Turnover (x)	1.9	1.4	1.6	1.8	1.8	1.7	1.8
Inventory (Days)	29	31	43	34	34	34	34
Debtor (Days)	94	102	95	85	85	85	85
Creditor (Days)	162	207	201	177	177	177	177
Leverage Ratio (x)							
Current Ratio	1.3	1.6	1.3	1.3	1.3	1.3	1.4
Interest Cover Ratio	19.3	11.7	12.2	12.8	9.7	8.6	9.1
Net Debt/Equity	-0.4	-0.6	-0.6	-0.5	-0.4	-0.4	-0.4

Consolidated - Cash flow Statement

(INR Million)

Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
OP/(Loss) before Tax	3,745	2,752	4,101	6,033	7,808	9,187	10,861
Depreciation	1,166	1,146	1,132	1,169	1,221	1,424	1,604
Interest & Finance Charges	86	118	135	260	672	945	1,058
Direct Taxes Paid	-1,313	-938	-1,030	-1,512	-1,972	-2,320	-2,743
(Inc)/Dec in WC	218	4,734	-5	-628	-197	-187	-240
CF from Operations	3,903	7,811	4,333	5,321	7,533	9,049	10,540
Others	-648	-117	-1,084	-726	-2,444	-1,976	-2,260
CF from Operating incl EO	3,256	7,695	3,248	4,596	5,089	7,073	8,280
(Inc)/Dec in FA	-480	-834	-838	-6,499	-7,434	-5,477	-3,525
Free Cash Flow	2,776	6,861	2,411	-1,904	-2,345	1,596	4,755
(Pur)/Sale of Investments	-1,443	-5,789	-4,263	-993	0	0	0
Others	238	266	885	696	1,938	1,976	2,260
CF from Investments	-1,685	-6,357	-4,216	-6,797	-5,496	-3,501	-1,265
Issue of Shares	0	0	0	379	0	0	0
Inc/(Dec) in Debt	-339	891	762	4,481	3,000	3,000	0
Interest Paid	-85	-118	-135	-256	-672	-945	-1,058
Dividend Paid	-1,901	0	-788	-1,021	-1,351	-1,576	-1,689
Others	0		-45	-98	0	0	0
CF from Fin. Activity	-2,325	772	-206	3,485	976	478	-2,747
Inc/Dec of Cash	-754	2,110	-1,173	1,284	569	4,050	4,268
Opening Balance	3,691	4,761	19,392	9,535	11,316	11,863	15,914
Closing Balance	4,761	19,392	9,535	11,316	11,863	15,914	20,181

Cummins India

BSE SENSEX
67,481S&P CNX
20,268

CMP: INR1,920

TP: INR2,250 (+17%)

Buy



Bloomberg	KKC IN
Equity Shares (m)	277
M.Cap.(INRb)/(USD\$b)	532.3 / 6.4
52-Week Range (INR)	1981 / 1350
1, 6, 12 Rel. Per (%)	8/0/26
12M Avg Val (INR M)	1295
Free float (%)	49.0

Financials & Valuations (INR b)

Y/E Mar	2023	2024E	2025E
Sales	77.4	85.5	100.3
EBITDA margin	16.0	16.0	16.3
Adj. PAT	12.5	13.5	16.1
EPS (INR)	40.8	45.7	54.6
EPS Gr. (%)	50.4	8.5	19.0
BV/Sh. (INR)	193.7	212.2	234.5

Ratios

RoE (%)	22.4	22.5	24.4
RoCE (%)	14.0	10.2	12.1
Payout (%)	60.6	59.4	59.1

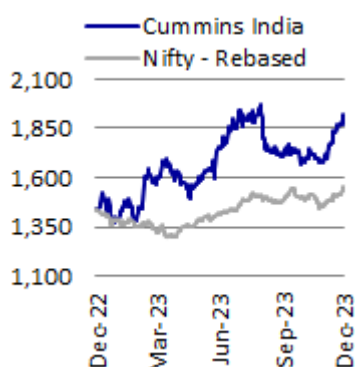
Valuations

P/E (x)	42.7	39.4	33.1
P/BV (x)	9.9	9.0	8.2
EV/EBITDA (x)	41.2	37.3	30.9
EV/Sales (x)	6.7	6.1	5.2

Shareholding pattern (%)

As On	Sep-23	Jun-23	Sep-22
Promoter	51.0	51.0	51.0
DII	22.2	24.0	26.7
FII	16.5	14.4	10.4
Others	10.4	10.7	11.9

FII Includes depository receipts

Stock's performance (one-year)**Well placed with new products**

Cummins India has benefited from strong demand in the powergen and distribution segments and a revival in exports over the last two years. While the implementation timeline for pollution norms CPCB 4+ has been revised, the company is ready with both types of products, CPCB 2 and CPCB 4+, as it has control over its supply chain. Moreover, Cummins keeps developing new products for industrial, distribution and fit-for-market (FFM) products for export markets. We expect a 14% CAGR in revenues during FY2023-26, driven by faster growth in the powergen and distribution segments. Exports are expected to remain weak in the near term, which may weigh on margins. However, the company has levers to reduce costs for new gensets with more localization. We expect margin improvement of 50bps over FY2023-26, resulting in a 16% PAT CAGR over the same period. We value Cummins at 34X P/E on two-year forward earnings at INR2,250. Reinitiate with a BUY rating. Key risks include a sharper-than-expected slowdown in exports, sooner-than-expected transition toward clean sources of fuel and the company's inability to keep pace with new products.

Long-term demand intact in powergen segment, near-term weakness persists

Long-term demand drivers for the powergen segment are strong, mainly led by the real estate, commercial, hospitality, data centre and manufacturing areas. In the last quarter, the genset market was impacted by inventory destocking due to postponement of CPCB 4+ implementation. The postponement of the implementation of norms resulted in a mixed state of market where both types of products were available but demand took a beating for the short term. Demand for CPCB 4+ compliant products has started improving, particularly in states like NCR where stringent emission norms will be implemented. Currently, a large share of incremental demand is for CPCB 2 products, which will start coming down when the norm implementation date gets closer. Thus, the genset market is yet to reflect true demand and pricing of CPCB 4+ compliant products. We expect it to start getting reflected in FY25.

Cummins is ready with new products across segments

Cummins is ready with new products in compliance with CPCB4+ norms. Depending upon market demand in the near term for both CPCB 2 and CPCB 4+ products, it can alter the supply chain network and deliver accordingly. It has also developed new products for rail, marine, alternate fuel as well as for Dual- Kits and Retrofitted Emission Control Devices (RECDs), which will boost growth in its industrial and distribution segments. In line with the recent requirements in the NCR market for emission-free products, the company has already launched new CPCB 4+ products. We expect a 14% CAGR in overall revenues during FY23-26.

Export weakness may continue for next few quarters

We expect weakness in exports to continue for the next few quarters as developed market demand fell by 50% yoy and developing markets were down by 5-10% yoy. Company has maintained INR5b run rate of exports during last quarter but exports can come down further in next 2 quarters as demand is very weak in developed markets such as US, EU, China, Middle-East. Accordingly, we expect a flat trend in exports for FY24. In order to tide over weakness in exports, the company has launched several product improvement initiatives, specific to markets, to offer more value to its customers. These initiatives include enhancements to existing products, cost optimization and the launch of FFM products for unregulated markets. If oil prices remain strong, we expect the Middle East and Africa to rebound first. Near-term weakness in exports can also weigh on margins as exports have better margins than the domestic business.

We expect margin levers to come from cost savings

For Cummins, margins have a strong correlation with export revenues. Weakness in exports and demand uncertainty for old and new products in powergen in FY24 could impact margins negatively. However, going forward, we expect margin gain to be driven by gross margin improvement on increased value addition as well as other cost saving and efficiency improvement initiatives. We expect EBITDA margin of 16.0%/16.3%/16.5% for FY24/FY25/FY26.

Dependence on related parties remains as volumes grow

Sourcing from related parties, particularly Tata Cummins and CTIL, has increased over last few years. This is primarily driven by volume growth and the scale that these entities have in specific products such as engines for CV industry and SCR kits. All these transactions are done at arm's length and for any specific technology that Cummins procures from its parent, it pays royalty to Cummins Inc. This royalty payment is in the range of 2% of net sales.

Financials

We expect a CAGR of 14% in revenue over FY23-26E, driven by 17%/12%/7%/20% CAGR in powergen/industrial/exports/distribution. We bake in moderation in margins for FY24 to factor in delays and uncertainty related to timeline of CPCB 4+ implementation. Over FY2023-26E, we bake in 50bps improvement in margins to build in cost benefits related to the indigenization of components, which are currently imported. We expect a 16% CAGR in PAT over the same period.

Valuations

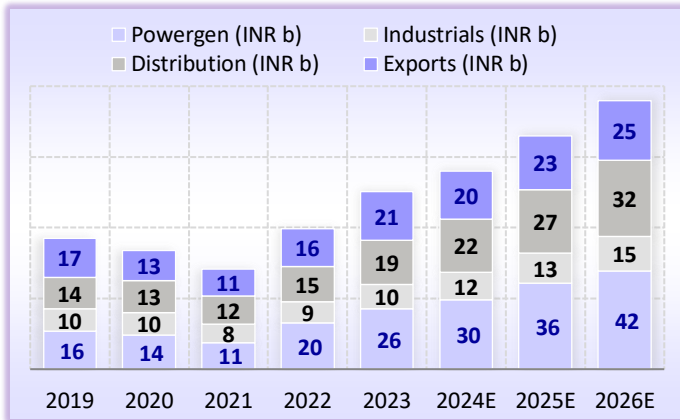
The stock is currently trading at 33.1X/28.2X FY25/26E earnings. We value the company at 34X two year forward at INR2,250 and reinstate coverage with a BUY rating.

Keys risks and concerns

Key risks include a sharper-than-expected slowdown in exports, sooner-than-expected transition toward clean sources of fuel, the company's inability to keep pace with new products, increased competition and faster growth for other group entities.

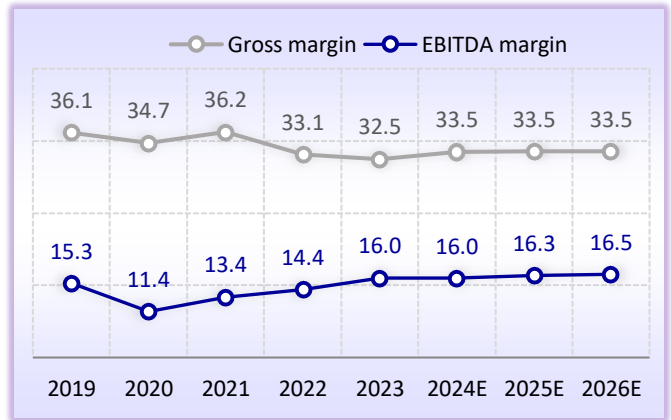
STORY IN CHARTS

We expect powergen and distribution segment revenue to remain strong over FY23-26 (INR b)



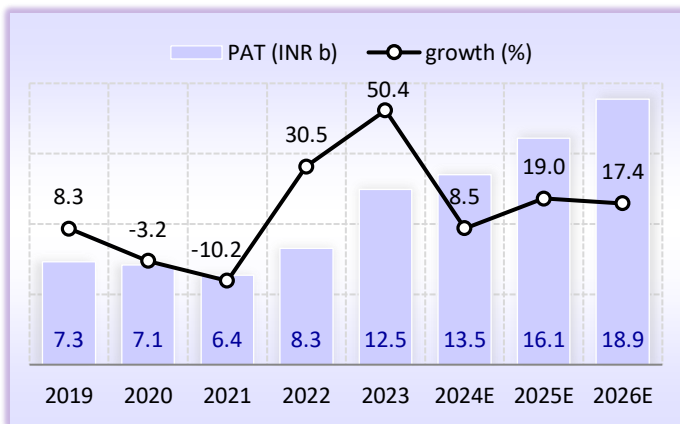
Source: Company, MOFSL

We expect Cummins to maintain gross margins of 33.5% as share of CPCB4+ products increases (%)



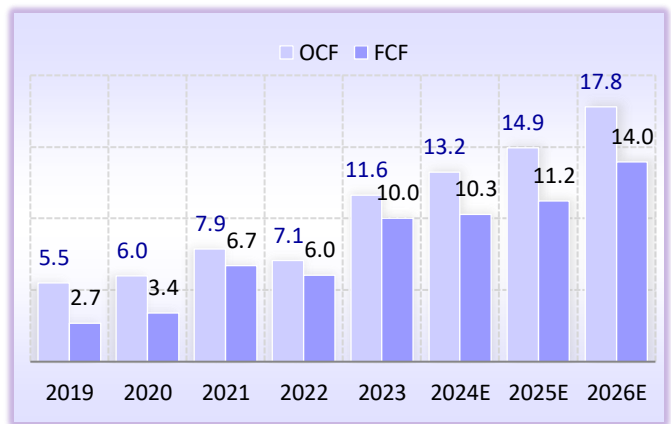
Source: Company, MOFSL

We expect PAT CAGR of 16% between FY23-26 (INR b)



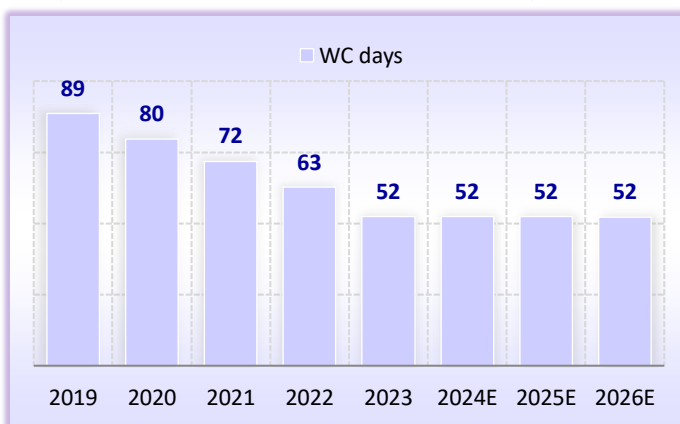
Source: Company, MOFSL

Stable WC to result in OCF/FCF improvement (INRb)



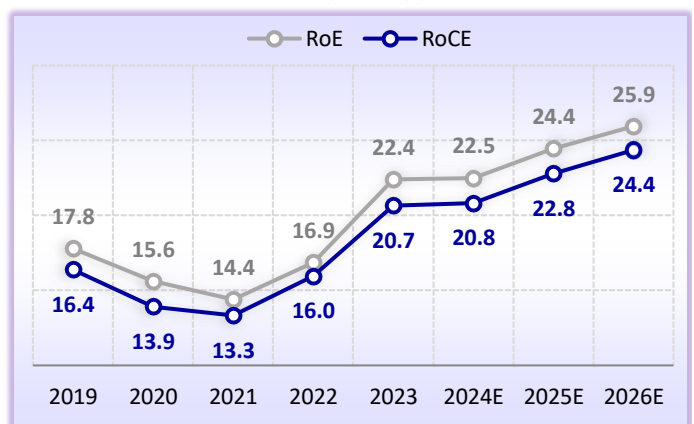
Source: Company, MOFSL

WC cycle remains comfortable for Cummins (days)



Source: Company, MOFSL

Return ratios have started improving post FY21 (%)



Source: Company, MOFSL

Long-term demand drivers intact for powergen segment

Long-term demand drivers are strong for the powergen segment, particularly from the real estate, commercial, hospitality, data centre and manufacturing sectors. In the last quarter, the genset market was impacted by inventory destocking due to postponement of the CPCB 4+ norm implementation. Owing to strong buying in 1QFY24 ahead of the implementation date of revised pollution norms, dealer inventory was already full which is now clearing up. The postponement of norms resulted in a mixed state of market, where both types of products were available in market. Demand for CPCB 4+ compliant products has started improving, particularly in states like NCR where stringent emission norms will be implemented. A major share of incremental demand is currently coming for CPCB 2 products, which will start coming down as the implementation date gets closer.

Channel checks with other distributors indicate:

- **Big players are ready with their CPCB 4+ compliant products.** Cummins and KOEL control a larger share of market and have invested in building the network and team to handle improved technology products. Other players are still smaller in the entire value chain.

Exhibit 188: KOEL has launched 37 diesel genset models across CPCB 4+ compliant products across ranges

Range	No. of models
3.5-5.5kVA	2 (3.5, 5.5kVA)
7.5-20kVA	7 (7,7.5, 10, 12.5, 15, 17.5, 20kVA)
25-62.5kVA	7 (25, 30, 35, 40, 45, 58.5, 62.5kVA)
70-160kVA	7 (70, 75, 82.5, 100, 125, 140, 160kVA)
180-250kVA	3 (180, 200, 250kVA)
275-750kVA	11 (275, 300, 320, 380, 400, 450, 500, 625, 650, 700, 750kVA)

Source: Company, MOFSL

Exhibit 189: Cummins has launched 33 models across CPCB 4+ compliant products across ranges

Range	No. of models
7.5-20kVA	8 (7.5, 7.5, 10, 10, 15, 15, 18.5, 20kVA)
25-40kVA	7 (25, 25, 27.5, 30, 35, 35, 40kVA)
41-50kVA	2 (41,50kVA)
50-58.5kVA	2 (50, 58.5kVA)
82.5-140kVA	4 (82.5, 100, 125, 140kVA)
160-250kVA	4 (160, 180, 200, 225, 250kVA)
320kVA	1 (320kVA)
380-500kVA	3 (380, 400, 500kVA)
650-750kVA	2 (650, 750kVA)

Source: Company, MOFSL

- **Pricing outlook:** Pricing has increased for CPCB 4+ compliant products by 20-40%. Whenever a new product is launched, companies pass on all the costs associated with raw materials, technology, marketing, etc., but over a period of time, pricing comes down. Prices may correct by 5-10% in FY25 as several parts, which are currently imported, are expected to be indigenized and as scale benefits are likely to result in gains on operating leverage, which companies can pass on. However, it is not going to be aggressive competition as seen in the last norm change.
- **Differential in pricing vs. competition:** Cummins pricing for CPCB 4+ is higher than competition by nearly 10-22% across various nodes. This premium is based on the brand, superior technology, 3) spare part availability, 4) reliability of product. Cummins enjoys a market share of 60% in the range of 600-1000 KVA range. However, on existing CPCB 2 based products, other players are also catching up on pricing.

Exhibit 190: Cummins commands a premium as seen from price points across key nodes for players for CPCB 2 products (INR lakh)

Node	Cummins	KOEL	Mahindra	Perkins	Baudouin
15kva	2,60,000	2,50,000	2,60,000		
62.5kva	5,30,000	5,20,000	5,10,000		
125kva	7,80,000	7,25,000	6,89,915		
160kva	11,10,000	10,25,000	9,75,000		
200kva	12,66,000	12,50,000	12,25,000		
320kva	19,50,000	18,40,000	18,60,000		21,56,000
400kva	26,48,000	23,50,000	21,70,000	23,00,000	23,10,000
500kva	29,48,000	26,98,750	25,00,000	25,00,000	24,50,000
625kva	38,50,000	35,50,000	38,00,000	37,00,000	39,00,000
750kva	50,00,000	48,50,000		50,00,000	47,00,000
1010kva	70,00,000	65,00,000		65,00,000	65,00,000
1250kva	98,00,000	90,00,000		92,00,000	90,00,000
1500kva	1,35,00,000	1,20,00,000		1,00,00,000	
2000kva	1,50,00,000			2,00,00,000	1,66,00,000
2750kva	1,70,00,000				

Source: Channel checks, Industry, MOFSL

Exhibit 191: Prices for CPCB 4+ products are at substantial premium to similar nodes for CPCB 2 (INR lakh)

Node	Cummins	KOEL
15kva		3,35,000
20kva	3,50,000	3,40,000
30kva	6,35,000	6,25,000
40kva	7,33,000	7,67,000
58.5kva	8,26,000	8,66,000
82.5kva	11,95,000	11,80,000
125kva	14,50,000	14,55,000
160kva	16,50,000	
200kva	24,25,000	19,25,000
250kva	26,75,000	22,50,000
500kva	42,00,000	

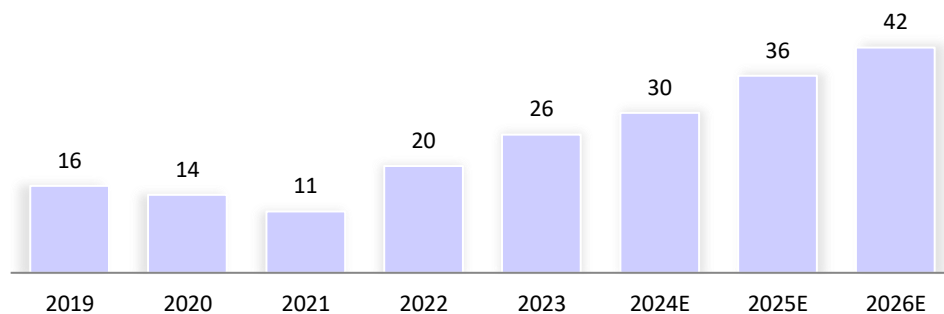
Source: Channel checks, Industry, MOFSL

- **CPCB 2 products dominate the demand currently:** During 1HFY24, most of the sales for powergen were dominated by CPCB 2 related gensets – nearly 70-80% of powergen revenues are from CPCB 2 gensets. Demand for CPCB 4+ gensets is strong in NCR region despite higher pricing.

Powergen segment demand is fairly strong

Powergen segment has reported a healthy 12% CAGR during FY19-23, led by strong demand from Datacentres, Real estate, Manufacturing, and Infrastructure. We expect these demand drivers to continue to be led by (1) increasing investments by global and domestic players in data centre market, (2) expected launches in real estate market on commercial as well as residential side, (3) ramp-up of PLI- led capex, which so far has remained only in few sectors, (4) the government's plan for greenfield as well as brownfield expansion of airports.

Exhibit 192: We expect powergen revenues to grow at a CAGR of 17.5% over FY23-26 (INR b)



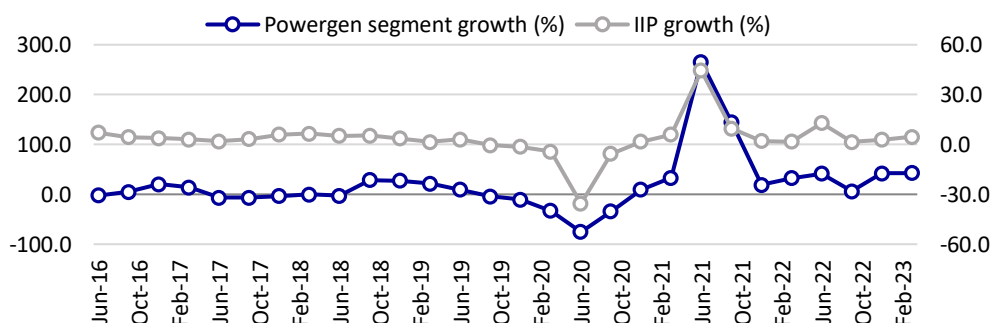
Source: Company, MOFSL

Exhibit 193: Continued power deficit situation will keep driving demand for power gensets

MW	FY20	FY21	FY22	FY23
Peak demand	1,83,804	1,90,198	2,03,014	2,15,888
Peak met	1,82,533	1,89,395	2,00,539	2,07,231
Deficit	1,271	803	2,475	8,657

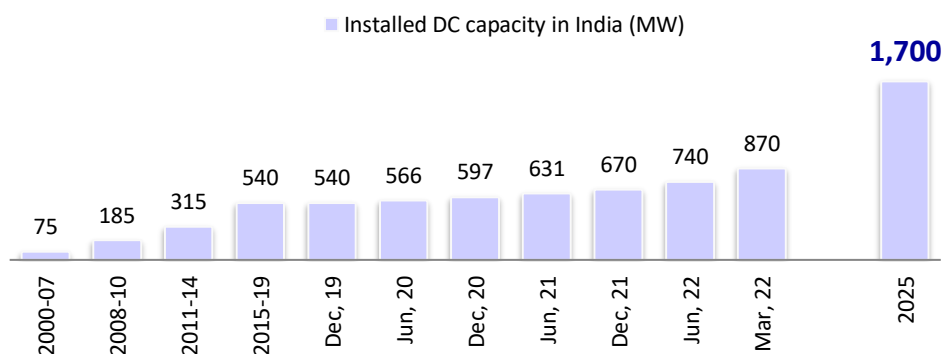
Source: Company, MOFSL

Exhibit 194: Powergen segment growth is closely linked to IIP growth and we expect it to remain strong



Source: Company, MOFSL

Exhibit 195: Data centre market is witnessing a sharp growth where Cummins has a dominant market share



Source: Industry, CRISIL

Exhibit 196: Real estate new launches have seen an uptick post FY20 which will continue to drive genset demand

Million sq ft	2015	2016	2017	2018	2019	2020	2021	2022
New launches (Residential)	625	550	410	504	538	440	642	851
New launches (Commercial)	41	36	27	34	51	39	38	52

Source: Industry, MOFSL

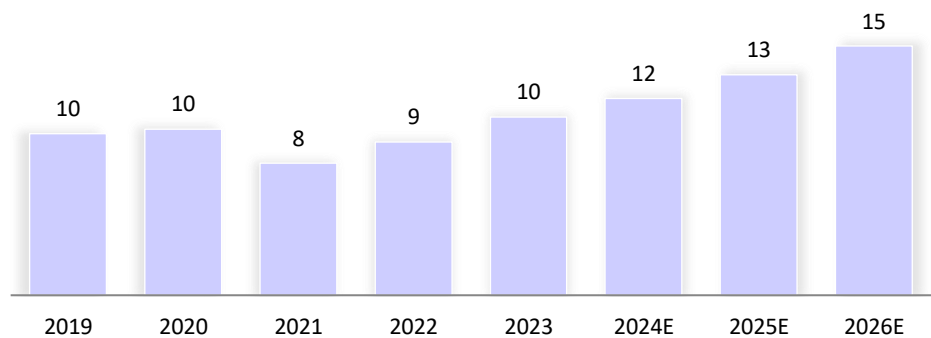
Industrial segment growth is gradually catching up with segments

Industrial segment growth has been lower than other segments but is now witnessing traction from railways, mining, construction as well as defence.

Competition has increased in industrial segment from Chinese players but company continues to work with various players and has a good product portfolio to cater to demand. Company has good relationship with Chinese players too for local value add requirement. Following are the key growth drivers for the industrial segment:

- Indian Railways is set to achieve its ambitious target of 100% track electrification of broad-gauge network by 2023, which is driving demand for Diesel Electric Tower Cars (DETCs) that are used in the installation and maintenance of overhead electric lines. Indian Railways’ focus on reducing dependency on diesel in the auxiliary power sub-segment is driving demand for hotel load converters. The company has ventured into the supply of hotel load converters, which will help regain business in the auxiliary power sub-segment.
- To move toward a green economy with net zero emissions, Indian Railways is also evaluating hydrogen fuel cell solutions for the ‘Hydrogen for Heritage’ initiative. The company is actively exploring ways to partner with Indian Railways on this initiative.
- For mining, growth in domestic coal production is expected to have a favorable impact on the heavy earth moving machinery (HEMM) market in which Cummins is a critical technology supplier.
- For defence and marine too, Cummins expects growth to come from engine requirements from Original Equipment Manufacturers (OEMs) as well as use of indigenous vessels for marine applications.
- For the construction segment, we expect the pace of road construction to improve during FY24 to around 35km per day, which would also boost demand for construction equipment. The company is developing BSV certified electronic 4-cylinder and 6-cylinder engine platforms to address Bharat Stage V (CEV BSV) emission norms from Apr’24 for the Off-highway wheeled segment in India. For tracked applications, the company is planning to introduce electronic 4-cylinder and 6-cylinder engines before the implementation of next emission norms from April, 2024.

Exhibit 197: We expect industrials segment revenue to grow at 12% over FY23-26E (INR b)

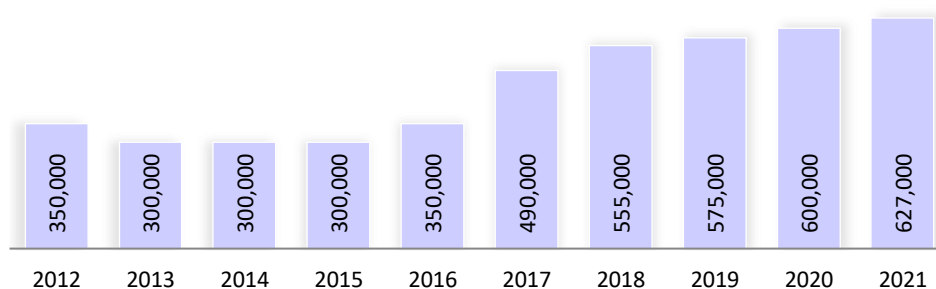


Source: Company, MOFSL

Distribution segment growth to remain strong in line with new launches

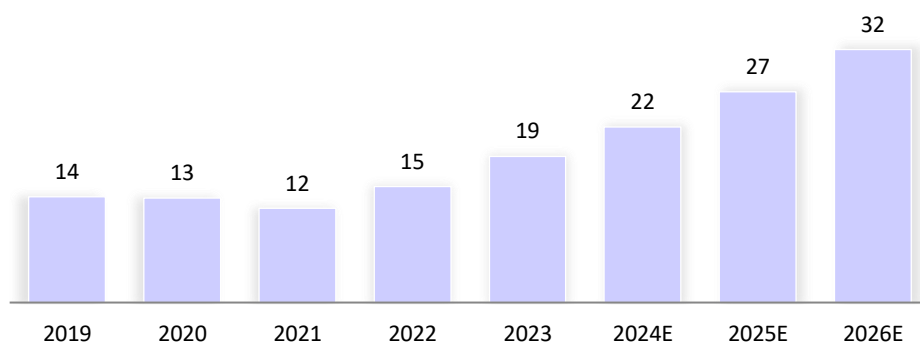
Distribution segment revenues grew 26% YoY in FY23 on a strong installed base of more than 6 lakh gensets. Growth from hereon would be led by increased after-market opportunities on revised CPCB4+ norms for powergen, revised norms for off-highway equipment to CEV BSIV, and data centres. This will also be driven by higher utilization of equipment in the mining, railways and natural gas sectors, thereby requiring more maintenance. The National Green Tribunal's (NGT) emphasis on cleaner energy alternatives and regulations on the use of diesel-based power backup gensets will increase demand for Dual Fuel Kits and Retrofitted Emission Control Devices (RECDs).

Exhibit 198: Cummins - installed base of engines (no.)



Source: Company, MOFSL

Exhibit 199: We expect distribution segment revenue to grow at a CAGR of 20% between FY23-26E (INR b)



Source: Company, MOFSL

Export growth to remain weak in near term

Cummins's exports grew 27% YoY in FY23 on strong demand for powergen mainly from Latin America and the Middle East regions. The telecom, rental, healthcare, manufacturing, and marine segments are driving growth in these markets. The company has undertaken several product improvement initiatives, specific to markets, to offer more value to its customers. These initiatives include enhancements to existing products, cost optimization and the launch of FFM products for unregulated markets – Africa, Middle East, Asia Pacific, and Latin America. It is also tapping into opportunities available in the industrial segments such as rail and marine in regions such as Latin America, Africa, and Asia Pacific. Moreover, we also believe that with CPCB 4+ compliant products, the company would be able to gain market share in the US and Europe too. Currently, with

geopolitical concerns and a slowdown in developed markets, Cummins is diversifying its exposure to other countries that are not impacted by the slowdown in developed markets. We expect next two quarters to remain weak on exports as markets are impacted by weak demand and inventory destocking.

Exhibit 200: Trend of LHP and HHP exports (INR b)

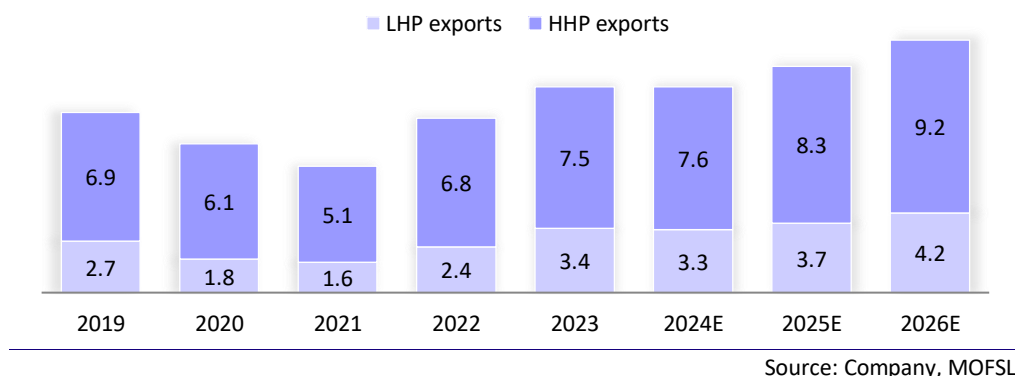


Exhibit 201: We expect exports to remain weak in FY24 (INR b)

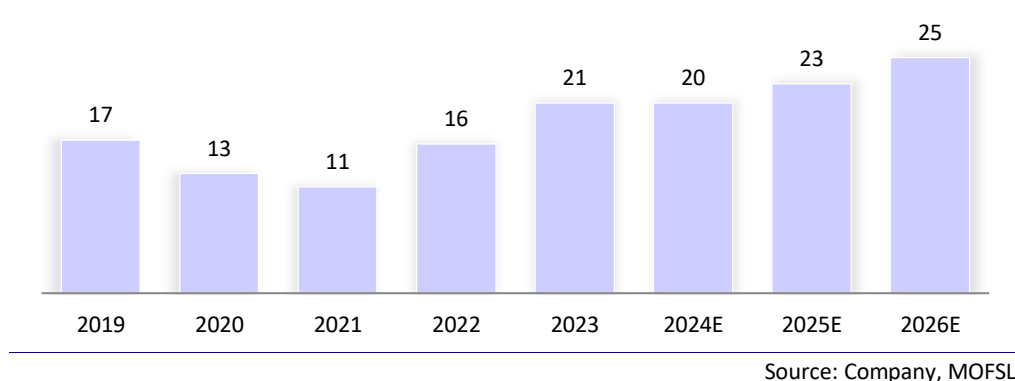


Exhibit 202: Cummins exports have a strong correlation with overall India's exports (%)

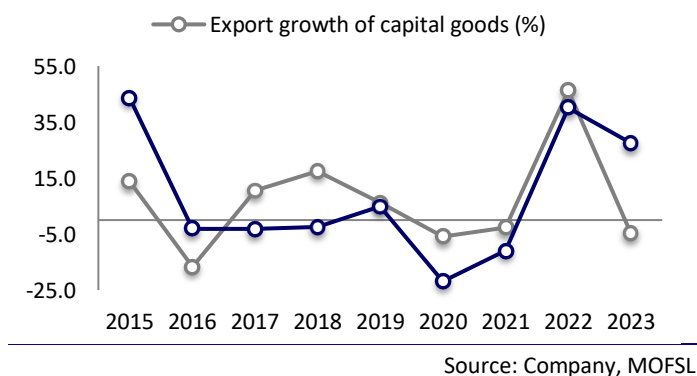


Exhibit 203: Company is trying to diversify across markets to counter export weakness

INR m	FY22	FY23
Asia Pacific	4,730	4,510
Latin America	3,830	5,130
Middle East	2,810	3,860
Europe	3,220	5,480
Africa	1,510	1,520
Total Exports	16,100	20,500

Source: Company, MOFSL

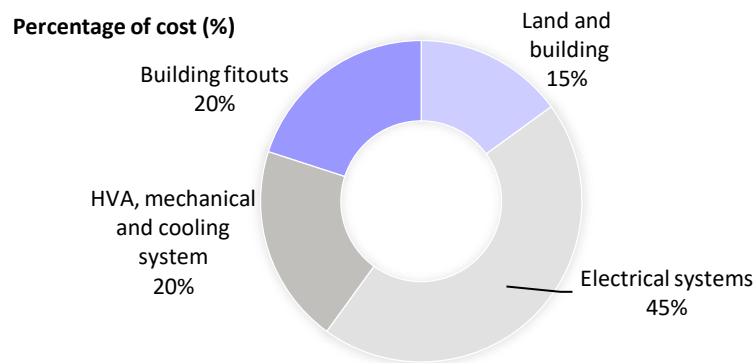
Will demand and margins sustain at current levels?

Data centre remains key growth driver for powergen segment

The biggest driver of demand is the growth in data centres. The data centre market is currently at 890MW and as per CRISIL estimates, it is expected to grow to 1700MW, entailing investments of USD5b by FY27. Cummins has a market share of more than 65% in the data center market and we expect it to benefit from demand for HHP gensets for data centres. So far, demand from data centre has grown at >25%+ on yearly basis.

On the cost structure, electrical systems and HVAC and cooling systems account for 55-65% of total costs, where there is an opportunity for most product companies like ABB, Siemens and Cummins. We expect an addressable opportunity of USD3-3.6b for these players on incremental investment of USD5-6b in the data center market by FY25. Within this, we expect Cummins' addressable market of around 15-20% of USD3-3.6b.

Exhibit 204: Cost breakup of a data centre (%)

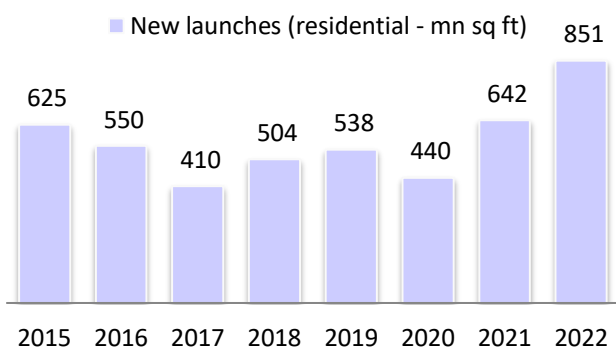


Source: Industry, MOFSL

Demand is also driven by realty sector, pick-up in manufacturing capex and power shortage in the country

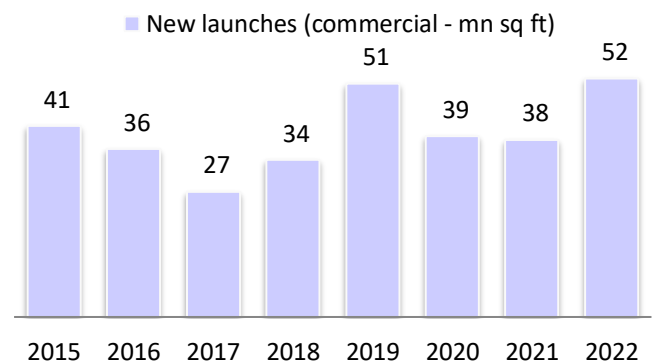
We expect demand for diesel gensets to remain strong from the real estate sector – both residential and commercial based on the recent launches over past two years. An uptick in manufacturing capex and the power shortage in the country would also help to keep demand for gensets strong.

Exhibit 205: Residential real estate launches were strong in last 2 years and would drive genset demand



Source: Propequity

Exhibit 206: Commercial real estate launches were also strong in last 2 years and would drive genset demand



Source: Propequity

Exhibit 207: PLI incentives for different sectors to drive capex growth (INR b)

Sector	Incentives outlay
Mobile phones	420
Advanced Chemistry cell batteries	181
Electronics and Tech products	50
Automobile and components	570
Pharmaceuticals and drugs	150
Telecom and networking products	122
Textiles	107
Food products	109
High efficiency solar PV modules	45
White goods	62
Speciality steel	63
Solar modules	185
Total	2,064

Source: MeITY, PIB

Exhibit 208: India power deficit situation will result in higher demand for backup power from gensets

MW	FY20	FY21	FY22	FY23
Peak demand	1,83,804	1,90,198	2,03,014	2,15,888
Peak met	1,82,533	1,89,395	2,00,539	2,07,231
Deficit	1,271	803	2,475	8,657

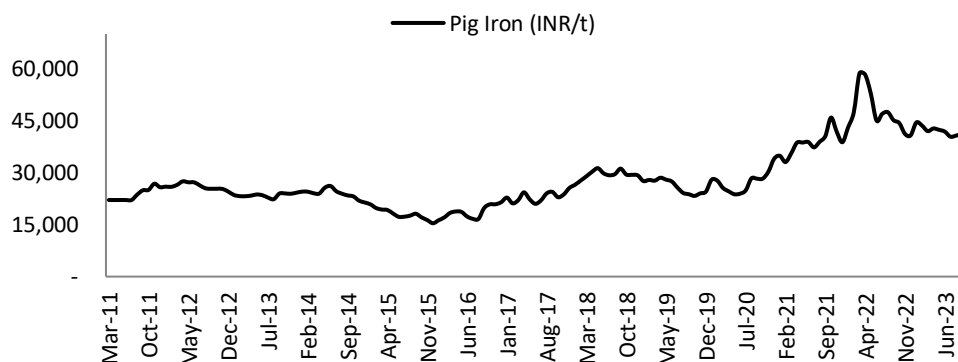
Source: Company, MOFSL

We thus expect demand momentum to stay strong for powergen segment.

Margin levers exist from cost savings

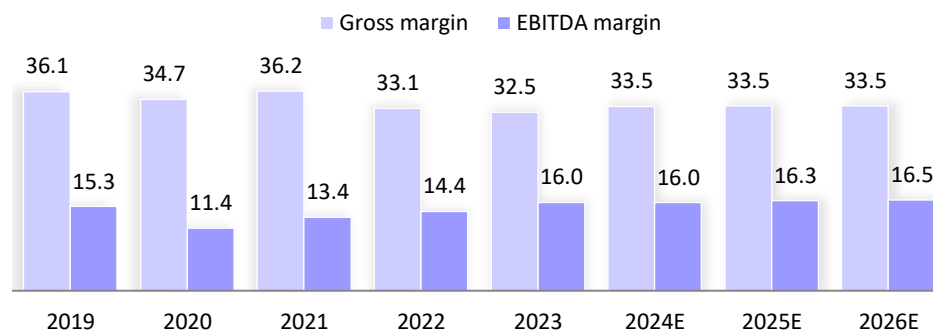
Export weakness and market demand uncertainty on old and new products in powergen in FY24 could dent margins. However, going forward, we expect the following margin levers to play out for Cummins:

- RM costs: We expect a 100bp reduction in RM costs to bake in incremental localization of imported components for new gensets beyond FY24. This would improve gross margins to 33.5%/33.5% by FY25/FY26, which is still lower than the peak gross margins that Cummins reported in FY14.
- Employee costs will remain around 7.8-8% of sales as new technologies will require skilled manpower.

Exhibit 209: Pig iron prices have already started coming down (INR/t)

Source: Steelmint, MOFSL

Exhibit 210: We expect margin increase to be limited in FY24 on weak exports and then stabilize around 16-16.5% (%)



Source: Company, MOFSL

Comparison of demand and margins with past transition

During the last transition to CPCB 2, prices were initially hiked to pass on the transition cost. However, increased competition in the market impacted pricing and put pressure on margins during FY2015-16. The impact of higher prices was also reflected in slow revenue growth for the powergen segment. Increased competition and its adverse impact on demand and margins is not ruled out. However, with its superior product, strong distribution channel, availability of trained workforce, the company will always stand ahead of competition.

New Product Development

The following new products were developed during FY23: -

- Rail engine product families to support the growing Rail Business
- Marine engine product families to support the increasing commercial Marine Business
- Further enhancements of non-diesel product development capability such as use of alternative fuels are being explored in India
- Telematics and Analytics capabilities have been developed to improve uptime and fuel efficiency performance of products
- To enhance its position in the low kVA segment, the company has introduced a 40 kVA genset with X2.7 litre engine
- Further, the company continues to strengthen its channel presence through its GOEM partners who have added 12 additional sales dealers across various geographies

Exhibit 211: New product launches over last 3 years

FY23	❖ Retrofit Emission Control Kit (RECD), Cummins Brake Lining, Cummins Funnel Fuel Filter, New range of Clutches, Power Booster Kit
FY22	❖ Oversized Liner Sleeves, All Make Filters, Racor Filter, CNG Retrofit Kit, Dual Fuel Kit, Li-ion Battery, UPS Inverters
FY21	❖ 50 kVA genset for defence application, 12K and 24K overhaul kits, BSIV certified electronic gadget platforms

Source: Company, MOFSL

Government directives point toward its keenness to move away from diesel gensets

CIL expects that diesel-based products would continue to see demand over the next 4-5 years as the required infrastructure and battery back-ups are currently not available if diesel gensets are to be phased out in near future. Next 4-5 years would witness a shift toward hybrid fuels like LNG and CNG. A shift toward fuel cells and hydrogen-based products would happen over a long term when there is enough clarity on the policy or guidelines related to hydrogen usage. This will sustainably reduce dependence on diesel gensets. The parent company has technology, products and services to cater to customers when the energy transition happens. It would only have to localize it as demand moves up.

Exhibit 212: Emission limits set for diesel gensets (g/kw-hr)

	CPCB-I	CPCB-II	CPCB-IV+
Nox+HC			
<56 KW	11	5	5
>56 KW upto 800 KW	11	4	0.6
PM			
<19 KW	0.3	0.3	0.3
> 19 KW upto 56 KW	0.3	0.3	0.03
> 56 KW upto 800 KW	0.3	0.2	0.02

Source: Company, MOFSL

Exhibit 213: Cummins has a wide range of gas generators to take care of demand transition

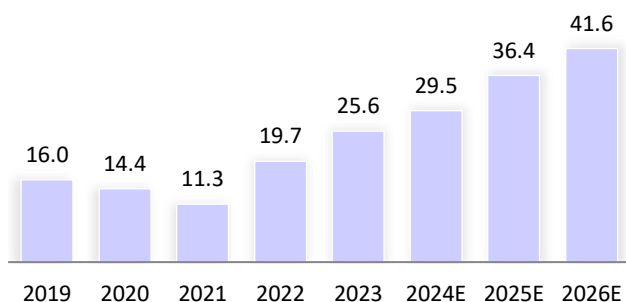
Product	kW	kVA
KTA19 SLB	350	437
GTA28E	400-500	500-625
GTA38e	335-550	419-688
GTA38	635-690	793-862
GTA50E	600-750	750-937
GTA50	760-815	950-1018

Source: Company, MOFSL

Financial Outlook

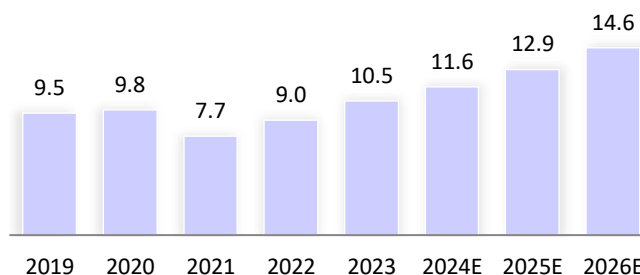
We expect a 14% CAGR in revenues over FY23-26, driven by a CAGR of 17%/12%/7%/20% in powergen/industrial/exports/distribution. We bake in a moderation in margins in FY24 to factor in delays and uncertainty related to timeline of CPCB 4+ implementation. Over FY2023-26E, we bake in a 50bp improvement in margins to build in cost benefits related to indigenization of components, which are currently imported. We expect a 16% CAGR in PAT over FY23-26.

Exhibit 214: We expect impact of higher pricing to get reflected in powergen segment from FY25 (INR b)



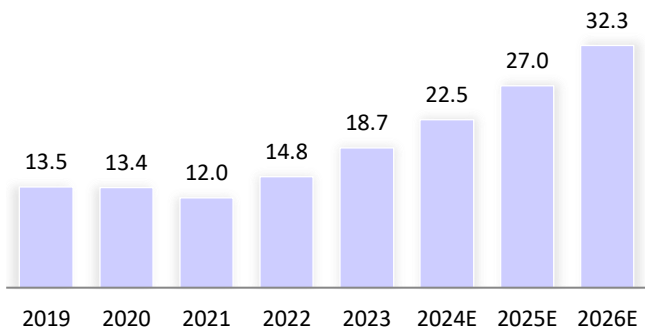
Source: Company, MOFSL

Exhibit 215: We expect industrial segment revenue to grow at 12% CAGR from FY23-26 (INR b)



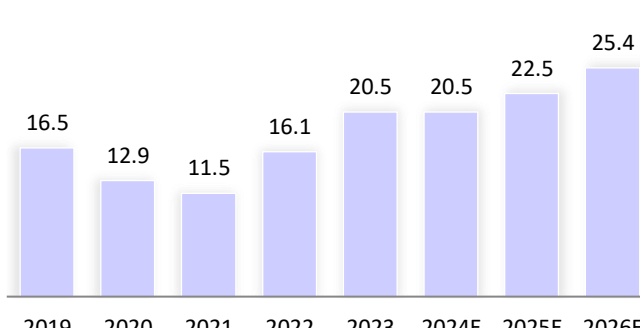
Source: Company, MOFSL

Exhibit 216: Distribution segment growth to remain strong on aftermarket and spare sales (INR b)



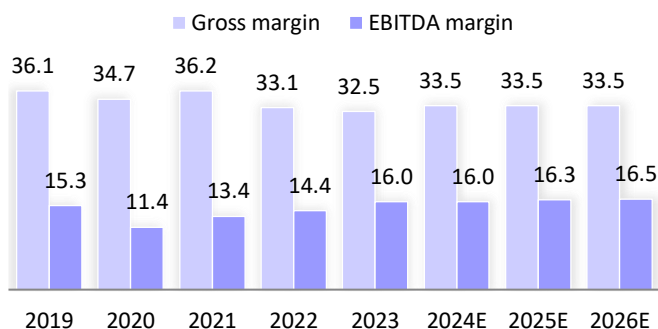
Source: Company, MOFSL

Exhibit 217: We expect exports to remain weak in FY24 and start recovering from FY25 (INR b)



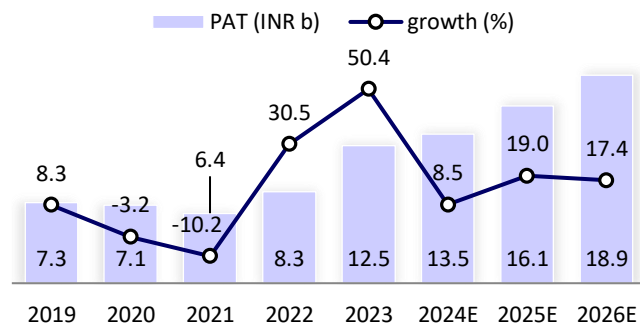
Source: Company, MOFSL

Exhibit 218: We expect gross margin to improve to 33.5%



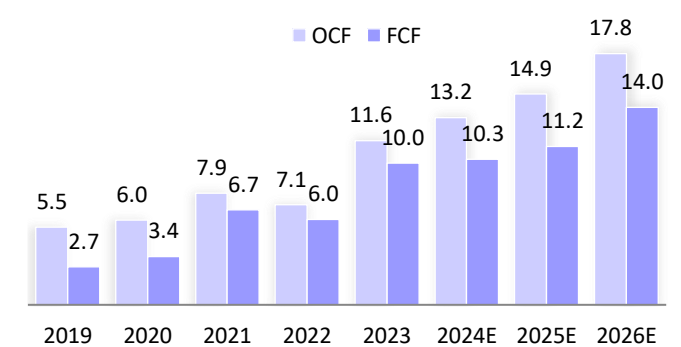
Source: Company, MOFSL

Exhibit 219: We expect 16% PAT CAGR over FY23-26 (INR b)



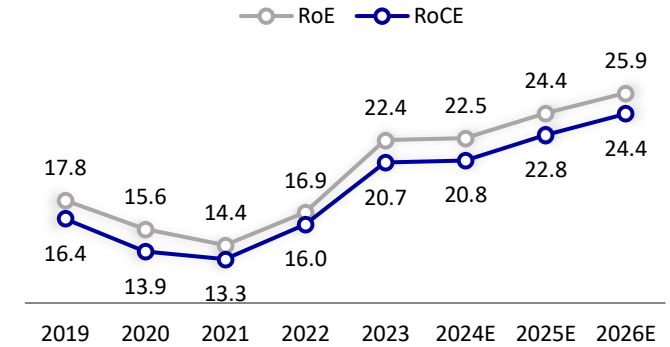
Source: Company, MOFSL

Exhibit 220: We expect OCF to improve further (INR b)



Source: Company, MOFSL

Exhibit 221: Return ratio to remain strong (%)



Source: Company, MOFSL

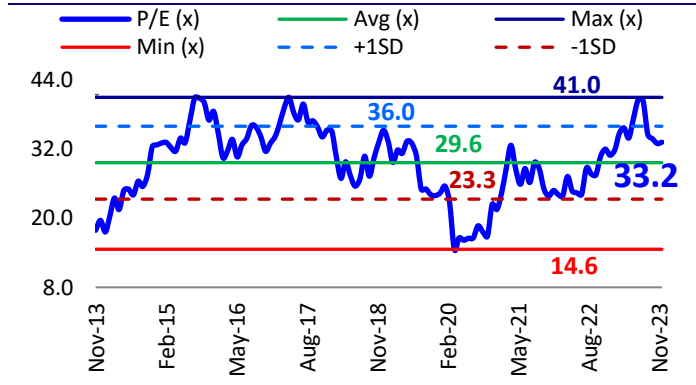
Key risks and concerns

- Faster energy transition toward cleaner sources.** A sooner-than-expected transition toward clean sources of fuel in India and the company's inability to keep pace with new products. However, the company is continuously working on new products and has access to technology for products related to natural gas gensets or hydrogen-based gensets.
- Slowdown in exports.** Its margins have a high correlation with exports. A prolonged slowdown in export markets can impact margins adversely.
- Increasing competition.** Increased competition from domestic and international players can result in pricing pressure, thereby impacting margins over the medium to long term.
- Steep increase in prices for OCPCB 4+ norms can impact demand growth.** Prices for gensets below 800 kVA category have increased by 30-50%. Such high levels of pricing can impact the demand and result in high-range users shifting to higher kVA categories where prices have not increased.
- High proportion of purchase of goods from related parties.** The company's purchase of traded goods from related parties, especially CTIL, has been increasing continuously, from 12.5% of RM costs in FY18 to 23% of RM costs in FY23.
- Faster growth seen for CTIL.** CTIL was set up as a feeder factory for the parent. However, growth in CTIL exports has been much higher than CIL India's exports. Further clarity on the development of new technology-driven products by CTIL or CIL would be of interest to assess future growth paths of both entities.

Valuation and recommendation

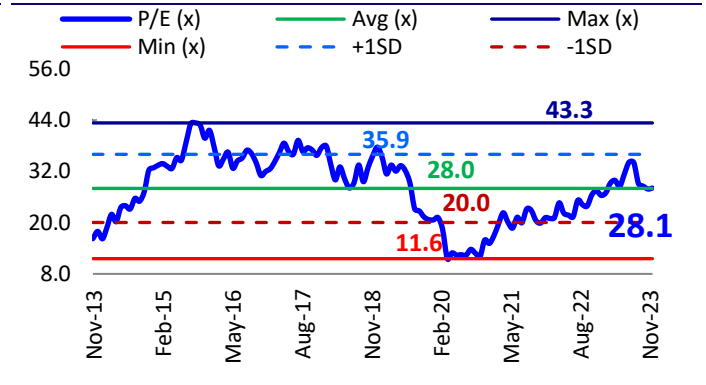
Stock is currently trading at 33.1X/28.2X FY25/26E earnings. We value company at 34X two year forward at INR2,250 and reinitiate coverage with a BUY rating.

Exhibit 222: 1-year forward PE valuation band



Source: Bloomberg, MOFSL

Exhibit 223: 2-year forward PE valuation band



Source: Bloomberg, MOFSL

Exhibit 224: Sensitivity analysis - Bear/Base/Bull case valuation

	Bear case	Base case	Bull case
EPS (INR)	59	66	72
Valuation multiple (x)	25	34	38
Target price (INR/share)	1,476	2,250	2,500

Source: MOFSL

SWOT analysis

- ❖ Market leadership
- ❖ Strong parentage
- ❖ Technical prowess
- ❖ Diversified geographical presence

S

STRENGTH



- ❖ Demand uncertainty in view of regulations
- ❖ Weak outlook for exports
- ❖ Cyclical nature of business
- ❖ High dependence on traded goods

W

WEAKNESS



- ❖ Strong capex traction in India
- ❖ Parent's focus on KKC to make it an export hub
- ❖ Widening power deficit
- ❖ Growth in data centres leading to demand for uninterrupted power

O

OPPORTUNITY



- ❖ Obsolescence on account of emerging technologies
- ❖ Competition catching up in terms of technology
- ❖ Geopolitical tensions
- ❖ Higher business to the group entity CTIL from parent

T

THREATS



Management profile



Ashwath Ram (Managing Director)

Ashwath Ram has been the Managing Director of Cummins India Limited since August 2019. He has led the Business Unit Operations as well as key strategic transformation for the Engine Business Unit and Power System Business Unit in India, where his key focus areas of the business included strategy, sales, profitability, operations and supply chain.



Ajay S. Patil (VP & Chief Financial Officer)

Ajay S. Patil has multi-industry work experience spanning 20+ years in multiple countries with fortune 500 companies. He has deep and extensive experience as finance leader, with strong functional skills in financial accounting, internal controls, tax, treasury, mergers and acquisition, JVs, startups, turning around businesses.

Financials and valuation

Standalone - Income Statement

(INR Million)

Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Total Income from Operations	51,577	43,292	61,404	77,444	85,483	1,00,320	1,15,578
Change (%)	-8.9	-16.1	41.8	26.1	10.4	17.4	15.2
Raw Materials	33,679	27,606	41,068	52,309	56,884	66,670	76,824
Gross Profit	17,899	15,687	20,336	25,135	28,599	33,651	38,754
Employee Cost	5,602	4,926	5,956	6,298	6,823	7,859	8,970
Other Expenses	6,434	4,965	5,529	6,411	8,123	9,408	10,688
Total Expenditure	45,715	37,497	52,553	65,018	71,830	83,937	96,482
% of Sales	88.6	86.6	85.6	84.0	84.0	83.7	83.5
EBITDA	5,863	5,795	8,851	12,426	13,652	16,383	19,096
Margin (%)	11.4	13.4	14.4	16.0	16.0	16.3	16.5
Depreciation	1,187	1,255	1,340	1,405	1,436	1,575	1,802
EBIT	4,676	4,540	7,511	11,022	12,216	14,808	17,294
Int. and Finance Charges	203	162	115	158	284	312	312
Other Income	3,315	3,702	2,875	4,200	4,740	5,431	6,481
PBT bef. EO Exp.	7,789	8,080	10,271	15,064	16,672	19,926	23,463
EO Items							
PBT after EO Exp.	7,789	8,080	10,271	15,064	16,672	19,926	23,463
Total Tax	1,297	1,901	2,463	3,623	4,009	4,792	5,642
Tax Rate (%)	16.7	23.5	24.0	24.0	24.0	24.0	24.0
Minority Interest							
Reported PAT	6,492	6,179	7,808	11,441	12,663	15,134	17,820
Adjusted PAT	6,492	6,179	7,808	11,441	12,663	15,134	17,820
Change (%)	-10.2	-4.8	26.4	46.5	10.7	19.5	17.7
Margin (%)	12.6	14.3	12.7	14.8	14.8	15.1	15.4

Standalone - Balance Sheet

(INR Million)

Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Equity Share Capital	554	554	554	554	554	554	554
Total Reserves	41,195	43,513	47,972	53,125	58,271	64,459	71,781
Net Worth	41,750	44,068	48,527	53,680	58,825	65,014	72,336
Minority Interest							
Total Loans	4,854	156	3,933	3,500	3,500	3,500	3,500
Deferred Tax Liabilities	800	823	971	1,057	1,057	1,057	1,057
Capital Employed	47,404	45,047	53,430	58,237	63,382	69,571	76,893
Gross Block	20,894	20,337	22,278	23,458	26,178	29,887	33,702
Less: Accum. Deprn.	8,617	8,684	10,024	11,429	12,836	14,411	16,213
Net Fixed Assets	12,277	11,654	12,254	12,030	13,342	15,476	17,489
Capital WIP	800	1,275	608	413	608	608	608
Total Investments	18,606	13,892	15,939	21,042	21,042	21,036	21,036
Curr. Assets, Loans&Adv.	27,713	29,950	39,230	41,625	47,026	54,322	62,957
Inventory	5,729	5,578	7,288	8,862	9,781	11,479	13,225
Account Receivables	11,316	10,745	12,473	15,927	17,580	20,632	23,770
Cash and Bank Balance	4,538	9,652	14,267	13,808	16,322	18,289	21,444
Loans and Advances	2,448	1,517	2,646	539	595	699	805
Other Current Assets	3,682	2,459	2,556	2,488	2,746	3,223	3,713
Curr. Liability & Prov.	12,137	11,922	14,621	16,883	18,636	21,870	25,196
Account Payables							
Other Current Liabilities	9,650	9,723	12,362	14,497	16,001	18,779	21,635
Provisions	2,487	2,199	2,258	2,386	2,634	3,091	3,561
Net Current Assets	15,576	18,029	24,609	24,741	28,390	32,451	37,761
Misc Expenditure	144	199	21	11	0	0	0
Appl. of Funds	47,404	45,047	53,430	58,237	63,382	69,571	76,893

Financials and valuation

Ratios

Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Basic (INR)							
EPS	23	22	28	41	46	55	64
Cash EPS	27.7	26.8	33.0	46.3	50.9	60.3	70.8
BV/Share	150.6	159.0	175.1	193.7	212.2	234.5	261.0
DPS	17.0	14.0	10.5	25.0	27.1	32.3	37.9
Payout (%)	87.5	62.8	37.3	60.6	59.4	59.1	58.9
Valuation (x)							
P/E	81.0	85.2	67.4	46.0	41.5	34.8	29.5
Cash P/E	68.5	70.8	57.5	41.0	37.3	31.5	26.8
P/BV	12.6	11.9	10.8	9.8	8.9	8.1	7.3
EV/Sales	10.2	11.9	8.4	6.7	6.0	5.1	4.4
EV/EBITDA	89.8	89.2	58.3	41.5	37.6	31.2	26.6
Dividend Yield (%)	0.9	0.7	0.6	1.3	1.4	1.7	2.0
FCF per share	13.1	24.3	28.1	23.7	37.2	40.5	50.4
Return Ratios (%)							
RoE	15.6	14.4	16.9	22.4	22.5	24.4	25.9
RoCE	14.6	13.9	16.3	21.1	21.6	23.5	25.0
RoIC	15.7	15.9	26.7	36.7	38.4	40.9	41.4
Working Capital Ratios							
Fixed Asset Turnover (x)	2.5	2.1	2.8	3.3	3.3	3.4	3.4
Asset Turnover (x)	1.1	1.0	1.1	1.3	1.3	1.4	1.5
Inventory (Days)	41	47	43	42	42	42	42
Debtor (Days)	80	91	74	75	75	75	75
Creditor (Days)	0	0	0	0	0	0	0
Leverage Ratio (x)							
Current Ratio	2.3	2.5	2.7	2.5	2.5	2.5	2.5
Interest Cover Ratio	23.1	28.1	65.3	69.8	43.0	47.4	55.4
Net Debt/Equity	-0.4	-0.5	-0.5	-0.6	-0.6	-0.6	-0.5

Standalone - Cashflow Statement

(INR Million)

Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
OP/(Loss) before Tax	7,599	8,711	9,614	11,631	17,258	19,719	23,423
Direct Taxes Paid	-1,609	-832	-2,543	-3,520	-4,009	-4,792	-5,642
(Inc)/Dec in WC							
CF from Operations	5,990	7,879	7,071	8,111	13,248	14,927	17,781
CF from Operating incl EO	5,990	7,879	7,071	8,111	13,248	14,927	17,781
(Inc)/Dec in FA	-2,366	-1,140	705	-1,540	-2,933	-3,709	-3,814
Free Cash Flow	3,623	6,738	7,776	6,571	10,316	11,218	13,967
(Pur)/Sale of Investments	-1,163	-75	-7,597	376	0	6	0
Others	1,395	1,371	1,030	1,857	0	0	0
CF from Investments	-2,135	155	-5,862	694	-2,933	-3,703	-3,814
Dividend Paid	-5,681	-3,881	-4,435	-6,237	-7,518	-8,945	-10,499
Others	1,572	-4,844	3,661	-607	-284	-312	-312
CF from Fin. Activity	-4,109	-8,724	-774	-6,844	-7,802	-9,258	-10,811
Inc/Dec of Cash	-254	-691	434	1,960	2,514	1,967	3,155
Opening Balance	7,379	4,538	9,652	14,267	13,808	16,322	18,289
Other adjustments	-2,587	5,804	4,181	-2,420			
Closing Balance	4,538	9,652	14,267	13,808	16,322	18,289	21,444

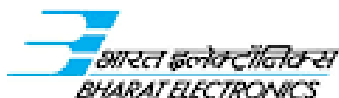
Bharat Electronics

BSE SENSEX
67,481S&P CNX
20,268

CMP: INR147

TP: INR165 (+12%)

Neutral



Bloomberg	BHE IN
Equity Shares (m)	2437
M.Cap.(INRb)/(USDb)	1077.8 / 12.9
52-Week Range (INR)	150 / 87
1, 6, 12 Rel. Per (%)	5/21/34
12M Avg Val (INR M)	1754
Free float (%)	48.9

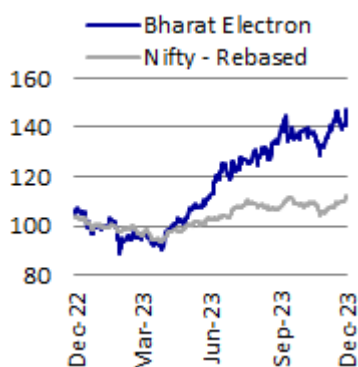
Financials & Valuations (INR b)

Y/E Mar	2023	2024E	2025E
Sales	176.5	206.4	228.1
EBITDA margin	22.9	22.8	22.8
Adj. PAT	30.1	34.6	37.2
EPS (INR)	4.1	4.7	5.1
EPS Gr. (%)	28.0	15.1	7.6
BV/Sh. (INR)	18.7	21.4	24.4
Ratios	-	-	-
RoE (%)	22.0	22.1	20.8
RoCE (%)	23.5	23.7	22.3
Payout (%)	41.3	41.3	41.3
Valuations	-	-	-
P/E (x)	35.8	31.1	28.9
P/BV (x)	7.9	6.9	6.0
EV/EBITDA (x)	24.7	21.7	19.3
EV/Sales (x)	5.8	5.0	4.4

Shareholding pattern (%)

As On	Sep-23	Jun-23	Sep-22
Promoter	51.1	51.1	51.1
DII	24.2	24.8	25.6
FII	17.2	17.4	17.4
Others	7.5	6.7	5.9

FII Includes depository receipts

Stock's performance (one-year)**Play on defence indigenization**

Bharat Electronics (BEL) is well positioned to benefit from (1) growing defense expenditure by the government, (2) its focus on indigenization and presence in multiple segments, (3) strong manufacturing base, (4) strategic technology tie-ups and in-house R&D, (5) improving share of non-defense segments, and (6) focus on increasing exports. We expect a 15% CAGR in BEL's order inflows over FY23-26, resulting in a CAGR of 14%/13%/11% in revenue/ EBITDA/PAT of over the same period. We value the company at 28x two-year forward earnings and reinstate coverage on the stock with a Neutral rating with TP of INR165. Key risks to our estimates and rating would come from delays in the finalization of large tenders, margin pressure and higher working capital.

Growing defense spending positive for BEL

The Indian government's defense budget as a percentage of GDP has hovered in the range of 1.5-1.6% over the last few years and capital outlay forms a third of the total defense budget. In order to achieve USD25b in domestic defense turnover, government will have to increase defense spending to 1.8-2% of GDP. BEL has a revenue market share of 11% in overall defense market and a market share of nearly 60% in the highly specialized defense electronics segment. We also expect BEL to get a share in large order opportunities worth nearly INR750b from QRSAM, MRSAM, Akash Prime over the next 2-3 years.

BEL has a strong presence in import embargo lists

Based on the breadth of offerings, BEL is a key beneficiary of the product import embargo lists released by the Ministry of Defense. It has presence across products such as different types of radars, simulators, EW systems, electronic fuses, thermal imaging, integrated air command and control system, border surveillance system and counter drone systems etc which will be indigenized over next five years. We expect BEL to be a key beneficiary of an opportunity potential of INR5t from all four import embargo lists released so far.

Strong manufacturing presence, new expansions to aid revenue growth

The company has over 350 products, including radars, missile systems, military communications, naval systems, electronic warfare & avionics, C4I systems, electro optics, tank electronics & gun/weapon system upgrades, solar photovoltaic systems, electronic components, and civilian products. BEL is investing in setting up facilities in Neemaluru for electro-optics and IF seekers, Palasamudram for RF seekers, Telangana for EW system, Devanhalli for the space electronics division and Nagpur for electronic fuses, EVs and artillery ammunition. It expects to spend nearly INR8b on capex over the next two years.

Strategic tie ups on technologies and in house R&D enable faster product development

BEL has remained focused on strategic alliances, technology tie ups, MoUs as well as on in-house R&D to provide complete solution and platforms, thereby enhancing its market access and facilitating entry into new areas. In FY23, the company filed 242 IPRs (including 121 patents) in the areas of Communications, Artificial Intelligence, Radars, Antennae, Embedded Systems, etc. etc. and was granted 22 patents, taking the total to 46. R&D investments declined slightly to 6.3% of sales (from 7% in FY22) and the company achieved 75% of turnover from indigenous products.

Improving share of non-defense segments

BEL is working in various areas and is also investing in technologies to increase scope of work across non-defense segments such as healthcare, metro, airport, smart cities, EVs, space, etc. It expects the defense and non-defense mix of 85:15 for FY24 due to the execution of EVM and VVPAT machines.

Focus on increasing services and exports

The company aims to increase business opportunities in South East Asia, Europe, Middle East, Africa, and North and South America. It expects to clock exports of nearly USD90m in FY24, with 15-20% growth every year. The share of services is expected to remain around 10-12% of overall revenues.

Financial outlook

We expect a CAGR of 14%/13%/11% in sales/EBITDA/PAT over FY23-26. We expect OCF/FCF to remain strong over FY23-26 on control over working capital. Further, the company had a cash surplus of INR39b (as of FY23), providing scope for further expansion in capacities.

Key risks and concerns

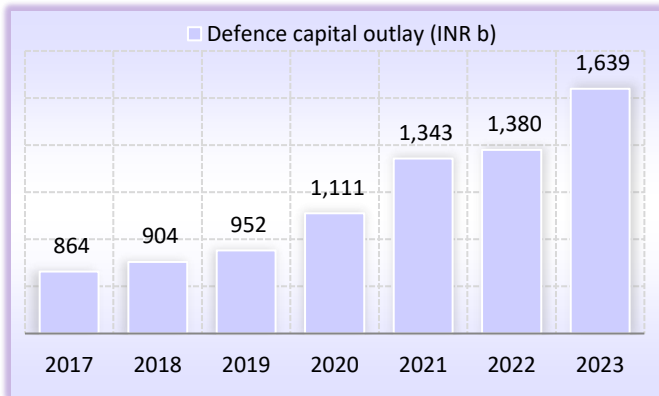
Slowdown in order inflows from defense and non-defense segments, increased competition, further delays in finalization of large tenders, a sharp rise in commodity prices and delays in payments from MoD can adversely impact our estimates on revenues, margins and cash flows.

Valuation and recommendation

BEL is currently trading at 28.9X/26.0X on FY25/26E earnings. With a larger addressable market of nearly INR5t over the next 5-7 years from defense indigenization and scope of improvement in non-defense segments, we expect the company's order inflow and revenues to grow at a much faster rate. We value BEL at 28x P/E on two-year forward earnings and arrive at a fair value of INR165. We re-initiate coverage with a NEUTRAL rating.

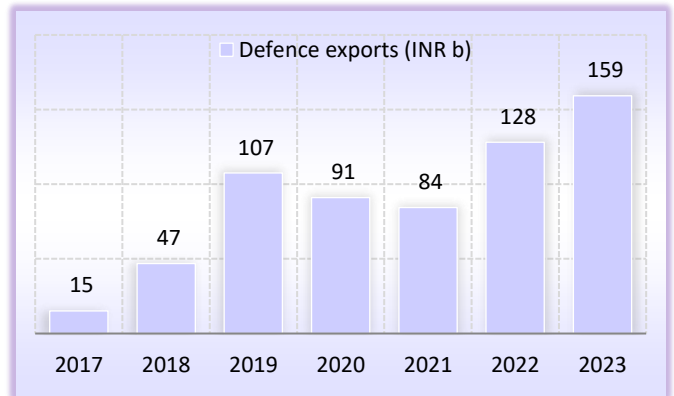
STORY IN CHARTS

Capital outlay on defence has been moving up (INR b)



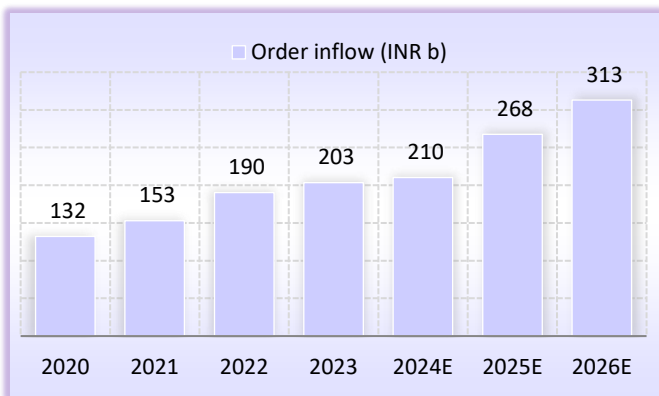
Source: Budget documents, MOFSL

Overall defence exports are up sharply from India (INR b)



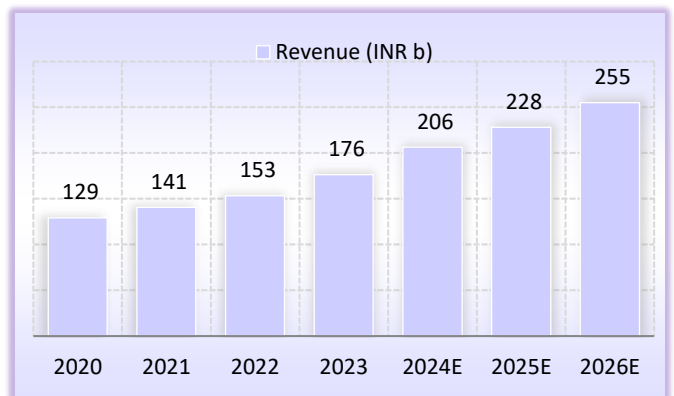
Source: PIB, MOSFL

We expect order inflows to grow at a CAGR of 15% over FY23-26E (INR b)



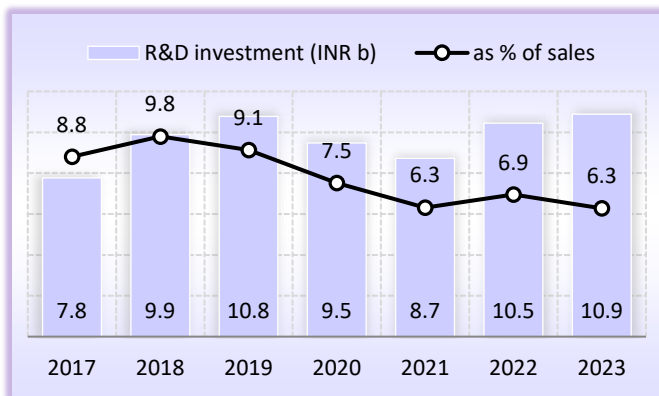
Source: Company, MOFSL

We expect revenues to grow at a CAGR of 14% over FY23-26E (INR b)



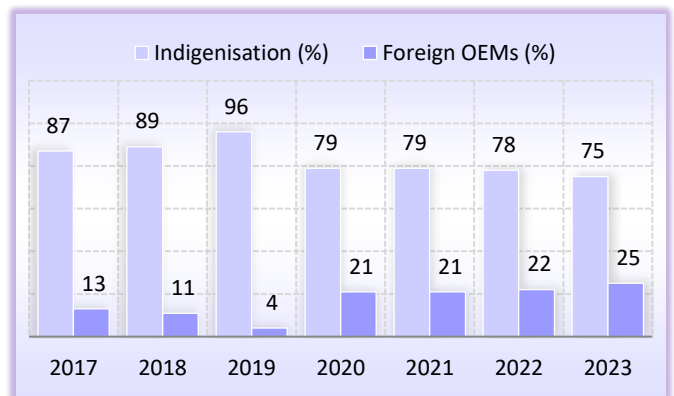
Source: Company, MOFSL

R&D Investment has hovered around 6-7% of sales for BEL (INR b, %)



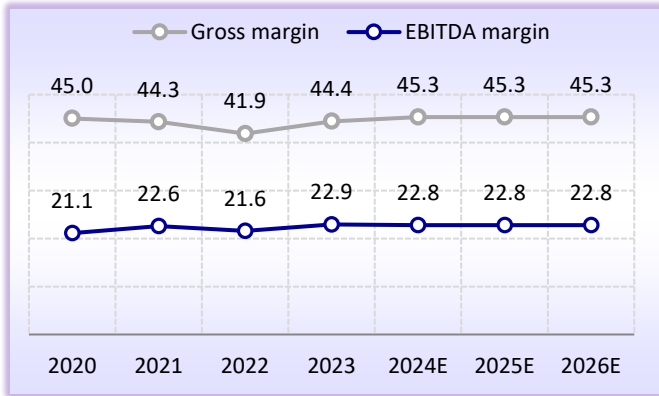
Source: Company, MOFSL

Indigenous content has hovered around 75% in overall revenues in BEL revenue (%)



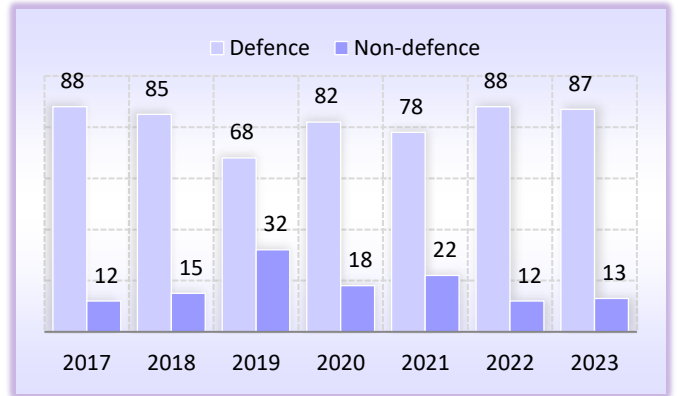
Source: Company, MOFSL

We expect gross margin to improve on lower RM and higher indigenization (%)



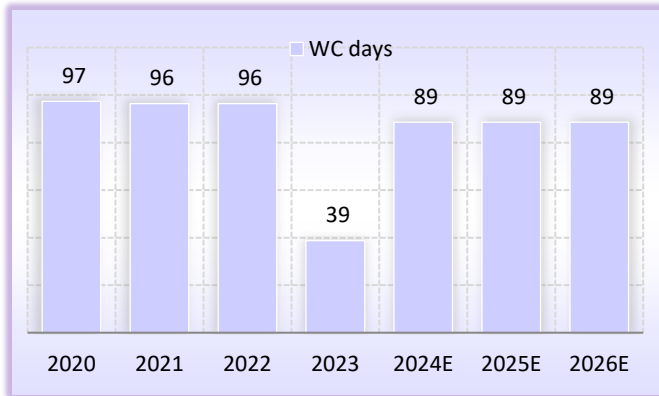
Source: Company, MOFSL

BEL intends to scale up share of non-defence revenues in overall revenues (%)



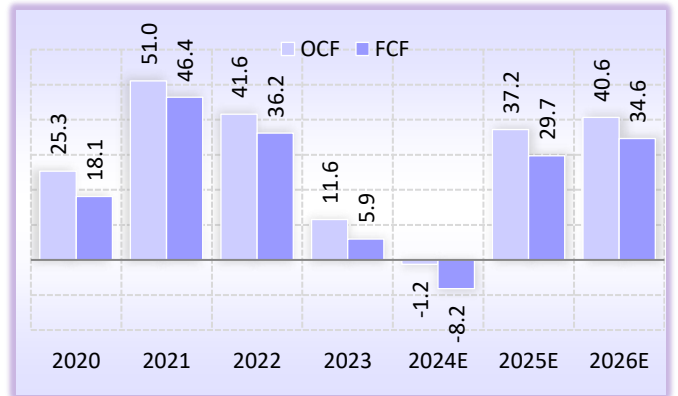
Source: Company, MOFSL

Working Capital cycle to remain largely stable (days)



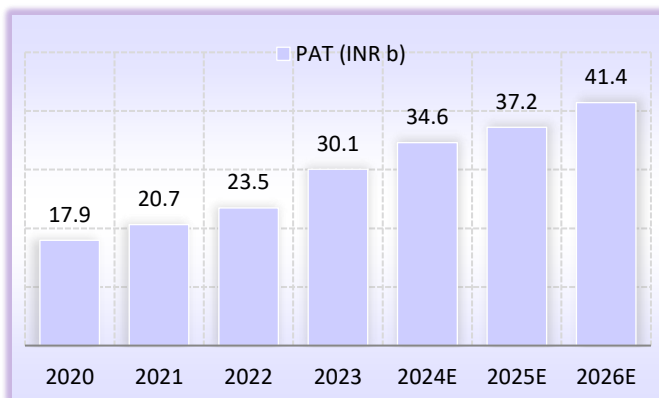
Source: Company, MOFSL

We expect OCF and FCF to start improving from FY25 (INR b)



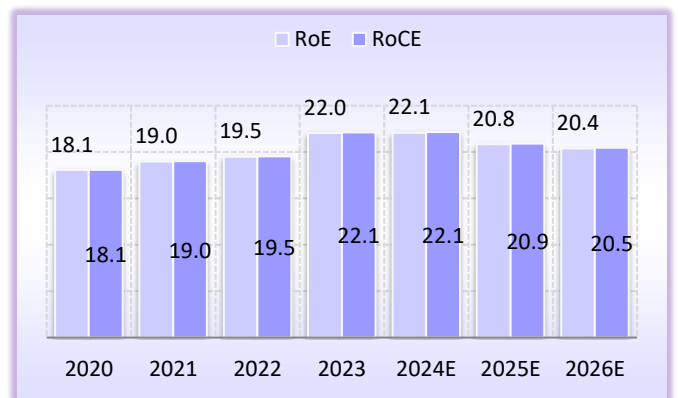
Source: Company, MOFSL

We expect PAT CAGR of 11% over FY23-26 (INR b)



Source: Company, MOFSL

RoE and RoCE to remain healthy above 20% (%)

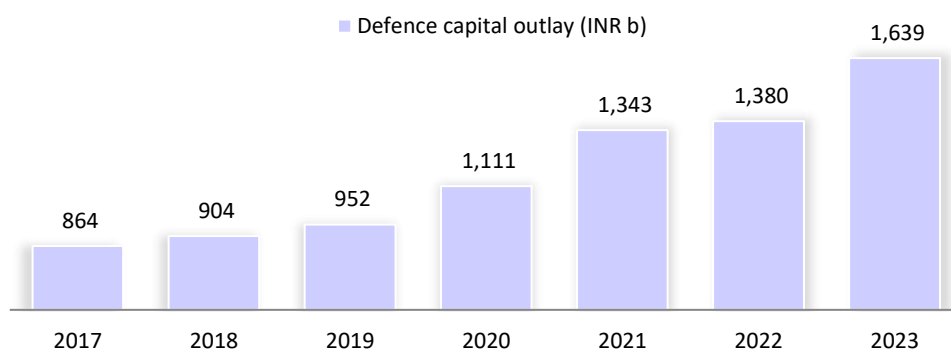


Source: Company, MOFSL

Growing defense spending to be positive for BEL

The government of India aims to achieve a turnover of USD25b, including exports of USD5b in the aerospace and defense goods and services by 2025. In order to achieve USD25b in domestic defense turnover, the government will have to increase its defense spending to 1.8-2% of GDP. BEL has a market share of 11% in the overall defense market and a market share of nearly 60% in the highly specialized defense electronics segment.

Exhibit 225: Capital outlay on defence (INR b)



Source: Budget documents

The government has launched several measures and reforms in the area of defense that are aimed at increasing domestic manufacturing capacity while also encouraging the use of new technology. These initiatives include –

Defence Acquisition Procedure (DAP-2020)

The Government under its Aatmanirbhar Bharat plan came out with the DAP-2020 with a view to give a fillip to domestic design and production of defence products. Under the DAP, three categories of “Make” are delineated with varying amounts of government funding and support. Additionally, two defence corridors have also been announced in Uttar Pradesh and Tamil Nadu with a cumulative investment of INR200b to be set up by 2024.

Other key initiatives

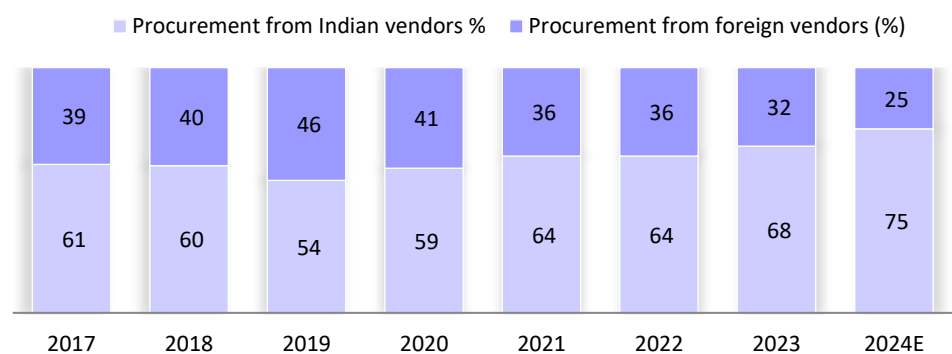
- **FDI Policy:** FDI limit has been raised from 49% to 74% under the automatic route and up to 100% through the government route. This has resulted in a quantum jump in terms of FDI flows (USD410m received between 2014-22 vs USD170m between 2001-14).
- **Offset Policy:** The policy seeks to better facilitate investments in ToT (Transfer of Technology) to domestic players.
- **Indigenisation list:** In a bid to promote domestic manufacturing of components/sub-systems, the Government has released 4 lists consisting of >1,000 products/platforms/sub-systems which place an embargo on imports post the cutoff date. This is expected to boost domestic production and benefit players such as BEL.

Exhibit 226: Details of schemes accorded AoN/CNC negotiated cost for contracting during FY24 & FY25

S. No.	Scheme	Anticipated Cost (INR b)
1	❖ Fleet Support Ships/Fleet Tanker (FSS) - Sec A	170.0
2	❖ Cadet Training Ship - Sec B	30.7
3	❖ Procurement of Upgraded SRGM (R/o)	23.5
4	❖ Next Generation Offshore Patrol Vessels (NGOPVs))- Sec B	89.3
5	❖ Procurement of High Data Rate VLF-HF Receivers	2.6
6	❖ Lynx U-2 for 11 NGOPV & two WWR (R/O)	19.2
7	❖ SDR (Portables) Version -1 - MP Version -2- FP Version - 3- HH	2.7
8	❖ Modernisation of Naval Aircraft Yards (NAY)-Kochi and Goa on 'Turnkey' Basis	3.7
9	❖ Special Maintenance Tools and Special Test Equipment(SMT/STE) for shore based Repair Facility at NSRY(PB)and Shore Based Training Facility at INS Shivaji for Integrated Platform Management System(IPMS) Fitted Onboard LCU MK IV Ships	0.4
10	❖ Setting up of Naval Aircraft and Ship Instrumentation Including Telemetry (NASI)	2.5
11	❖ Upper Air Sounding System (UASS) - Make II	0.2
12	❖ Procurement of Bottom Opening Dumb Barges	0.6
13	❖ Implementation of ERP solution (AIIMS) for NAI organization	0.9
14	❖ Procurement of Integrated Platform Management System with Motion Control (IPMS-MC) Simulator in-house developed By WESEE For Project – 75 Submarines	1.1
15	❖ Universal Proximity and DA Fuze (with electronics adaptable to 76 mm to 127 mm ammunition) for 76/62 Gun Ammunition	0.2
16	❖ Digital Beam forming Based Satellite TV (DB2ST) - Make II	0.6
17	❖ Three Phase Static Inverter for ELTA MPR - Make II	0.1
18	❖ Next Generation Corvettes (NGC)	364.3
19	❖ Procurement of 500 Ton Self Propelled Water Barges (Karwar and Mumbai)	0.7
20	❖ 500 Ton Fuel Barge	1.7
21	❖ Procurement of Six Integrated Bridge System (IBS)	0.3
22	❖ AI in SCM & Logistics	0.0
23	❖ Procurement of Infantry Weapon Training Simulator (IWTS)	0.6
24	❖ Dornier MLU	22.0
25	❖ Procurement of Expendable Aerial Targets (EATs)	1.7
26	❖ DPR, Consultation for Contract Conclusion and Project Monitoring for Strategic Special Assets Facility (SSAF)	0.1
27	❖ Other Schemes (9 Nos)*	184.2
Total		923.6

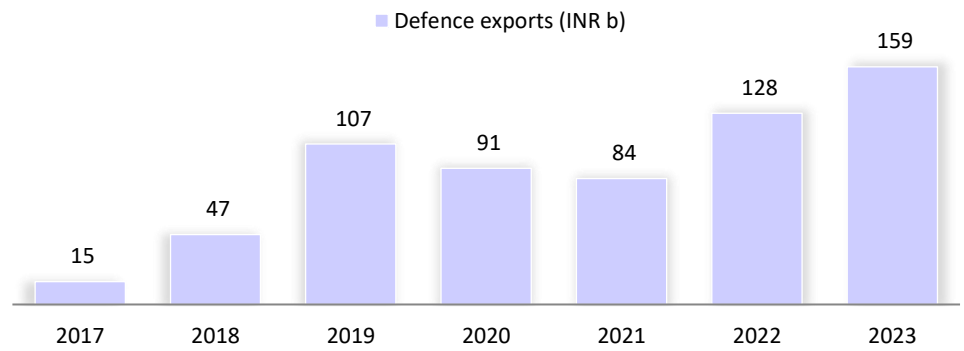
Source: MoD

With these measures, the government expects the share of indigenization to further move up from current levels.

Exhibit 227: Indigenisation in India has been on an uptrend (%)

Source: PIB

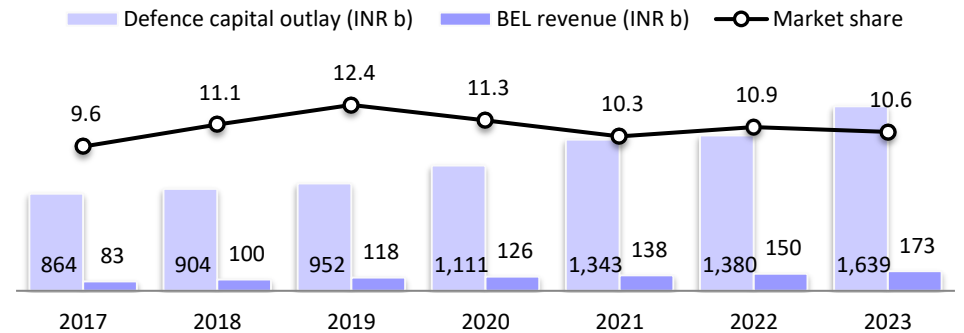
Exhibit 228: Defence exports from India have moved up sharply over last 3 years (INR b)



Source: PIB

Our estimates suggest that by FY30, BEL can post a revenue CAGR of 14% over FY23-30, assuming a 16% CAGR in defence budget based on 1.4% of GDP and BEL maintaining a similar market share of 10% in overall defence spending.

Exhibit 229: BEL's market share has been broadly around 10-11% based on revenues



Source: Company, MOFSL, Budget documents

Order inflow pipeline remains strong and company expect defence orders from fuses (worth INR40 b), NGOPV from Goa Shipyard and GRSE (worth INR25 b), tanks (worth INR30 b), EW systems (worth INR20 b) to materialize in next 6 months to 1 year. Apart from that, large sized orders like QRSAM have completed all trials and should get awarded by FY25.

Key beneficiary of embargo lists for imports/exports

Based on the breadth of offerings, BEL is a key beneficiary of the product import embargo lists released by the Ministry of Defense. It has presence across products such as different types of radars, simulators, EW systems, electronic fuses, thermal imaging, integrated air command and control system, border surveillance system, counter drone systems, etc., which are to be indigenized over the next five years. We expect BEL to be a key beneficiary of an opportunity potential of INR5t from all four import embargo lists released so far.

Exhibit 230: Import embargoes to benefit BEL

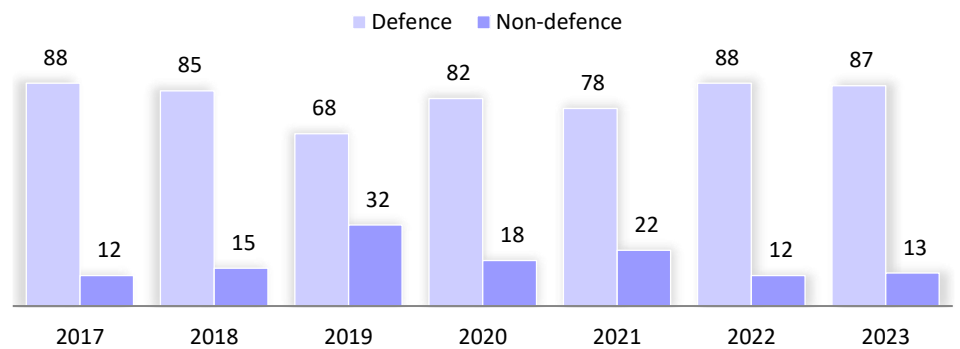
Items where BEL has expertise	
First embargo	❖ Successor of Flycatcher, Shipborne close in weapon system, RWR for transport aircraft, ground based mobile ELINT system, GSAT 6 satellite terminal, digital tropo scatter system, low level transportable radar, high power radar, simulators, software defined radio, EW systems, EW suit, close in weapon system, electronic fuses
Second embargo	❖ Mission System for Airborne Early Warning & Control (AEW&C) System, Anti-Torpedo Decoy System for Ships (Mareech), Shipborne High Accuracy ELINT system, SDR for Combat Ships, Border surveillance system, Ship borne Surface Surveillance Radar (SSR), Battlefield Surveillance Radar (BFSR) up to 10 KM, Through Wall imaging Radars, Portable Diver Detection Sonar, Sarvatra Kavach, Multi-Functional Display System, Instant Fire Detection and Suppression System (IFDSS) for Tanks, Power Amplifier for Tropo upgradation - 10W, 2KW, 4KW, Steering Gear for Destroyers and Frigates, Land Based Medium Power Radar, Mountain Weapon Locating Radar (AESAs Based), Upgraded Integrated Air Command And Control System, Land Based MRSAM Weapon System, Software Defined Radio (Manpack), Software Defined Radio (Hand Held), Medium Power Radar for Mountain, D-29 Unified Receiver Exciter Processor (UREP) Based EW Suite, Network Centric Operation (NCO) Application for Software Defined Radio (SDR), Thermal Imaging (TI) sight for Small Arms, Image Intensifier (II) Sight for Small Arms, Day Sight for Small arms including Telescopic & Reflex sight, D-29 Unified Receiver Exciter Processor (UREP) Based EW Suite
Third embargo	❖ Long Range Reconnaissance & Observation system (LORROS) upto 30 km, Weapon Locating Radar (Plain & Desert) upto 30 Km, Intercom System for Ships & Submarines, Naval Anti-Drone System (NADS), Radar Finger Print System for ELINT Application, SNF Gas Turbine Generator (GTG) Control System, Very Low Frequency (VLF) Communication Station, Light Weight ESM System for small Ships, 3D C/D Band Radar for Ships, Multi-Functional Surveillance & Threat Alert Radar (MF STAR) for Ships, COMINT (Ship Based), Advance Light Weight Torpedo (Ship Launch), Ship Based Medium Range Surface to Air Missile (MRSAM), Global Navigation Satellite System (GNSS): Jammer System, Global Navigation Satellite System (GNSS): Spoofing System, Hand Held Counter Drone System, Counter Drone System (Hard Kill), Counter Drone System (Soft Kill), Thermal Imaging (TI) Sight for Automatic Grenade System, 40mm Multi Grenade Launcher (MGL), Helo Deck Communication System, Stabiliser for Ships, Long Range Weapon with IR Seeker (70-100KM), Land Based Tactical Communication System, Radar Warning Receiver (RWR) for Su-30 MKI, Radar Warning Receiver (RWR) for Mi-17 & Mi-17 IV, Instrumented Electronic Warfare Range (IEWR), Battle Field Surveillance Radar (Range 30 KM), Operational Control System for Air Defence Weapon for Army (Project AKASHTEER), Medium Altitude Long Endurance (MALE) Unmanned Aerial Vehicles (UAV), Twin Store Rack for Smart Anti Airfield Weapon (SAAW), Infrared Search & Track (IRST) for Su-30

Source: MoD

Strong manufacturing presence in defense/non-defense sectors

BEL has a strong domain knowledge and core competencies in radar and fire control systems, weapon systems, communication, network centric systems (c4i), electronic warfare systems, avionics, anti-submarine warfare systems & sonars, electro-optics, tank electronics, gun upgrades, strategic components and has also diversified into arms & ammunitions, seekers & missiles, network & cyber security and unmanned systems. The company has product competencies in the core areas of electronic voting machine (EVM) & VVPAT, HS&SC, software solutions/services, healthcare solutions, civil aviation and solar cells/power plants. It has also diversified into providing railway/metro/ airport solutions, space electronics and systems, EV charging infrastructure, alternate energy solutions, secure communication solutions and software.

Exhibit 231: Defence and non-defence revenue split (%)



Source: Company, MOFSL

Technology tie-ups, MoUs and R&D spending to help BEL capture a larger pie in market

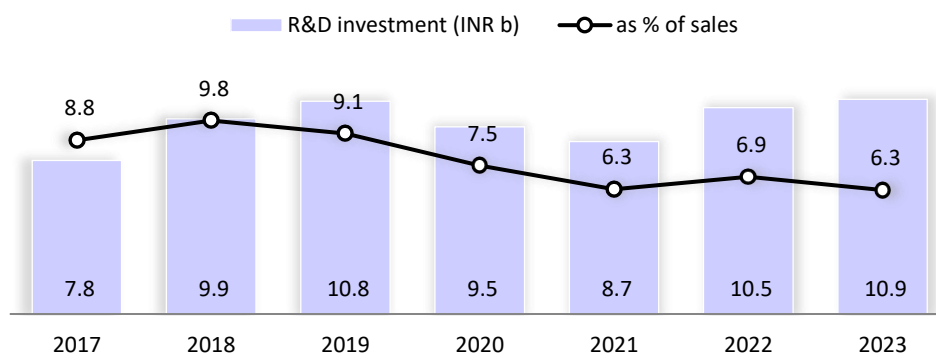
BEL has remained focused on strategic alliances, technology-related tie-ups, MoUs as well as in-house R&D to provide complete solutions and platforms, thereby enhancing its market access and facilitating its entry into new markets. In FY23, the company filed 242 IPRs (including 121 patents) in the areas of f Communications, Artificial Intelligence, Radars, Antennae, Embedded Systems, etc. etc. and was granted 22 patents, taking the total to 46. R&D investments declined slightly to 6.3% of sales (from 6.9% in FY22) and the company achieved 75% of turnover from indigenous products.

Exhibit 232: Key R&D initiatives taken by the company during FY23

Strategic Partner	Area of Cooperation
Advanced Weapons and Equipment India Limited (AWEIL)	❖ Joint development and production of Air Defence Guns, Artillery Guns and Upgrades for Indian Defence and export market
Armoured Vehicles Nigam Ltd (AVNL), Chennai	❖ Joint development and production of Armoured Fighting Vehicles (AFV) and variants and upgrades for Indian Defence and export market
Munitions India Limited (MIL)	❖ Cooperation for Make in India Programs for Ammunition and related products
Safran Electronics & Defense	❖ Domestic manufacture/upgrade of sensors for naval platforms, precision guide munitions (PGMs) etc.
IAI, Israel	❖ Domestic manufacture of Weapon Systems
Aeronautical Design Agency (ADA), Bengaluru	❖ Joint Development of Onboard Computer (IWBC) and Other LRUs for Advanced Medium Combat Aircraft (AMCA)
Hindustan Shipyard Ltd	❖ Joint development and manufacturing of sub systems for Naval platforms, Unmanned Underwater Systems, etc.
Mazagon Dock Shipbuilders Ltd	❖ Joint development and manufacturing of Indigenous materials/equipment required for shipbuilding, submarine programmes and other platforms
Indian Institute of Science (IISc), Bengaluru	❖ Co-operate and work in areas of Artificial Intelligence (AI) and Machine Learning (ML)
AAI Delhi	❖ Joint development for Integrated Air Traffic Management (ATM) automation system and Advance Surface Movement & Guidance Control System (ASMGCS)
University of Agriculture Sciences	❖ Develop solution for Digital farming/agriculture
Smiths Detection Systems Pvt Ltd	❖ Domestic manufacturing and supply of high energy scanners

Source: Company

Exhibit 233: R&D investment has hovered around 6-7% of net sales (%)



Source: Company, MOFSL

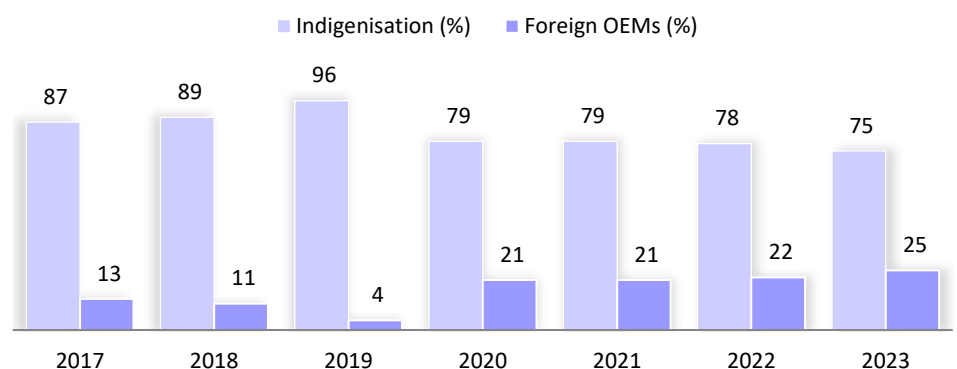
Exhibit 234: BEL has signed several MoUs in FY23 with various players to enter into newer fields and technologies

Date	Company	Areas to explore	Target market	Technical expertise of MoU partner
23-Aug-22	NHPC	Giga Watt Scale vertically integrated Solar Manufacturing Unit	Domestic markets	❖ This MoU will help in creating required infrastructure for indigeneous manufacturing of poly silicon to solar modules to reduce import dependency.
02-Sep-22	Smiths Detection India	High energy scanning systems	Domestic markets	❖ With this MoU, BEL would target non-defence opportunities for high energy scanning systems.
18-Oct-22	Munitions India Ltd (MIL)	Ammunitions, explosives and related subsystems	Domestic and export markets	❖ BEL would target opportunities in ammunitions and explosives through this MoU.
19-Oct-22	Triton Electric vehicle	Manufacturing of Hydrogen Fuel cells with technology transfer from TEV	Domestic and export markets	❖ Triton Electric Vehicle LLC has recently forayed into Hydrogen run vehicles and has started the journey of manufacturing Hydrogen-run Two-Wheelers, Three-Wheelers and Buses.
31-Oct-22	Meslova Systems	Artificial intelligence and machine learning for Air Defence platforms in EW and C4I domains	Domestic and export markets	❖ Meslova is extensively working with IAF and RDO in EW & C4I domains. BEL already has a product in integrated air command and control system.
04-Nov-22	Bosch Global Software Technologies	e-Governance, ERP, cloud solutions	Domestic and export markets	❖ Bosch has the unique ability to offer end-to-end solutions that connect sensors, software and services.
07-Nov-22	Motorola systems	Broadband and push to talk services (WAVE PTX)		❖ Motorola Solutions is a global leader in public safety and enterprise security. Their solutions in landmobile radio communications, video security & access control and command center software, create the most integrated technology ecosystem.
07-Nov-22	DMRC	Joint development of Indigenous Communicationbased Train Control System (i-CBTC)	Domestic markets	❖ i-CBTC, being indigenously developed for the first time in India, will enable unmanned operations of metro and trains. The MoU aims at leveraging the complementary strengths and capabilities of BEL and DMRC.
08-Nov-22	Inery, Singapore	Blockchain technology		❖ Inery is a first mover in the decentralised database solutions market to enable enterprises to scale up as streams of data keeps growing.
10-Nov-22	Goa Shipyard Ltd	Autonomous Navigation and associated fields, simulation ofships, networking of vessels	Domestic and export markets	❖ GSL's proven product range includes multiple variants of Offshore Patrol Vessels, Fast Patrol Vessels, Extra Fast Attack crafts, Missile Boats, Survey Vessels, LCUs, etc.
11-Nov-22	Aerosense technologies	Development and marketing of Drones and soft kill aerial anti drone	Domestic and export markets	❖ Aerosense is engaged in the development and indigenous manufacture of various types of Drones fordefence and homeland with cutting-edge advancements. Aerosense has developed Antidrones andhas five patents
15-Nov-22	Hindustan Shipyard Ltd	Manufacturing and product upgrades	Domestic and export markets	❖ Hindustan Shipyard caters to the needs of shipbuilding, ship repairs, submarine construction and refits as well as design and construction of offshore and onshore structures
15-Nov-22	SVS Tech Ventures LLP	Manufacturing and marketing of Heavy Duty Blast Doors.		❖ SVC TECH is engaged in the development and indigenous manufacture of Blast Proof Doors certified by an international testing agency as well as by CFEES, DRDO
15-Nov-22	Profence, LLC, US	Jointly develop light weapons	Domestic and export markets	❖ Profence is specialised in Defence weapon systems' manufacturing, system integration and training. Profence has requisite National Stock Numbers (NSNs) for direct commercial or foreign military sales.
15-Nov-22	Yantra India Limited (YIL)	Ammunition Hardware and military grade components	Domestic and export markets	❖ Yantra India Limited is an Indian state-owned Defence company, established in 2021 as part of the restructuring and corporatisation of the Ordnance Factory Board into multiple Public Sector Undertakings. YIL has its production facilities at eight locations and primarily manufacture specialised components and equipment required for the manufacture of hardware for small to high caliber ammunitions, rockets, bombs, fuzes, etc.
17-Nov-22	Advanced weapons and	Air Defence, Artillery Gun Systems, Medium	Domestic and export markets	❖ AWEIL, one of the seven DPSUs formed by the corporatisation of the erstwhile Ordnance Factory Board

Date	Company	Areas to explore	Target market	Technical expertise of MoU partner
	equipment India Ltd (AWEIL)	Caliber Weapons, Small Arms and related systems.		(OFB) and is engaged in the design, development and manufacture of Defence systems such as Small Arms, Medium Caliber Weapons, Air Defence, Artillery Gun Systems, Ammunition Hardware, etc
17-Nov-22	Armoured Vehicles Nigam Limited (AVNL/AVANI)	Combat Vehicles, Main Battle Tanks (MBTs), Infantry Fighting Vehicles (IFVs), Armored Fighting Vehicles	Domestic and export markets	❖ AVANI possesses modern infrastructure and capability of designing and building sophisticated Armoured Fighting Vehicles
17-Nov-22	IITM Pravartak Technologies Foundation	Develop the technology of Distributed Acoustic Sensing	Domestic and export markets	❖ Pravartak is a Section 8 company created by Indian Institute of Technology Madras (IITM) with an aim to promote science, research and development.
18-Nov-22	R&DE (E), DRDO (LaToT)	Manufacturing of Unexploded Ordnance Handling Robot (UXOR)	Domestic markets	❖ R&DE (E) has developed and delivered combat engineering systems like military bridging, mine-warfare and allied systems, ground support systems and launchers for weapon programs and field defence
18-Nov-22	DRDL, IRDE (LaToT)	Manufacturing of Laser Based End Game Fuze		❖ DRDL and IRDE are working on several technologies required for missiles and strategic systems including Aerodynamics and Airframe Design, Computational Fluid Dynamics, Solid, Liquid, Ramjet and Scramjet Propulsion, Precision Fabrication, Systems Analysis, as well as Command and Control systems for missile based weapon systems.
18-Nov-22	Centre for High Energy Systems and Sciences (CHESS)	Manufacturing of Multi kW Beam Directed Optical Channel (BDOC)		❖ CHESS, DRDO is engaged in the development of High Energy Weapon Systems. Its primary focus is in the research and development of various laser materials, components and laser systems including high power laser. It has already developed and delivered directed energy weapon system based on high-power laser technology
18-Nov-22	IIT Madras (JDA)	Quantum Science and Technology		❖ Indian Institute of Technology Madras (IITM) is known for excellence in technical education, basic and applied research, innovation, entrepreneurship and industrial consultancy.
18-Nov-22	Combat Aircraft Systems Development and Integration Centre (CASDIC), DRDO (LaToT)	For transfer of technology of Digital Radar Warning Receiver		❖ CASDIC is a laboratory under DRDO, MoD, GoI, specialising in the area of systems and solutions for fighter aircraft

Source: Company

Exhibit 235: Trend in indigenization as percentage of revenues (%)



Source: Company, MOFSL

Improving share of non-defense segments

BEL intends to improve the share of non-defense segments in overall revenues. Inflow pipeline from non-defense segment also looks good particularly from air traffic management (INR8-9 b worth of projects from 40 airports) and metros where company has already delivered automatic train supervision system for Delhi Metro.

Metro

- It expects to grow the metro segment by jointly developing products. It has signed an MoU with Delhi Metro for design and development of products for future metro trains, which will be developed in the country. BEL will make the products, but intellectual property rights will lie with both the parties. It will work out a royalty-based methodology in this. It also expects to reduce reliance on imported components for metros via indigenized products made by BEL.

E-vehicle

- It has signed an MoU with HPCL to install their own electric chargers at HPCL outlets. BEL has also indigenously developed EV slow and fast chargers. The Ministry of Heavy Industries has entrusted BEL with installing EV charging infrastructure at four highways/expressways. It is also working with e-vehicle manufacturers for batteries for EVs. They are also in process of manufacturing lithium cells with indigenous technology or with a foreign technology tie-up.

Space

- BEL is participating in tender for building a PSLV rocket along with Adani and BEML. It is working with HAL for aerospace and many other orders for electro optic sensors and composite manufacturing facility for making composite parts for the LCA program. It will also work on the navigational platform.

Smart city

- The company is doing a lot of projects in the smart city segment and expects to expand in the segment in a much bigger way. It is working very closely with the Airports Authority of India to increase indigenization of upcoming airports in India.

Healthcare

- BEL has worked on ventilators, oxygen concentrators and hemodialysis machines.

Focus on increasing services and exports

BEL aims to increase business opportunities in South East Asia, Europe, Middle East, Africa and North and South America and is targeting exports of nearly USD90m in FY24, with 15-20% growth every year. It plans to grow exports via defense, non-defense as well as emerging areas. The share of services is expected to remain around 10-12% of overall revenues.

Defense exports:

The company has been increasingly focusing on harnessing the export potential of defense electronics products & systems, including homeland security solutions, border protection systems and state-of-the-art systems & solutions and professional electronics. Major leads in the pipeline for following products and systems offered to foreign countries/customers are -

- Coastal Radar System
- Radar Systems and Solutions
- Upgradation of Naval Radar and Sonars
- Contract Manufacturing
- Communication Equipment
- Electronic Warfare & Avionics

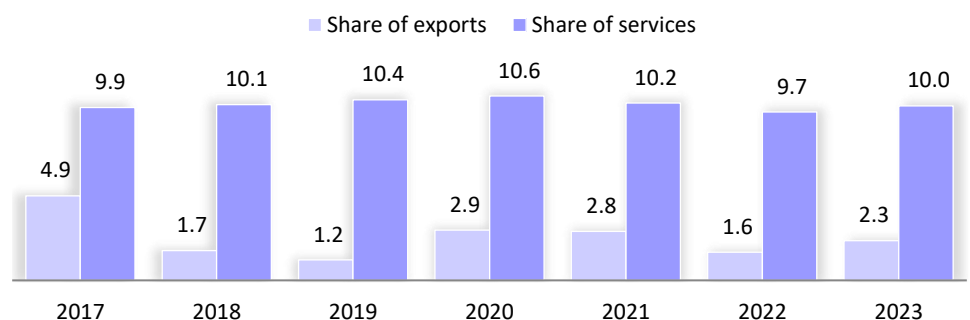
Non-defense exports

BEL is also exploring the civil and medical equipment market in developed markets, as well as developing and third-world countries, with products and solutions like artificial intelligence-based solutions, software development for various civilian projects, IOT sensors, sensor fusion and management systems, unified data analytics platform system, smart hub, security package for VVIP areas, smart cities, critical infrastructure development, solar power generation projects etc.

Emerging areas of export

BEL is focusing on opportunities in the area of helping OEMs to meet offset obligations in various RFPs of the government on account of the offset policy incorporated in the defense procurement procedure. To this end, the company is closely working and partnering with various major foreign aerospace and defense companies. BEL has identified contract manufacturing (build to print and build to spec) and transfer of technology of the latest systems and solutions as new areas of emerging export opportunities.

Exhibit 236: Share of exports and services (%)

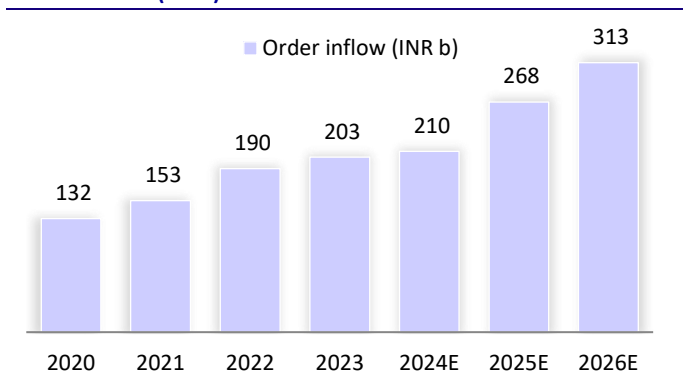


Source: Company, MOFSL

Financial outlook

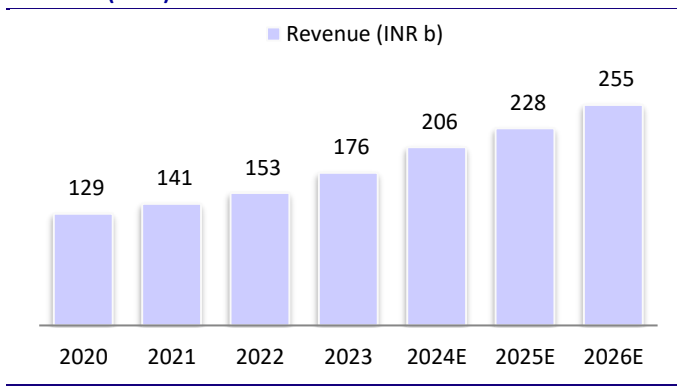
We expect its sales/EBITDA/PAT to register 14%/13%/11% CAGRs over FY23-26. We expect OCF/FCF to remain strong over FY23-26 on control over working capital. Further, the company had a cash surplus of INR39b (as of FY23), providing scope for further expansion in capacities.

Exhibit 237: We expect order inflows to grow at a CAGR of 15% over FY23-26E (INRb)



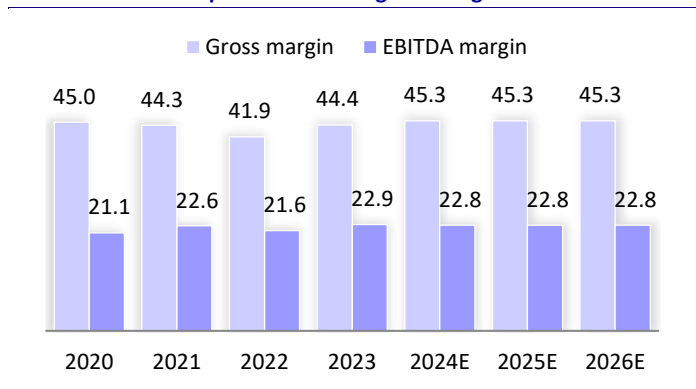
Source: Company, MOFSL

Exhibit 238: We expect revenues to grow at a CAGR of 14% over FY23-26E (INRb)



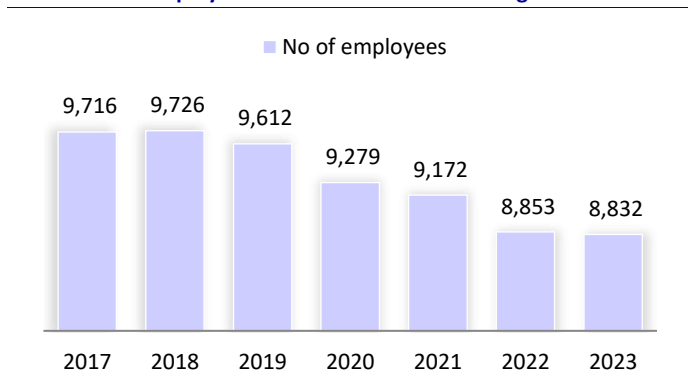
Source: Company, MOFSL

Exhibit 239: We expect EBITDA margin to range between 22-23%



Source: Company, MOFSL

Exhibit 240: Employee headcount has been coming down for BEL



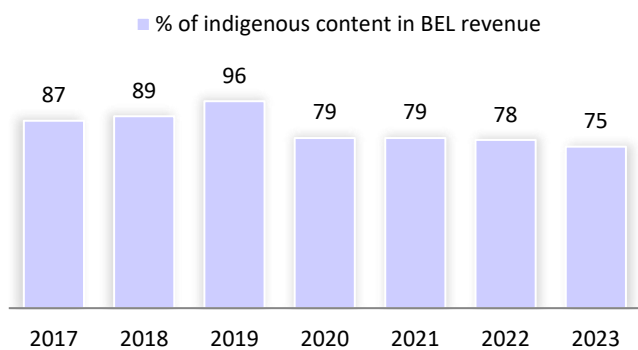
Source: Company, MOFSL

Exhibit 241: Company's net provisioning had come down from FY20-22 resulting in lower other expenses and providing margin boost. This had moved up again in FY23.

INR m	2017	2018	2019	2020	2021	2022	2023
Other expenses - reported	4,469	5,106	7,524	5,932	7,596	9,926	14,921
Write offs and provisions charged (A)	4,418	5,246	6,433	4,351	3,546	4,553	7,728
Write offs and provisions withdrawn (B)	1,989	2,054	1,645	2,084	1,261	1,133	1,202
Net provisions (A-B)	2,429	3,192	4,788	2,267	2,285	3,420	6,526
As a % of revenue	2.8	3.1	4.0	1.8	1.6	2.2	3.7

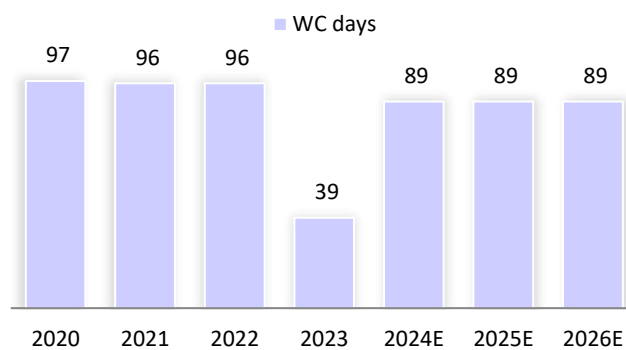
Source: Company, MOFSL

Exhibit 242: Share of indigenous content in revenue



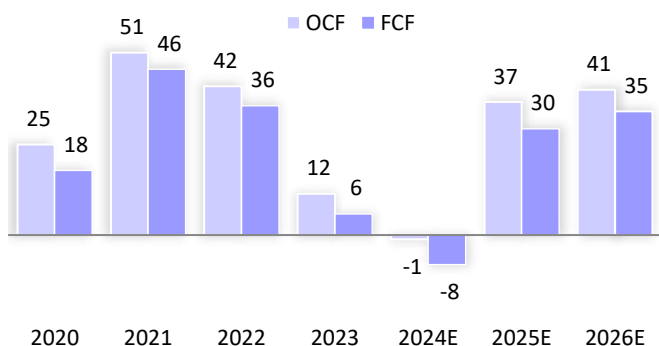
Source: Company, MOFSL

Exhibit 243: We expect WC days to remain around 90 days



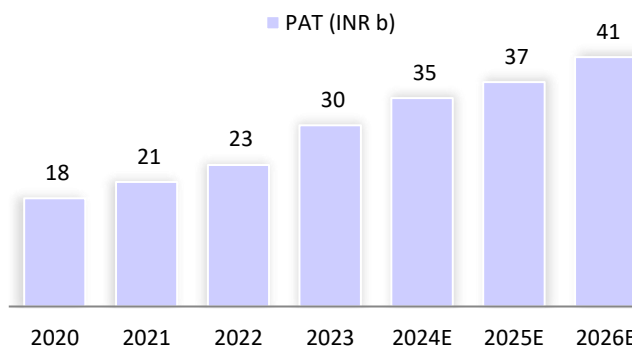
Source: Company, MOFSL

Exhibit 244: We expect OCF & FCF to improve from FY25 as company has lined up capex of INR7-8b



Source: Company, MOFSL

Exhibit 245: We expect PAT to grow at a CAGR of 11% between FY23-26



Source: Company, MOFSL

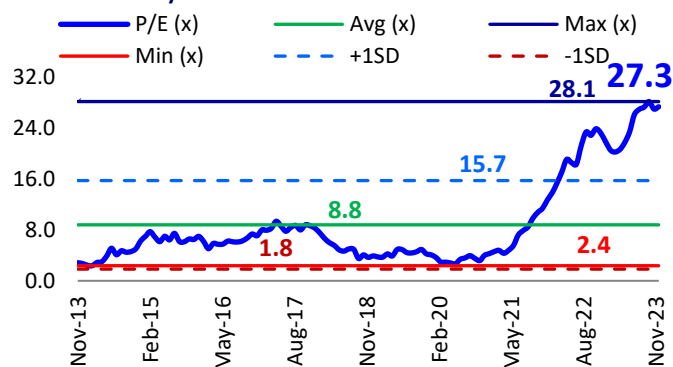
Key risks and concerns

Slowdown in order inflows from defense and non-defense segments, increased competition, further delays in finalization of large sized tenders, a sharp rise in commodity prices and delays in payments from the government can adversely impact our estimates on revenues, margins and cash flows.

Valuation and recommendation

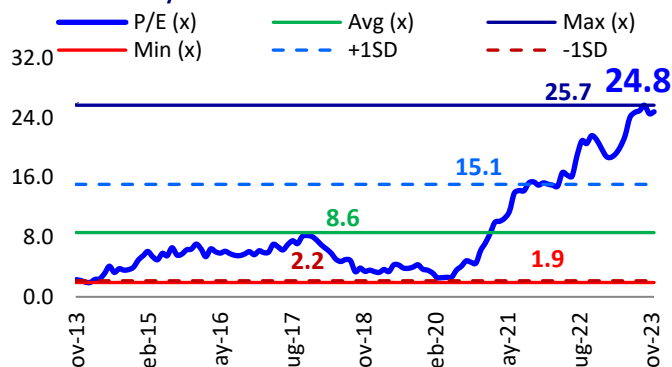
BEL is currently trading at 28.9x/26.0x on FY25/26E earnings. With a larger addressable market of nearly INR5t spanning over the next 5-7 years from defense indigenization and scope of improvement in non-defense segments, we expect the company’s order inflow and revenues to grow at a much faster rate. We value it at 28X P/E on two-year forward earnings and arrive at a fair value of INR165. We reinstate coverage with a Neutral rating.

Exhibit 246: 1-year forward PE valuation band



Source: Bloomberg, MOFSL

Exhibit 247: 2-year forward PE valuation band



Source: Bloomberg, MOFSL

Exhibit 248: Sensitivity analysis - bear, base and bull case valuations

	Bear case	Base case	Bull case	Rationale
PAT (INR b)	36.3	40.3	44.4	❖ 10% sensitivity of Dec, 25 earnings
Valuation multiple (X)	26	28	32	❖ 10% sensitivity of multiples
Core business valuation (INR b)	922	1,138	1,377	
Price per share (INR)	126	165	188	

Source: MOFSL

SWOT analysis

- ❖ Prime beneficiary of defence spending
- ❖ Stellar execution track record
- ❖ Consistent innovation and R&D
- ❖ Robust balance sheet

S
STRENGTH



- ❖ Longer Delivery Cycles
- ❖ Huge chunk of orders won on nomination basis
- ❖ Dependence on MoD for payments

W
WEAKNESS



- ❖ Rising defence spends
- ❖ Indigenisation
- ❖ Improving export opportunity
- ❖ Increasing opportunity from non-defence segments

O
OPPORTUNITY



- ❖ Rising competition
- ❖ Lower defence spending
- ❖ Higher input prices
- ❖ Supply chain issues impacting RM procurement

T
THREATS



Management profile



Mr Bhanu Prakash Srivastava, [Director (Other Units), and Additional Charge, Chairman and Managing Director]

Mr Bhanu Prakash Srivastava, who is Director (Other Units) of BEL since April 20, 2022, assumed Additional Charge as Chairman & Managing Director and Director (Marketing) on November 1, 2022. He was serving as General Manager of the Advanced Defence Systems-Navy (ADSN) Strategic Business Unit at BEL's Bangalore Complex prior to being elevated to the Board. He degree in Bachelor of Technology (Mechanical Engineering) from IIT-BHU and Master of Business Administration (Marketing).



Mr Manoj Jain, [Director (R&D) & Additional Charge, Director (Bangalore Complex)]

Mr Manoj Jain took charge as the Director (R&D) of Navratna Defence PSU Bharat Electronics Limited (BEL) on September 26, 2022. He was General Manager of the Electronic Warfare & Avionics SBU at BEL's Bangalore Complex prior to his elevation. He has completed his BE (Electronics) from REC Jaipur (MNIT) with Gold medal. In an illustrious career spanning over three decades, he has made significant contributions to the field of Research & Development.



Mr Damodar Bhattad, [Director (Finance) & CFO]

Mr Damodar Bhattad S has taken charge as the Director (Finance) of Navratna Defence PSU Bharat Electronics Limited (BEL) with effect from January 11, 2023. He was working as General Manager (Finance) at BEL's Corporate Office prior to his elevation.



Mr K V Suresh Kumar, [Director (Marketing)]

Mr Kaipa Venkata Suresh Kumar took charge as Director (Marketing) of Navratna Defence PSU Bharat Electronics Limited (BEL) on June 16, 2023. He was serving as the General Manager of BEL's Product Development & Innovation Center (PD&IC) in Bengaluru before his elevation

Financials and valuation

Income statement							(INR M)
Y/E March	2020	2021	2022	2023	2024E	2025E	2026E
Net Sales	1,29,211	1,40,638	1,53,138	1,76,462	2,06,408	2,28,147	2,55,196
Change (%)	6.9	8.8	8.9	15.2	17.0	10.5	11.9
Manufacturing Expenses	76,984	85,875	98,951	1,13,010	1,32,496	1,46,451	1,63,814
Gross Profit	52,227	54,764	54,186	63,453	73,912	81,696	91,382
Staff Cost	20,575	19,407	21,094	22,977	26,833	29,659	33,175
Office & Site Establishment Exps	4,351	3,546	0	0	0	0	0
EBITDA	27,301	31,811	33,092	40,475	47,079	52,037	58,207
% of Net Sales	21.1	22.6	21.6	22.9	22.8	22.8	22.8
Depreciation	3,496	3,663	3,802	4,079	4,570	5,128	5,648
Interest	33	61	49	148	148	148	148
Other Income	1,019	1,261	2,336	3,600	3,880	2,995	2,925
PBT	24,792	29,348	31,578	39,849	46,241	49,756	55,336
Tax	6,853	8,694	8,089	9,782	11,639	12,524	13,928
Rate (%)	27.6	29.6	25.6	24.5	25.2	25.2	25.2
Adjusted PAT	17,938	20,654	23,489	30,067	34,602	37,233	41,408
EO Income (Net of Expenses)	0	0	0	0	0	0	0
Reported PAT	17,938	20,654	23,489	30,067	34,602	37,233	41,408
Change (%)	-6.9	15.1	13.7	28.0	15.1	7.6	11.2

Balance sheet							(INR M)
Y/E March	2020	2021	2022	2023	2024E	2025E	2026E
Share Capital	2,437	2,437	2,437	7,310	7,310	7,310	7,310
Reserves	96,824	1,06,331	1,18,055	1,29,146	1,49,446	1,71,290	1,95,584
Net Worth	99,261	1,08,768	1,20,492	1,36,455	1,56,756	1,78,600	2,02,893
Loans	-	-	-	-	-	-	-
Deffered Tax Liability	(4,974)	(4,634)	(6,207)	(5,034)	(5,034)	(5,034)	(5,034)
Capital Employed	94,287	1,04,134	1,14,285	1,31,422	1,51,722	1,73,566	1,97,859
Gross Fixed Assets	42,815	45,103	50,090	55,847	62,847	70,347	76,347
Less: Depreciation	12,784	16,448	20,250	24,328	28,898	34,026	39,674
Net Fixed Assets	30,030	28,655	29,840	31,518	33,948	36,320	36,672
Capital WIP	1,994	3,507	3,986	3,616	3,616	3,616	3,616
Investments	12,233	13,313	15,543	6,645	6,645	6,645	6,645
Curr. Assets	1,89,879	2,40,423	2,78,924	3,03,732	3,36,770	3,80,388	4,34,372
Inventory	39,628	49,547	55,669	64,121	72,717	80,376	89,905
Debtors	40,055	65,515	61,034	70,220	96,154	1,06,281	1,18,881
Cash & Bank Balance	15,562	50,082	74,991	80,090	57,416	71,612	88,988
Loans & Advances	400	527	88	83	773	855	956
Other Current Assets	94,235	74,752	87,142	89,219	1,09,709	1,21,264	1,35,641
Current Liab. & Prov.	1,39,850	1,81,764	2,14,008	2,14,089	2,29,257	2,53,402	2,83,445
Liabilities	1,25,091	1,64,265	1,91,851	1,99,468	2,03,574	2,25,015	2,51,692
Provisions	14,759	17,499	22,157	14,621	25,682	28,387	31,753
Net Current Assets	50,029	58,659	64,916	89,643	1,07,513	1,26,985	1,50,927
Misc. Expenses	-	-	-	-	-	-	-
Application of Funds	94,287	1,04,134	1,14,285	1,31,422	1,51,722	1,73,566	1,97,859

Financials and valuation

Ratios

Y/E March	2020	2021	2022	2023	2024E	2025E	2026E
Adjusted EPS	7.4	8.5	9.6	4.1	4.7	5.1	5.7
Growth (%)	-6.9	15.1	13.7	-57.3	15.1	7.6	11.2
Cash EPS	8.8	10.0	11.2	4.7	5.4	5.8	6.4
Book Value	40.7	44.6	49.5	18.7	21.4	24.4	27.8
DPS	3.1	3.4	4.2	1.7	2.0	2.1	2.3
Payout (incl. Div. Tax.)	42	40	44	41	41	41	41
Valuation (x)							
P/E (standalone)	20.0	17.4	15.3	35.8	31.1	28.9	26.0
Cash P/E	16.8	14.8	13.2	31.6	27.5	25.4	22.9
EV/EBITDA	12.6	9.7	8.6	24.7	21.7	19.3	17.0
EV/Sales	2.7	2.2	1.9	5.8	5.0	4.4	3.9
Price/Book Value	3.6	3.3	3.0	7.9	6.9	6.0	5.3
Dividend Yield (%)	2.1	2.3	2.8	1.2	1.3	1.4	1.6
Profitability Ratios (%)							
RoE	18.1	19.0	19.5	22.0	22.1	20.8	20.4
RoCE	18.9	19.9	20.5	23.5	23.7	22.3	21.8
RoIC	26.7	38.9	76.5	90.3	50.8	39.9	41.3
Turnover Ratios							
Debtors (Days)	113	170	170	170	170	170	170
Inventory (Days)	112	129	129	129	129	129	129
Fixed Asset Turnover (x)	2.9	3.1	3.0	3.1	3.2	3.2	3.3

Cash flow statement

Y/E March	2020	2021	2022	2023	2024E	2025E	2026E
PBT before Extraordinary Items	24,792	29,348	31,578	39,849	46,241	49,757	55,336
Add : Depreciation	3,496	3,663	3,802	4,079	4,570	5,128	5,648
Interest	(292)	750	(1,241)	(2,046)	148	148	148
Less : Direct Taxes Paid	5,684	5,323	8,024	9,150	11,639	12,524	13,928
(Inc)/Dec in WC	3,013	22,597	15,498	(21,179)	(40,544)	(5,276)	(6,565)
CF from Operations	25,325	51,035	41,612	11,552	(1,225)	37,233	40,639
Extra-ordinary Income	-	-	-	-	-	-	-
CF from Operations after EOI	25,325	51,035	41,612	11,552	(1,225)	37,233	40,639
(Inc)/Dec in FA	(7,264)	(4,664)	(5,461)	(5,621)	(7,000)	(7,500)	(6,000)
Free Cash Flow	18,062	46,371	36,151	5,931	(8,225)	29,733	34,639
(Pur)/Sale of Investments	(731)	(1,094)	(43,145)	33,442	-	-	-
CF from Investments	(7,995)	(5,758)	(48,606)	27,820	(7,000)	(7,500)	(6,000)
(Inc)/Dec in Networth	(250)	(83)	-	-	-	0	-
(Inc)/Dec in Debt	(13)	(16)	-	-	-	-	-
Less : Interest Paid	552	431	539	697	148	148	148
Dividend Paid	9,793	10,227	10,233	12,424	14,301	15,389	17,115
CF from Fin. Activity	(10,608)	(10,757)	(10,772)	(13,121)	(14,449)	(15,537)	(17,262)
Inc/Dec of Cash	6,722	34,519	(17,766)	26,251	(22,674)	14,196	17,376
Add: Beginning Balance and other adjustments	8,840	15,562	92,757	53,838	80,090	57,416	71,612
Closing Balance	15,562	50,082	74,991	80,090	57,416	71,612	88,988

Kirloskar Oil Engine

BSE SENSEX
67,481S&P CNX
20,268

CMP: INR584

TP: INR710 (+22%)

Buy



Bloomberg	KOEL IN
Equity Shares (m)	145
M.Cap.(INRb)/(USDb)	84.6 / 1
52-Week Range (INR)	606 / 284
1, 6, 12 Rel. Per (%)	-2/34/66
12M Avg Val (INR M)	228
Free float (%)	58.8

Financials & Valuations (INR b)

Y/E Mar	2023	2024E	2025E
Sales	41.2	48.0	56.0
EBITDA margin	10.4	11.1	11.6
Adj. PAT	2.7	3.5	4.3
EPS (INR)	18.7	23.9	29.9
EPS Gr. (%)	62.5	27.9	25.1
BV/Sh. (INR)	161.3	185.2	215.1

Ratios

RoE (%)	12.1	14.1	15.8
RoCE (%)	11.8	13.8	15.6
Payout (%)	26.8	26.8	26.8

Valuations

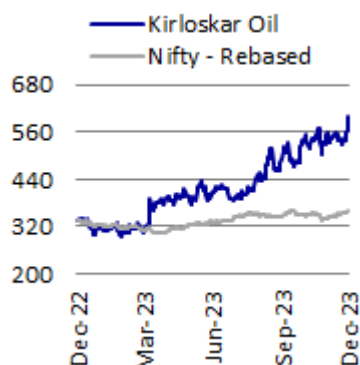
P/E (x)	31.3	24.4	15.8
P/BV (x)	3.6	3.3	2.9
EV/EBITDA (x)	19.9	15.6	12.4
EV/Sales (x)	2.1	1.7	1.4

Shareholding pattern (%)

As On	Sep-23	Jun-23	Sep-22
Promoter	41.2	41.2	59.4
DII	24.3	28.6	13.6
FII	7.8	6.2	2.7
Others	26.7	24.0	24.4

FII Includes depository receipts

Stock's performance (one-year)



Ramping up portfolio across segments

KOEL is benefiting from strong demand in the powergen, industrial, and distribution segments and is targeting to increase its exports from current levels. The company is already ready with products related to revised pollution norms for CPCB 4+ and has also introduced several fuel agnostic products. The company has a market leadership in the mid-kVA range and has also introduced new products in the 1,500 kVA range. With several new products and focus on increasing exports, distribution and aftermarket and higher market share in existing segments, company has lined out a plan to double its revenues in 3 years. We expect revenues to grow at a CAGR of 16% between FY2023-26E driven by faster growth in powergen, industrial, distribution segment while exports will gradually start inching up. We expect margin improvement of 180 bps over FY23-26E, resulting in 25% PAT CAGR over the same period. We value the company on SOTP methodology valuing core business at 18X P/E on two-year forward earnings. Initiate with a BUY rating with TP of INR710. Key risks to recommendation would come from sharper-than-expected slowdown in exports, slowdown in demand for powergen and industrial segments and higher commodity prices.

Beneficiary of strong demand environment

Despite near term uncertainty in the market on mixed sale products based on CPCB 2 and CPCB 4+, long term demand growth drivers for powergen segment are strong particularly from realty, commercial, hospitality, data centre and manufacturing. The requirement for generator sets as the primary power source in off-grid areas, particularly for telecom towers in 5G infrastructure and rising requirement for uninterrupted power supply in various sectors, such as manufacturing, infrastructure, healthcare, data centres and residential areas is positive for genset demand. Demand for CPCB 4+ compliant products has also started improving particularly from states like NCR where emissions norms are more stringent. KOEL has a strong positioning in low and mid kVa ranges and is expanding presence across high kVa ranges. We expect it to continue to benefit from powergen segment demand growth. Near term uncertainty in demand for both CPCB 2 and CPCB 4+ products was managed well by KOEL owing to its strong relationship with supply chain vendors and distributors.

Ready with CPCB4+ and HHP products in powergen segment

KOEL is ready with new products, which are in compliance with CPCB4+ norms. Depending on market demand in the near term - for both CPCB 2 and CPCB 4+ products, it can alter the supply chain network and deliver accordingly. Along with this, the company also has fuel agnostic products in its portfolio. The company has developed IOT-enabled gas generators across various power nodes with digital monitoring systems. It has also introduced a dual fuel kit that can be retrofitted to existing and future diesel generators,

enabling them to operate on a combination of gas and diesel. Furthermore, KOEL has strategically entered the high horse power (HHP) range, with the introduction of its OptiPrime series, focused on key segments such as data centres and infrastructure. These products will enable KOEL to meet demand coming from changing emission norms, dual fuel requirements of specific regions such as NCR as well as enhance its positioning in fast growing data centre market. We expect powergen segment revenue CAGR of 18% over FY23-26.

Widening scope of industrial segment

The company's industrial segment revenues registered a CAGR of 10% over FY19-23. In comparison, Cummins, saw its industrial segment revenues grow at a rate of 2.5% during the same period. KOEL has been expanding its presence in diverse sectors such as rail, defence, fisheries. Through strategic partnerships with organizations that complement its strengths, KOEL is enhancing its market presence. Additionally, the company has ventured into offering turnkey solutions for projects within the defence and marine industry. We thus expect this segment's revenues to clock a CAGR of 18% over FY23-26.

Focusing on increasing exports

Export markets are currently witnessing a mixed trend with demand coming in from the Middle East, while other markets such as the US, Europe, Latin America, and Africa are currently weak. KOEL is appointed as GOEM for key International markets particularly GCC countries. The company's powergen segment is witnessing traction on account of new products and will see improved growth in the coming years for its CPCB 4+ compliant products in markets such as the US. KOEL is trying to increase its position in the firefighting segment across markets by adding new OEMs and increasing market share with the existing OEMs. Though KOEL aims to take the share of exports to 30% of sales by FY25, we expect it to grow at a CAGR of 15%, forming 10% of sales by FY25 due to weak growth scenario currently seen across major export geographies

Strengthening distribution and aftermarket network

In the distribution and aftermarket sectors, the company has established two distinct segments (i) Customer support and service channel (ii) Retail channel for spare parts, oil and allied products. Within the Customer support and service channel, company has an extensive network of over 400 service outlets throughout India, all of which, are seamlessly connected through a robust digital platform. In the retail segment, the company is strategically planning to expand its footprint in other markets such as Andhra Pradesh, Telangana, Kerala, and Rajasthan.

B2C segments form a smaller proportion of sales

Currently, B2C sales forms 13% of net sales. Within the B2C segment, the company focuses on water management solutions (focusing on pump sets and diesel engines) and farm mechanisation, focusing on power tiller and weeders. Water management solutions witnessed a slowdown in demand for diesel pump sets as the industry is now moving close to electric pump sets. It continued to witness good growth for diesel engines. We expect B2C sales to register a CAGR of 10% over FY23-26E.

Strategy of 2X revenues in 3 years

The company has drawn out a road map to double its revenues to INR65b in three years from the base of FY22. It intends to achieve this through 1) the introduction of new products in HHP category between 1,500 kVA and 3,000 kVA, 2) growing share of exports to 30% of sales through new product launches and penetration of CPCB 4+ products in international markets, 3) increasing distribution and after-market presence. Our estimates bake in a lower growth in revenues to INR56b by FY25.

Financial outlook

We expect revenues to register a CAGR of 16% over FY23-26E, driven by 18%/18%/16%/15%/10% CAGR in powergen/industrial/distribution/exports/B2C. We bake in weakness seen in margins in 1HFY24 to factor in delays in timeline of CPCB 4+ implementation. Over FY23-26E, we bake in 170bps improvement in margins to build in operating leverage benefits. We expect PAT CAGR of 25% over the same period.

Valuations

The stock is currently trading at 20X/16.2X FY25/26E earnings. We value the company on SOTP methodology valuing core business at 18X P/E on two-year forward earnings. Initiate with a BUY rating with TP of INR710.

Keys risks and concerns

Key risks to recommendation would come from sharper-than-expected slowdown in exports, sooner-than-expected transition toward clean sources of fuel and the company's inability to keep pace with new products, heightened competition.

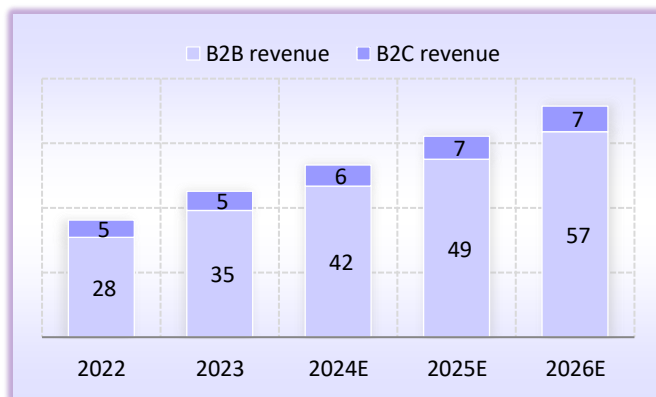
STORY IN CHARTS

KOEL launched 37 diesel genset models across CPCB 4+ compliant product range

Range	No. of models
3.5-5.5kVA	2 (3.5, 5.5kVA)
7.5-20kVA	7 (7,7.5, 10, 12.5, 15, 17.5, 20kVA)
25-62.5kVA	7 (25, 30, 35, 40, 45, 58.5, 62.5kVA)
70-160kVA	7 (70, 75, 82.5, 100, 125, 140, 160kVA)
180-250kVA	3 (180, 200, 250kVA)
275-750kVA	11 (275, 300, 320, 380, 400, 450, 500, 625, 650, 700, 750kVA)

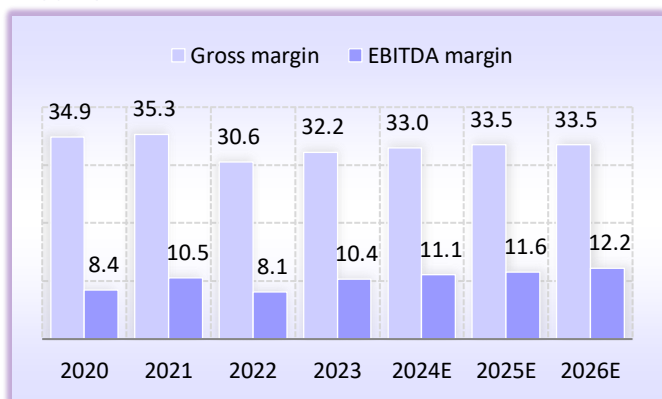
Source: Company, MOFSL

We expect overall revenues to grow at 16% CAGR over FY23-26 with larger share of B2B (INR b)



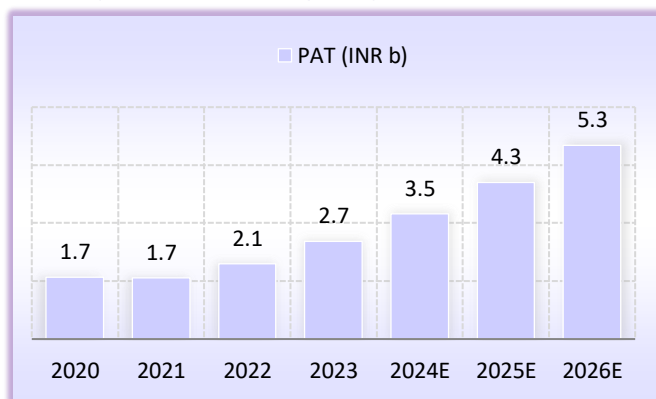
Source: Company, MOFSL

Gross margins of KOEL have started improving after dropping in FY22 (%)



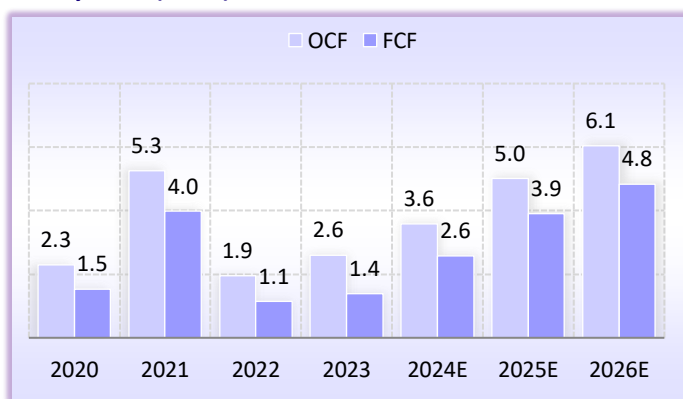
Source: Company, MOFSL

We expect PAT to grow at a CAGR of 25% over FY23-26E driven by revenue and margin improvement



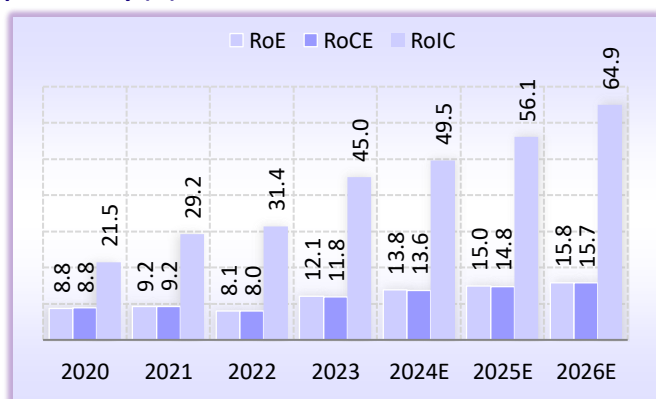
Source: Company, MOFSL

FCF to remain strong as large part of capex for CPCB 4+ is already done (INR b)



Source: Company, MOFSL

We expect return ratios to improve on improving profitability (%)

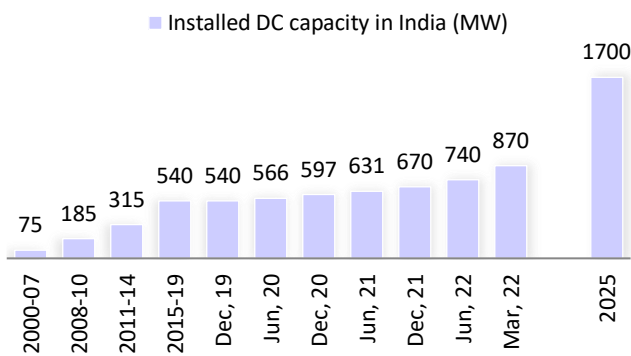


Source: Company, MOFSL

Demand drivers in place for powergen as well as industrial segments

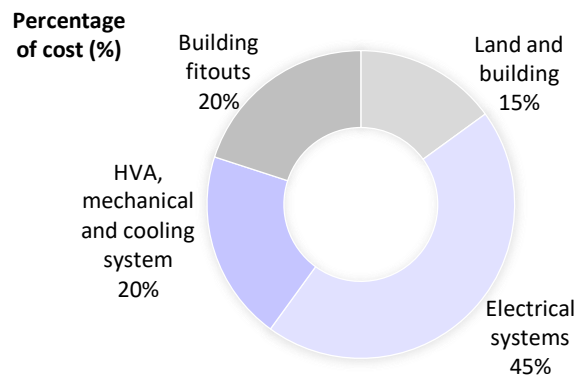
Despite near-term uncertainty surrounding mixed-sale products based on CPCB 2 and CPCB 4+, long term demand growth drivers for powergen segment are strong particularly from realty, commercial, hospitality, data centre and manufacturing. The consistent demand for generator sets as the primary power source in off-grid areas, especially for powering telecom towers in the context of 5G infrastructure, signifies a promising trend. Additionally, the rising need for uninterrupted power supply across various sectors, such as manufacturing, infrastructure, healthcare, data centres, and residential areas, augments the positive trajectory of genset demand. Demand for CPCB 4+ compliant products has also started improving particularly from regions such as NCR, where emission norms are more stringent. KOEL has a strong positioning in low and mid KVA ranges and is expanding presence across high KVA ranges with launch of OptiPrime series. We expect it to continue to benefit from powergen segment demand growth.

Exhibit 249: Data centre market is witnessing a sharp growth



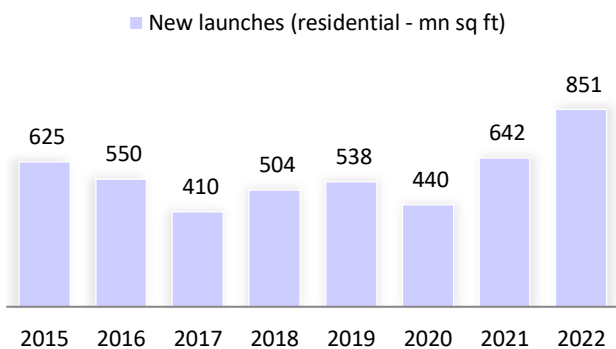
Source: Industry, CRISIL

Exhibit 250: Cost break up of a data centre



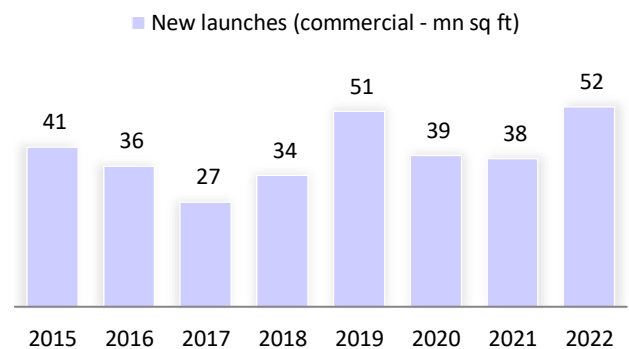
Source: Industry, MOFSL

Exhibit 251: Residential real estate launches were strong in last 2 years and would drive genset demand



Source: Industry, MOFSL

Exhibit 252: Commercial real estate launches were also strong in last 2 years and would drive genset demand

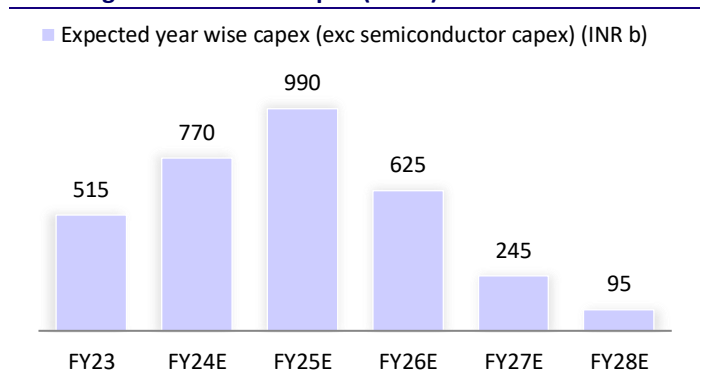


Source: Industry, MOFSL

Exhibit 253: PLI incentives for different sectors would drive incremental capex (INR b)

Sector	Incentives outlay
Mobile phones	420
Advanced Chemistry cell batteries	181
Electronics and Tech products	50
Automobile and components	570
Pharmaceuticals and drugs	150
Telecom and networking products	122
Textiles	107
Food products	109
High efficiency solar PV modules	45
White goods	62
Speciality steel	63
Solar modules	185
Total	2,064

Source: MeITY, PIB

Exhibit 254: PLI-led yearly capex spend expectations excluding semiconductor capex (INR b)

Source: MeITY, PIB

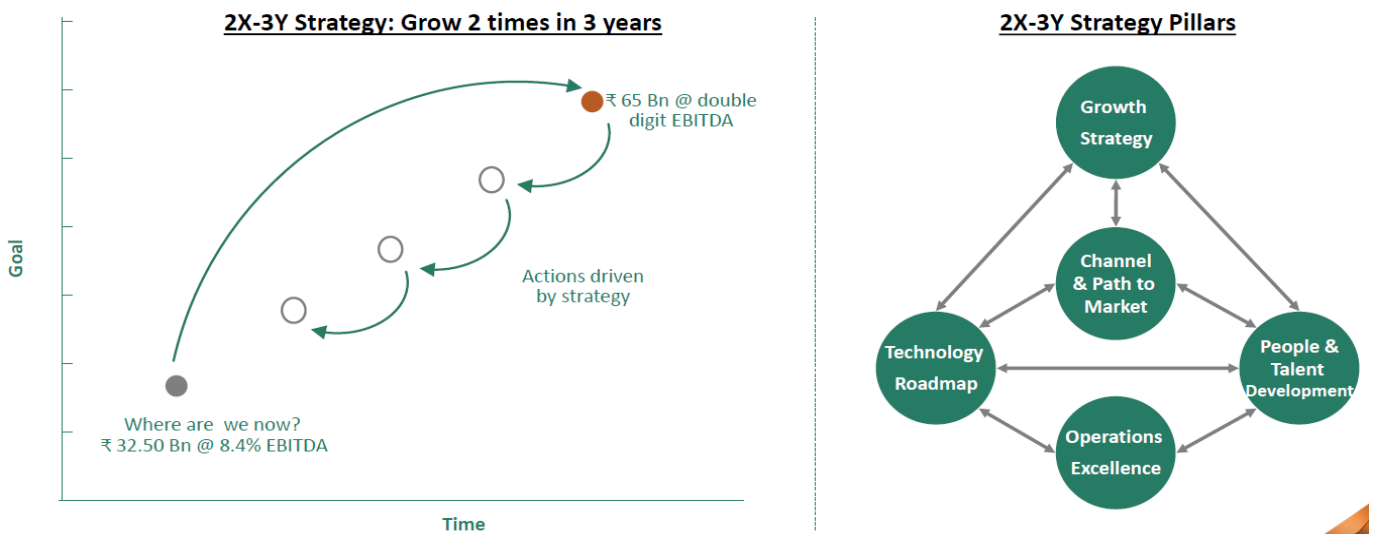
Strategy of 2X 3Y

The company has developed a strategic roadmap to double its revenues within the next three years, starting from FY23. It intends to achieve this by 1) introducing new products in HHP category (1,500 kVA to 3,000 kVA), 2) expanding the share of exports to 30% of sales through new product launches and penetration of CPCB 4+ products in international markets, 3) strengthening its distribution network and enhancing its presence in the aftermarket segment.

Exhibit 255: KOEL's intends to double revenues to INR65 b in 3 years from FY22 via 2X3Y strategy

Looking to drive exponential growth over the next 3 years

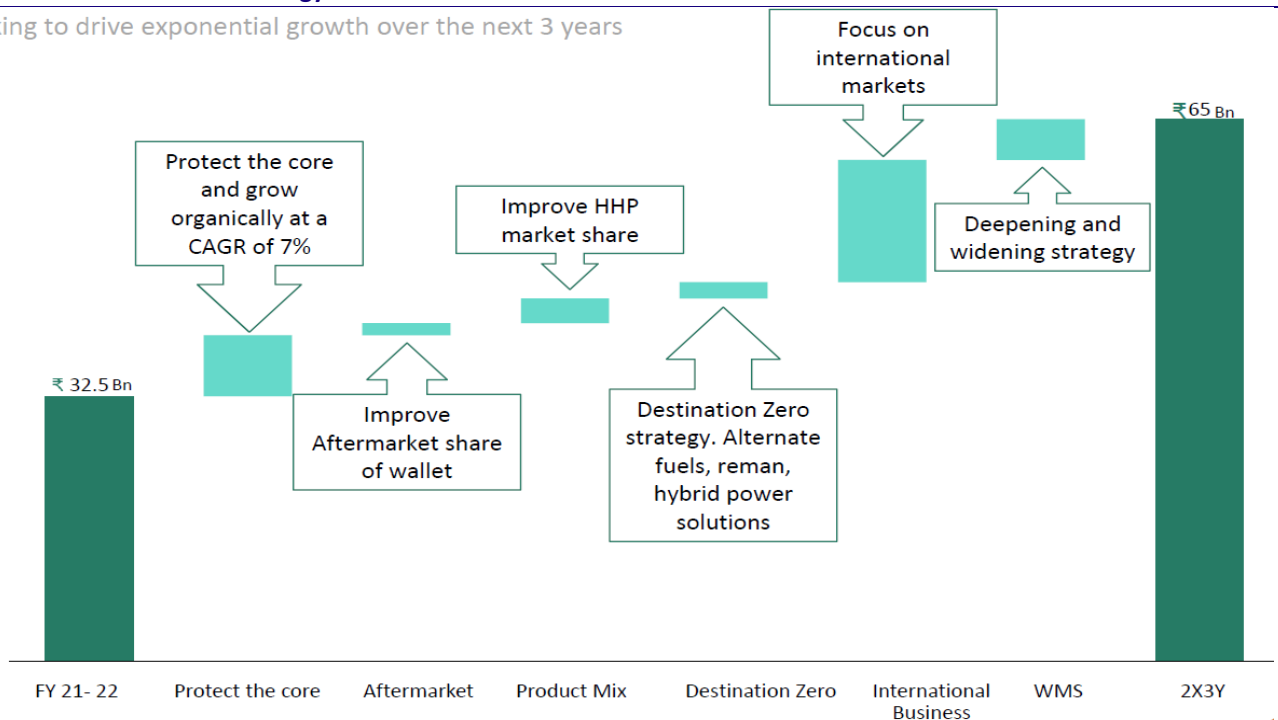
Oil Engine:



Source: Company

Exhibit 256: Drivers for 2X3Y strategy

Looking to drive exponential growth over the next 3 years



Source: Company

KOEL is ramping up across nodes versus peers

KOEL has launched 37 diesel genset models across CPCB 4+ compliant product range and Cummins has launched 33 CPCB 4+ compliant models. Company is also catching up on pricing with Cummins and based on our channel check, there isn't a significant difference in pricing across various nodes of existing CPCB 2 products. Market demand is currently dominated by CPCB 2 products and we expect it to start shifting to CPCB 4+ products by 4QFY24/1QFY25 which will have further higher pricing by 20-40% across nodes. Company also has nodes available across 750kVA and 1,010kVA and has recently launched Optiprime series to cater to 1,500kVA and above market.

However, KOEL still has to catch up with Cummins in EBITDA margin despite largely similar gross margins by now. Cummins has much better EBITDA margin on higher share of exports and distribution segment revenues which KOEL is now targeting to ramp up.

Exhibit 257: KOEL's has launched 37 diesel genset models across CPCB 4+ compliant products across ranges

Range	No. of models
3.5-5.5kVA	2 (3.5, 5.5kVA)
7.5-20kVA	7 (7,7.5, 10, 12.5, 15, 17.5, 20kVA)
25-62.5kVA	7 (25, 30, 35, 40, 45, 58.5, 62.5kVA)
70-160kVA	7 (70, 75, 82.5, 100, 125, 140, 160kVA)
180-250kVA	3 (180, 200, 250kVA)
275-750kVA	11 (275, 300, 320, 380, 400, 450, 500, 625, 650, 700, 750kVA)

Source: Company, MOFSL

Exhibit 258: Cummins has launched 33 models across CPCB 4+ compliant products across ranges

Range	No. of models
7.5-20kVA	8 (7.5, 7.5, 10, 10, 15, 15, 18.5, 20kVA)
25-40kVA	7 (25, 25, 27.5, 30, 35, 35, 40kVA)
41-50kVA	2 (41,50kVA)
50-58.5kVA	2 (50, 58.5kVA)
82.5-140kVA	4 (82.5, 100, 125, 140kVA)
160-250kVA	4 (160, 180, 200, 225, 250kVA)
320kVA	1 (320kVA)
380-500kVA	3 (380, 400, 500kVA)
650-750kVA	2 (650, 750kVA)

Source: Company, MOFSL

Exhibit 259: Company also has 17 models on gas gensets compliant with latest norms

Range	No. of models
5-20kVA	5 (5, 7.5, 10, 12.5, 15kVA)
25-58 kVA	4 (45, 50, 55, 58kVA)
82.5-160kVA	4 (100, 125, 140, 160kVA)
180-250kVA	4 (180, 200, 225, 250kVA)

Source: Company, MOFSL

Exhibit 260: KOEL is catching up with Cummins in price points across key nodes in the power genset industry for CPCB 2 products (INR lakh)

Node	Cummins	KOEL	Mahindra	Perkins	Baudouin
15kva	2,60,000	2,50,000	2,60,000		
62.5kva	5,30,000	5,20,000	5,10,000		
125kva	7,80,000	7,25,000	6,89,915		
160kva	11,10,000	10,25,000	9,75,000		
200kva	12,66,000	12,50,000	12,25,000		
320kva	19,50,000	18,40,000	18,60,000		21,56,000
400kva	26,48,000	23,50,000	21,70,000	23,00,000	23,10,000
500kva	29,48,000	26,98,750	25,00,000	25,00,000	24,50,000
625kva	38,50,000	35,50,000	38,00,000	37,00,000	39,00,000
750kva	50,00,000	48,50,000		50,00,000	47,00,000
1010kva	70,00,000	65,00,000		65,00,000	65,00,000
1250kva	98,00,000	90,00,000		92,00,000	90,00,000
1500kva	1,35,00,000	1,20,00,000		1,00,00,000	
2000kva	1,50,00,000			2,00,00,000	1,66,00,000
2750kva	1,70,00,000				

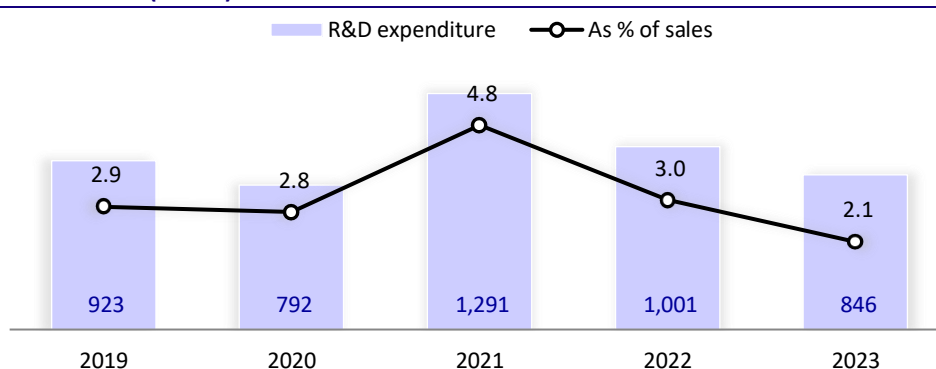
Source: Channel checks, Industry, MOFSL

Exhibit 261: KOEL has started entering the high-ratings segment in 750kVa, 1010kVa, 1,500kVa and 2,020kVa

Ratings segment	End Use Industries
<160 kVA (Low)	❖ Telecom(15-75kva), Retail sales, Small scale Industries Units
200-375 kVA (Mid)	❖ Real Estate(Residential and Commercial), Hospitals
375-750 kVA (Heavy)	❖ Large Industrial Applications, IT, ITES, Hospitals, Hotels, Healthcare
750-3,000 kVA (High)	❖ Data Centers, Metros, Hospitals, Educational Institutions

Source: Industry, MOFSL

Exhibit 262: Company also ramped up R&D investments in FY21 and FY22 to prepare for CPCB IV+ norms (INR m)

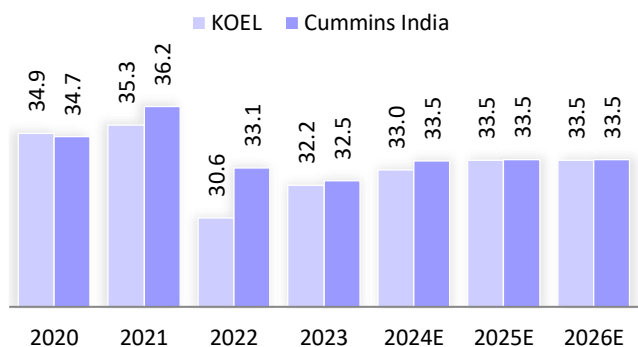


Source: Company, MOFSL

...It still has to catch up on margins, share of HHP gensets, exports and share of distribution with market leader

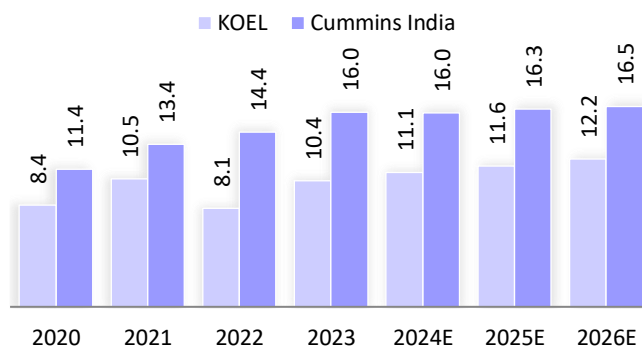
The pricing of products in the domestic market for KOEL and Cummins in powergen is quite similar. However, KOEL has lower profit margins due to its lower share of exports, lower share of HHP genset sales and lower margins in the B2C segment.

Exhibit 263: While gross margins of KOEL have started improving in line with Cummins.. (%)



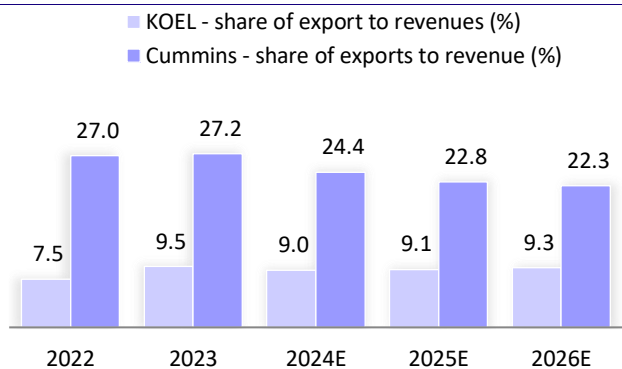
Source: Company, MOFSL

Exhibit 264: ...however KOEL's EBITDA margin is lower due to lower share of exports and distribution (%)



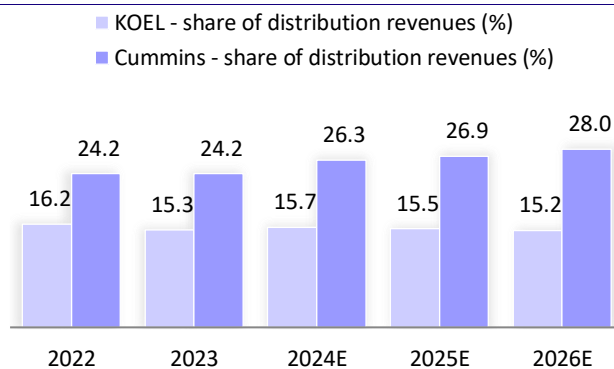
Source: Company, MOFSL

Exhibit 265: Export share is still much lower for KOEL versus Cummins (%)



Source: Company, MOFSL

Exhibit 266: KOEL's share of distribution is also lower versus Cummins (%)

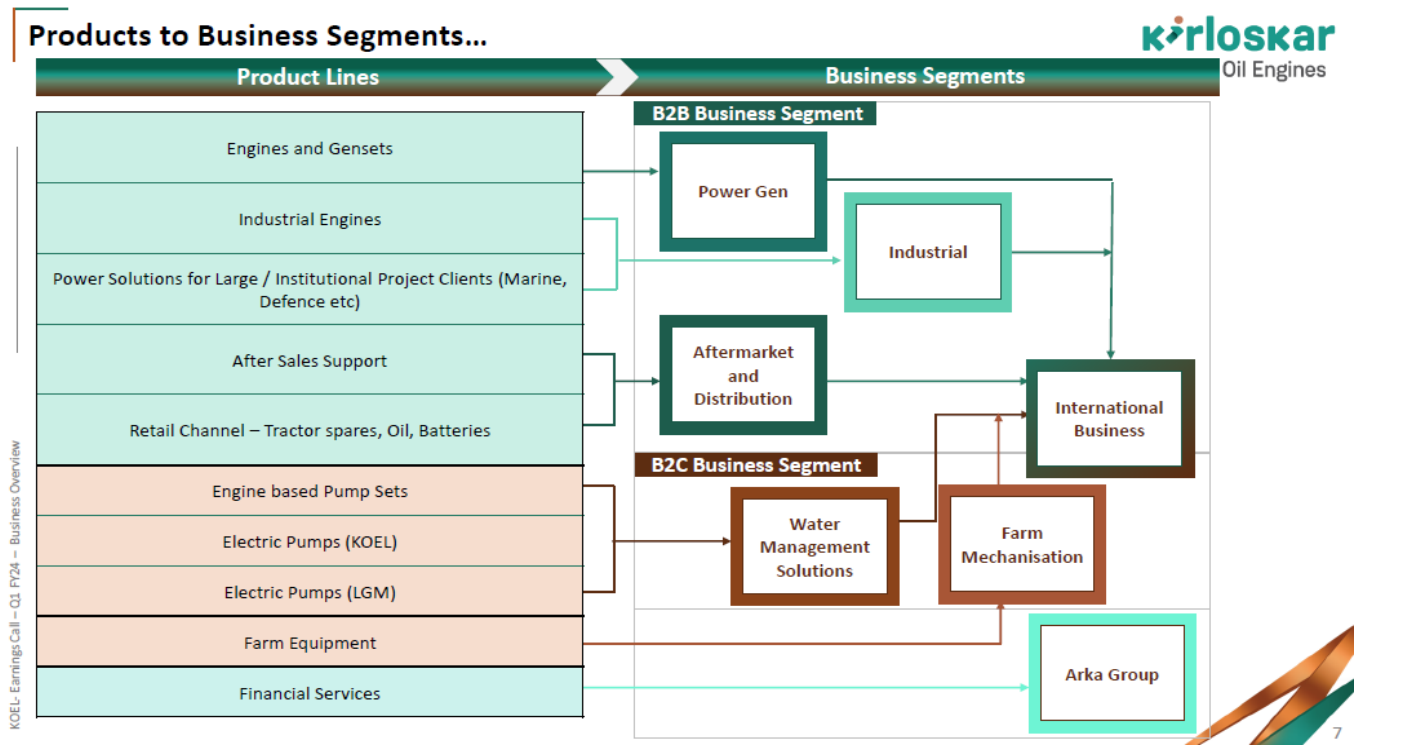


Source: Company, MOFSL

KOEL is ready with new products to meet growing market demand

In FY21/22, KOEL invested approximately INR1.3b/1b in in-house research and development of new products, leading to the development of new products that comply with CPCB4+ norms. Depending on the market demand for both CPCB 2 and CPCB 4+ products in the near term, KOEL can adjust its supply chain network and deliver products accordingly. Additionally, the company has also introduced other fuel agnostic products in its portfolio. The company has developed IOT-enabled gas generator across various power nodes with digital monitoring systems. It has also introduced a dual fuel kit that can be retrofitted to existing and future diesel generators, enabling them to operate efficiently using a combination of both gas and diesel fuels. It has also entered the high horse power (HHP) range, with the introduction of its OptiPrime range, focused on segments such as data centres and infrastructure. These products will enable KOEL to meet demand coming from changing emission norms, dual fuel requirements of specific regions such as NCR as well as enhance its positioning in fast growing data centre market.

Exhibit 267: KOEL product lines and business segments



Source: Company

Exhibit 268: KOEL has launched 37 diesel genset models across CPCB 4+ compliant products across ranges

Range	No. of models
3.5-5.5kVA	2 (3.5, 5.5kVA)
7.5-20kVA	7 (7, 7.5, 10, 12.5, 15, 17.5, 20kVA)
25-62.5kVA	7 (25, 30, 35, 40, 45, 58.5, 62.5kVA)
70-160kVA	7 (70, 75, 82.5, 100, 125, 140, 160kVA)
180-250kVA	3 (180, 200, 250kVA)
275-750kVA	11 (275, 300, 320, 380, 400, 450, 500, 625, 650, 700, 750kVA)

Source: Company, MOFSL

Exhibit 269: KOEL also has 17 gas genset models across CPCB 4+ compliant products across ranges

Range	No. of models
5-20kVA	5 (5, 7.5, 10, 12.5, 15kVA)
25-58 kVA	4 (45, 50, 55, 58kVA)
82.5-160kVA	4 (100, 125, 140, 160kVA)
180-250kVA	4 (180, 200, 225, 250kVA)

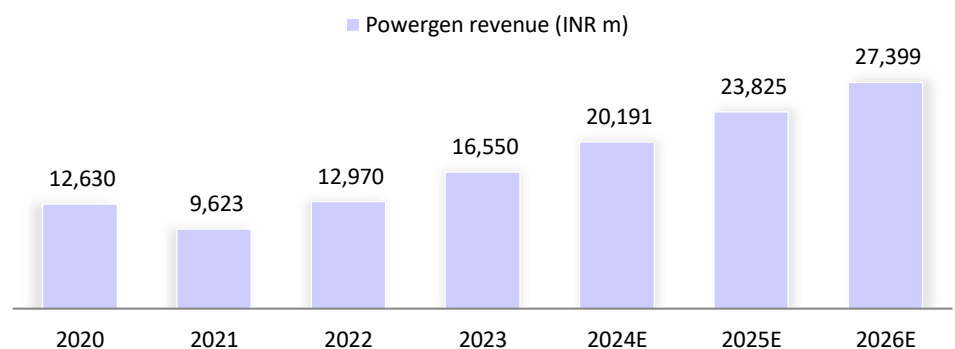
Source: Company, MOFSL

Exhibit 270: Company has constantly introduced new products across new technology and fuel agnostic engines

Product	Description
HHP K4300 platform	❖ Development of 12, 16 & 20 cylinder engines that cater to both power generation & industrial applications
OptiPrime	❖ The 'OptiPrime' can be used as a single unit, two different ones, prime and standby in the same box. It is perfect for applications that have variable power needs
Fuel agnostic engines - gas	❖ KOEL is a key member in the power generation market developing the widest range of dedicated PNG based Central Pollution Control Board (CPCB) compliant gensets from 15kVA to 500kVA range.
Fuel agnostic engines - ethanol	❖ KOEL developed technology to utilise 100% Ethanol fuel (E100) in power generation application and installed one set of 62.5kVA in field
Fuel agnostic engines - hydrogen-blended gas	❖ KOEL is working with Industry partners to deliver H2 blended natural gas as a fuel to improve engine performance, emissions and reliability
Fuel agnostic engines - methanol	❖ KOEL developed technology for 100% Methanol fuel (M100) in power generation application and two genset nodes 20kVA and 62.5kVA are under development
Fuel agnostic engines - hybrid	❖ KOEL is leveraging its patented hybrid technology to create hybrid and microgrid power systems combining power generators, batteries, grid, solar and other renewable energy sources to provide a complete power solution to its customers

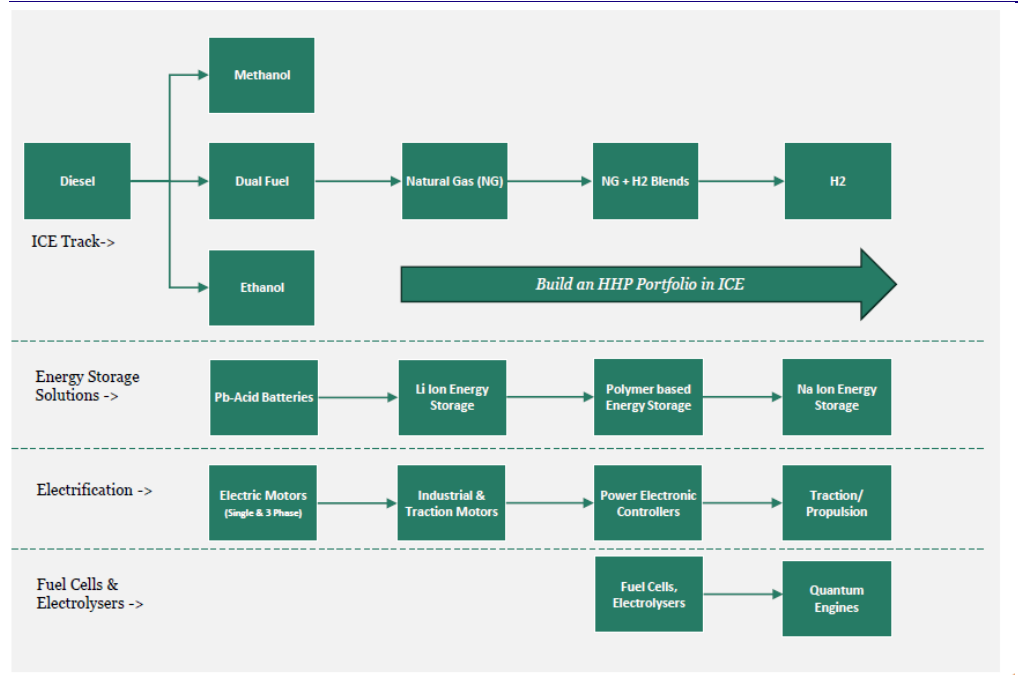
Source: Company, MOFSL

Exhibit 271: These new products as well as CPCB 4+ range will drive powergen revenue (INR m)



Source: Company, MOFSL

Exhibit 272: Company is also venturing into energy storage solutions and fuel cell electrolyzers



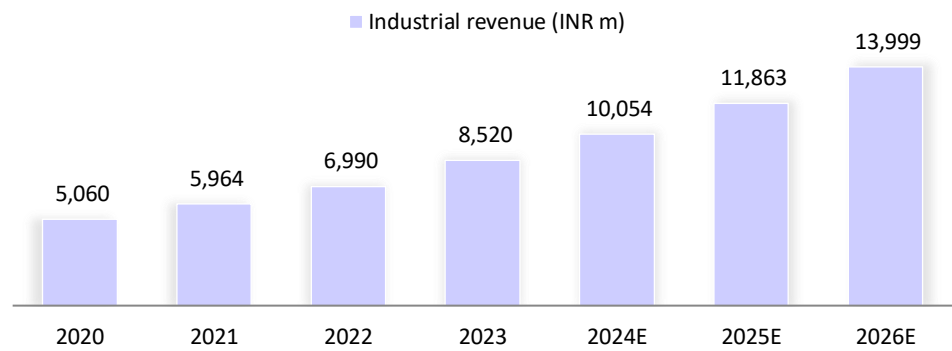
Source: Company, MOFSL

KOEL is expanding its presence in industrial segment

The company's industrial segment registered a revenue CAGR of 10% over FY19-23, outpacing Cummins, whose industrial segment revenues grew at 2.5% over the same period. KOEL is expanding its presence across diverse sectors such as rail, defence, fisheries. Through strategic partnerships with organizations that align with its strengths, KOEL is well-positioned to capitalize on new opportunities.

The company is also offering turnkey solutions for projects of strategic interest, such as the Airfield Integrated Security System and communication systems for the Air Force and as a propulsion system provider in the Marine industry. The Company has also started manufacturing the new K43 series of high-horsepower engines at its Nashik plant. We thus expect this segment to register a revenue CAGR of 18% over FY23-26.

Exhibit 273: We expect growth in Industrial segment to remain strong at a CAGR of 18% over FY23-26 (INR m)

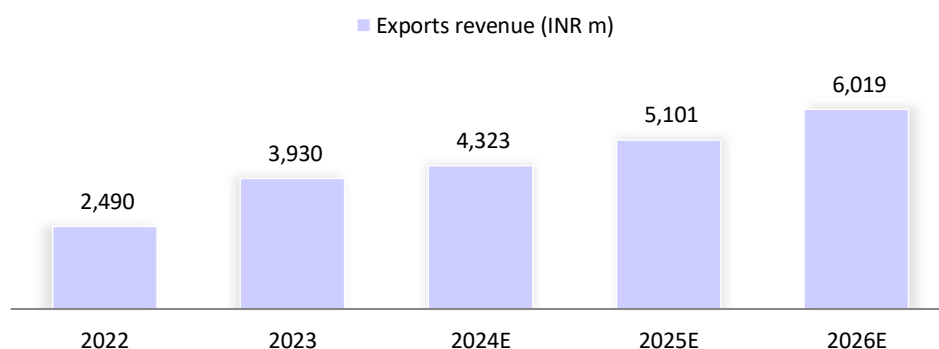


Source: Company, MOFSL

Targeting to take exports to 30% of sales in next 2 years

Export markets are currently witnessing a mixed trend with demand coming in from the Middle East, while other markets such as the US, Europe, Latin America, and Africa are currently weak. The company's powergen segment is witnessing traction on account of new products and will see improved growth in the coming years for its CPCB 4+ compliant products in markets such as the US. KOEL is trying to enhance its position in firefighting segment across markets by adding new OEMs and increasing market share with the existing OEMs. It maintained its leading position in the FM/UL segment in the Middle East and also gained traction in other regions such as the US, Europe, and the Asia-Pacific. The company also augmented its product offerings in the non-listed firefighting space to increase its business share in the Asia-Pacific region and Europe. It is also planning to develop new products for the mining industry in South Africa. Though KOEL aims to take the share of exports to 30% of sales by FY25, we expect it to achieve a CAGR of 15%, forming 10% of sales by FY25 due to weak growth scenario currently seen across major export geographies.

Exhibit 274: Exports revenues are inching up but still lower than management's target



Source: Company, MOFSL

Aftermarket revenues to clock a CAGR of 16% over FY23-26

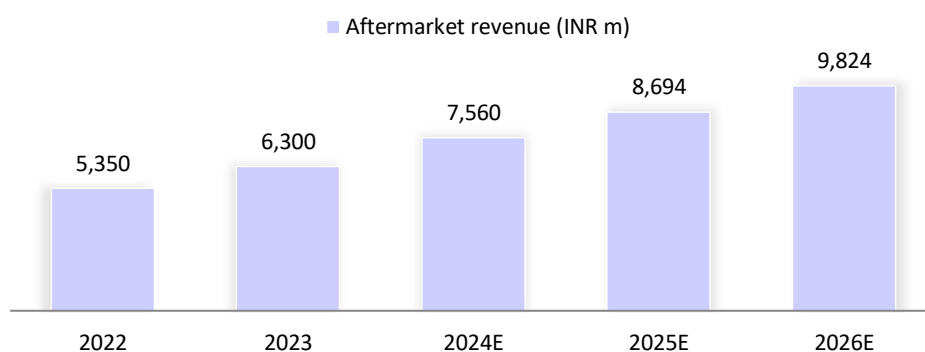
In the distribution and aftermarket sectors, the company has established two distinct segments (i) Customer support and service channel: This segment encompasses revenue and service organizations dedicated to providing customer support and services (ii) Retail channel for spare parts, oil and allied products: This segment focuses on retailing spare parts, oil, and related products, which include Electric Motors and Organic Waste Composter.

Within the Customer support and service channel, the Kirloskar CARE brand is renowned for providing exceptional dedicated after-sales services for Kirloskar Powergen and Industrial products. The company has an extensive network of over 400 service outlets throughout India, all of which, are seamlessly connected through a robust digital platform. This segment achieved a revenue of INR5.05b in FY23, up 15% YoY.

The retail distribution channel has experienced a decline in spare parts revenue contribution and has been mostly reliant on the oil business. The company aims to introduce agriculture and construction parts and other allied products, including Electric Motors and Organic Waste Composter within this segment to target a wider reach.

Currently, the retail channel consists of over 300 networks, reaching both rural and urban areas, and providing access to local retail counters. In FY23, the channel generated a revenue of INR1.25 b. Additionally, the company plans to diversify its channels into other markets such as Andhra Pradesh, Telangana, Kerala, and Rajasthan. It will also implement digitalization solutions to improve sales visibility. Additionally, it plans to launch loyalty programs aimed at boosting sales.

Exhibit 275: We expect aftermarket revenue growth to remain strong

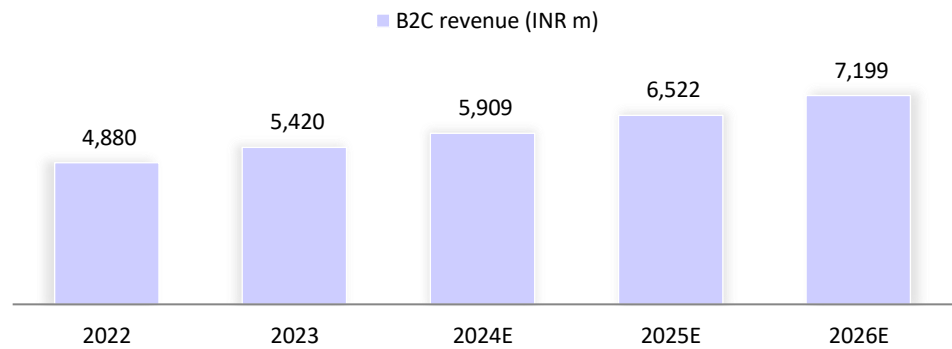


Source: Company, MOFSL

B2C sales is currently a smaller proportion of sales

In FY23, B2C sales accounted for 13% of the company's net sales. Within the B2C segment, the company primarily concentrates on water management solutions (focusing on pump sets and diesel engines) as well as farm mechanization. However, there has been a decline in demand for diesel pump sets with the industry transitioning toward electric pump sets. KOEL intends to bring more products on electric pump sets. Farm mechanisation focuses on power tillers and weeders.

Exhibit 276: We expect B2C revenues to grow at a CAGR of 10% between FY23-26



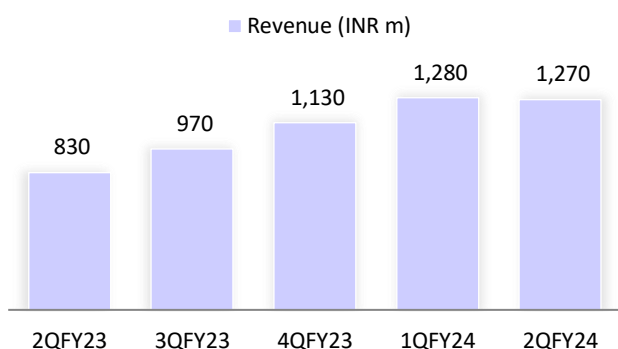
Source: Company, MOFSL

Exposure to Arka Fincap and LGM

Arka Fincap (AFL)

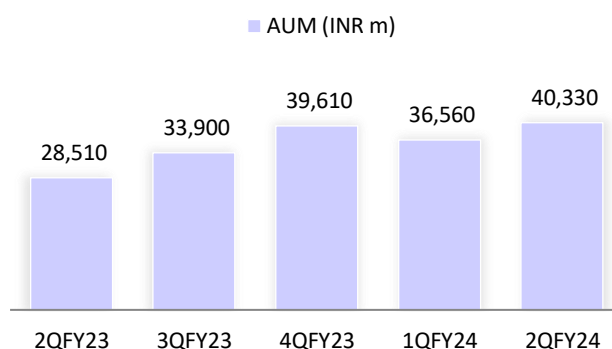
Arka Fincap was established in 2018 and is a subsidiary of KOEL. The company focuses on providing Structured-Term Financing Solutions to Corporates & Loans to Micro, Small & Medium Enterprises (MSMEs) borrowers in India. AFL operates in four principal lines of business viz. Corporate Lending, Real Estate and Urban Infra Financing, Syndication, MSME and Personal Lending. KOEL's commitment of equity infusion into Arka Fincap was INR10b and the company has already infused INR9.6b and remaining INR400m will be infused over the next few quarters.

Exhibit 277: Quarterly revenue trend of Arka Fincap



Source: Company, MOFSL

Exhibit 278: Quarterly AUM trend of Arka Fincap



Source: Company, MOFSL

La-Gajjar Machinerics (LGM)

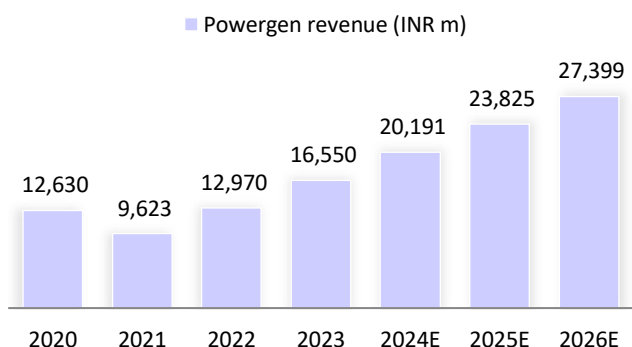
KOEL forayed into pump manufacturing through an acquisition of a majority stake of 76% in La-Gajjar Machinerics (LGM) and later acquired the remaining 24% stake at an acquisition price of INR1.09bn in Sep, 2022. LGM acquisition helped KOEL establish its footprint into the electric pump market. La-Gajjar is a submersible and mono block pump manufacturer in the country with established brands "Varuna" and "Raindrop" and a pan-India distribution setup. LGM's revenues were INR5.8b in FY23.

LGM continued to expand its network both in domestic and international markets and geographies. It expanded its footprint in new geographical regions viz. South Africa, South East Asia, and Latin America. The company had exports of INR1.53b in FY23 and is also consolidating its manufacturing facilities at one location in Ahmedabad.

Financial outlook

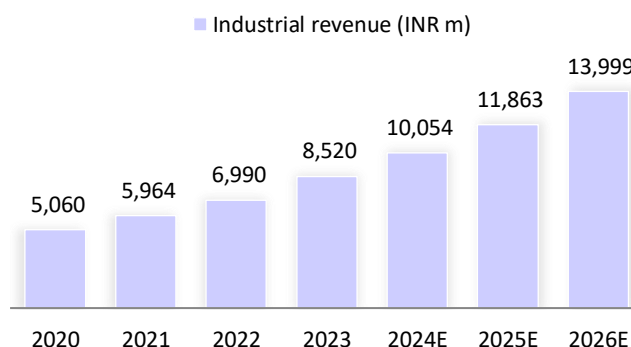
We expect revenues to grow at a CAGR of 16% over FY23-26E driven by 18%/18%/16%/15%/10% CAGR in powergen/industrial/distribution/exports/B2C. We bake in weakness in margins seen during 1HFY24 to factor in delays and uncertainty related to the timeline of CPCB 4+ implementation. Over FY23-26E, we bake in 170bps improvement in margins to build in operating leverage benefits. We expect PAT CAGR of 25% over the same period.

Exhibit 279: We expect powergen revenue to start witnessing improvement in coming quarters



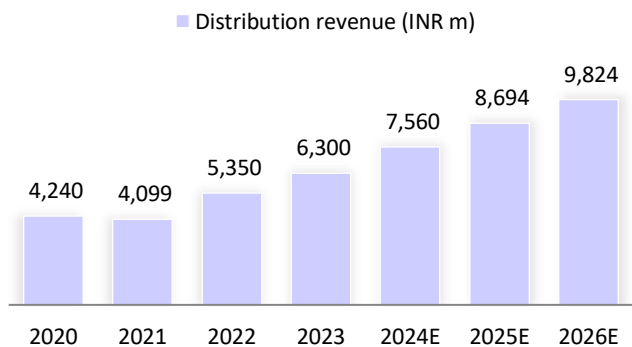
Source: Company, MOFSL

Exhibit 280: We expect industrial revenue to grow at a CAGR of 18% between FY23-26 on strong demand



Source: Company, MOFSL

Exhibit 281: We expect distribution revenue growth to remain strong at 16% CAGR over FY23-26



Source: Company, MOFSL

Exhibit 282: We expect exports revenue to grow at a steady pace of 15% CAGR over FY23-26



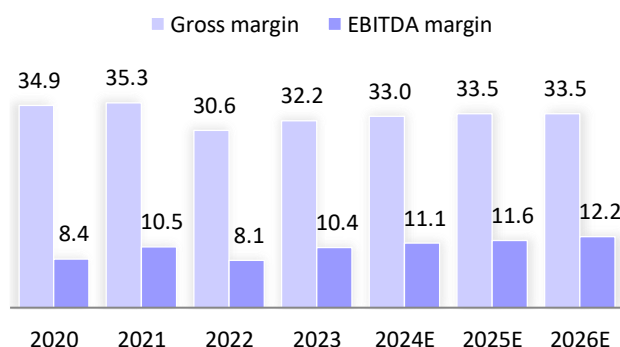
Source: Company, MOFSL

Exhibit 283: We expect B2C revenue to grow at a CAGR of 10% over FY23-26 with expanding footprint



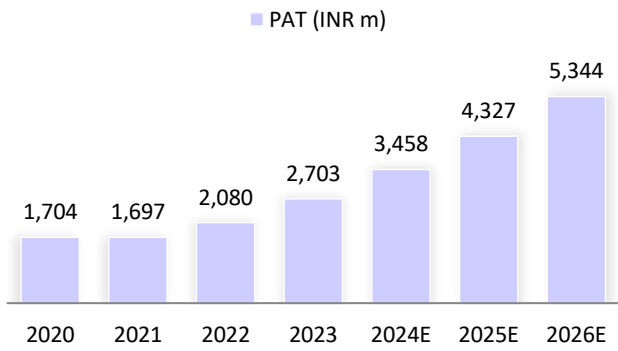
Source: Company, MOFSL

Exhibit 284: We expect margin expansion to be driven by price hikes and higher share of exports (%)



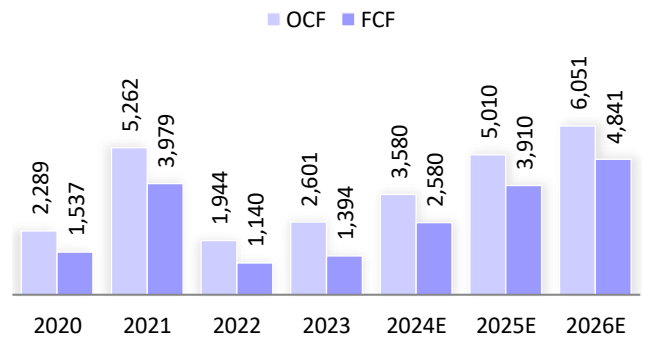
Source: Company, MOFSL

Exhibit 285: We expect PAT to post 25% CAGR over FY23-26



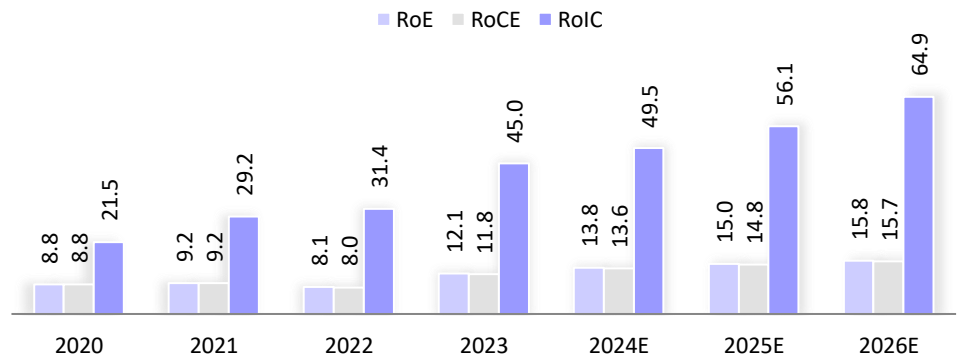
Source: Company, MOFSL

Exhibit 286: We expect OCF & FCF to improve further (INR m)



Source: Company, MOFSL

Exhibit 287: Return ratios to improve with improved profitability (%)

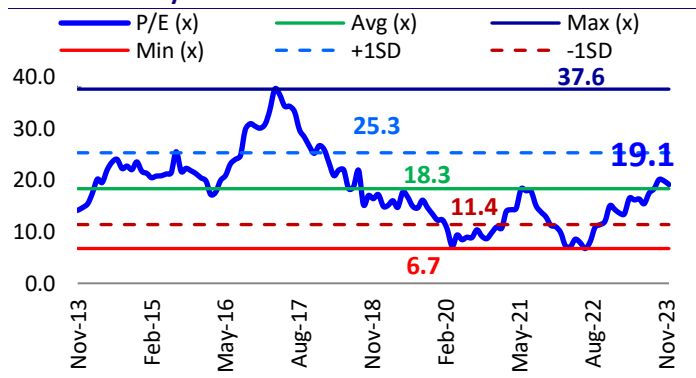


Source: Company, MOFSL

Valuations

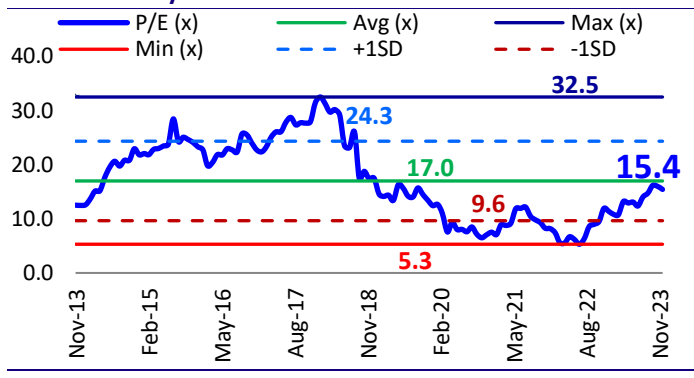
The stock is currently trading at 20X/16.2X FY25/26E earnings. We value the company on SOTP methodology valuing core business at 18X P/E on two-year forward earnings. Initiate with a BUY rating with TP of INR710.

Exhibit 288: 1-year forward PE valuation band



Source: Bloomberg, MOFSL

Exhibit 289: 2-year forward PE valuation band



Source: Bloomberg, MOFSL

Exhibit 290: 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	5,090	18.0	91,613	100.0	91,613	633	❖ 18X two-year fwd EPS
Investments							
La Gajjar Machineries	104	10.0	1,042	100.0	1,042	7	❖ 10X P/E two-year forward earnings
Arka Fincorp	10,000	1.0	10,000	100.0	10,000	69	❖ 1X P/BV of investment of INR10b
Total					102,656	710	

Source: Company, MOFSL

Exhibit 291: Sensitivity analysis: Bear, base and bull case valuations

	Bear case	Base case	Bull case	Rationale
Core business	4,581	5,090	5,599	❖ 10% sensitivity of earnings
Valuation multiple	15.0	18.0	20.0	❖ 10% sensitivity of multiples
Core business valuation	68,710	91,613	111,972	
Valuation of investments	8,834	11,042	13,251	❖ 20% sensitivity to base valuations
Total valuation	77,744	102,656	1,25,222	
Price per share	536	710	865	

Source: MOFSL

Keys risks and concerns

Key risks to the recommendation could arise from a sharper-than-expected slowdown in exports, sooner-than-expected transition toward clean fuel sources, and the company's inability to adapt to emerging products, heightened competition.

SWOT analysis

- ❖ KOEL is a major global engine manufacturer, serving various industries with a wide product range.
- ❖ Kirloskar Oil Engine has exceptional engineering capabilities, supported by their cutting-edge research centre
- ❖ Segment-specific products, value addition, higher kVA range, and accessory optimization boost company's business performance.

S

STRENGTH



- ❖ Vulnerability to cyclical in end-user industries leads to company experiencing fluctuations in their performance and demand over time.
- ❖ Volatility in raw materials and intense competition

W

WEAKNESS



- ❖ Unreliable power supply in rural areas remains an opportunity in the power generation sector.
- ❖ Digitalization and data center growth open new expansion avenues for the company.
- ❖ The company aims for global expansion with an upgraded, emission-compliant portfolio.

O

OPPORTUNITY



- ❖ Government initiatives for net-zero emissions, including the ban on diesel generators, may impact the company's growth.
- ❖ Inflation, rising commodity prices, and supply chain constraints are challenging economic factors.
- ❖ The shift to renewable energy may reduce

T

THREATS



Management profile



Ms. Gauri Kirloskar (Managing Director)

Ms. Gauri Kirloskar received a BSc. in Business Administration with a concentration in Finance from Carnegie Mellon University, USA. She is a member of the boards of Kirloskar Oil Engines' subsidiaries, La-Gajjar Machineries, a pumps manufacturing company and Arka Fincap, the group's foray into the financial services business.



Mr. Anurag Bhagania (CFO)

Mr. Anurag Bhagania is a Chartered Accountant (CA) with a MBA specialized in Marketing. Bhagania has over 25 years of experience across finance and accounting functions including auditing and taxation, financial planning analysis and reporting, compliance & legal, merger and acquisition, corporate governance and investor relations



Mr. Rahul Sahai (B2B CEO)

Mr. Rahul is an experienced leader with a demonstrated history of working in international environments. He is skilled in scaling business, developing channel capabilities, leading engineering product launches, and deploying strategic growth initiatives. He has worked across India, USA, Nigeria, South Africa in various organizations.

Financials and valuation

Standalone - Income Statement

(INR Million)

Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Total Income from Operations	28,775	26,944	32,997	41,161	48,036	56,006	64,441
Change (%)	-10.2	-6.4	22.5	24.7	16.7	16.6	15.1
Raw Materials	18,740	17,431	22,912	27,897	32,184	37,244	42,853
Gross Profit	10,035	9,513	10,085	13,264	15,852	18,762	21,588
Employees Cost	2,178	1,989	2,070	2,365	2,882	3,360	3,866
Other Expenses	5,439	4,686	5,327	6,630	7,638	8,905	9,859
Total Expenditure	26,357	24,106	30,309	36,892	42,704	49,509	56,579
% of Sales	91.6	89.5	91.9	89.6	88.9	88.4	87.8
EBITDA	2,418	2,838	2,688	4,269	5,332	6,497	7,862
Margin (%)	8.4	10.5	8.1	10.4	11.1	11.6	12.2
Depreciation	666	622	772	848	883	935	992
EBIT	1,752	2,217	1,915	3,422	4,449	5,562	6,870
Int. and Finance Charges	38	64	62	54	54	40	24
Other Income	374	245	248	273	264	308	354
PBT bef. EO Exp.	2,087	2,398	2,100	3,641	4,659	5,830	7,201
EO Items	165	-84	527	0	0	0	0
PBT after EO Exp.	2,252	2,314	2,627	3,641	4,659	5,830	7,201
Total Tax	548	617	547	939	1,201	1,503	1,857
Tax Rate (%)	24.3	26.6	20.8	25.8	25.8	25.8	25.8
Minority Interest	0	0	0	0	0	0	0
Reported PAT	1,704	1,697	2,080	2,703	3,458	4,327	5,344
Adjusted PAT	1,579	1,759	1,663	2,703	3,458	4,327	5,344
Change (%)	-29.8	11.4	-5.4	62.5	27.9	25.1	23.5
Margin (%)	5.5	6.5	5.0	6.6	7.2	7.7	8.3

Standalone - Balance Sheet

(INR Million)

Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Equity Share Capital	289	289	289	290	290	290	290
Total Reserves	18,013	19,542	21,105	23,028	25,560	28,729	32,642
Net Worth	18,302	19,832	21,395	23,318	25,850	29,019	32,932
Total Loans	156	793	976	751	601	401	201
Deferred Tax Liabilities	52	125	146	61	61	61	61
Capital Employed	18,510	20,749	22,517	24,131	26,513	29,481	33,195
Gross Block	14,904	16,281	16,990	17,425	18,425	19,525	20,735
Less: Accum. Deprn.	11,281	11,826	12,488	13,174	14,057	14,991	15,983
Net Fixed Assets	3,623	4,455	4,502	4,251	4,368	4,533	4,752
Capital WIP	744	549	393	664	664	664	664
Total Investments	11,014	15,340	16,722	16,925	16,925	16,925	16,925
Curr. Assets, Loans&Adv.	9,203	8,092	8,505	11,557	15,370	19,967	25,361
Inventory	3,003	2,652	3,031	4,685	6,125	7,141	8,217
Accounts Receivable	3,628	3,558	3,945	4,672	5,452	6,357	7,314
Cash and Bank Balance	171	294	314	338	1,788	4,299	7,486
Loans and Advances	1,349	872	656	852	994	1,159	1,333
Other Assets	1,051	716	558	1,011	1,011	1,011	1,011
Curr. Liability & Prov.	6,073	7,686	7,606	9,267	10,814	12,609	14,508
Accounts Payable	4,798	6,419	6,175	6,326	7,383	8,608	9,904
Other Current Liabilities	696	646	729	1,700	1,983	2,313	2,661
Provisions	580	622	702	1,241	1,448	1,689	1,943
Net Current Assets	3,129	406	899	2,291	4,555	7,358	10,853
Misc Expenditure	0	0	0	0	0	0	0
Appl. of Funds	18,510	20,749	22,517	24,131	26,513	29,481	33,195

Financials and valuation

Ratios

Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Basic (INR)							
EPS	10.9	12.2	11.5	18.7	23.9	29.9	36.9
Cash EPS	15.5	16.4	16.8	24.5	30.0	36.4	43.8
BV/Share	126.4	137.0	147.8	161.1	178.6	200.5	227.5
DPS	7.8	1.5	4.7	5.0	6.4	8.0	9.9
Payout (%)	66.5	12.8	32.6	26.8	26.8	26.8	26.8
Valuation (x)							
P/E	53.5	48.1	50.8	31.3	24.4	19.5	15.8
Cash P/E	37.6	35.5	34.7	23.8	19.5	16.1	13.3
P/BV	4.6	4.3	4.0	3.6	3.3	2.9	2.6
EV/Sales	2.9	3.2	2.6	2.1	1.7	1.4	1.2
EV/EBITDA	35.0	30.0	31.7	19.9	15.6	12.4	9.8
Dividend Yield (%)	1.3	0.3	0.8	0.9	1.1	1.4	1.7
FCF per share	10.6	27.5	7.9	9.6	17.8	27.0	33.4
Return Ratios (%)							
RoE	8.8	9.2	8.1	12.1	14.1	15.8	17.3
RoCE	8.8	9.2	8.0	11.8	13.8	15.6	17.1
RoIC	21.5	29.2	31.4	45.0	49.5	56.1	64.9
Working Capital Ratios							
Fixed Asset Turnover (x)	1.9	1.7	1.9	2.4	2.6	2.9	3.1
Asset Turnover (x)	1.6	1.3	1.5	1.7	1.8	1.9	1.9
Inventory (Days)	38	36	34	42	47	47	47
Debtor (Days)	46	48	44	41	41	41	41
Creditor (Days)	61	87	68	56	56	56	56
Leverage Ratio (x)							
Current Ratio	1.5	1.1	1.1	1.2	1.4	1.6	1.7
Interest Cover Ratio	45.9	34.9	30.7	63.8	82.2	138.7	284.9
Net Debt/Equity	-0.6	-0.7	-0.8	-0.7	-0.7	-0.7	-0.7

Standalone - Cash Flow Statement

(INR Million)

Y/E March	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
OP/(Loss) before Tax	2,252	2,314	2,627	3,641	4,659	5,830	7,201
Depreciation	666	622	772	848	883	935	992
Interest & Finance Charges	38	38	50	35	54	40	24
Direct Taxes Paid	-679	-324	-567	-960	-1,201	-1,503	-1,857
(Inc)/Dec in WC	407	2,654	-157	-1,025	-815	-291	-308
CF from Operations	2,685	5,304	2,726	2,539	3,580	5,010	6,051
Others	-396	-42	-782	61	0	0	0
CF from Operating incl EO	2,289	5,262	1,944	2,601	3,580	5,010	6,051
(Inc)/Dec in FA	-752	-1,282	-804	-1,206	-1,000	-1,100	-1,210
Free Cash Flow	1,537	3,979	1,140	1,394	2,580	3,910	4,841
(Pur)/Sale of Investments	4,159	-2,855	680	3,235	0	0	0
Others	-4,995	-1,316	-8,870	-3,585	0	0	0
CF from Investments	-1,588	-5,453	-8,994	-1,556	-1,000	-1,100	-1,210
Issue of Shares	0	0	0	0	0	0	0
Inc/(Dec) in Debt	10	613	172	-236	-150	-200	-200
Interest Paid	-38	-62	-53	-50	-54	-40	-24
Dividend Paid	-940	-217	-578	-723	-926	-1,158	-1,430
Others	-1,422	-20	7,529	-12	0	0	0
CF from Fin. Activity	-2,391	314	7,070	-1,021	-1,130	-1,398	-1,655
Inc/Dec of Cash	-1,690	123	20	23	1,450	2,512	3,187
Opening Balance	1,861	171	294	314	338	1,788	4,299
Closing Balance	172	294	314	338	1,788	4,299	7,486

Triveni Turbine

BSE SENSEX
67,481S&P CNX
20,268

CMP: INR430

TP: INR520 (+21%)

Buy



Bloomberg	TRIV IN
Equity Shares (m)	318
M.Cap.(INRb)/(USDb)	136.7 / 1.6
52-Week Range (INR)	457 / 241
1, 6, 12 Rel. Per (%)	13/0/39
12M Avg Val (INR M)	397
Free float (%)	44.2

Financials & Valuations (INR b)

Y/E Mar	2023	2024E	2025E
Sales	12.5	16.4	21.3
EBITDA margin	18.7	19.1	19.9
Adj. PAT	1.9	2.5	3.4
EPS (INR)	6.1	7.8	10.7
EPS Gr. (%)	56.1	29.6	36.2
BV/Sh. (INR)	23.9	29.6	37.3

Ratios

RoE (%)	23.8	29.4	32.0
RoCE (%)	23.9	29.5	32.1
Payout (%)	26.0	28.0	28.0

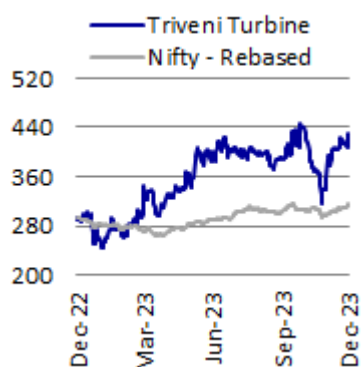
Valuations

P/E (x)	67.7	52.2	38.3
P/BV (x)	17.1	13.9	11.0
EV/EBITDA (x)	54.5	40.7	30.0
EV/Sales (x)	10.2	7.8	6.0

Shareholding pattern (%)

As On	Sep-23	Jun-23	Sep-22
Promoter	55.8	55.8	55.9
DII	11.7	12.6	16.1
FII	27.7	26.8	22.3
Others	4.8	4.8	5.7

FII Includes depository receipts

Stock's performance (one-year)**Strong growth and recovery in margin to drive earnings**

Triveni Turbine (TRIV) is a market leader in the below-30MW domestic turbine market with a market share of more than 55% supported by high demand from industrial capex and its stellar track record in the domestic market. Over the years, the company has also intensified its presence in international markets and is benefitting from the global shift towards renewables and waste-to-energy as well as improved after-market demand.

The company reported a revenue/EBITDA/PAT CAGR of 10%/11%/18% over FY19-23. We believe TRIV would continue to benefit from: 1) its market leadership in the sub-30MW turbine market; 2) higher share of exports and aftermarket, which results in better margins than competitors; and 3) enhanced scope for API turbines for refineries.

We expect TRIV's revenue/EBITDA/PAT to clock in a CAGR of 31%/34%/32% over FY23-26. Backed by a comfortable negative working capital cycle, strong margins and low capex requirements, we expect OCF and FCF to report a CAGR of 39%/46% over the same period. We initiate coverage on the stock with a BUY rating and target price of INR520.

Industry growth drivers in place

Domestic demand for turbines comes mainly from the following sectors: steel; cement; chemicals; pharma; distilleries; paper and pulp; etc., all of which are seeing capex improvements. Overall, the domestic turbine industry is still at around 2.2GW, which is below the peak seen in the previous decade. Globally demand for turbines results from incremental investments in renewables; WTE/ biomass investments in Europe, SE Asia and LATAM. While broad-based private capital spending is yet to revive, we do expect domestic market growth to be driven by demand from captive power plants and waste heat generation requirements. TRIV's exports have remained strong and the company is likely to benefit from an increased focus on energy transition and geographical footprint expansion.

Dominant player in the domestic steam turbine market

The company operates in three categories: 1) **0-30 MW** – Domestic market is currently 2.2GW where the company enjoys a market share of 55-60%, 2) **30-100 MW** – the market for turbines of this size is more developed internationally and the company is trying to expand its share, and 3) **Aftermarket**, which comprises three distinct segments – spares and services for its own existing turbine base and refurbishment of turbines of TRIV and other makes as well. In FY23, TRIV had a market share of about 45-50% for the entire categories upto 100 MW. Going forward, we expect TRIV's market share at around 40-45% given its existing leadership position in the domestic duopolistic market as well as the lack of initiatives from bigger players to tap into this niche market.

Export portfolio strong despite weakness seen in global markets

The international market presence of TRIV has experienced a notable expansion in the past year, largely due to a surge in orders and inquiries, which remain a primary source of growth for the company. The key markets driving this growth include Southeast Asia, Africa, Europe, South America, and North America. TRIV over time has developed strong technological prowess and R&D capabilities. This has enabled it to emerge as the second-largest player globally (after Siemens) with a market share of ~15% in its target geographies. As a result, export contribution to revenue has jumped to 45% in FY23 from 36% in FY16. With better realizations and margins in export markets, TRIV's overall margins have seen a marked improvement over this period.

Spreading its wings through aftermarket solutions

In FY23, TRIV's aftermarket business accounted for 33% of its total sales (vs 22% in FY16). The company intends to further increase the revenue contribution of this segment. The TRIV aftermarket is composed of two distinct segments: One is parts and services for its own turbines and the other is refurbishment, which is for turbines of other makes as well. The parts and services segment for its own turbines will grow based on the offerings that company has as well as the installed base of 6,000 turbines. This will grow in line with the product sales growth. TRIV is making aggressive marketing efforts for the refurbishment business. The addressable market for refurbishment is much larger, since it also includes turbines made by other OEMs. This provides TRIV with a significantly higher headroom to scale up its offerings. The company aims to continue with its strategy of increasing refurbishment as a percent of aftermarket by having more localized presence in international markets and catering to a wider range of turbines.

API turbines to grow in future

TRIV has diversified into American Petroleum Institute (API)-compliant drive turbines that find applications in oil & gas, petrochemical, refinery, and fertilizer sectors. This opens up a new geography for the company in the form of the Middle East. While currently it only has a single-digit contribution to sales, the growth potential is immense given that hydrocarbon investment traction has been robust on the back of healthy crude prices. Further, since these turbines are used in critical sectors, the approval process is stringent and TRIV has already secured approvals from major global EPCs, PMCs and OEMs such as Fluor, L&T Hydrocarbons, Qatar Petroleum, Engineers India, ADNOC, Tata Consulting Engineers, etc.

Strong focus on R&D initiatives

TRIV is a leader in the field of innovation and energy transition, collaborating with leading Indian educational institutions to develop cutting-edge technologies. The company has filed more than 330 Intellectual Property Rights, and continues to expand its product range and research efforts on an ongoing basis.

Healthy pace of growth in financials

We expect TRIV's revenue/EBITDA/PAT to clock a CAGR of 31%/34%/32% over FY23-26. Backed by a comfortable negative working capital cycle, strong margins and low capex requirements, we expect OCF and FCF to report a CAGR of 39%/46% over the same period.

Valuation and recommendation

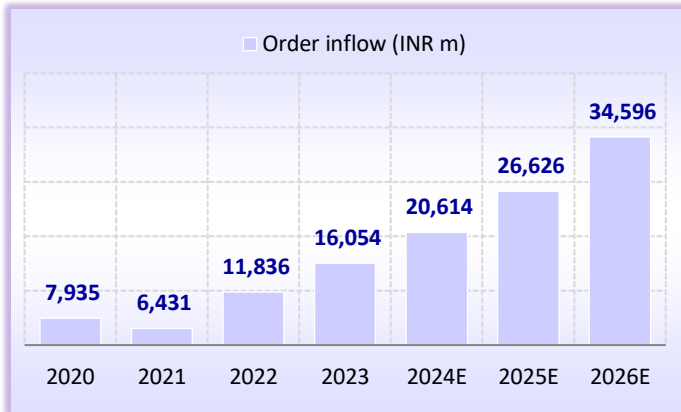
The stock is currently trading at 40.9x/31.1x FY25/26E P/E. We value the company at 39X two-year forward earnings to arrive at our TP of INR520. We initiate coverage on the stock with a BUY rating. We would wait for better price points to enter the stock.

Key downside risks

Slowdown in capex initiatives, intensified competition, technology disruption, inability to innovate and launch new products, and geopolitical headwinds resulting in a sharp slowdown in exports and aftermarket segments.

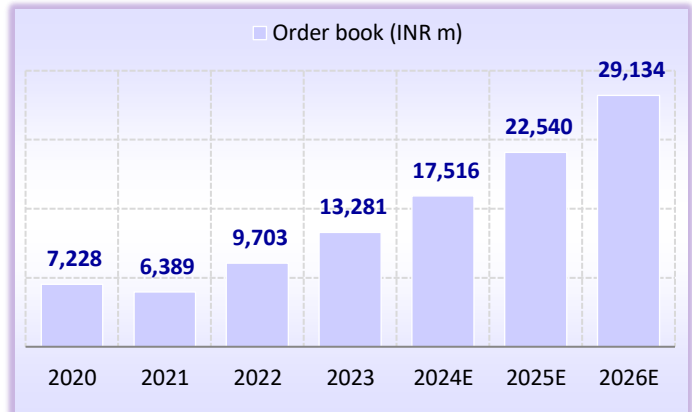
STORY IN CHARTS

We expect order inflow to grow at 29% CAGR over FY23-26



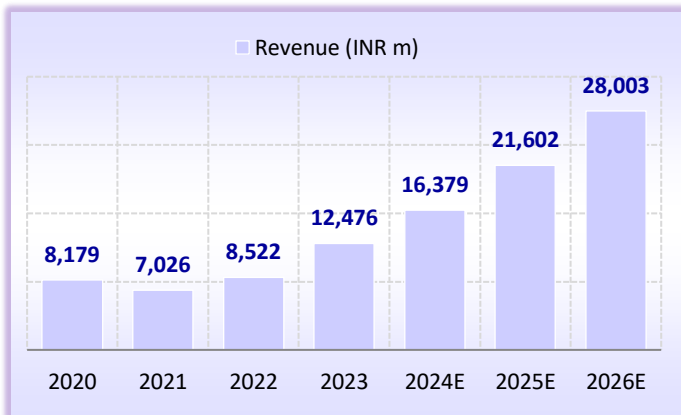
Source: Company, MOFSL

Order book buoyed by robust inquiry levels



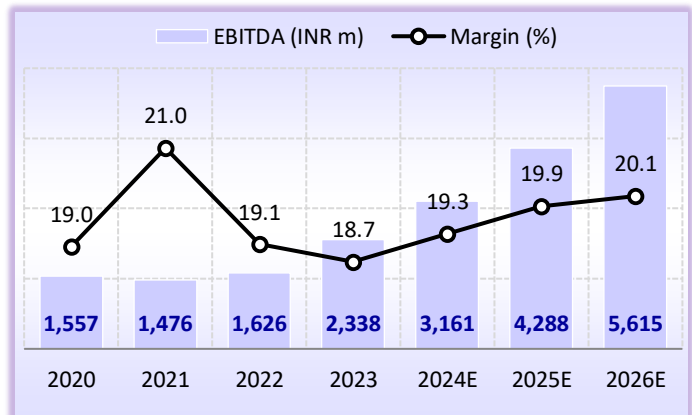
Source: Company, MOFSL

We expect revenue to grow at a CAGR of 31% over FY23-26



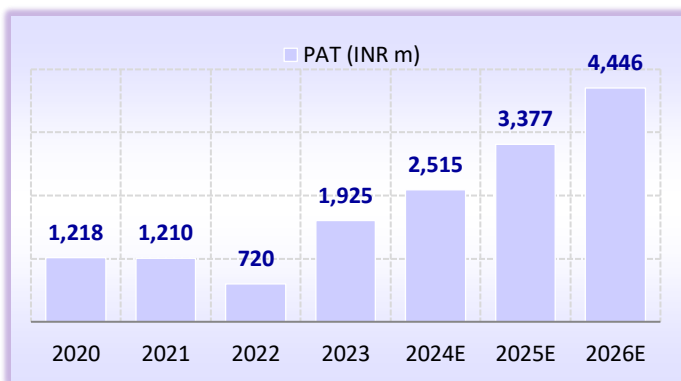
Source: Company, MOFSL

We expect EBITDA margin to remain strong around 20%



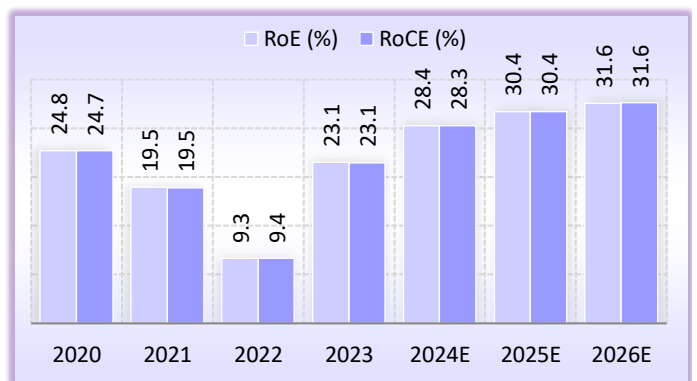
Source: Company, MOFSL

We expect PAT to grow at a CAGR of 32% over FY23-26



Source: Company, MOFSL

Return ratios to see a consistent improvement



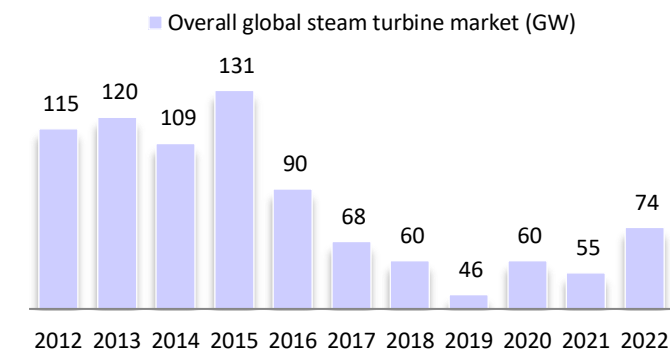
Source: Company, MOFSL

Industry growth drivers in place

The demand for turbines comes mainly from the following sectors: steel, cement, chemicals, pharma, distilleries, paper and pulp, etc. which are witnessing capex improvement. The overall domestic turbine industry at 2.2 GW is still below the peak levels seen during late 2010s. Globally, the demand for turbines is driven by incremental investments in renewable energy, WTE/biomass investments in Europe, SE Asia and Latin America. Though broad-based private capex revival is yet to take off, we do expect domestic market growth to be led by captive power plant and waste heat energy generation requirements. While the global sentiment is a muted one with key regions witnessing economic slowdown, TRIV’s exports are expected to be largely unaffected with increasing focus towards energy transition and wide geographical reach.

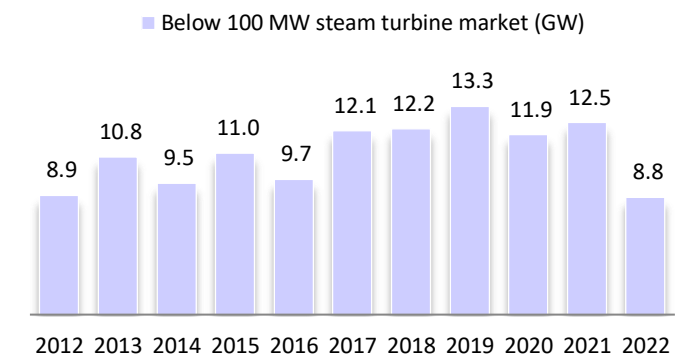
TAM still below the previous peak: The global steam turbine market (<100MW size) is pegged at 8.8GW as of CY22. This represents a steep 30% decline over CY21 levels of ~12.5GW owing to weakness in key geographies of China and Japan. However, TRIV does not have a presence in these markets. On the domestic front, the addressable market is pegged at ~2.2GW. It had peaked at ~4GW in the late 2010s during the previous capex cycle. It started declining from those levels and reversed the trend only from FY21.

Exhibit 292: Overall global steam turbine market size across markets (GW)



Source: Industry, Company

Exhibit 293: Below 100MW global steam turbine market size (GW)

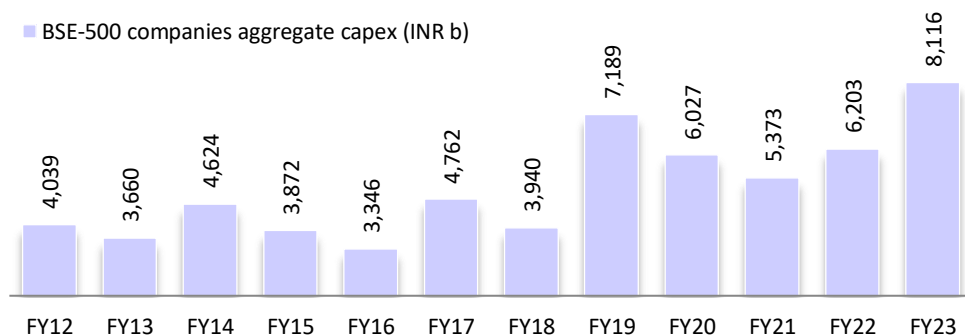


Source: Industry, Company

Key sectors driving growth: In domestic markets, while large industries have not ordered as much, the spending has been more from SMEs as large-scale private capital expenditure is yet to see a meaningful uptick. The demand for turbines comes mainly from the following industries: Steel, Cement, Chemicals, Pharmaceuticals, Distilleries, Paper and Pulp, etc. In addition to these, there are a number of other industries that are increasing their capex. With expected improvement in private capex, (which seems to have bottomed out in FY21), we expect demand for captive power plants and waste heat recovery plants to improve. Our overall assessment of key sectors such as Steel, Cement, chemicals, pharmaceuticals etc under our coverage universe indicates that capex is likely to increase in coming years. Incremental opportunities are also likely to come from, biomass and waste-to- energy that will continue to drive investment in captive

power generation. Turbine forms nearly 30% of total captive power plant cost and hence, we expect demand to improve in line with the market.

Exhibit 294: Aggregate capex of BSE500 companies (INR b)



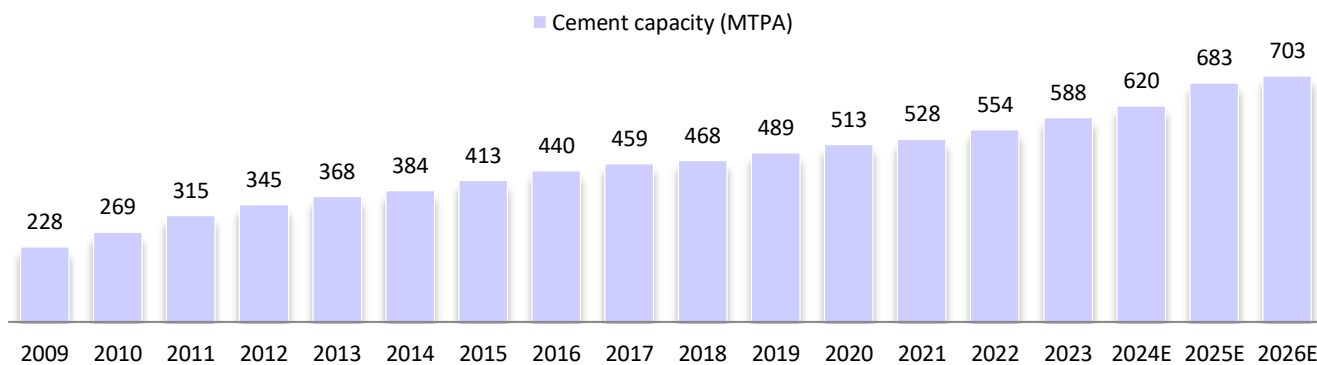
Source: Capitaline, MOFSL

Exhibit 295: Capex across key sectors has started improving – (INR b)

Capex across key sectors under coverage universe	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Automobile	573	533	368	378	449	600	624	699
Cement	106	130	104	188	247	274	251	281
Chemical	11	17	10	21	28	34	30	34
Metals and mining	530	563	493	620	839	998	919	1,030
Oil and Gas	1,625	1,660	1,717	1,671	2,058	2,196	1,743	1,952
Pharmaceuticals	200	98	151	182	261	202	145	162
FMCG	21	22	45	28	45	41	29	33
Total across these key sectors	3,067	3,022	2,888	3,088	3,927	4,344	3,741	4,190

Source: Companies, MOFSL

Exhibit 296: Installed cement capacity trend (MTPA)



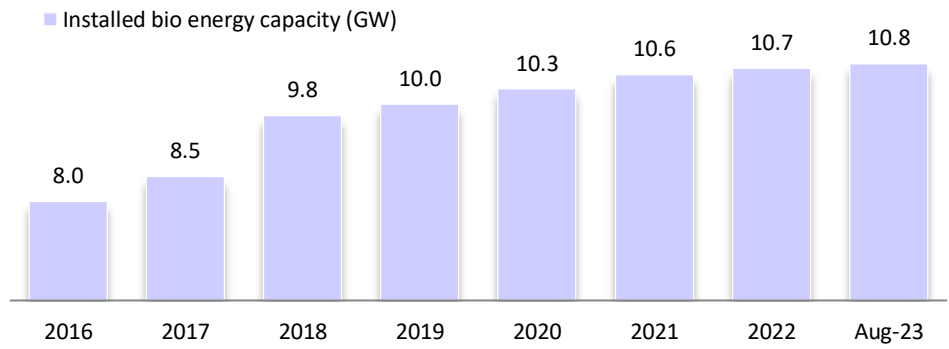
Source: Companies, MOFSL

Exhibit 297: Expanded steel capacity is likely to be around 300MT as per industry estimates

Companies	Current Domestic Capacity (in MT)	Expanded Capacity over next 7-8 years (in MT)
Tata Steel	21.4	40.0
JSW Steel	28.2	50.0
JSPL	9.6	15.9
SAIL	21.4	35.0
RINL	7.3	7.3
AM/NS	9.0	15.0
Others	57.2	136.8
Total domestic crude steel capacity	154.1	300.0

Source: Companies, JPC, Ministry of Steel, worldsteel.org, MOFSL

Exhibit 298: Installed bio energy capacity in India which will move up further (GW)



Source: Company, MOFSL

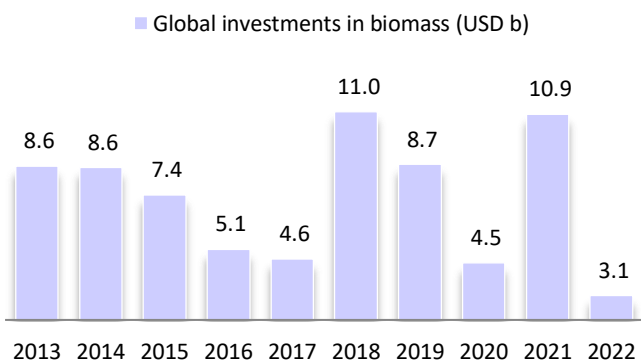
Growing opportunities from export markets, near-term headwinds not a concern:

The global steam turbine market reached a peak of 131GW in 2015 and has been declining steadily ever since, reaching an estimated 74GW in 2022, led by a sharp drop in demand for fossil-fuel-based turbines. However, the thermal renewable turbine market, where TRIV is active, has remained resilient, driven by renewable energy led by WTE/ biomass investments in Europe, Southeast Asia and Latin America.

- **Europe:** It has a very strong capital outlay towards its energy transition and hence, it has seen healthy growth in enquiries and orders across segments of renewable energy. Though we may see some near-term weakness in exports in European region, there is still a high spending towards WTE projects in Europe.
- **Southeast Asia:** It is also witnessing growth in fixed capital formation from both traditional industries, as well as certain renewable energy power generation based on biomass.
- **North America:** Healthy demand is spurring fresh capacity for renewable energy power generation.
- **China and Japan:** TRIV does not participate in the Chinese or the Japanese markets.

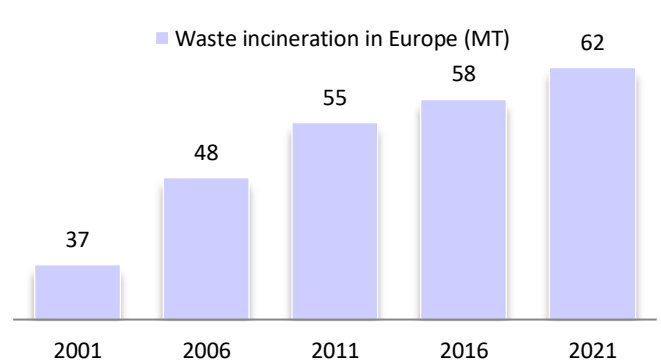
From a global perspective, the climate change mandate appears to be benefiting TRIV in its segment of operations.

Exhibit 299: Global investment in biomass is volatile (USD b)



Source: Statista, MOFSL

Exhibit 300: Waste incineration market in Europe (MT)



Source: European Parliament, MOFSL

Dominant player in the domestic steam turbine market

TRIV is a dominant player in the industrial steam turbine industry (up to 100MW) both in India and globally. In India, TRIV enjoys a market share of ~50-60% with Siemens commanding 30-40% share, thus effectively making the market a duopoly. Globally, Siemens is the market leader and TRIV is the second-largest player with ~15% market share in its target geographies.

TRIV offers steam turbine solutions for Industrial Captive and Renewable Power specifically for Biomass, Independent Power Producers, Process Cogeneration, Waste-to-Energy, Waste Heat Recovery and District Heating. Its steam turbines cater to diverse industries, such as Sugar, Distilleries, Steel, Cement, Textiles, Chemicals, Oil & Gas, Pulp & Paper, Petrochemicals, Fertilizers, Solvent Extraction, Metals, Palm Oil, Food Processing, etc. Apart from manufacturing, the company also provides a wide range of aftermarket services to its own fleet of turbines as well as turbines and other rotating equipment such as compressors, rotors, etc.

Market leader in <30MW range: TRIV has consistently maintained domestic market leadership (~50-60% market share) in the below 30MW range of made-to-order industrial turbines where it has operated independently. Traditionally, India has been a sub-30MW market largely led by captive power plants across process industries such as metals and cement. The market size had hit a peak of ~4GW in the previous capex cycle and by FY15 it had declined to 700MW due to a tepid capex cycle. However, it has recovered to ~2.2 GW by FY23 fueled by investments in WHR, cogen operations, and led by industries such as metals, chemicals, sugar/ethanol, biomass, etc.

The 30-100MW market ripe to be tapped into: The company had entered into a JV with General Electric (GE) in FY11 to manufacture 30-100MW turbines for both domestic and global markets. However, things did not go as had been envisaged and after a long-drawn saga, the companies decided to call off the JV. Subsequently, TRIV bought out GE's stake for INR80m while GE paid INR2b in damages to TRIV in an out-of-court settlement. Now, TRIV operates independently in the 30-100MW space and the global market for the same is pegged at 1.5x the size of the 0-30MW market. The enquiry pipeline for the 30-100MW segment remains robust across geographies and is expected to provide a fillip to ordering activity.

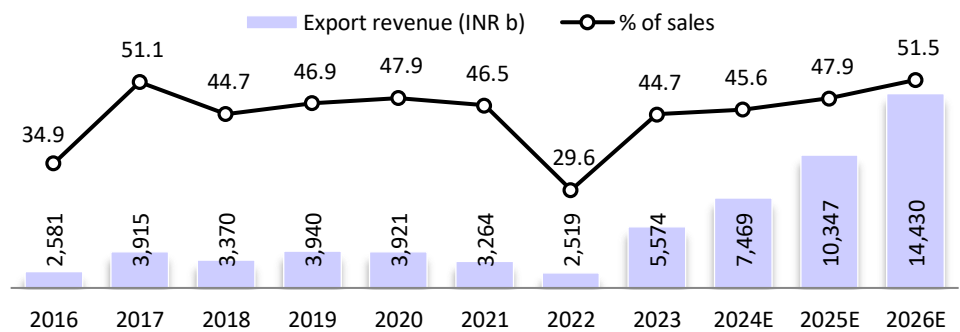
The majority of the order intake in the domestic market came from Sugar, Distillery, Food Processing, Pulp & Paper, Chemicals and Waste Heat Recovery (comprising Steel and Cement) during the year. We expect this market to remain strong over FY23-26 due to continuous investments by small- and mid-sized industries on energy efficiency improvement initiatives. Going forward, we expect TRIV's market share at around 40-45% given its existing leadership position in the domestic duopoly market as well as the lack of initiatives from bigger players to invest in this niche market.

Export portfolio strong despite weaker global markets

The global steam turbine market reached a peak of 131GW in 2015 and has been declining steadily ever since, reaching an estimated 74GW in 2022, led by a sharp drop in demand for fossil-fuel-based turbines. TRIV’s international market presence has undergone a significant change during the last year driven by a surge in orders and enquiries, which continues to be a key growth driver. The key markets driving this growth include Southeast Asia, Africa, Europe, and South America & North America.

Unlike the utility-scale turbines that are more or less standardized in nature, industrial steam turbines require higher customization in terms of feedstock, engineering, and other key aspects. Therefore, manufacturing such customized turbines in developed geographies is cost intensive and hence outsourcing to players like TRIV who also possess a strong technological prowess and R&D capabilities making it a more viable option. This approach has enabled TRIV to emerge as the second- largest player globally (after Siemens) with a market share of ~15% in its target geographies. As a result, export contribution to revenue has increased to 45% in FY23 from 36% in FY16. Notably, realizations per turbine are higher for exports vis à vis domestic markets and therefore exports margin is ~2x of domestic markets. While the demand in Europe is largely driven by WTE/MSW, the make-up of end- user industries in Southeast Asia is similar to that of India.

Exhibit 301: Share of exports has increased in line with company's strategy



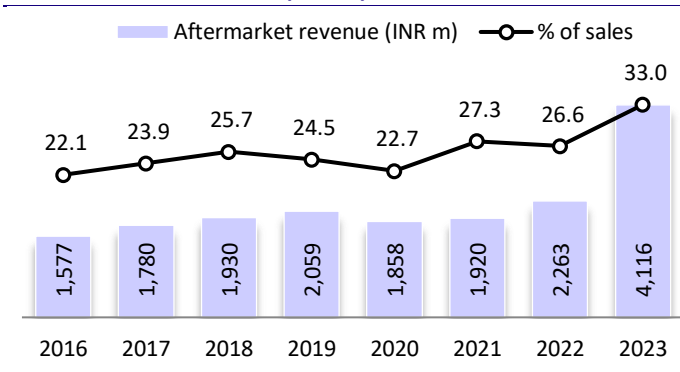
Source: Company, MOFSL

Spreading its wings through aftermarket solutions

In FY23, TRIV's aftermarket business accounted for 33% of its total sales. The company intends to further expand this segment as a percentage of net sales. The TRIV aftermarket is composed of two distinct segments: One is parts and services for its own turbines and the other is refurbishment, which is for the third-party turbine users. The parts and services segment for its own turbines will grow based on the offerings that company has as well as the installed base of ~6,000 turbines. This will grow in line with the product sales growth. TRIV is making aggressive marketing efforts for the refurbishment business. The addressable market for refurbishment is much larger, since it also includes turbines made by other OEMs. This provides TRIV with a significantly higher headroom to scale up its offerings. The company aims to continue with its strategy of increasing refurbishment as a percent of aftermarket by having more localized presence in international markets and catering to a wider range of turbines.

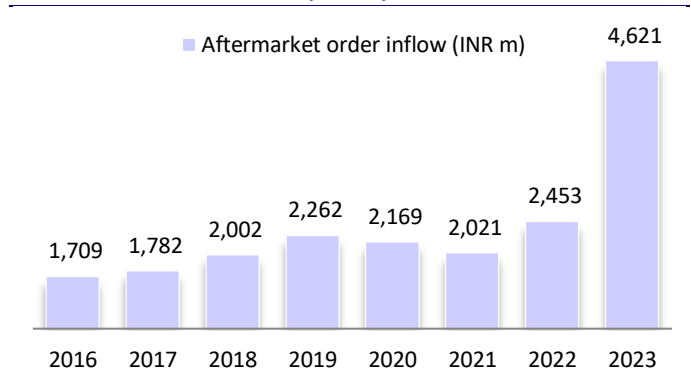
Overall, the company has placed a clear thrust on expanding its export footprint by making forays into the aftermarket business. TRIV clocked a ~15% CAGR in aftermarket solutions over FY16-23 vs. 6% CAGR for the product business. Aftermarket accounted for 33% of its FY23 revenue as against 22% in FY16. TRIV has expanded its aftermarket business in the South African Development Community (SADC) region, since augmenting its capacity in the geography. It bagged a significant services contract for large (utility) steam turbines in the aftermarket during FY23. This order has driven a healthy revenue growth for TRIV in the aftermarket segment, and the company has the potential to enhance this in future as well.

Exhibit 302: Share of aftermarket revenue has increased to 33% in FY23 and 1HFY24 (INR m)



Source: Company, MOFSL

Exhibit 303: Aftermarket order inflow has also improved by 88%/57% in FY23/1HFY24 (INR m)



Source: Company, MOFSL

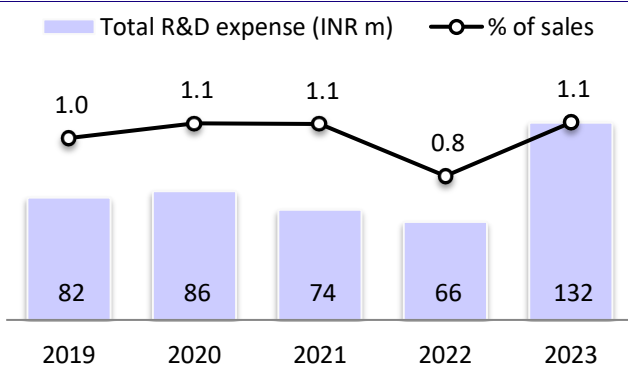
API turbines to propel future growth

- TRIV has diversified into API-compliant drive turbines that find applications in oil & gas, petrochemical, refinery, and fertilizer sectors. This opens up a new geography for the company in the form of the Middle East. While currently it only has a single-digit contribution to sales, the growth potential is immense given that hydrocarbon investment traction has been robust on the back of healthy crude prices. Further, since these turbines are used in critical sectors, the approval process is stringent and TRIV has already secured approvals from major global EPCs, PMCs and OEMs such as Fluor, L&T Hydrocarbons, Qatar Petroleum, Engineers India, ADNOC, Tata Consulting Engineers, etc.
- Enquiry generations in API turbines have been very healthy from both export markets and in India, on the back of government expenditures in fertilizers, oil & gas, etc., which augurs well for API turbines going ahead.

Focus on R&D and technology-related initiatives

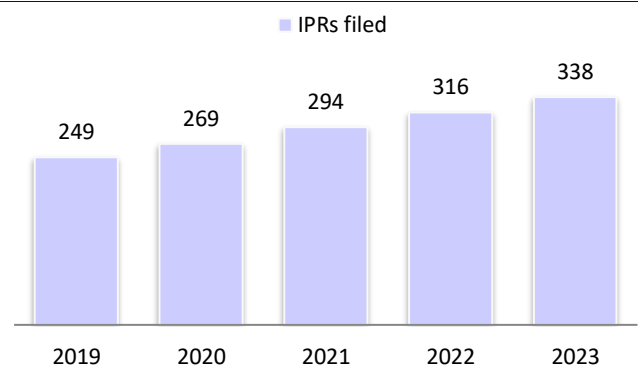
TRIV is a leader in the field of innovation and energy transition, collaborating with leading Indian educational institutions to develop cutting-edge technologies. The company has filed more than 330 Intellectual Property Rights, and continues to expand its product range and research efforts on an ongoing basis.

Exhibit 304: Consistent spending on R&D and innovation...



Source: Company, MOFSL

Exhibit 305: ...resulting in increasing number of IPR filings



Source: Company, MOFSL

A large portion of the order book is from non-fossil or thermal renewable fuels

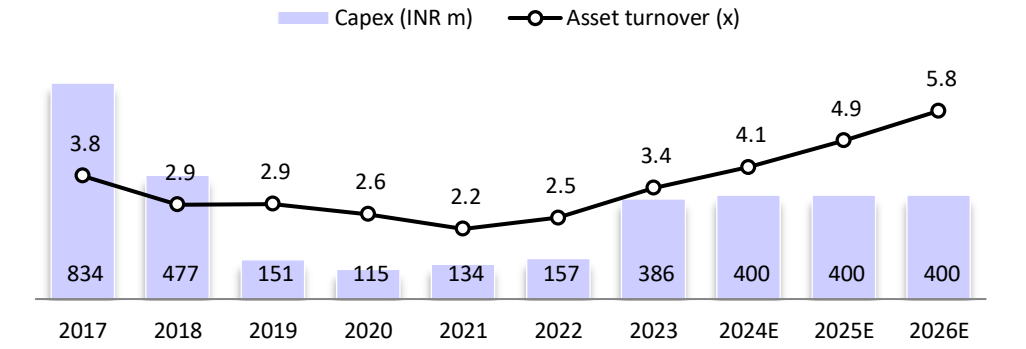
During FY23, ~80% of the company’s order booking came from non-fossil or thermal renewable fuels. The growing demand for steam turbines below 100 MW can be attributed to the increasing focus on renewable energy (RE) space. The company’s international order bookings are driven by non-fossil fuel or thermal renewable fuel-based solutions.

Capacity expansion to cater to incremental demand

TRIV is one of the few industrial steam turbine manufacturing companies that has in-house capability for complete manufacturing of critical components, such as blades, rotors and casings. With the addition of a new bay in the Sompura unit, it augmented the capacity for assembly and testing of steam turbines to 250-300 machines from 150-180 machines per annum. To meet the aftermarket requirements, TRIV also implemented new processes and tools, such as LASER

hardening on blade edges, high alloy steels, etc. This has enhanced its execution speed in refurbishment by implementing 3D printing, instead of physical machining of prototype from steel material for verification of fitment of blade roots to the existing old rotors.

Exhibit 306: Asset turnover to inch up led by higher contribution of aftermarket revenue



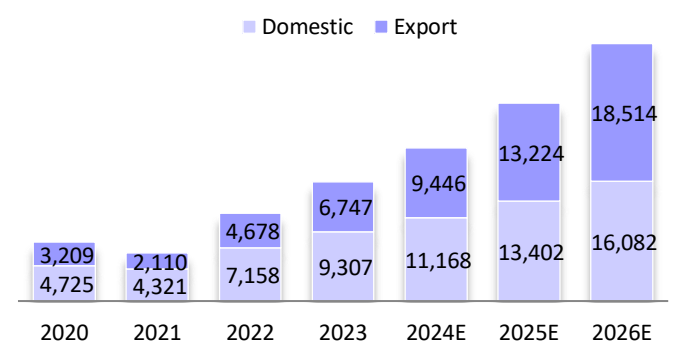
Source: Company, MOFSL

Financial outlook

The company reported a revenue/EBITDA/PAT CAGR of 10%/11%/18% over FY19-23. We believe TRIV would continue to benefit from: 1) its market leadership in the sub-30MW turbine market; 2) higher share of exports and aftermarket, which results in better margins than competitors; and 3) enhanced scope for API turbine for refineries.

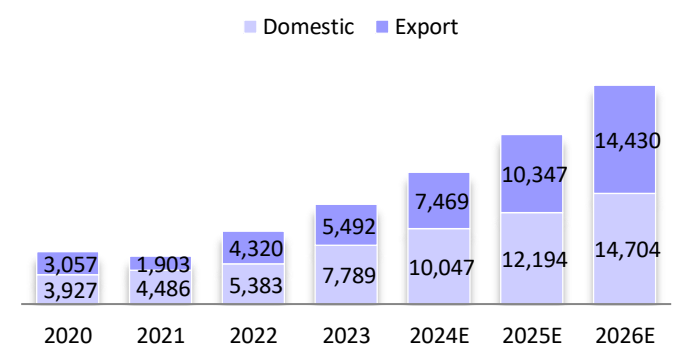
We expect TRIV's revenue/EBITDA/PAT to clock a CAGR of 31%/34%/32% over FY23-26. Backed by a comfortable negative working capital cycle, strong margins and low capex requirements, we expect OCF and FCF to report a CAGR of 39%/46% over the same period.

Exhibit 307: We expect order inflow momentum to be maintained (INR m)



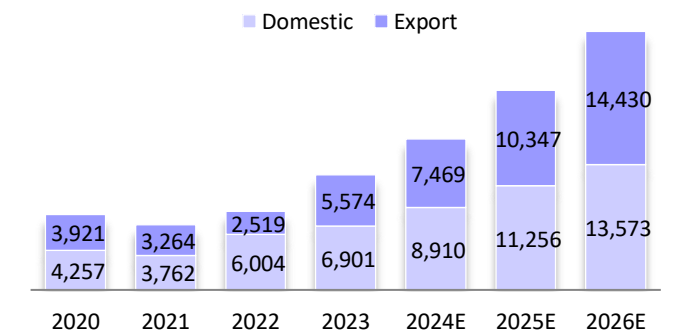
Source: Company, MOFSL

Exhibit 308: Order book on a strong footing on healthy enquiry levels and foray into newer markets (INR m)



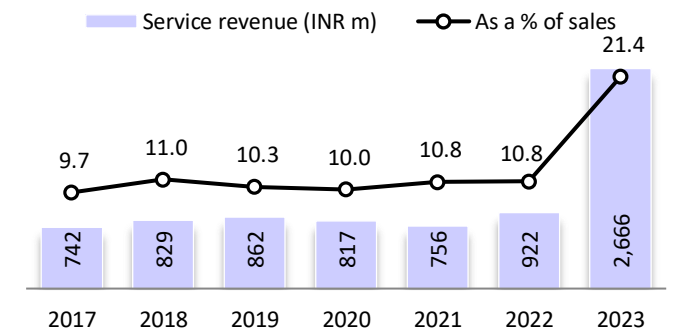
Source: Company, MOFSL

Exhibit 309: Overall revenue to post a CAGR of 31% (INR m)



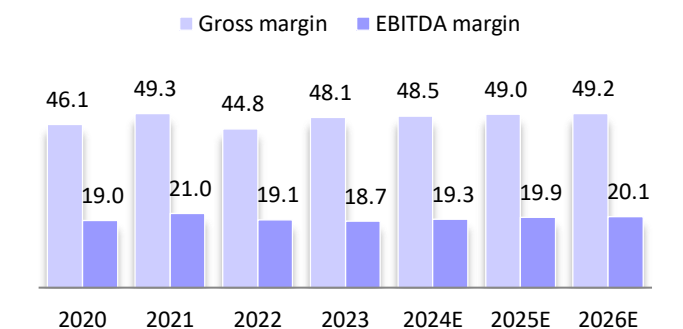
Source: Company, MOFSL

Exhibit 310: Company has made a healthy foray into Service



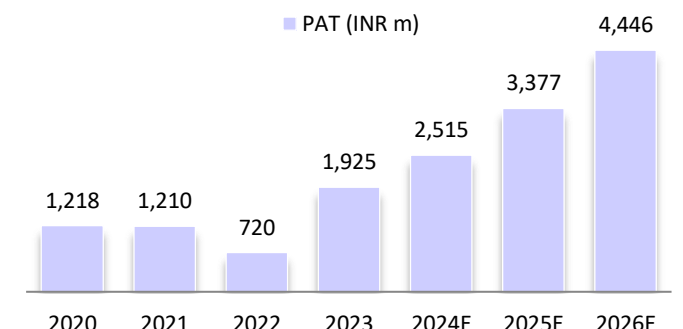
Source: Company, MOFSL

Exhibit 311: We expect EBITDA margin of around 20% (%)



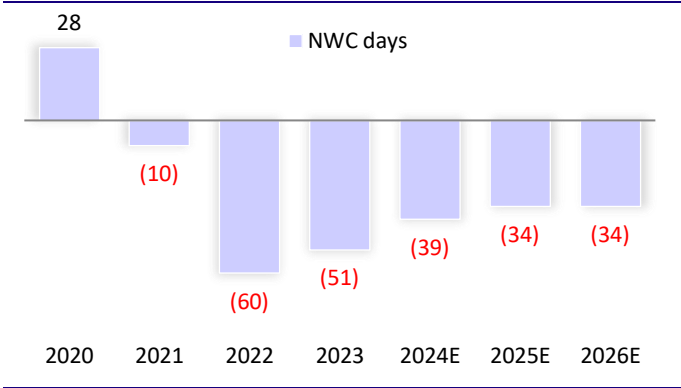
Source: Company, MOFSL

Exhibit 312: PAT to grow at a robust CAGR of 31% (INR m)



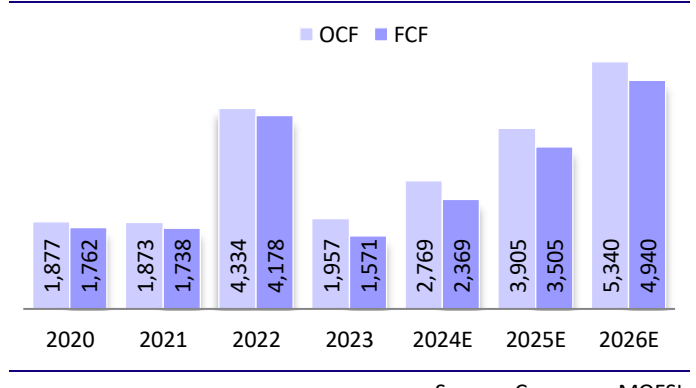
Source: Company, MOFSL

Exhibit 313: NWC days had declined continuously and we expect it to be at comfortable levels



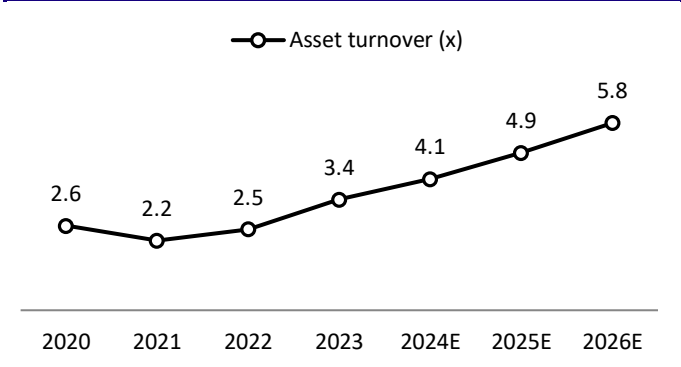
Source: Company, MOFSL

Exhibit 314: OCF & FCF to remain healthy on negative working capital and low capex (INR m)



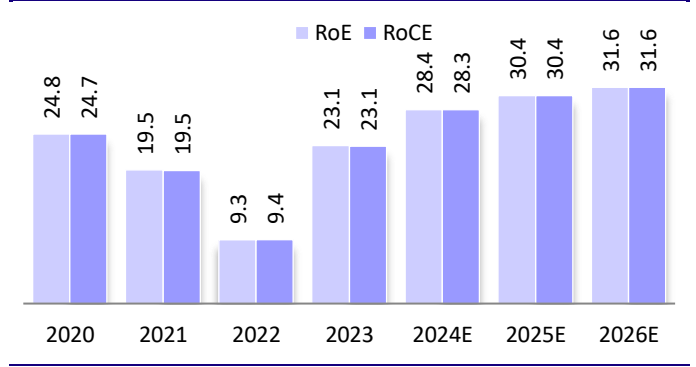
Source: Company, MOFSL

Exhibit 315: Asset turnover to inch up on higher aftermarket contribution (X)



Source: Company, MOFSL

Exhibit 316: Return ratios to remain strong on healthy profitability (%)

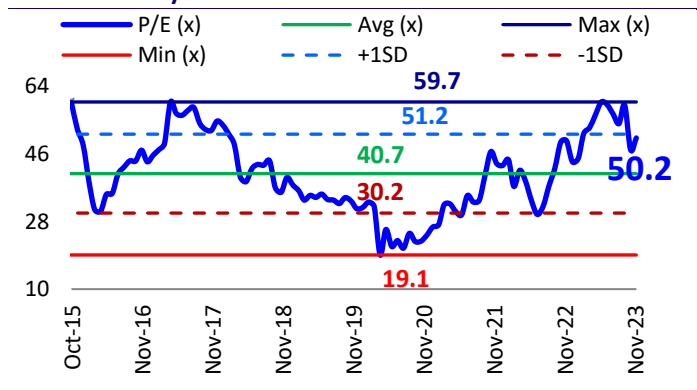


Source: Company, MOFSL

Valuation and recommendation

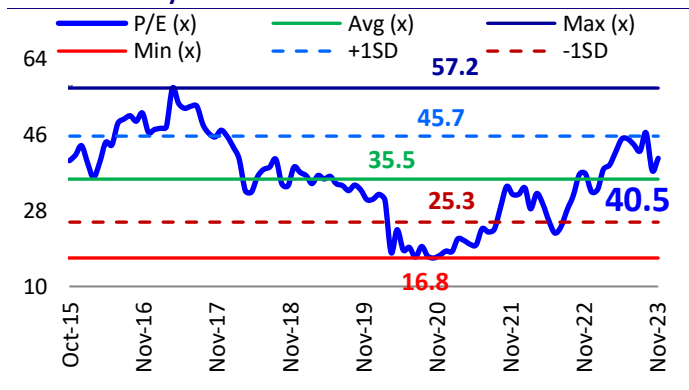
The stock is currently trading at 40.9x/31.1x FY25/26E P/E. We value the company at 39X two-year forward earnings to arrive at our TP of INR520. We initiate coverage on the stock with a BUY rating.

Exhibit 317: 1-year forward PE valuation band



Source: Bloomberg, MOFSL

Exhibit 318: 2-year forward PE valuation band



Source: Bloomberg, MOFSL

Exhibit 319: Sensitivity analysis - Base case, bear case and bull case valuations

	Bear case	Base case	Bull case	
2 year forward EPS (INR)	11.8	13.1	14.5	❖ 10% sensitivity in earnings
Valuation multiple (x)	35	39	42	❖ ~10% sensitivity in valuation multiple
Target Price (INR/share)	420	520	610	

Source: MOFSL

Key risks and concerns

Key downside risks: Slowdown in capex initiatives, intensified competition, technology disruption, inability to innovate and launch new products, and geopolitical headwinds resulting in a sharp slowdown in exports and aftermarket segments.

SWOT analysis

- ❖ Market leadership position in the domestic steam turbine segment
- ❖ Proven execution track record
- ❖ Strong R&D investment

S

STRENGTH



- ❖ Barriers to entry in product export markets
- ❖ Highly cyclical industry

W

WEAKNESS



- ❖ Global investments in green energy
- ❖ Capex activity in key end user industries
- ❖ Foray in export regions through aftermarket opportunities

O

OPPORTUNITY



- ❖ Slowdown in investment activity
- ❖ Commodity fluctuation

T

THREATS



Management profile



Mr. Dhruv Sawhney, (Chairman & Managing Director)

Mr. Sawhney graduated with a Master's degree in Mechanical Sciences from Emmanuel College, University of Cambridge, U.K. and an M.B.A with distinction from the Wharton School, University of Pennsylvania, U.S.A. He was on the Dean's list for all terms, came second in the University, and is a life member of Beta Gama Sigma.



Mr. Nikhil Sawhney (Vice Chairman & Managing Director)

Nikhil has a Bachelor's degree in Arts and a Master's degree in Arts from Emmanuel College, University of Cambridge, and a Master's degree in Business Administration from The Wharton School, University of Pennsylvania. Nikhil Sawhney is the Vice Chairman and Managing Director of Triveni Turbine Limited and a Director with Triveni Engineering and Industries Limited in Noida, India.



Mr. Arun Mote, (Executive Director)

Mr. Arun Mote has a Master's degree in Technology from Indian Institute of Technology (IIT) – Bombay and a Master's degree in Business Administration from Jamnalal Bajaj Institute of Management Studies, Bombay University

Financials and valuation

Consolidated - Income Statement								(INR Million)
Y/E March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Total Income from Operations	8,400	8,179	7,026	8,522	12,476	16,379	21,602	28,003
Change (%)	11.8	-2.6	-14.1	21.3	46.4	31.3	31.9	29.6
Raw Materials	4,691	4,411	3,562	4,703	6,471	8,435	11,017	14,225
Gross Profit	3,709	3,768	3,464	3,820	6,004	7,944	10,585	13,777
Employees Cost	991	1,016	870	1,029	1,285	1,802	2,484	3,220
Other Expenses	1,205	1,195	1,118	1,164	2,381	2,981	3,813	4,942
Total Expenditure	6,887	6,622	5,550	6,896	10,138	13,218	17,314	22,388
% of Sales	82.0	81.0	79.0	80.9	81.3	80.7	80.2	80.0
EBITDA	1,513	1,557	1,476	1,626	2,338	3,161	4,288	5,615
Margin (%)	18.0	19.0	21.0	19.1	18.7	19.3	19.9	20.1
Depreciation	201	201	202	203	199	232	254	276
EBIT	1,311	1,356	1,274	1,424	2,139	2,929	4,034	5,338
Int. and Finance Charges	11	33	11	10	10	16	22	28
Other Income	194	237	244	253	426	447	499	629
PBT bef. EO Exp.	1,494	1,559	1,506	1,666	2,555	3,359	4,511	5,940
EO Items	0	0	-185	1,982	0	0	0	0
PBT after EO Exp.	1,494	1,559	1,321	3,648	2,555	3,359	4,511	5,940
Total Tax	492	342	296	946	626	845	1,134	1,493
Tax Rate (%)	32.9	21.9	22.4	25.9	24.5	25.1	25.1	25.1
Minority Interest	0	0	0	0	3	0	0	0
Reported PAT	1,002	1,218	1,025	2,702	1,925	2,515	3,377	4,446
Adjusted PAT	1,002	1,218	1,168	1,234	1,925	2,515	3,377	4,446
Change (%)	4.4	21.5	-4.1	5.6	56.1	30.6	34.3	31.7
Margin (%)	11.9	14.9	16.6	14.5	15.4	15.4	15.6	15.9

Consolidated- Balance Sheet								(INR Million)
Y/E March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Equity Share Capital	323	323	323	323	318	318	318	318
Total Reserves	4,011	4,978	6,052	8,242	7,286	9,096	11,528	14,729
Net Worth	4,334	5,302	6,376	8,566	7,604	9,414	11,846	15,047
Minority Interest	0	0	0	8	10	10	10	10
Total Loans	0	10	0	2	0	0	0	0
Deferred Tax Liabilities	141	72	51	35	44	44	44	44
Capital Employed	4,475	5,383	6,427	8,610	7,657	9,468	11,899	15,101
Gross Block	3,096	3,153	3,342	3,449	3,820	4,220	4,620	5,020
Less: Accum. Deprn.	587	727	903	1,071	1,214	1,446	1,700	1,976
Net Fixed Assets	2,509	2,426	2,440	2,378	2,606	2,774	2,919	3,043
Goodwill on Consolidation								
Capital WIP	43	64	0	33	54	54	54	54
Total Investments	231	1,571	3,010	4,866	3,880	5,380	7,380	9,880
Curr. Assets, Loans&Adv.	4,626	4,160	3,969	6,072	6,859	8,535	11,141	14,561
Inventory	2,168	1,727	1,596	1,617	2,000	2,692	3,551	4,603
Account Receivables	1,750	1,253	771	1,015	1,293	1,795	2,367	3,069
Cash and Bank Balance	272	684	1,164	2,731	2,849	2,998	3,535	4,702
Loans and Advances	3	2	0	0	0	0	0	0
Other Current Assets	433	493	437	709	716	1,050	1,687	2,187
Curr. Liability & Prov.	2,934	2,839	2,992	4,738	5,742	7,275	9,595	12,438
Account Payables	1,166	617	745	1,091	1,143	1,481	1,953	2,532
Other Current Liabilities								
Provisions	1,768	2,222	2,247	3,648	4,598	5,794	7,642	9,906
Net Current Assets	1,691	1,322	977	1,333	1,117	1,260	1,545	2,123
Appl. of Funds	4,475	5,383	6,427	8,610	7,657	9,468	11,899	15,101

Financials and valuation

Ratios

	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Basic (INR)								
EPS	3.2	3.8	3.7	3.9	6.1	7.9	10.6	14.0
Cash EPS	3.8	4.5	4.3	4.5	6.7	8.6	11.4	14.9
BV/Share	13.6	16.7	20.1	26.9	23.9	29.6	37.3	47.3
DPS	0.5	0.5	2.2	1.6	1.6	2.2	3.0	3.9
Payout (%)	18.9	16.1	69.4	18.5	26.0	28.0	28.0	28.0
Valuation (x)								
P/E	138.0	113.6	118.4	112.1	71.8	55.0	40.9	31.1
Cash P/E	114.9	97.5	100.9	96.3	65.1	50.3	38.1	29.3
P/BV	31.9	26.1	21.7	16.1	18.2	14.7	11.7	9.2
EV/Sales	16.4	16.8	19.5	15.9	10.9	8.3	6.2	4.8
EV/EBITDA	91.2	88.4	92.9	83.3	57.9	42.8	31.4	23.8
Dividend Yield (%)	0.1	0.1	0.5	0.4	0.4	0.5	0.7	0.9
FCF per share	4.2	5.5	5.5	13.2	4.9	7.5	11.0	15.5
Return Ratios (%)								
RoE	22.6	25.3	20.0	16.5	23.8	29.6	31.8	33.1
RoCE	22.8	25.8	20.1	16.6	23.9	29.7	31.9	33.2
RoIC	22.6	30.3	37.2	65.2	174.1	229.7	307.3	573.5
Working Capital Ratios								
Fixed Asset Turnover (x)	2.7	2.6	2.1	2.5	3.3	3.9	4.7	5.6
Asset Turnover (x)	1.9	1.5	1.1	1.0	1.6	1.7	1.8	1.9
Inventory (Days)	94	77	83	69	59	60	60	60
Debtor (Days)	76	56	40	43	38	40	40	40
Creditor (Days)	51	28	39	47	33	33	33	33
Leverage Ratio (x)								
Current Ratio	1.6	1.5	1.3	1.3	1.2	1.2	1.2	1.2
Interest Cover Ratio	116.8	40.7	112.1	139.6	215.0	178.8	186.7	190.6
Net Debt/Equity	-0.1	-0.4	-0.7	-0.9	-0.9	-0.9	-0.9	-1.0

Y/E March - Cash Flow Statement

(INR Million)

Y/E March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
OP/(Loss) before Tax	1,494	1,559	1,321	3,648	2,555	3,359	4,511	5,940
Depreciation	201	201	202	203	199	232	254	276
Interest & Finance Charges	11	33	11	10	10	16	22	28
Direct Taxes Paid	-479	-414	-323	-902	-628	-845	-1,134	-1,493
(Inc)/Dec in WC	336	594	796	1,570	230	6	252	590
CF from Operations	1,563	1,974	2,007	4,529	2,366	2,769	3,905	5,340
Others	-84	-97	-134	-195	-409	0	0	0
CF from Operating incl EO	1,479	1,877	1,873	4,334	1,957	2,769	3,905	5,340
(Inc)/Dec in FA	-150	-115	-132	-148	-384	-400	-400	-400
Free Cash Flow	1,329	1,762	1,740	4,187	1,573	2,369	3,505	4,940
(Pur)/Sale of Investments	71	-1,178	-2,026	-3,617	1,111	-1,500	-2,000	-2,500
Others	1	4	13	-98	136	0	0	0
CF from Investments	-78	-1,288	-2,144	-3,862	862	-1,900	-2,400	-2,900
Issue of Shares	-1,013	0	0	0	0	0	0	0
Inc/(Dec) in Debt	-1	11	-2	-20	-1	0	0	0
Interest Paid	-11	-33	-11	-10	-10	-16	-22	-28
Dividend Paid	-181	-162	0	-711	-501	-704	-946	-1,245
Others	-37	-17	-2	1	-2,335	0	0	0
CF from Fin. Activity	-1,243	-201	-16	-740	-2,847	-721	-967	-1,273
Inc/Dec of Cash	158	388	-288	-268	-28	148	538	1,167
Opening Balance	117	296	1,452	2,998	2,878	2,849	2,998	3,535
Closing Balance	275	684	1,164	2,731	2,849	2,998	3,535	4,702

K E C International

BSE SENSEX
67,481S&P CNX
20,268

CMP: INR590

TP: INR640 (+9%) Neutral



Bloomberg	KECI IN
Equity Shares (m)	257
M.Cap.(INRb)/(USDb)	151.6 / 1.8
52-Week Range (INR)	748 / 416
1, 6, 12 Rel. Per (%)	-12/1/34
12M Avg Val (INR M)	357
Free float (%)	48.1

Financials & Valuations (INR b)

Y/E Mar	2023	2024E	2025E
Sales	172.8	210.5	242.2
EBITDA margin	4.8	6.6	7.6
Adj. PAT	1.8	4.3	7.7
EPS (INR)	6.8	16.9	30.0
EPS Gr. (%)	-53.1	146.5	77.7
BV/Sh. (INR)	146.7	161.8	188.5

Ratios

RoE (%)	4.8	10.9	17.1
RoCE (%)	9.2	12.4	15.0
Payout (%)	3.0	1.8	3.2

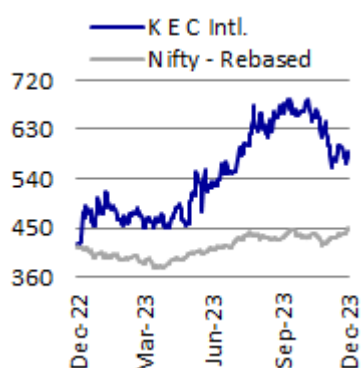
Valuations

P/E (x)	86.1	34.9	19.7
P/BV (x)	4.0	3.6	3.1
EV/EBITDA (x)	23.3	14.5	10.8
EV/Sales (x)	1.0	0.9	0.8

Shareholding pattern (%)

As On	Sep-23	Jun-23	Sep-22
Promoter	51.9	51.9	51.9
DII	27.2	26.7	26.5
FII	11.3	11.6	11.6
Others	9.7	9.9	10.0

FII Includes depository receipts

Stock's performance (one-year)**Margins bottomed out**

KEC is ideally positioned to capitalize on upcoming opportunities in the transmission and civil segment. Over FY21-23, the company has grown its order inflow/order book at a CAGR of 37%/26%, mainly driven by civil and Transmission & Distribution (T&D) sectors. KEC remains focused on (1) maintaining its market share in domestic T&D projects and widening its presence in international T&D, (2) diversifying across various segments in civil projects, (3) concluding legacy projects, and (4) minimizing working capital and borrowings. Over FY23-26E, we expect (1) KEC to post 17% revenue CAGR, on the back of strong OB (INR313b; OB/Rev: 1.5x), (2) EBITDA to compound at ~40% during the same time period on margin improvement from the low base of FY23; (3) stable working capital cycle. We expect overall borrowings and interest expenses to remain high over FY23-26. We reinitiate coverage on the stock with a Neutral rating and a TP of INR640 based on 16X 2-year forward earnings.

Benefiting from strong addressable market in T&D and civil

We expect KEC to benefit from a strong prospect pipeline of INR1.25t across T&D, railways, and civil segments over the next one year. The prospect pipeline spans across the transmission side of renewable projects and increasing scope of work in civil engineering across various sub-segments. KEC is consistently enhancing its capabilities to tap into a broader market opportunity base across T&D, civil, and railways. On the international T&D projects too, the company is targeting large-sized projects from the Kingdom of Saudi Arabia. The company also stands to benefit from spending on the Kavach initiative by Indian Railways, which we believe would gain momentum starting in FY25. We expect transmission and civil to contribute 48%/30% of the overall revenues by FY25.

Strong inflows and diversified OB gives healthy revenue visibility

Order inflows have remained strong for KEC over the last two years and registered a CAGR of 37% over FY21-23. The company has diversified across segments over the years in order to reduce dependence on the T&D segment. With strong inflow CAGR of 15% and order book of INR313b, we expect revenues to grow at a CAGR of 17% over FY23-26E. With continued focus on diversification, we expect T&D and non-T&D mix of 48%:52% for KEC by FY26.

Softening RM prices and near completion of legacy projects to aid margins

In the near term, a margin decline is expected due to the execution of legacy projects valued at INR15b based on the fixed price. With SAE already turning PBT positive and with the completion of legacy projects on domestic T&D by 3QFY24, we expect a gradual 50bp quarterly improvement in margins. We, however, expect KEC to still take time to return to the double-digit margins observed before the Covid-19 pandemic, even with a decrease in commodity prices. We model margins of 6.6%/7.6%/8.4% for FY24/25/26E.

Working capital management is key to leverage reduction

The company is targeting to bring down net working capital days by 15 days by FY24 end, following the release of milestone-based payments from railway projects. However, we do not bake in large reduction in working capital for the company as we expect revenue growth to remain strong at 17% CAGR over FY23-26, and hence, working capital requirements will also be higher. We expect net debt of INR 60/65/67b for FY24/25/26E.

Financial outlook

We expect revenue/EBITDA CAGR of 17%/40% over FY23-26 for KEC. This is driven by (1) order inflow growth of 15% over the same period, led by strong prospect pipeline, (2) gradual recovery in EBITDA margin to 6.6%/7.6%/8.4% by FY24/25/26, (3) control over working capital on improved customer advances, improved debtor collections from railways and Afghanistan projects. With improvement in margins and stable working capital, we expect RoE and RoCE to improve to 21.1%/17.6% by FY26.

Key risks and concerns

A slowdown in order inflows, a sharp rise in commodity prices, elevated crude oil prices, lower-than-expected monsoon leading to higher inflation, rising receivables and working capital, and heightened competition are potential risks that could impact our estimates.

Valuation and view

KEC is currently trading at 19.7X/13.5X on FY25E/26E earnings. We value the company at 16X two-year forward estimated earnings, which bakes in a revenue CAGR of ~17% and EBITDA margins of 6.6%/7.6%/8.4% for FY24-26E. We reinstate coverage with a Neutral rating with a target price of INR640. We would look for better price points to enter the stock.

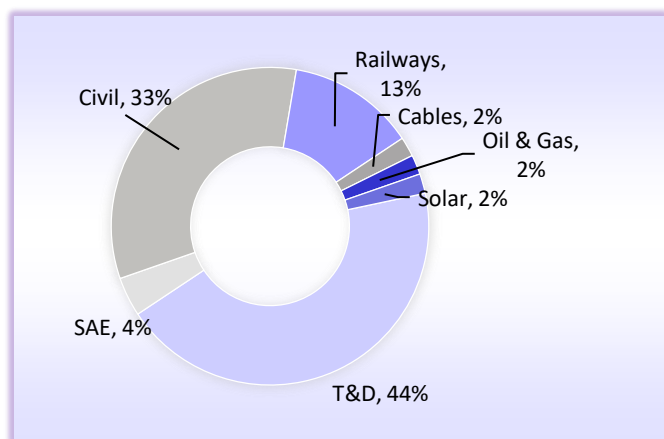
STORY IN CHARTS

Transmission line network worth INR2.4t will have to be set up before renewable energy capacity gets commissioned

Details	Capacity (GW)
RE capacity already commissioned	166
66.5 GW RE capacity to be integrated to ISTS network (8.8 GW already commissioned)	58
Additional RE capacity to be integrated to ISTS network (55 GW+181.5GW)	237
Margin already available in ISTS sub-stations which can be used for integration	34
Balance RE capacity from GEC-1 to be integrated to intra-state system	7
RE capacity from GEC-II to be integrated to intra-state system	19
Additional hydro capacity likely by FY2030	17
Total RE capacity targeted till FY2030	537

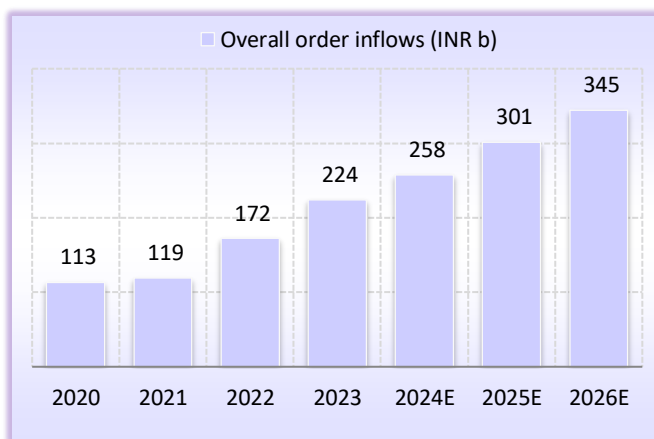
Source: Ministry of Power

Order book is fairly diversified across segments (INR313b)



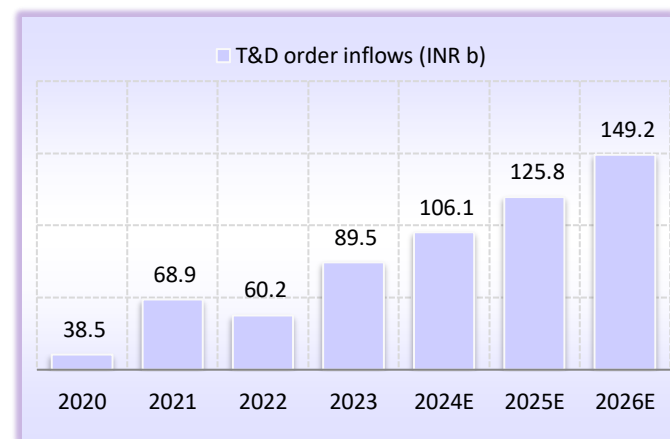
Source: Company, MOFSL

Overall order inflows have remained strong (INR b)



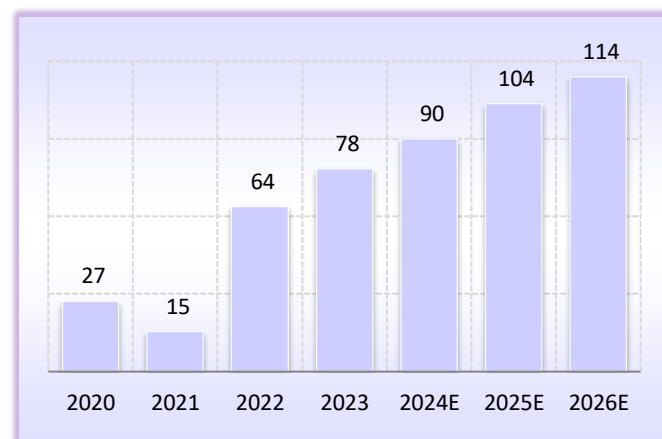
Source: Company, MOFSL

T&D segment order inflows will be driven by both domestic and international (INR b)



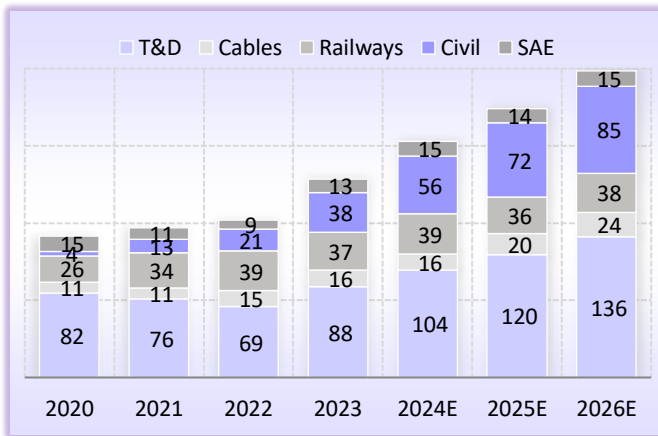
Source: Company, MOFSL

Civil segment order inflows have grown at a fast pace since FY21 (INR b)



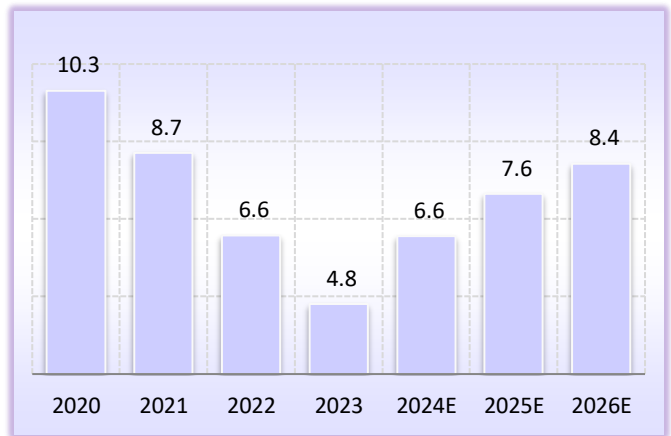
Source: Company, MOFSL

We expect share of non-T&D revenues to move up on improved revenues from civil segment (INR b)



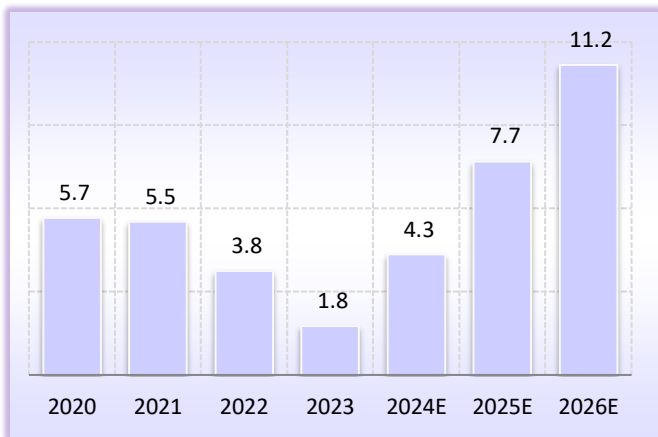
Source: Company, MOFSL

We expect EBITDA margin to start improving from FY24 onwards (%)



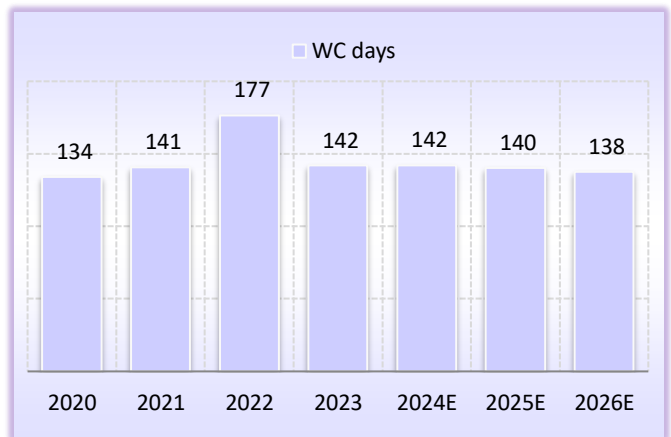
Source: Company, MOFSL

We expect PAT growth to be led by revenue growth and margin improvement (INR b)



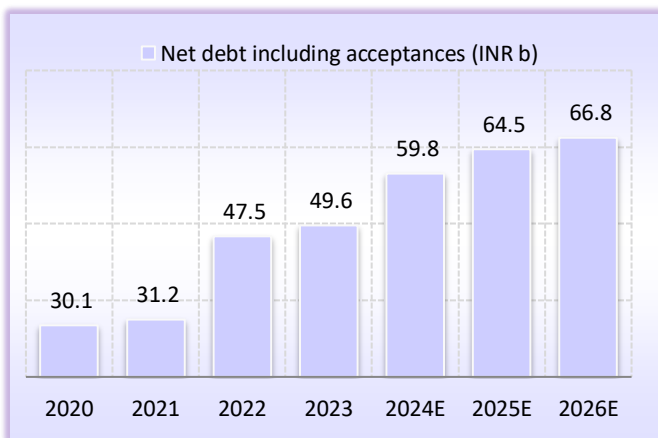
Source: Company, MOFSL

WC days to remain flat on increased requirements of WC to support strong revenue growth



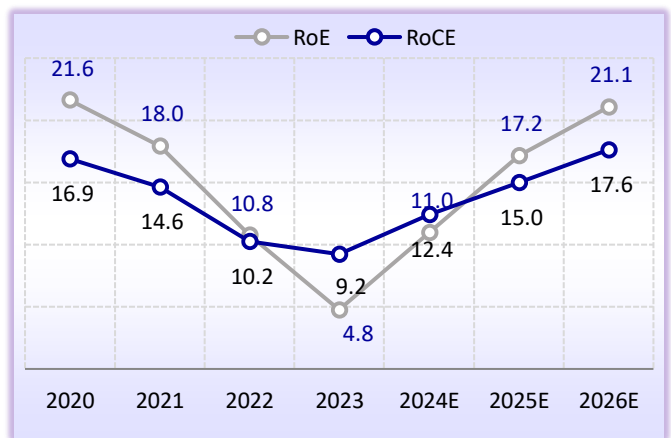
Source: Company, MOFSL

Net debt to remain at high levels to fund growth (INR b)



Source: Company, MOFSL

Return ratios to improve on better profitability (%)



Source: Company, MOFSL

Strong opportunity pipeline across segments

Domestic T&D is now ramping up

Transmission plan for 500 GW RE capacity

The Ministry of Power has formulated a comprehensive strategy to establish additional systems required for having 500 GW of green energy fuel, and transmission system for the integration of over 500 GW RE capacity by FY2030. The plan entails an investment potential of INR2.44t. The proposed infrastructure includes 8,120 ckm of high voltage direct current transmission corridors, 25,960 ckm of 765 kV AC lines, 15,758 ckm of 400 kV lines, and 1,052 ckm of 220 kV cable. The transmission plan also includes transmission system required for evacuation of 10 GW off-shore wind located in Gujarat and Tamil Nadu at an estimated cost of INR280 b. The plan has also identified regions such as Fatehgarh, Bhadla, Bikaner (in Rajasthan), Khavda (in Gujarat), Anantapur, Kurnool RE Zones (in Andhra Pradesh), offshore wind potentials in Tamil Nadu and Gujarat, RE park in Ladakh, where transmission systems will be set up.

Out of the transmission schemes planned, the schemes for Bikaner-II, Bikaner-III RE Zones in Rajasthan, Koppal-II, Gadag-II RE Zones in Karnataka, and Kallam in Maharashtra have already been recommended by the NCT. Based on the near term pipeline from CEA, projects worth INR762b have been recommended by NCT to MoP.

Exhibit 320: CEA's near term pipeline

Transmission Scheme	Mode of implementation	Tentative Implementation timeframe	Survey Agency	BPC	Est Cost (INR b)
❖ Augmentation of transformation capacity by 1x1500 MVA (3rd), 765/400 kV ICT at Maheshwaram (PG) substation in Telangana	RTM	21 months		POWERGRID	1.2
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (7 GW): Part E1	RTM	24 months		Adani Transmission	2.2
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (7 GW): Part E3	RTM	24 months		POWERGRID	2.2
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (7 GW): Part E4	RTM	24 months		POWERGRID	2.4
❖ Western Region network expansion scheme in Kallam area in Maharashtra	TBCB	18 months	RECPDCL	RECPDCL	1.6
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (7 GW): Part A	TBCB	24 months from SPV Transfer	RECPDCL	RECPDCL	40.9
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (7 GW): Part B	TBCB	24 months from SPV Transfer	PFCL	PFCL	47.7
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (7 GW): Part C	TBCB	24months from SPV Transfer	RECPDCL	RECPDCL	53.4

Transmission Scheme	Mode of implementation	Tentative Implementation timeframe	Survey Agency	BPC	Est Cost (INR b)
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (7 GW): Part D	TBCB	24 months from SPV Transfer	PFCL	PFCL	34.6
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (7 GW): Part E2	TBCB	21 months SPV Transfer	RECPDCL	RECPDCL	7.0
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (8GW): Part A	TBCB	48 months for Bipole-1 and 54 months for Bipole -2 from SPV Transfer	RECPDCL	RECPDCL	248.2
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-V (8 GW): Part C	TBCB	48 months from SPV Transfer	PFCL	PFCL	120.0
❖ Transmission system for evacuation of power from Rajasthan REZ Ph-IV (Part-2:5.5 GW) (Jaisalmer/Barmer Complex): Part A	TBCB	24 months from SPV Transfer	RECPDCL	RECPDCL	22.1
❖ Transmission system for evacuation of power from Rajasthan REZ Ph-IV (Part-2 :5.5 GW) (Jaisalmer/Barmer Complex): Part B	TBCB	24 months from SPV Transfer	PFCL	PFCL	32.8
❖ Transmission system for evacuation of power from Rajasthan REZ Ph- IV (Part-2 :5.5 GW)(Jaisalmer/Barmer Complex): Part C	TBCB	24 months from SPV Transfer	CTUIL	RECPDC L	27.1
❖ Transmission system for evacuation of power from Rajasthan REZ Ph- IV (Part-2 :5.5 GW) (Jaisalmer/Barmer Complex): Part D	TBCB	24 months from SPV Transfer	CTUIL	PFCL	22.3
❖ Transmission system for evacuation of power from Rajasthan REZ Ph- IV (Part-2 :5.5 GW)(Jaisalmer/Barmer Complex): Part E	TBCB	24 months from SPV Transfer	RECPDCL	RECPDCL	32.5
❖ Transmission system for evacuation of power from Rajasthan REZ Ph- IV (Part-2:5.5GW) (Jaisalmer/Barmer Complex): Part F (By clubbing Part F1 & F2)	TBCB	24 months from SPV Transfer	PFCL	PFCL	27.4
❖ Transmission system for evacuation of power from Rajasthan REZ Ph- IV (Part-2:5.5 GW) (Jaisalmer/Barmer Complex): Part H1	TBCB	24 months from SPV Transfer	RECPDCL	RECPDCL	36.7
Total					762.0

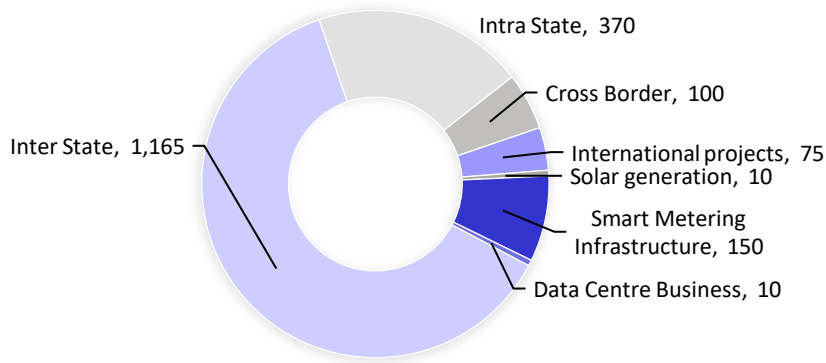
Source: CEA; MOFSL

Exhibit 321: Transmission line network worth INR2.4t will have to be set up before renewable energy capacity gets commissioned

Details	Capacity (GW)
RE capacity already commissioned	166
66.5 GW RE capacity to be integrated to ISTS network (8.8 GW already commissioned)	58
Additional RE capacity to be integrated to ISTS network (55 GW+181.5GW)	237
Margin already available in ISTS sub-stations which can be used for integration	34
Balance RE capacity from GEC-1 to be integrated to intra-state system	7
RE capacity from GEC-II to be integrated to intra-state system	19
Additional hydro capacity likely by FY2030	17
Total RE capacity targeted till FY2030	537

Source: Ministry of Power, MOFSL

Exhibit 322: Powergrid has lined up a capex of INR1.9t till FY32 which includes a spend of INR1.7t on transmission



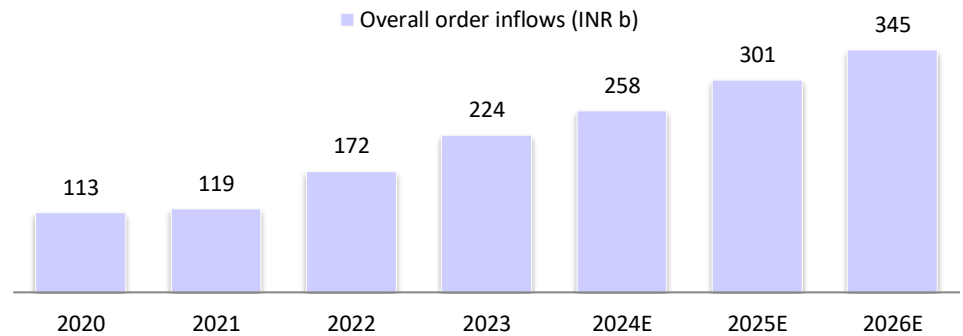
Source: Powergrid, MOFSL

T&D players would target the TBCB, EPC, substations, and we expect KEC to have a market share of around 10-15% in this opportunity base, translating into yearly opportunity of INR40-50b on the domestic T&D side.

International T&D

Tender pipeline remains strong from the Middle East—specifically from Saudi Arabia and the UAE. KEC was recently awarded a contract from NEOM City project for the Design, Supply, and Installation of 380 kV Overhead Transmission Line in the Kingdom of Saudi Arabia (KSA). The company expects international T&D ordering to grow 15-20% YoY.

Exhibit 323: Strong traction in domestic & international markets to drive T&D order inflows

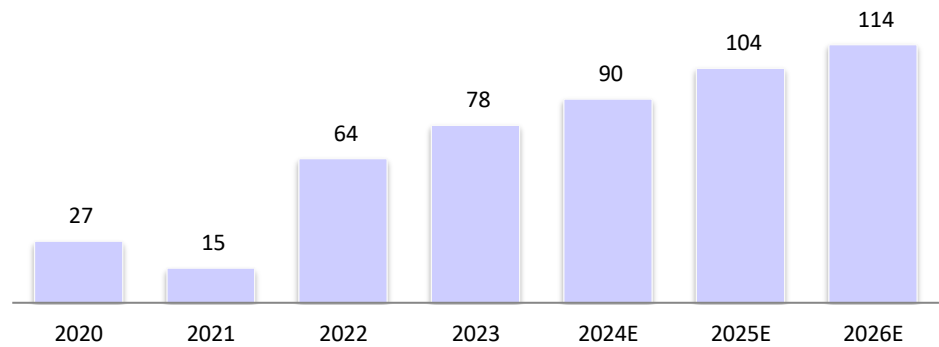


Source: Company, MOFSL

We expect overall T&D segment growth inflows of 18% CAGR over FY23-26E.

Non-T&D projects - Civil

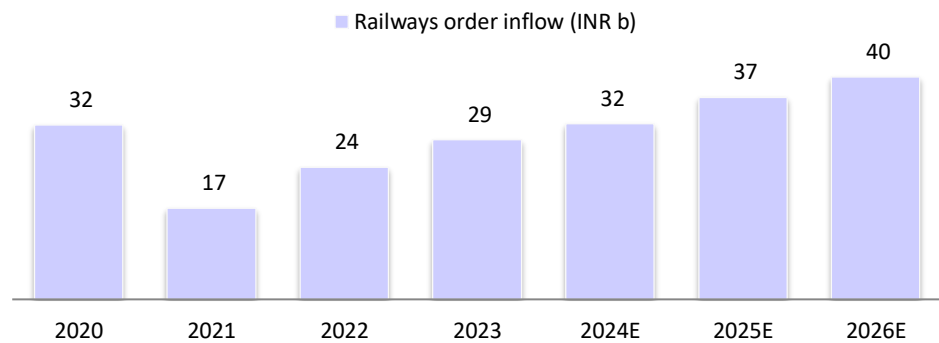
Among non-T&D, we expect the civil segment to be the key growth driver as KEC has diversified across various sectors such as metros, RRTS, commercial, industrial, logistics, cement, and data centers. Order intake and revenue for the civil segment have registered a CAGR of 62%/59% over FY19-23. Last year, the company also received the single largest order of INR20b in the water pipeline segment and INR50b worth of projects from the Jal Jeevan Mission in the overall order book. We expect civil segment inflows and revenues to register a CAGR of 13% and 30% over FY23-26.

Exhibit 324: Civil segment order inflows to grow at 13% CAGR over FY23-26E (INR b)

Source: Company, MOFSL

Non-T&D projects: Railways and others

Inflow and revenue growth for the railways segment were weak during the year and the company would selectively bid for railway-related projects. A large part of increased budgetary allocation for railways is currently directed toward locomotives and rolling stock, areas where KEC lacks presence. However, as major projects reach finalization, there will be a surge in demand for advanced signaling, OHE and power supply by FY25. In the realm of advanced signaling, KEC stands as a potential beneficiary, particularly for Kavach-related opportunities. Oil and gas is still a smaller segment for KEC.

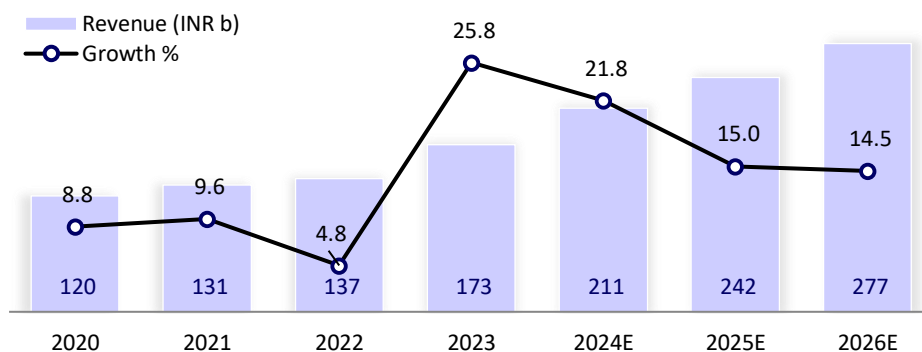
Exhibit 325: Railways order inflows (INR b)

Source: Company, MOFSL

Strong inflows and diversified OB provide healthy revenue visibility

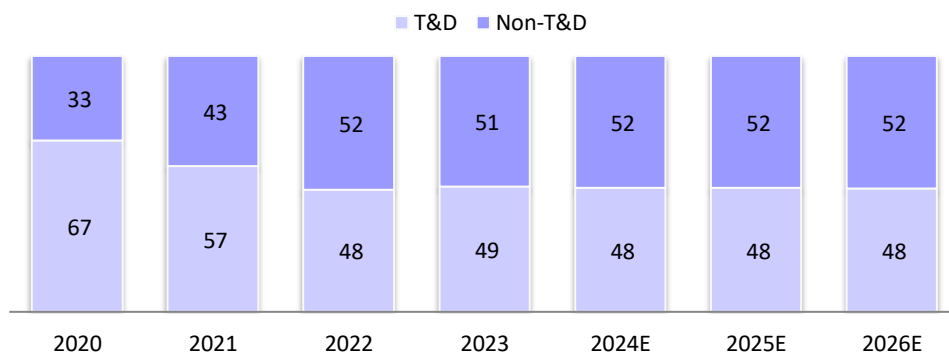
Order inflows have remained strong for KEC over the last two years, registering a CAGR of 37% over FY21-23. The company has diversified across segments over years in order to reduce its dependence on the T&D segment. With strong inflow CAGR of 15% and order book of INR313b, we expect revenue CAGR of 17% over FY23-26. With continued focus on diversification, we expect T&D and non-T&D mix of 48%:52% for KEC by FY26E.

Exhibit 326: We expect KEC to clock in revenue growth at a CAGR of 17% over FY23-26



Source: Company, MOFSL

Exhibit 327: Share of non-T&D revenues in overall revenues has increased over last two years and we expect it to be maintained (% of sales)

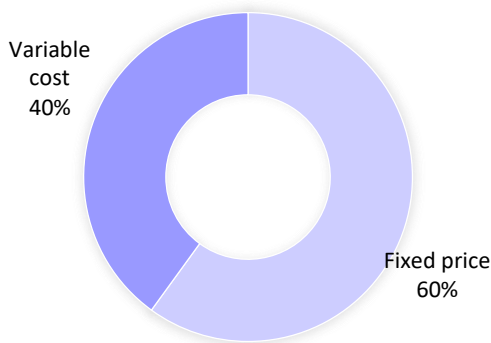


Source: Company, MOFSL

Softening RM prices and near completion of legacy projects to aid margins

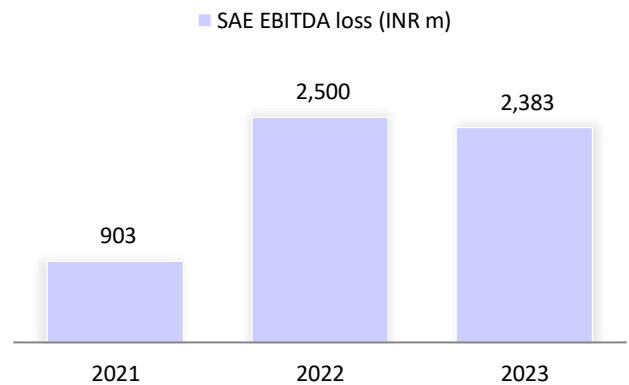
Near-term weakness in the margins is attributed to the execution of legacy projects based on fixed pricing. With SAE already turning PBT positive and with the completion of legacy projects in the domestic T&D sector by 3QFY24, we expect a gradual 50 bp improvement in margins each quarter. Despite a decline in commodity prices, we expect KEC to require additional time to regain the double-digit margins of pre-Covid times. Factors such as heightened competition, entry into new segments, and investments in building capabilities across diverse areas are expected to limit margin improvements. Consequently, we foresee the company’s long-term margins plateauing at around 8.5-9.0%.

Exhibit 328: Share of fixed price and variable price contracts



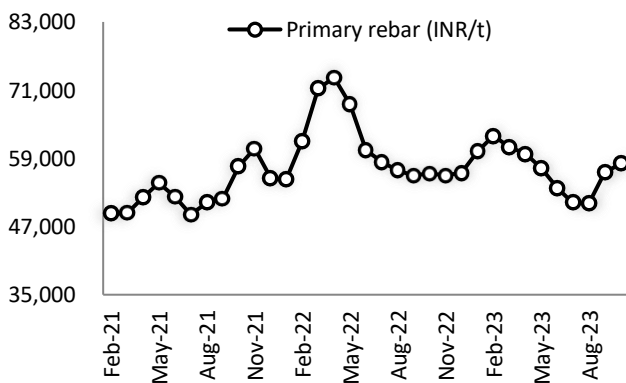
Source: Company, MOFSL

Exhibit 329: SAE losses are largely over now



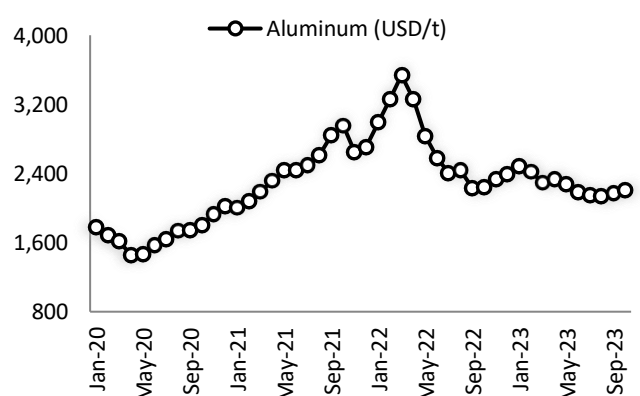
Source: Company, MOFSL

Exhibit 330: Steel prices have again started inching up from the lows (INR/t)



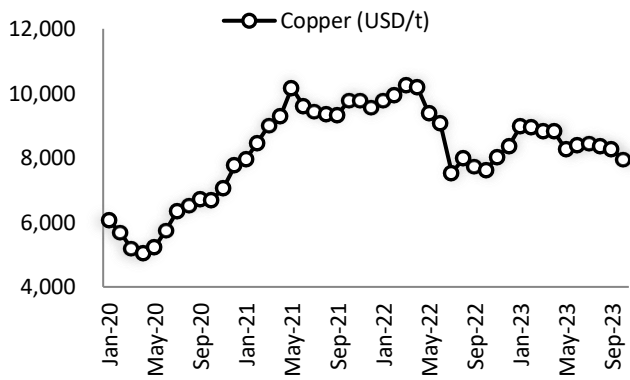
Source: Bloomberg, MOFSL

Exhibit 331: Aluminium prices are currently stable and can be hedged too (USD/t)



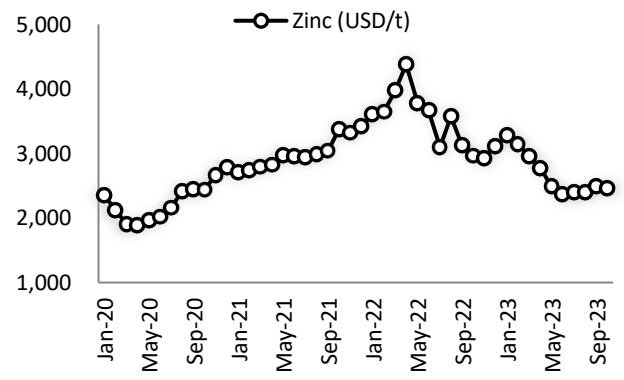
Source: Bloomberg, MOFSL

Exhibit 332: Copper prices are currently stable (USD/t)



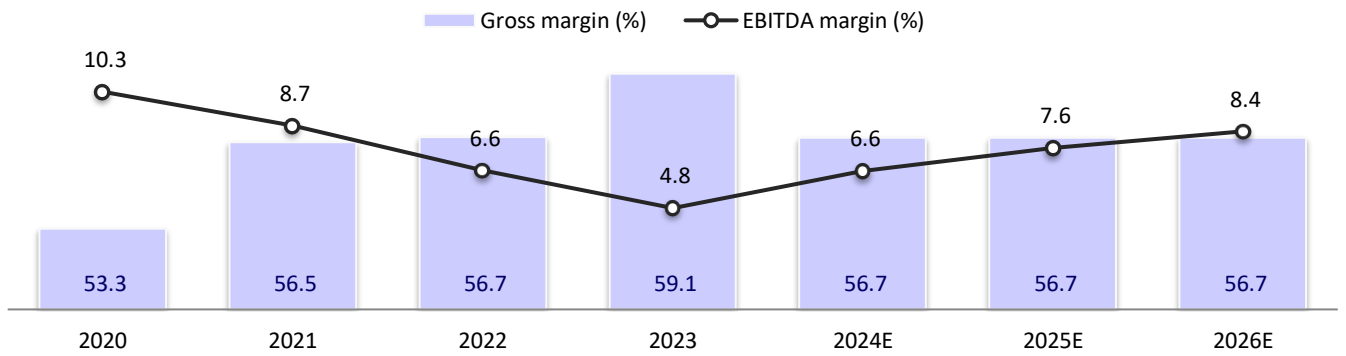
Source: Bloomberg, MOFSL

Exhibit 333: Zinc prices are also stable (USD/t)



Source: Bloomberg, MOFSL

Exhibit 334: Completion of legacy projects, stable input prices and higher non-T&D share to aid a gradual margin expansion



Source: Company, MOFSL

Working capital management is the key to leverage reduction

The company is targeting to bring down net working capital days by 15 days by FY24-end, following the release of milestone-based payments from railway projects. However, we do not bake in large reduction in working capital for the company as we expect revenue growth to remain strong at 17% CAGR over FY23-26, and hence, working capital requirements will also be higher. Pending GST proceeds, claims from Afghanistan, and reduction in loss funding for SAE projects would aid working capital cycle reduction.

We present below the scenarios for working capital reduction, which can result in improving overall leverage.

Exhibit 335: KEC's working capital reduction can lead to sharp reduction in debt

	FY23	FY24E	FY25E	FY26E
Working capital ex acceptances (INR m)	67,145	80,620	91,916	1,03,686
NWC days (ex-acceptances) - days	142	139	140	137
Net debt plus acceptances (INR m)	49,633	58,025	62,761	65,424
10% reduction in NWC days for FY24-26E	67,145	73,063	83,367	93,859
Working capital ex acceptances - days	142	126	127	124
Net debt plus acceptances (INR m)	49,633	50,263	53,382	54,091
20% reduction in NWC days for FY24-26E	67,145	65,506	74,817	84,032
Working capital ex-acceptances - days	142	113	114	111
Net debt plus acceptances (INR m)	49,633	42,500	44,189	43,097

Source: MOFSL

SWOT analysis

- ❖ Strong execution capabilities
- ❖ Well-diversified across businesses and geographies
- ❖ Backward integration for T&D in the form of towers and cables

S

STRENGTH



- ❖ Presence of fixed price contracts exposes the company to input fluctuations
- ❖ Elongated WC cycle due to project-based business
- ❖ Largest segment (T&D) is cyclical in nature

W

WEAKNESS



- ❖ Investments in renewable energy
- ❖ Improving prospects in GCC region
- ❖ Rising share of Civil business which will also improve margins

O

OPPORTUNITY



- ❖ Commodity volatility
- ❖ Global macroeconomic weakness
- ❖ Rising interest rates
- ❖ Capex slowdown

T

THREATS



Financial outlook

We expect revenue/EBITDA CAGR of 17%/40% over FY23-26 for KEC. This is driven by (1) order inflow growth of 15% over the same period, led by strong prospect pipeline, (2) gradual recovery in EBITDA margin to 6.6%/7.6%/8.4% by FY24/25/26, (3) control over working capital on improved customer advances, improved debtor collections from railways and Afghanistan projects. With improvement in margins and stable working capital, we expect RoE and RoCE to improve to 21%/17.3% by FY26. We take the following assumptions:

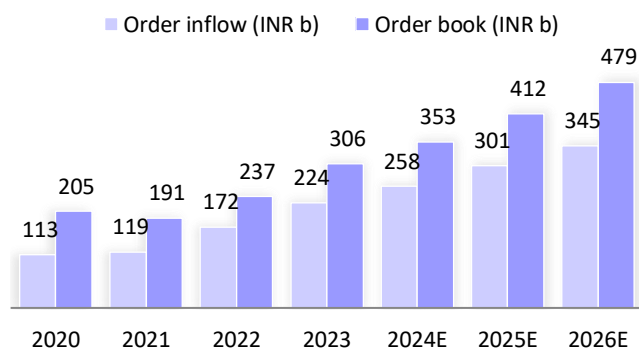
- Order inflow growth of 15% over the same period, led by strong prospect pipeline. We expect order inflow of INR258/301/344b for FY24/25/26. Our estimates bake in moderation in order inflow during 4QFY24-1QFY25 due to election schedule.
- There is a gradual recovery in the EBITDA margin, which is expected to reach 6.6%/7.6%/8.4% by FY2024/25/26. However, these figures still fall short of the double-digit mark the company maintained before the onset of the Covid-19 pandemic.
- The company has effective control over working capital and NWC as a percentage of sales currently stands at 38%. KEC is emphasizing on enhanced customer advances and improved debtor collections from railway and Afghanistan projects. Anticipating enhanced margins and a moderate working capital, we expect RoE and RoCE to improve to 21.1%/17.6% by FY26.

Exhibit 336: Segmental projections (INR m)

	2018	2019	2020	2021	2022	2023	2024E	2025E	2026E
Transmission & distribution									
Order inflows	81,529	70,295	38,525	68,881	60,211	89,512	1,06,072	1,25,771	1,49,210
yoy growth (%)	6.4	-13.8	-45.2	78.8	-12.6	48.7	18.5	18.6	18.6
Revenues	67,950	65,906	66,360	64,910	60,050	74,851	89,421	1,05,587	1,21,703
yoy growth (%)	12.7	-3.0	0.7	-2.2	-7.5	24.6	19.5	18.1	15.3
Order backlog	1,03,788	1,15,461	1,00,465	1,05,100	1,06,722	1,28,322	1,44,974	1,65,158	1,92,665
Bill to book ratio (%)	51.6	47.4	49.3	48.1	44.4	49.4	49.3	50.8	50.8
Cables									
Order inflows	10,569	9,539	10,198	8,313	10,322	11,189	16,784	20,979	25,175
yoy growth (%)	6.9	-9.7	6.9	-18.5	24.2	8.4	50.0	25.0	20.0
Revenues	10,090	11,830	11,050	10,620	15,240	16,160	15,643	19,930	24,126
yoy growth (%)	-4.3	17.2	-6.6	-3.9	43.5	6.0	-3.2	27.4	21.1
Order backlog	3,460	3,741	6,151	1,911	2,372	3,055	4,196	5,245	6,294
Bill to book ratio (%)	85.3	91.0	79.3	73.4	124.6	119.2	100.0	100.0	100.0
Railways									
Order inflows	39,255	26,885	31,727	16,626	24,084	29,091	32,000	36,800	40,480
yoy growth (%)	164.7	-31.5	18.0	-47.6	44.9	20.8	10.0	15.0	10.0
Revenues	8,440	19,180	25,510	34,080	38,600	37,020	39,297	35,843	37,816
yoy growth (%)	89.2	127.3	33.0	33.6	13.3	-4.1	6.1	-8.8	5.5
Order backlog	41,515	48,698	61,509	45,862	37,946	39,719	32,423	33,379	36,044
Bill to book ratio (%)	24.3	34.9	39.5	48.8	66.7	70.5	70.5	70.5	70.5
Civil									
Order inflows	4,529	11,266	27,194	15,418	63,651	78,323	90,071	1,03,582	1,13,940
yoy growth (%)	-26.7	148.7	141.4	-43.3	312.8	23.1	15.0	15.0	10.0
Revenues	4,230	5,950	3,760	12,810	21,440	38,310	55,826	71,818	84,748
yoy growth (%)	77.7	40.7	-36.8	240.7	67.4	78.7	45.7	28.6	18.0
Order backlog	5,189	4,682	26,654	32,485	78,263	1,19,157	1,53,403	1,85,167	2,14,359
Bill to book ratio (%)	49.3	55.0	20.6	37.3	33.3	32.6	34.0	35.0	35.0
SAE									
Order inflows	15,098	10,526	5,666	9,501	13,762	15,665	12,981	14,279	15,707
yoy growth (%)	-6.0	-30.3	-46.2	67.7	44.9	13.8	15.0	10.0	10.0
Revenues	10,250	9,655	15,390	11,460	8,840	13,240	14,636	13,960	14,655
yoy growth (%)	2.3	-5.8	59.4	-25.5	-22.9	49.8	10.5	-4.6	5.0
Order backlog	19,028	18,157	10,252	5,733	11,858	15,277	13,621	13,941	14,993
Bill to book ratio (%)	50.8	39.7	73.3	76.4	70.1	67.2	67.2	67.2	67.2
Order inflows	1,50,980	1,28,510	1,13,310	1,18,739	1,72,030	2,23,780	2,57,908	3,01,411	3,44,512
yoy growth (%)	22.2	-14.9	-11.8	4.8	44.9	30.1	15.3	16.9	14.3
Total Revenues	1,00,580	1,10,005	1,19,654	1,31,142	1,37,423	1,72,817	2,10,525	2,42,195	2,77,387
yoy growth (%)	17.2	9.4	8.8	9.6	4.8	25.8	21.8	15.0	14.5
Total Order backlog	1,72,980	1,90,740	2,05,030	1,91,091	2,37,160	3,05,530	3,52,913	4,12,129	4,79,255
Bill to book ratio (%)	50.0	47.4	49.3	50.6	52.0	51.4	49.4	49.1	48.4

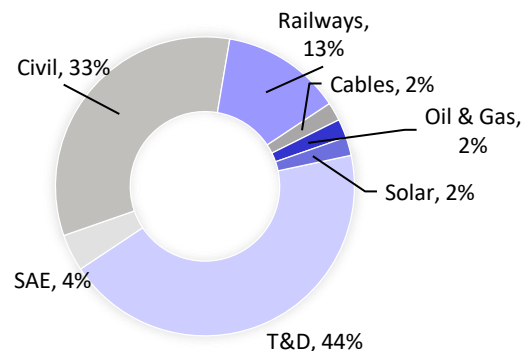
Source: Company, MOFSL

Exhibit 337: Order inflow & order book have started moving up fast since FY22 (INR b)



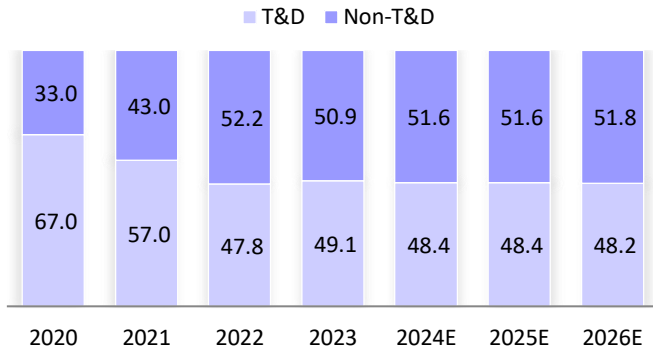
Source: Company, MOFSL

Exhibit 338: Order book is fairly diversified across T&D and other segments (INR313b)



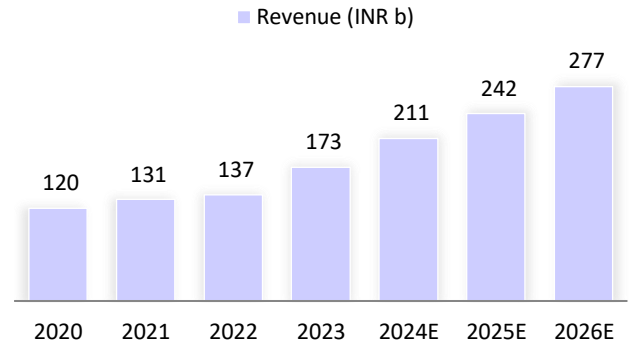
Source: Company, MOFSL

Exhibit 339: Share of non-T&D to inch up steadily in coming years(%)



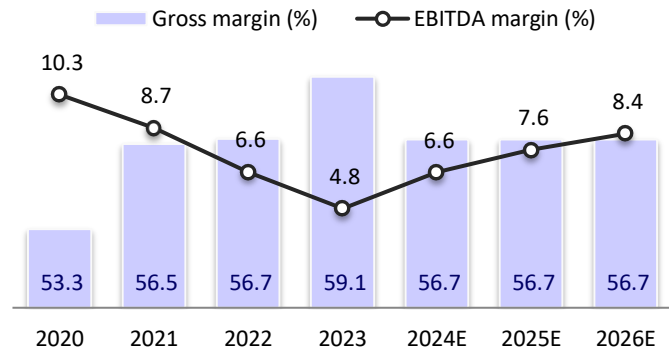
Source: Company, MOFSL

Exhibit 340: Strong order book provides healthy revenue visibility



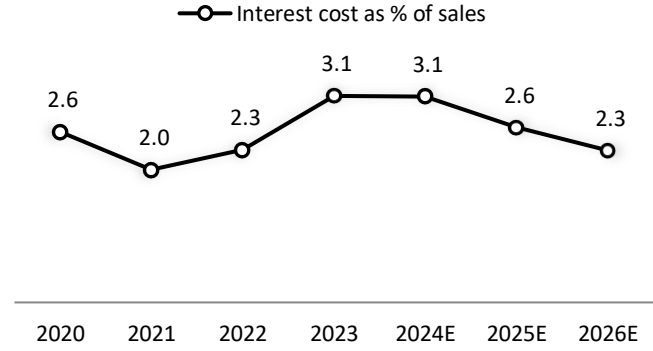
Source: Company, MOFSL

Exhibit 341: We expect a gradual margin expansion as legacy projects get over



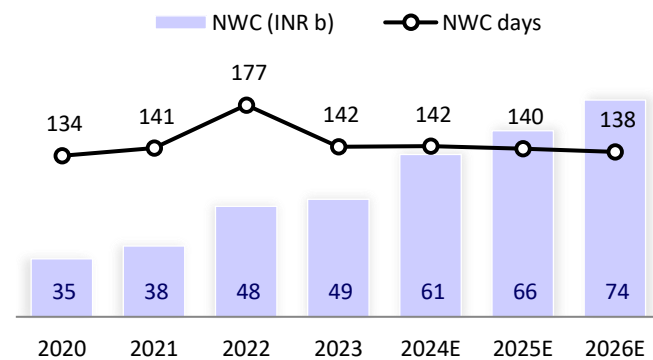
Source: Company, MOFSL

Exhibit 342: Interest cost as a % of sales to remain between 2.3-3% of sales in order to fund growth



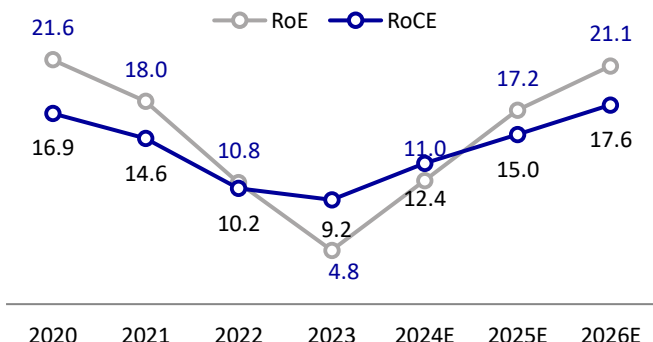
Source: Company, MOFSL

Exhibit 343: NWC days to see moderation



Source: Company, MOFSL

Exhibit 344: Return ratios to improve on better profitability

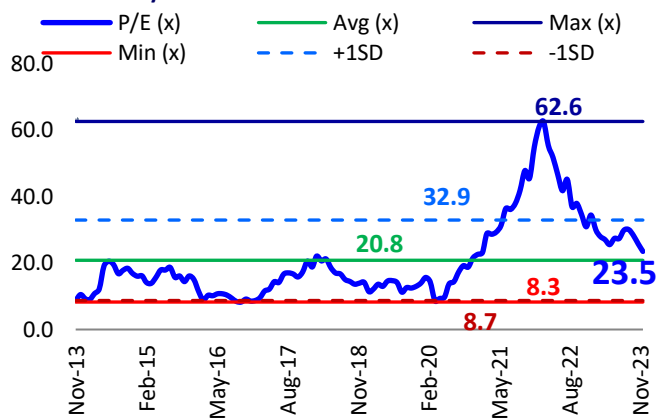


Source: Company, MOFSL

Valuation and recommendation

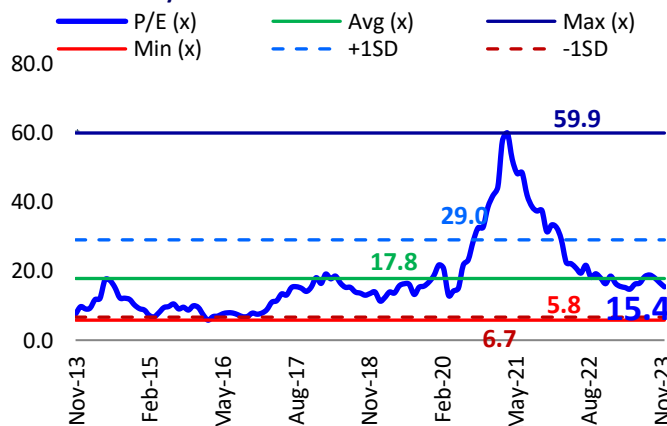
KEC is currently trading at 19.7X/13.5X on FY25/26E earnings. We value the company at 16X two-year forward estimated earnings, baking in a revenue CAGR of ~17% and EBITDA margins of 6.6%/7.6%/8.4% for FY2024-26E. We reinitiate coverage with a Neutral rating with a target price of INR640 based on 16X two year forward estimated earnings.

Exhibit 345: 1-year forward PE valuation band



Source: Bloomberg, MOFSL

Exhibit 346: 2-year forward PE valuation band



Source: Bloomberg, MOFSL

Exhibit 347: Scenario analysis: Bear/Base/Bull case valuations

	Bear case	Base case	Bull case
EPS (INR)	36	40	44
Valuation multiple (x)	14	16	18
Target Price (INR/share)	506	640	795

Source: MOFSL

Key risks and concern

A slowdown in order inflows, a significant surge in commodity prices, elevated crude oil prices, higher inflation, an increase in receivables and working capital, and heightened competition are some of the risks that could potentially impact our estimates.

Management profile



Financials and valuation

Consolidated - Income Statement

(INR Million)

Y/E March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Total Income from Operations	1,10,005	1,19,654	1,31,142	1,37,423	1,72,817	2,10,525	2,42,195	2,77,387
Change (%)	9.4	8.8	9.6	4.8	25.8	21.8	15.0	14.5
Raw Materials	54,097	55,916	57,006	59,490	70,686	91,157	1,04,870	1,20,108
Gross Profit	55,908	63,738	74,136	77,932	1,02,131	1,19,368	1,37,325	1,57,278
Employees Cost	8,322	11,044	11,151	11,219	14,749	17,901	20,594	23,586
Other Expenses	36,088	40,351	51,573	57,679	79,085	87,668	98,210	1,10,302
Total Expenditure	98,506	1,07,310	1,19,730	1,28,388	1,64,520	1,96,726	2,23,674	2,53,997
% of Sales	89.5	89.7	91.3	93.4	95.2	93.4	92.4	91.6
EBITDA	11,499	12,344	11,412	9,034	8,297	13,799	18,521	23,390
Margin (%)	10.5	10.3	8.7	6.6	4.8	6.6	7.6	8.4
Depreciation	1,171	1,472	1,525	1,579	1,615	1,803	1,941	2,100
EBIT	10,328	10,872	9,886	7,456	6,683	11,996	16,580	21,290
Int. and Finance Charges	3,119	3,080	2,627	3,160	5,386	6,543	6,397	6,361
Other Income	226	111	299	134	313	257	182	144
PBT bef. EO Exp.	7,435	7,903	7,559	4,430	1,610	5,710	10,365	15,072
EO Items	0	0	0	-436	0	0	0	0
PBT after EO Exp.	7,435	7,903	7,559	3,994	1,610	5,710	10,365	15,072
Total Tax	2,571	2,248	2,032	674	-151	1,370	2,653	3,859
Tax Rate (%)	34.6	28.4	26.9	16.9	-9.4	24.0	25.6	25.6
Minority Interest								
Reported PAT	4,864	5,655	5,527	3,320	1,761	4,340	7,711	11,214
Adjusted PAT	4,864	5,655	5,527	3,683	1,761	4,340	7,711	11,214
Change (%)	5.6	16.3	-2.3	-33.4	-52.2	146.5	77.7	45.4
Margin (%)	4.4	4.7	4.2	2.7	1.0	2.1	3.2	4.0

Consolidated - Balance Sheet

(INR Million)

Y/E March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Equity Share Capital	514	514	514	514	514	514	514	514
Eq. Share Warrants & App. Money	0	0	0	0	0	0	0	0
Preference Capital	0	0	0	0	0	0	0	0
Total Reserves	23,837	27,462	33,083	35,685	37,200	41,071	47,950	57,952
Net Worth	24,351	27,976	33,597	36,199	37,714	41,585	48,464	58,467
Total Loans	18,394	20,618	18,434	28,627	31,945	38,445	37,945	36,445
Deferred Tax Liabilities	1,183	527	-68	-1,703	-3,273	-3,273	-3,273	-3,273
Capital Employed	43,929	49,121	51,963	63,123	66,386	76,757	83,136	91,638
Gross Block	17,563	20,514	22,307	24,943	26,822	28,724	31,001	33,619
Less: Accum. Deprn.	7,776	9,221	10,485	12,064	13,679	15,481	17,422	19,522
Net Fixed Assets	9,787	11,292	11,821	12,880	13,143	13,242	13,578	14,097
Goodwill on Consolidation	2,037	2,226	2,154	2,497	2,685	2,685	2,685	2,685
Capital WIP	73	840	179	25	115	115	115	115
Total Investments	132	225	11	126	0	0	0	0
Curr. Assets, Loans&Adv.	1,04,602	1,13,963	1,25,696	1,45,720	1,67,470	2,03,255	2,32,060	2,64,202
Inventory	6,410	7,758	8,422	10,665	11,372	13,266	15,262	17,479
Account Receivables	83,123	91,096	1,01,498	1,16,659	1,34,966	1,68,420	1,95,747	2,24,189
Cash and Bank Balance	2,762	1,637	2,492	2,619	3,442	2,993	1,547	2,054
Loans and Advances	12,308	13,473	13,284	15,777	17,691	18,576	19,505	20,480
Curr. Liability & Prov.	72,703	79,425	87,897	98,125	1,17,027	1,42,539	1,65,302	1,89,460
Other Current Liabilities	72,060	78,664	87,107	97,109	1,15,841	1,40,809	1,63,311	1,87,180
Provisions	643	761	790	1,015	1,186	1,730	1,991	2,280
Net Current Assets	31,900	34,539	37,799	47,596	50,443	60,715	66,758	74,742
Misc Expenditure	0	0	0	0	0	0	0	0
Appl. of Funds	43,929	49,121	51,963	63,123	66,386	76,757	83,136	91,638

Financials and valuation

Ratios

Y/E March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
Basic (INR)								
EPS	18.9	22.0	21.5	14.3	6.8	16.9	30.0	43.6
Cash EPS	23.5	27.7	27.4	20.5	13.1	23.9	37.5	51.8
BV/Share	94.7	108.8	130.7	140.8	146.7	161.7	188.5	227.4
DPS	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payout (%)	0.0	0.1	0.1	0.1	0.2	0.0	0.0	0.0
Valuation (x)								
P/E	31.2	26.8	27.4	41.2	86.1	34.9	19.7	13.5
Cash P/E	25.1	21.3	21.5	28.8	44.9	24.7	15.7	11.4
P/BV	6.2	5.4	4.5	4.2	4.0	3.6	3.1	2.6
EV/Sales	1.5	1.4	1.3	1.3	1.0	0.9	0.8	0.7
EV/EBITDA	14.5	13.8	14.7	19.7	21.7	13.6	10.1	8.0
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FCF per share	11.9	7.2	20.8	-21.9	11.7	0.2	24.4	37.3
Return Ratios (%)								
RoE	21.9	21.6	18.0	10.6	4.8	10.9	17.1	21.0
RoCE	17.2	17.2	14.8	10.8	11.4	12.4	15.0	17.6
RoIC	17.8	17.8	15.1	11.3	11.9	13.4	15.9	18.5
Working Capital Ratios								
Fixed Asset Turnover (x)	6.3	5.8	5.9	5.5	6.4	7.3	7.8	8.3
Asset Turnover (x)	2.5	2.4	2.5	2.2	2.6	2.7	2.9	3.0
Inventory (Days)	21	24	23	28	24	23	23	23
Debtor (Days)	276	278	282	310	285	292	295	295
Creditor (Days)	0	0	0	0	0	0	0	0
Leverage Ratio (x)								
Current Ratio	1.4	1.4	1.4	1.5	1.4	1.4	1.4	1.4
Interest Cover Ratio	3.3	3.5	3.8	2.4	1.2	1.8	2.6	3.3
Net Debt/Equity	0.6	0.7	0.5	0.7	0.8	0.9	0.8	0.6

Consolidated - Cash Flow Statement

(INR Million)

Y/E March	FY19	FY20	FY21	FY22	FY23	FY24E	FY25E	FY26E
OP/(Loss) before Tax	7,435	7,903	7,559	4,430	1,610	5,710	10,365	15,072
Depreciation	1,171	1,472	1,525	1,579	1,615	1,803	1,941	2,100
Interest & Finance Charges	3,119	3,080	2,627	3,160	5,386	6,543	6,397	6,361
Direct Taxes Paid	-2,571	-2,248	-2,032	-674	151	-1,370	-2,653	-3,859
(Inc)/Dec in WC	-5,101	-3,764	-2,405	-9,669	-2,026	-10,721	-7,488	-7,478
CF from Operations	4,053	6,443	7,274	-1,174	6,736	1,965	8,561	12,198
Others	176	-656	-595	-1,636	-1,569	0	0	0
CF from Operating incl EO	4,229	5,787	6,679	-2,809	5,166	1,965	8,561	12,198
(Inc)/Dec in FA	-1,166	-3,933	-1,322	-2,826	-2,156	-1,902	-2,277	-2,619
Free Cash Flow	3,063	1,854	5,357	-5,635	3,010	63	6,284	9,579
(Pur)/Sale of Investments	261	-93	214	-116	126	0	0	0
Others								
CF from Investments	-905	-4,025	-1,107	-2,942	-2,030	-1,902	-2,277	-2,619
Issue of Shares	255	-977	1,334	310	526	0	0	0
Inc/(Dec) in Debt	731	2,224	-2,184	10,193	3,317	6,500	-500	-1,500
Interest Paid	-3,119	-3,080	-2,627	-3,160	-5,386	-6,543	-6,397	-6,361
Dividend Paid	-743	-1,054	-1,240	-1,028	-771	-469	-833	-1,211
Others								
CF from Fin. Activity	-2,875	-2,887	-4,716	6,315	-2,314	-512	-7,730	-9,072
Inc/Dec of Cash	449	-1,125	855	564	822	-449	-1,446	507
Opening Balance	2,313	2,762	1,637	2,492	2,619	3,442	2,993	1,547
Other Bank Balances				-436				
Closing Balance	2,762	1,636	2,492	2,619	3,442	2,993	1,547	2,054

Kalpataru Projects

BSE SENSEX	S&P CNX
67,481	20,268



Bloomberg	KPIL IN
Equity Shares (m)	162
M.Cap.(INRb)/(USDb)	108.5 / 1.3
52-Week Range (INR)	724 / 480
1, 6, 12 Rel. Per (%)	-5/14/19
12M Avg Val (INR M)	231
Free float (%)	58.9

Financials & Valuations (INR b)

Y/E Mar	2023	2024E	2025E
Sales	143.4	177.3	213.4
EBITDA margin	8.1	8.2	8.9
Adj. PAT	4.9	5.9	9.1
EPS (INR)	30.1	36.3	55.8
EPS Gr. (%)	5.7	20.7	53.5
BV/Sh. (INR)	325.3	362.8	413.6

Ratios

RoE (%)	9.6	10.6	14.4
RoCE (%)	8.9	9.5	12.3
Payout (%)	21.4	19.1	12.5

Valuations

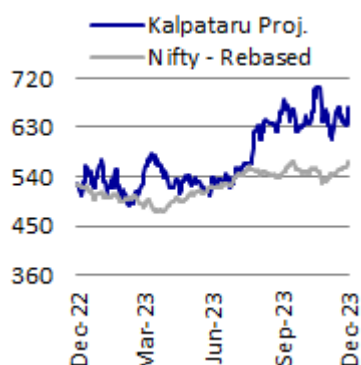
P/E (x)	22.2	18.4	12.0
P/BV (x)	2.1	1.8	1.6
EV/EBITDA (x)	11.1	9.3	7.1
EV/Sales (x)	0.9	0.8	0.6

Shareholding pattern (%)

As On	Sep-23	Jun-23	Sep-22
Promoter	41.1	41.1	51.6
DII	42.7	42.4	36.8
FII	8.5	8.2	5.1
Others	7.7	8.3	6.6

FII Includes depository receipts

Stock's performance (one-year)



CMP: INR668 TP: INR820 (+23%) Buy

Merger synergies will start playing out

Kalpataru Projects International Limited (KPIL) is benefiting from improved ordering in the T&D, Water, and B&F segments. It has reported a 36% CAGR in order inflows during FY20-23 driven by B&F and Civil, and followed by a revival in T&D. The company is already driving cost-optimization initiatives post-merger with JMC Projects (JMC) and it has aligned the borrowing rate of JMC with KPIL. We expect KPIL to: 1) maintain its market share in domestic T&D ordering, 2) scale up its presence in non-T&D segments across international markets, 3) focus on achieving 4.5-5.0% PBT margin over the next few years through interest cost savings and working capital management, and 4) improve its RoCE by monetizing non-core assets. Over FY23-26, we expect: a) KPIL to post 19% CAGR in revenue backed by strong order book (OB INR470b; OB/Revenue: 2.5x), b) EBITDA to compound at ~23% during the same period led by margin improvement, and c) working capital cycle of 120 days. We expect limited reduction in borrowings and interest expenses over FY23-26 as the company is on a high-growth path, which requires continuous capex and working capital. **We initiate coverage on KPIL with a BUY rating and a TP of INR820 (based on SoTP methodology and 13X two year forward earnings for core business).** The stock trades at a sharp discount of 35% to its nearest peer KEC. Promoter pledge continues to remain a key overhang on the stock.

Growing addressable market in T&D, buildings & factories, and water

We expect KPIL to benefit from a strong pipeline across its core areas. This will be driven by the Ministry of Power's continued investment in the T&D network for renewable projects, strong momentum in real estate launches (driving growth in the buildings segment), incremental spending on water supply and Jal Jeevan mission projects, as well as urban infrastructure projects such as Metro and High-speed Rail. We expect growth in railways and oil & gas sectors to remain muted. We bake in order inflow/revenue growth of 8%/19% over FY23-26E.

Merged entity to tap large, complex projects

Merger with JMC will bring in synergies related to: 1) stronger net worth to bid for complex projects, 2) judicious capital allocation towards high-RoCE projects, 3) scaling up of other segments (beyond T&D) in the international markets, 4) cost optimization across divisions on centralized procurement and 5) reduced interest cost on the alignment of the interest rate and ratings of JMC with KPIL.

Margins to expand from current levels

KPIL has largely completed its low-margin legacy projects and made a CTC provisioning of INR680m during last year. We bake in EBITDA margin of 8.2%/8.9/8.9% for FY24/25/26E on lower raw material prices, cost synergies with JMC and completion of the low-margin projects.

However, the margins are still lower than pre-Covid levels as the company is already investing in building capabilities across segments and increasing exposure in international geographies. Certain international projects are acquired at lower margins, only to gain pre-qualification in those geographies. This will limit margin expansion back to the pre-Covid double-digit levels. However, the company intends to maintain PBT margin at 4.5-5.0% over the next few years by focusing on interest cost savings and working capital management.

Working capital cycle and leverage better than peers

KPIL's working capital stood at 112 days for the standalone business. Management is focusing on rebalancing the portfolio in areas where working capital is lower. Civil projects, such as B&F and water, have lower NWC and these segments now contribute 45% of the order book. Debt mounted in FY23 due to increased capex and incremental working capital requirements. We expect debt to remain high because of the strong growth expected in the coming years. However, net debt/equity for KPIL, at 0.5X/0.5X for FY24/25E, is much better than its peers.

International subsidiaries to consolidate in the near term

KPIL had extended its local reach in the European market through its strategic acquisition of Linjemontage Grastorp AB in Sweden (2019). It also widened its presence in Latin America through the acquisition of Fasttel Engenharia SA in Brazil (2021). However, performances of both these companies were subdued in FY23 and KPIL is consolidating its position in Linjemontage with a focus on rebuilding the team first and then concentrating on growth. Fasttel's performance was hit by higher commodity prices in Brazil and cost overruns; it has also filed for claims.

Divesting non-core assets key to RoCE improvement

KPIL has nearly invested INR10-11b in non-core assets (such as roads, Indore real estate, Shubham Logistics, etc.); divesting these assets is critical for freeing up of capital and consequently, RoCE improvement. We expect the company to release capital worth INR5-6b from completion of the Indore real estate project and sale of the Vindhyachal road project in the next one year.

Real estate entity witnessing improving sales, though debt remains high

Our channel checks indicate that real estate entity is witnessing improving sales momentum, though debt on the books remain high for Kalpataru Ltd at INR83b during FY22. To alleviate some of this burden, Kalpataru Ltd had previously sold a land parcel in Thane to Amazon for INR18.7b with the intention of using the proceeds to repay high-cost debt. Going forward, debt reduction would be driven by improved sales performance and potential land parcel sales. IPO process of real estate entity is currently delayed. Promoters have provided a funding support of nearly INR6.8 bn to real estate entity via pledging and hence this pledging of KPI shares by promoters remains an overhang for KPI stock.

Financial outlook

We expect KPIL's revenue/EBITDA/PAT to report a CAGR of 19%/23%/31% over FY23-26. This would be driven by: 1) an order inflow growth of 8% over the same period due to a strong prospect pipeline, 2) gradual 70bps recovery in EBITDA margin to 8.2%/8.9%/8.9% in FY24/25/26, 3) control over working capital owing to improved customer advances, better debtor collections from railways, and claims settlement. Driven by improvement in margins and moderation in working capital, we expect KPIL's RoE and RoCE to improve to 14.8%/13.0% in FY26.

Valuation and view

KPIL is currently trading at 18.4x/12.0x FY24/25E earnings – at a sharp 37% discount to its nearest peer, KEC. We value the company at 13x two-year forward estimated earnings, which models a revenue CAGR of ~19% and EBITDA margin of 8.2%/8.9%/9.0% over FY24-26E. This discount in valuation vs. peer is due to the risks associated with promoter pledging as well as real estate exposure. However, we believe that as sales improve within the real estate segment, the level of promoter pledge will gradually decline over the next 1-2 years. We initiate coverage on KPIL with a BUY rating and a TP of INR820 based on SOTP methodology. Any reduction in the level of promoter pledge will result in re-rating of the stock.

Key risks and concerns

Key downside risks: 1) slowdown in order inflows, 2) sharp rise in commodity prices, 3) higher crude prices, 4) higher inflation, 5) increase in receivables and working capital, and 6) intensified competition.

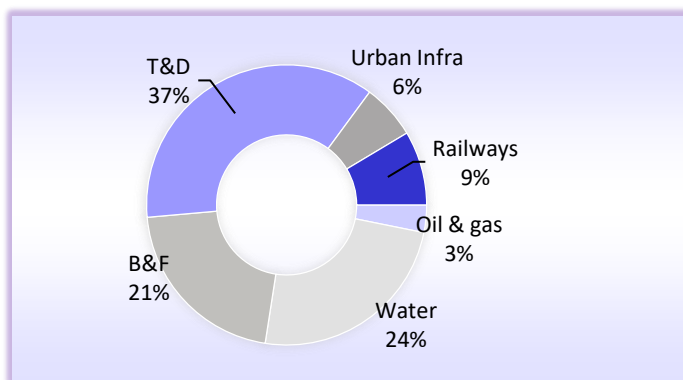
STORY IN CHARTS

Transmission line network worth INR2.4t will have to be set up before renewable energy capacity gets commissioned

Details	Capacity (GW)
RE capacity already commissioned	166
66.5 GW RE capacity to be integrated to ISTS network (8.8 GW already commissioned)	58
Additional RE capacity to be integrated to ISTS network (55 GW+181.5GW)	237
Margin already available in ISTS sub-stations which can be used for integration	34
Balance RE capacity from GEC-1 to be integrated to intra-state system	7
RE capacity from GEC-II to be integrated to intra-state system	19
Additional hydro capacity likely by FY2030	17
Total RE capacity targeted till FY2030	537

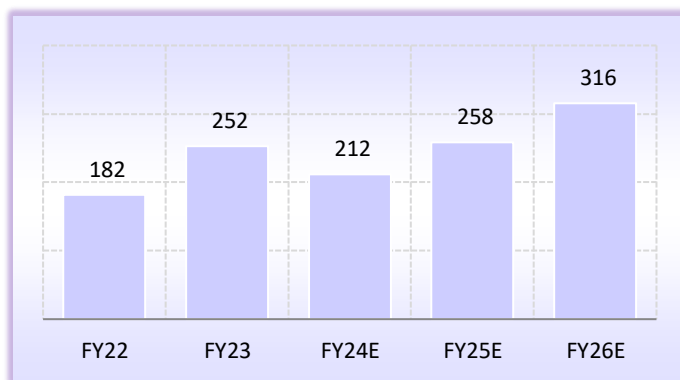
Source: Ministry of Power, MOFSL

KPI has a strong & diversified order book of INR470b on consolidated basis



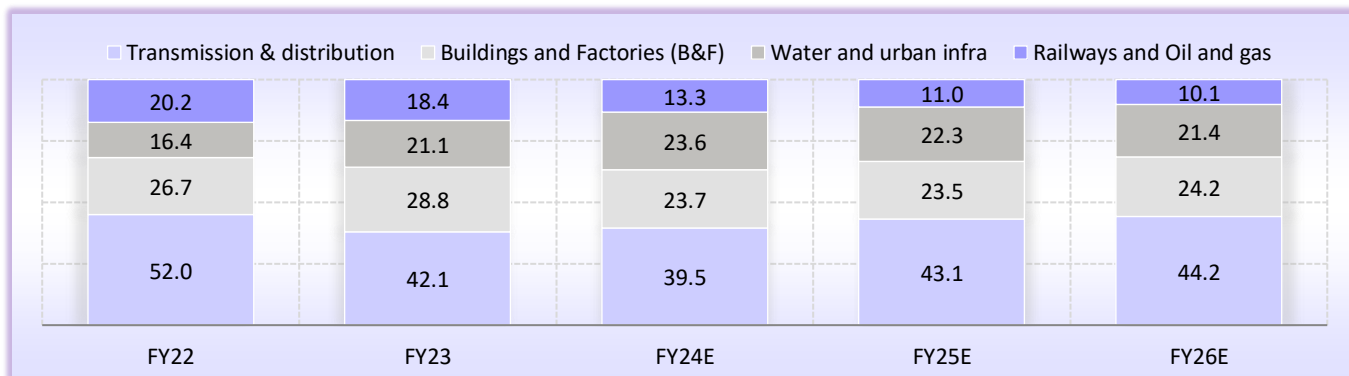
Source: Company, MOFSL

We expect order inflow to grow at a CAGR of 8% over FY23-26 (INR b)



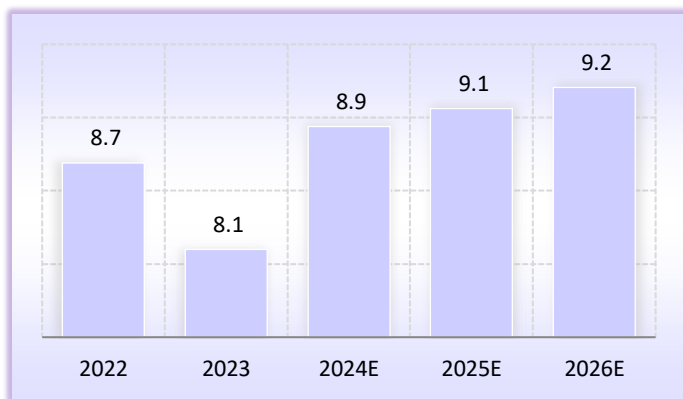
Source: Company, MOFSL

Share of non-T&D projects is increasing in overall revenue base (%)



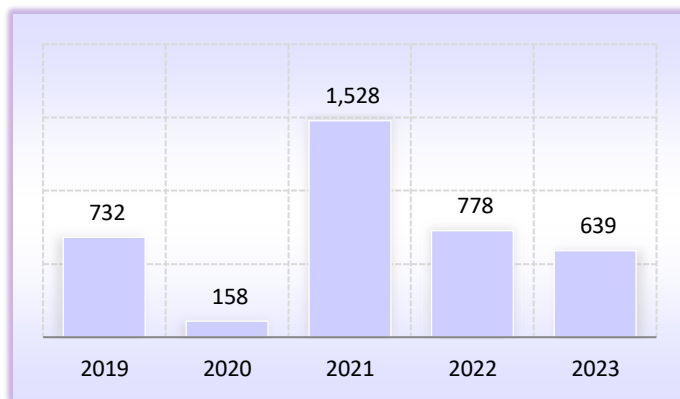
Source: Company, MOFSL

EBITDA margins to inch up from current levels (%)



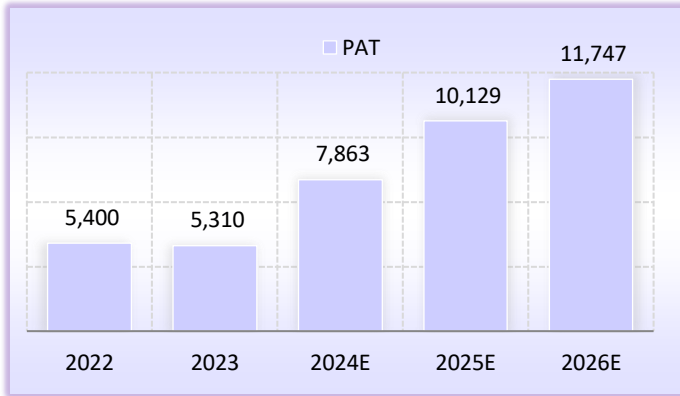
Source: Company, MOFSL

CTC Provisioning has been coming down (INR m)



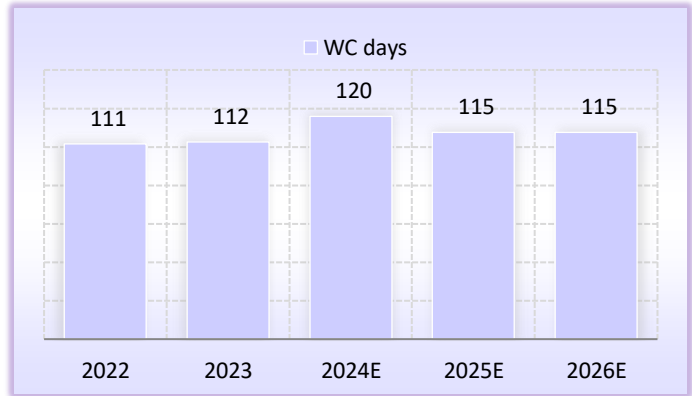
Source: Company, MOFSL

PAT growth to be higher on better margins (INR m)



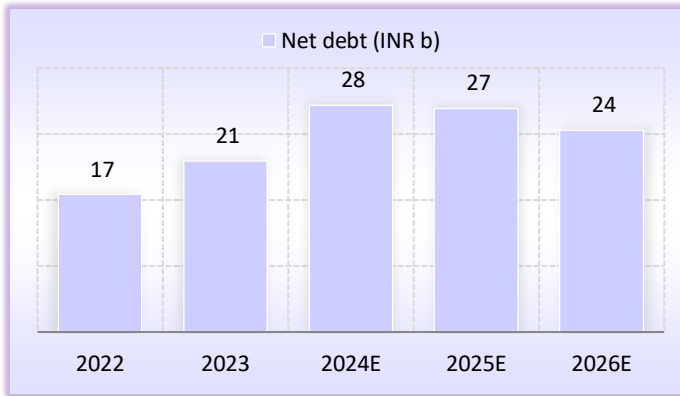
Source: Company, MOFSL

WC days to remain broadly around 115-120 days



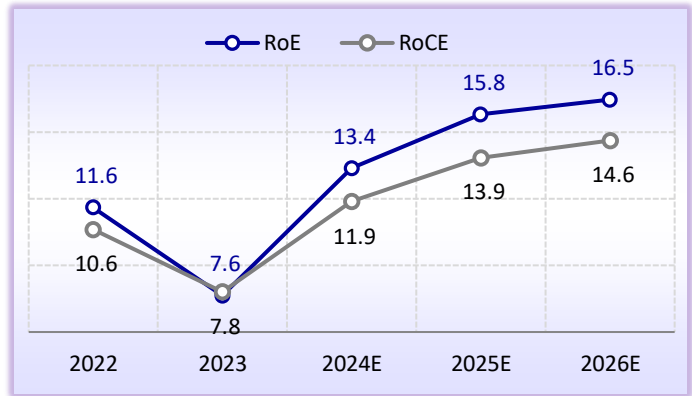
Source: Company, MOFSL

Net debt to remain higher on strong growth (INR b)



Source: Company, MOFSL

RoE & RoCE to improve on improved profitability



Source: Company, MOFSL

Growing addressable market in T&D, buildings, & water

We expect KPIL to benefit from a strong pipeline across its core areas. This will be driven by the Ministry of Power's continued investment in the T&D network for renewable projects, strong momentum in real estate launches (driving growth in the buildings segment), incremental spending on water supply and Jal Jeevan mission projects, as well as urban infrastructure projects such as Metro and high-speed rail. We expect growth in railways and oil & gas to remain subdued. We bake in order inflow/revenue growth of 8%/19% over FY23-26E.

- **Transmission:** KPIL has a robust tender pipeline of over INR500b in India during the next 20-24 months and a tender pipeline of over USD4b especially in the focused markets of Africa, Latin America, Asia and the Middle East.
- **Buildings:** KPIL is strengthening its presence in the building segment by targeting projects across data centers, institutional buildings, and processing plants apart from having a strong presence in the residential real estate market.
- **Water:** KPIL is present across the entire value chain of the water sector (including water intake, treatment, storage, supply, distribution, operation, and maintenance). Management is looking for specialized projects in the water segment.
- **Railways:** Due to intensified competition and higher receivables in the railways segment, the company will be targeting projects selectively in this segment. KPIL is primarily looking at areas such as Metro electrification, Signaling & Telecommunications (S&T), Regional Rapid Transit System (RRTS) and High-speed Rail.
- **Urban infrastructure:** KPIL is improving its capabilities to bid for projects across Metro, public spaces, elevated roads, airports, etc.
- **Oil and gas:** The company has received qualifications to bid in seven countries and is looking to expand its international presence in the Oil & Gas business. KPIL has a robust tender pipeline of over USD3b, both globally and in India, scheduled for the next 8-9 months.

Based on the near term pipeline from CEA, projects worth INR762b have been recommended by NCT to MoP.

Exhibit 348: CEA's near term pipeline

Transmission Scheme	Mode of implementation	Tentative implementation timeframe	Survey Agency	BPC	Est Cost (INR b)
❖ Augmentation of transformation capacity by 1x1500 MVA (3rd), 765/400 kV ICT at Maheshwaram (PG) substation in Telangana	RTM	21 months		POWERGRID	1.2
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (7 GW): Part E1	RTM	24 months		Adani Transmission	2.2
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (7 GW): Part E3	RTM	24 months		POWERGRID	2.2
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (7 GW): Part E4	RTM	24 months		POWERGRID	2.4

Transmission Scheme	Mode of implementation	Tentative Implementation timeframe	Survey Agency	BPC	Est Cost (INR b)
❖ Western Region network expansion scheme in Kallam area in Maharashtra	TBCB	18 months	RECPDCL	RECPDCL	1.6
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (7 GW): Part A	TBCB	24 months from SPV Transfer	RECPDCL	RECPDCL	40.9
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (7 GW): Part B	TBCB	24 months from SPV Transfer	PFCL	PFCL	47.7
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (7 GW): Part C	TBCB	24 months from SPV Transfer	RECPDCL	RECPDCL	53.4
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (7 GW): Part D	TBCB	24 months from SPV Transfer	PFCL	PFCL	34.6
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (7 GW): Part E2	TBCB	21 months SPV Transfer	RECPDCL	RECPDCL	7.0
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-IV (8GW): Part A	TBCB	48 months for Bipole-1 and 54 months for Bipole -2 from SPV Transfer	RECPDCL	RECPDCL	248.2
❖ Transmission System for Evacuation of Power from potential renewable energy zone in Khavda area of Gujarat under Phase-V (8 GW): Part C	TBCB	48 months from SPV Transfer	PFCL	PFCL	120.0
❖ Transmission system for evacuation of power from Rajasthan REZ Ph-IV (Part-2:5.5 GW) (Jaisalmer/Barmer Complex): Part A	TBCB	24 months from SPV Transfer	RECPDCL	RECPDCL	22.1
❖ Transmission system for evacuation of power from Rajasthan REZ Ph-IV (Part-2 :5.5 GW) (Jaisalmer/Barmer Complex): Part B	TBCB	24 months from SPV Transfer	PFCL	PFCL	32.8
❖ Transmission system for evacuation of power from Rajasthan REZ Ph- IV (Part-2 :5.5 GW)(Jaisalmer/Barmer Complex): Part C	TBCB	24 months from SPV Transfer	CTUIL	RECPDC L	27.1
❖ Transmission system for evacuation of power from Rajasthan REZ Ph- IV (Part-2 :5.5 GW) (Jaisalmer/Barmer Complex): Part D	TBCB	24 months from SPV Transfer	CTUIL	PFCL	22.3
❖ Transmission system for evacuation of power from Rajasthan REZ Ph- IV (Part-2 :5.5 GW)(Jaisalmer/Barmer Complex): Part E	TBCB	24 months from SPV Transfer	RECPDCL	RECPDCL	32.5
❖ Transmission system for evacuation of power from Rajasthan REZ Ph- IV (Part-2:5.5GW) (Jaisalmer/Barmer Complex): Part F (By clubbing Part F1 & F2)	TBCB	24 months from SPV Transfer	PFCL	PFCL	27.4
❖ Transmission system for evacuation of power from Rajasthan REZ Ph- IV (Part-2:5.5 GW) (Jaisalmer/Barmer Complex): Part H1	TBCB	24 months from SPV Transfer	RECPDCL	RECPDCL	36.7
Total					762.0

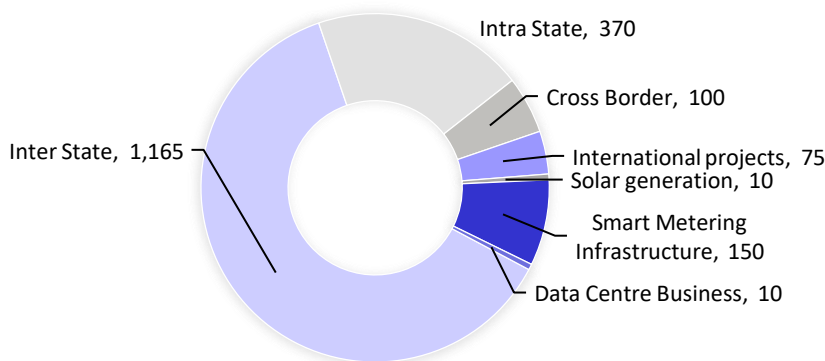
Source: CEA; MOFSL

Exhibit 349: Transmission line network worth INR2.4t will have to be set up before renewable energy capacity gets commissioned

Details	Capacity (GW)
RE capacity already commissioned	166
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Additional hydro capacity likely by FY2030	17
Total RE capacity targeted till FY2030	537

Source: Ministry of Power, MOFSL

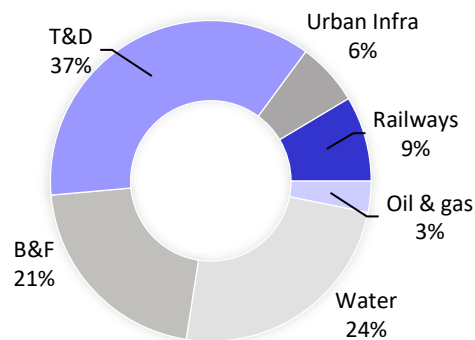
Exhibit 350: Powergrid has lined up a capex of INR1.9t till FY32 which includes a spend of INR1.7t on transmission



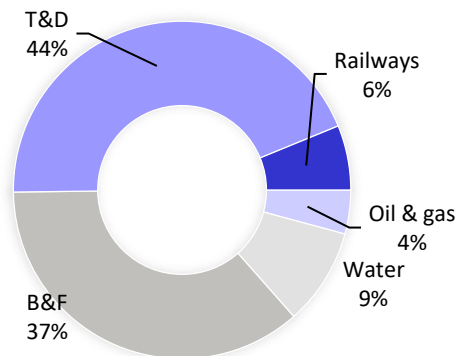
Source: Powergrid, MOFSL

T&D players would target the TBCB, EPC, substations, and we expect KPI to have a market share of around 15-20% in this opportunity base, translating into yearly opportunity of INR40-50b on the domestic T&D side.

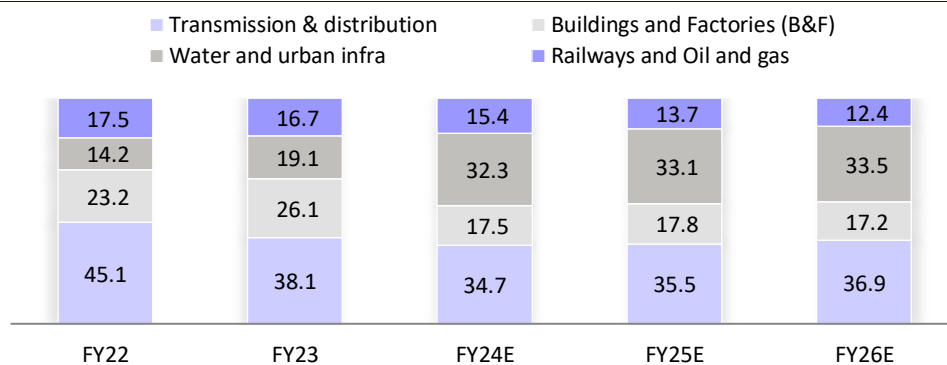
Exhibit 351: Order book is fairly diversified across segments (INR470b)



Source: Company, MOFSL

Exhibit 352: 1HFY24 order inflow was dominated by T&D and B&F (INR122b)

Source: Company, MOFSL

Exhibit 353: Share of non-T&D projects has also moved up in recent years (%)

Source: Company, MOFSL

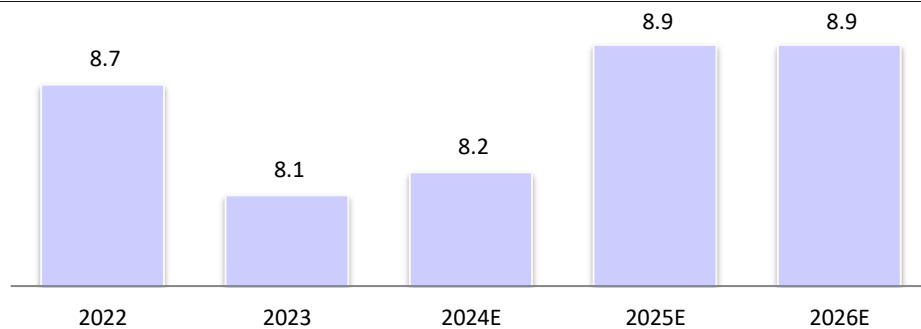
Merged entity to tap large, complex projects

Merger with JMC will bring in synergies related to: 1) stronger net worth to bid for complex projects, 2) judicious capital allocation towards high-RoCE projects, 3) scaling up of other segments (beyond T&D) in the international markets, 4) cost optimization across divisions on centralized procurement and 5) reduced interest cost on the alignment of the interest rate and ratings of JMC with KPIL.

Margins to improve from current levels

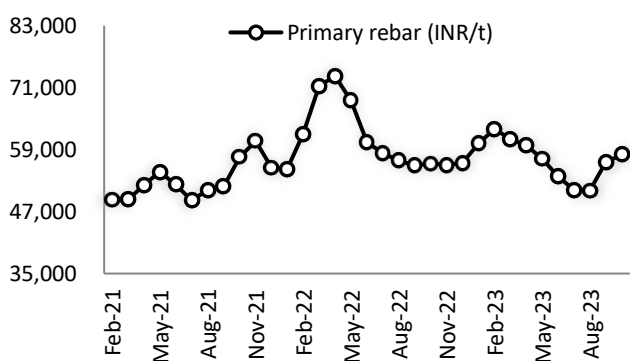
KPIL has already completed its low-margin legacy projects and made a CTC provisioning of INR639m during FY23. We bake in EBITDA margin of 8.2%/8.9%/8.9% for FY24/25/26E due to lower raw material prices, cost synergies with JMC and completion of the low-margin projects. However, the margins are still lower than pre-Covid levels as the company is already investing in building capabilities across segments and increasing exposure in international geographies. Certain international projects are acquired at lower margins, only to gain pre-qualification in those geographies. This will surely inhibit margin expansion back to the pre-Covid (of double-digit) levels. We also believe that margin pressure will remain in the Railways, Oil & Gas and B&F segments due to intense competition. However, the company intends to maintain PBT margin at 4.5-5.0% over the next few years by focusing on interest cost savings and working capital management.

Exhibit 354: Margin to get the benefit of lower RM prices



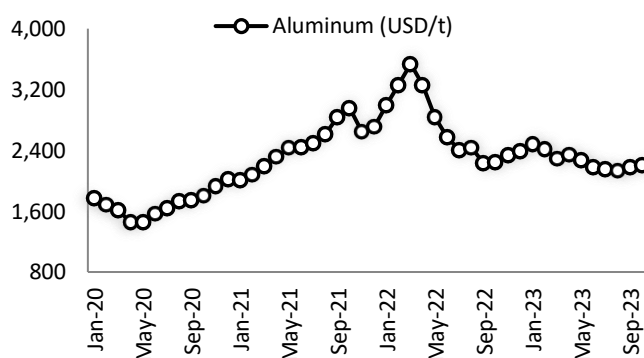
Source: Company, MOFSL

Exhibit 355: Steel prices have started inching up again



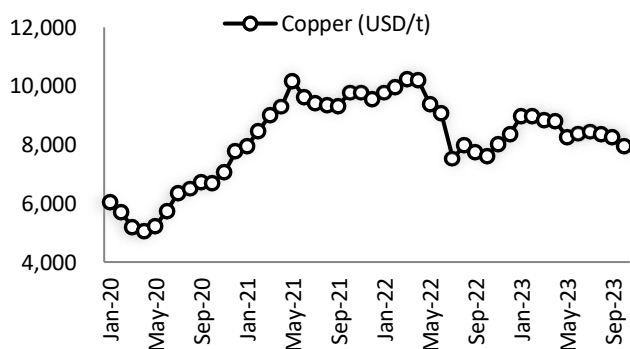
Source: Bloomberg, MOFSL

Exhibit 356: Aluminium is broadly stable since last few months



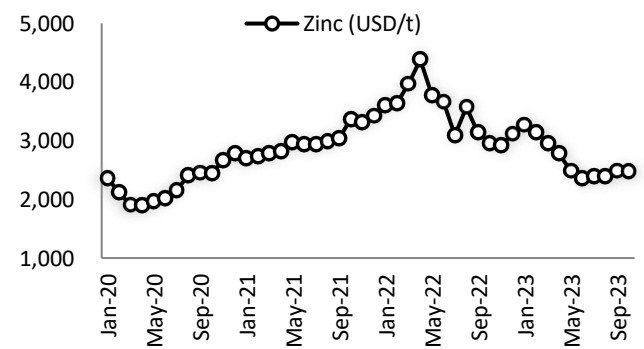
Source: Bloomberg, MOFSL

Exhibit 357: Copper prices are on a downtrend



Source: Bloomberg, MOFSL

Exhibit 358: Zinc prices are largely stable



Source: Bloomberg, MOFSL

Exhibit 359: Provisions made during FY22 and FY23 (INR m)

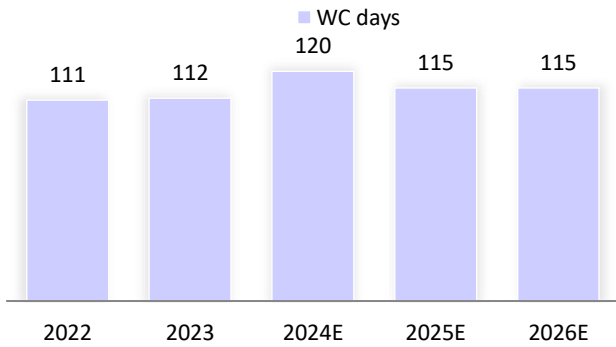
INR m	2022	2023
Provision for performance warranties		
Carrying amount at the beginning of the year	3,494	2,773
Add: Provision during the year	917	1,074
Less: Utilization during the year	1,639	914
Carrying amount at the end of the year	2,773	2,933
Provision for expected loss on long term contract		
Carrying amount at the beginning of the year	1,502	1,208
Add: Provision during the year	778	639
Less: Utilization during the year	1,072	967
Carrying amount at the end of the year	1,208	880
Other provisions	270	256
Total provisions	4,251	4,069

Source: Company, MOFSL

Working capital cycle and leverage better than peers

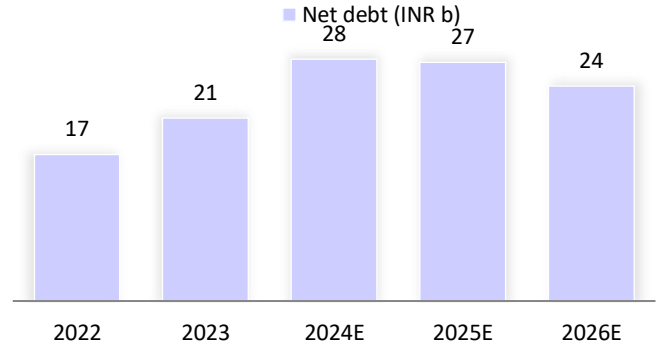
KPIL’s working capital stood at 112 days for the standalone business in FY23. Management is focusing on rebalancing the portfolio in areas where working capital is lower. Civil projects, such as B&F and water, have lower NWC and these segments now contribute 45% of the order book. Debt mounted in FY23 due to increased capex and incremental working capital requirements. We expect debt to remain high because of the strong growth expected in the coming years.

Exhibit 360: WC days are broadly around 115-120 days



Source: Company, MOFSL

Exhibit 361: Net debt trend (INR b)

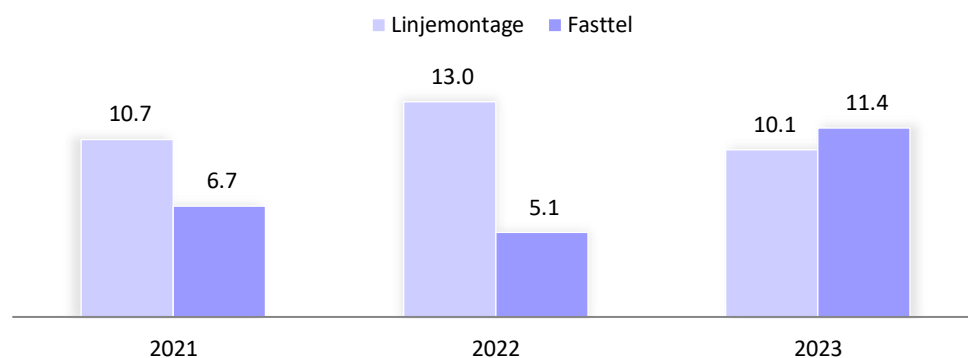


Source: Company, MOFSL

International subsidiaries to consolidate in the near term

KPIL had extended its local reach in the European market through its strategic acquisition of Linjemontage Grastorp AB in Sweden (2019). It also widened its presence in Latin America through the acquisition of Fasttel Engenharia SA in Brazil (2021). However, performances of both these companies were subdued in FY23 and KPIL is consolidating its position in Linjemontage with a focus on rebuilding the team first and then concentrating on growth. Fasttel's performance was hit by higher commodity prices in Brazil and cost overruns; it has also filed for claims.

Exhibit 362: Order book trend of Linjemontage and Fasttel (INR b)



Source: Company, MOFSL

Exhibit 363: Linjemontage key financials

Linjemontage (INR m)	2021	2022	2023
Order book	10,710	13,000	10,090
Revenue	11,155	11,910	10,226
Growth (%)	-3	7	-14
PBT	457	1,339	621
PAT	332	1,054	460
Margin (%)	3.0	8.9	4.5

Source: Company, MOFSL

Exhibit 364: Fasttel key financials

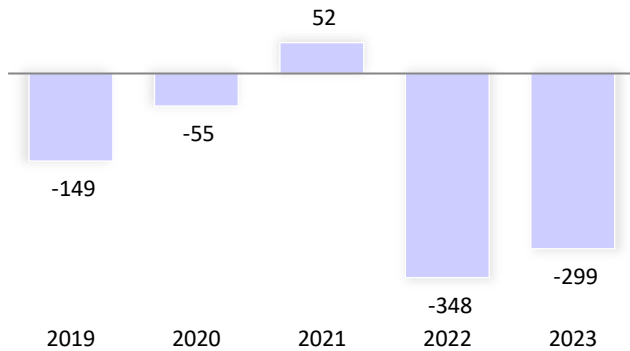
Fasttel (INR m)	2022	2023
Order book	5,090	11,400
Revenue	5,478	4,390
Growth (%)		-20
PBT	-206	-661
PAT	-40	-414

Source: Company, MOFSL

Divesting non-core assets key to RoCE improvement

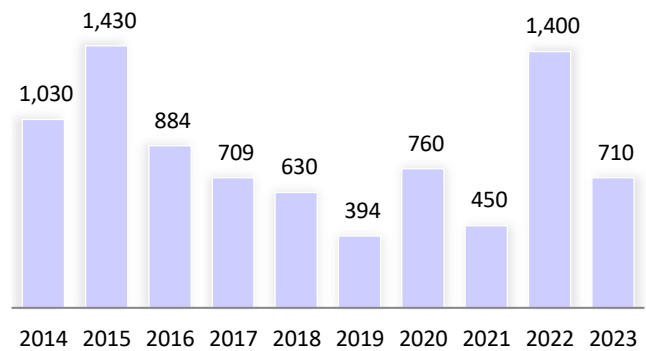
KPIL has nearly invested INR10-11b in non-core assets (such as roads, Indore real estate, Shubham logistics, etc.); divesting these assets is critical for freeing up of capital and consequently, RoCE improvement. We expect the company to release capital worth INR5-6b from completion of the Indore real estate project and sale of the Vindhyachal road project in the next one year.

Exhibit 365: Shubham Logistics PBT trend (INR m)



Source: Company, MOFSL

Exhibit 366: Loss funding for road projects (INR m)

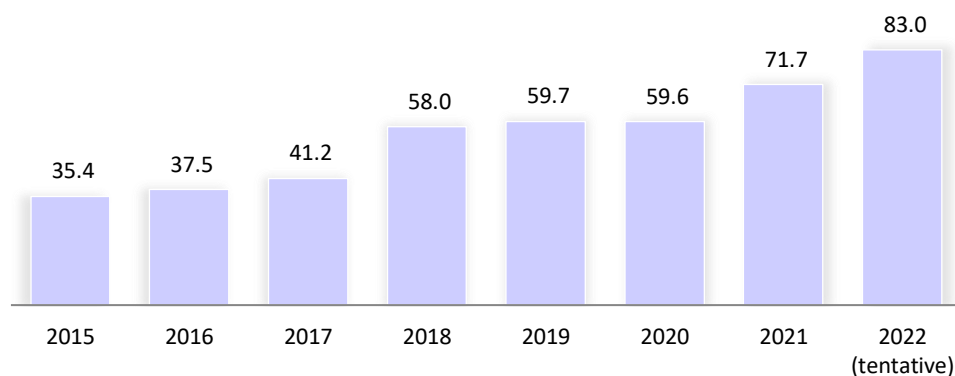


Source: Company, MOFSL

Real estate entity witnessing improving sales, though debt remains high

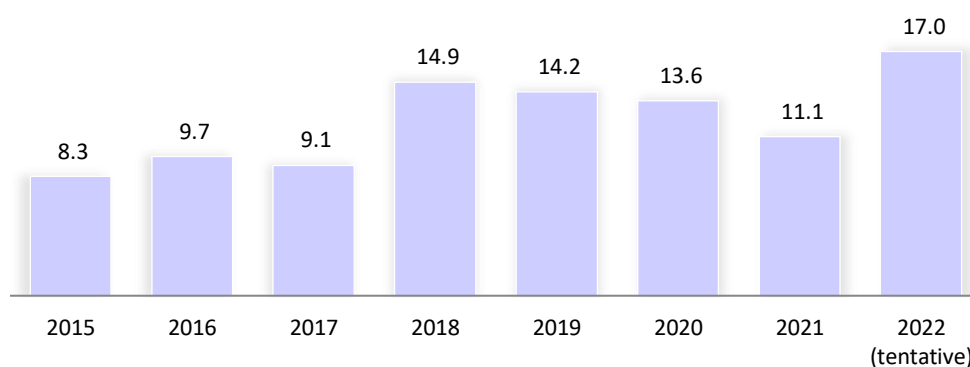
Performance of Kalpataru's real estate entity was hit during Covid-19 owing to slower-than-expected sales and delays in a few of its large-sized projects. Based on our channel checks, however, it appears that Kalpataru's real estate division is experiencing an uptick in sales momentum. Albeit, we note that the company still carries a substantial amount of debt on its balance sheet. To alleviate some of this burden, the real estate entity sold a 54-acre land parcel in Thane to Amazon last year for INR18.7b. The company used this amount to repay its high-cost debt. KPIL also availed the Maharashtra government's scheme of 50% reduction in all premiums, levied on the new and under-construction projects, by paying full stamp duty. KPIL's promoters have provided a funding of ~INR6.8b by pledging shares of KPIL. This, however, remains an overhang on the stock. Any reduction in the pledging level, from the current 23.1% of total shareholding, will result in re-rating of the stock.

Exhibit 367: Real estate debt (INR b)



Source: Company, MOFSL

Exhibit 368: Kalpataru Ltd's revenue have started improving (INR b)



Source: Company, MOFSL

Exhibit 369: Company provided incremental loans to Swedish subsidiary and road projects (INR m)

	2022	2023
Loans given		
Shree Shubham Logistics Limited	1,176	1,256
Kalpataru Power Transmission Sweden AB	1,104	2,042
Saicharan Properties Limited	1,992	1,424
Kalpataru Power Do Brasil Participações Ltda	-	264
Kalpataru Power Chile SpA	-	425
Brij Bhoomi Expressway Private Limited	336	608
Wainganga Expressway Private Limited	1,192	2,202
Vindhychal Expressway Private Limited	1,397	3,198
Guarantee/ Letter of Comforts Outstanding / Deed of indemnity		
Shree Shubham Logistics Limited	1,973	1,973
Kalpataru IBN Omairah Company Limited	2,890	3,635
Fasttel Engenharia S.A	398	1,632
Linjemontage i Grästorps Aktiefbolag	1,441	1,413
Kalpataru Power Senegal SARL	-	16
Kalpataru Power Chile SpA	-	3,258
Wainganga Expressway Private Limited	-	120
Brij Bhoomi Expressway Private Limited	377	377

Source: Company, MOFSL

Financial outlook

We expect KPIL's revenue/EBITDA/PAT to report a CAGR of 19%/23%/31% over FY23-26. This would be driven by: 1) an order inflow growth of 8% over the same period due to a strong prospect pipeline, 2) gradual 70bps recovery in EBITDA margin to 8.2%/8.9%/8.9% in FY24/25/26, 3) control over working capital owing to improved customer advances, better debtor collections from railways, and claims settlement. Driven by improvement in margins and moderation in working capital, we expect KPIL's RoE and RoCE to improve to 14.8%/13.0% in FY26.

Exhibit 370: We expect standalone revenues to grow at a CAGR of 19% between FY23-26E

	FY22	FY23	FY24E	FY25E	FY26E
Transmission & distribution					
Order inflows	70,893	1,01,790	93,647	1,17,059	1,46,323
yoy growth (%)	14.0	43.6	(8.0)	25.0	25.0
Revenues	64,460	60,380	70,002	92,079	1,06,817
yoy growth (%)	28.9	(6.3)	15.9	31.5	16.0
Order backlog	1,11,387	1,65,305	1,88,949	2,13,929	2,53,435
Bill to book ratio (%)	54.1	37.2	33.0	37.2	37.2
Buildings and Factories (B&F)					
Order inflows	43,658	37,550	52,570	62,033	73,198
yoy growth (%)	(8.0)	(14.0)	40.0	18.0	18.0
Revenues	33,130	41,360	42,006	50,242	58,479
yoy growth (%)		24.8	1.6	19.6	16.4
Order backlog	78,626	87,244	97,808	1,09,599	1,24,318
Bill to book ratio (%)	31.4	42.5	37.0	39.0	40.0
Water and urban infra					
Order inflows	58,211	90,240	45,000	56,250	70,313
yoy growth (%)	87.3	55.0	(50.1)	25.0	25.0
Revenues	20,320	30,250	41,767	47,551	51,641
yoy growth (%)		48.9	38.1	13.8	8.6
Order backlog	91,731	1,51,530	1,54,762	1,63,462	1,82,134
Bill to book ratio (%)	24.7	22.1	24.0	26.0	26.0
Railways and Oil and gas					
Order inflows	9,081	22,830	20,547	23,013	25,774
yoy growth (%)	(57.3)	151.4	(10.0)	12.0	12.0
Revenues	25,040	26,370	23,535	23,539	24,500
yoy growth (%)		5.3	(10.8)	0.0	4.1
Order backlog	45,865	55,102	52,114	51,587	52,861
Bill to book ratio (%)	41.5	46.0	36.0	37.0	38.0
Total Order inflows	1,81,843	2,52,410	2,11,764	2,58,354	3,15,608
yoy growth (%)	12.3	38.8	(16.1)	22.0	22.2
Total Revenues	1,24,071	1,43,370	1,77,310	2,13,410	2,41,437
yoy growth (%)		15.6	23.7	20.4	13.1
Order backlog	3,27,610	4,59,180	4,93,634	5,38,577	6,12,748
Bill to book ratio (%)	33.8	31.6	31.4	34.3	34.7

Source: Company, MOFSL

Exhibit 371: Order inflow and order book trend

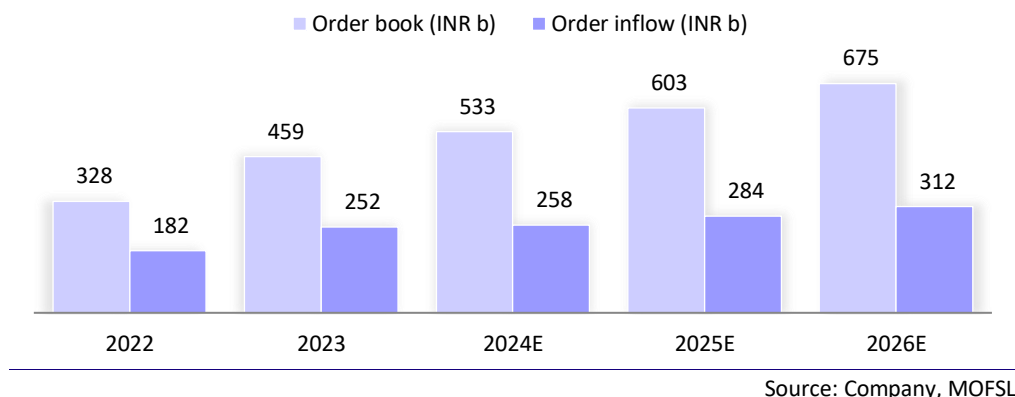


Exhibit 372: Revenue trend over FY23-26E (INR b)

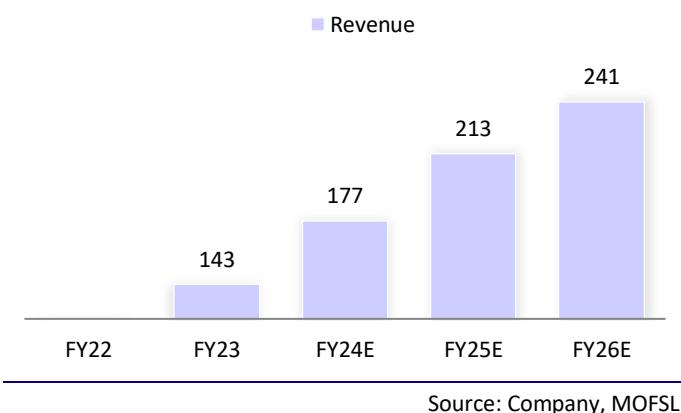


Exhibit 373: Revenue mix is diversified across segments (%)

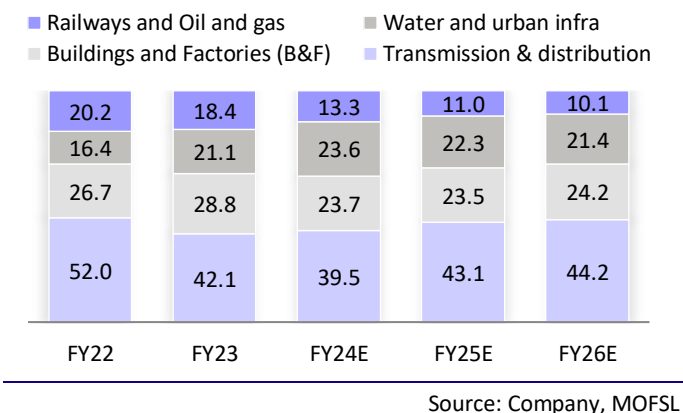


Exhibit 374: EBITDA margin to improve from FY25E

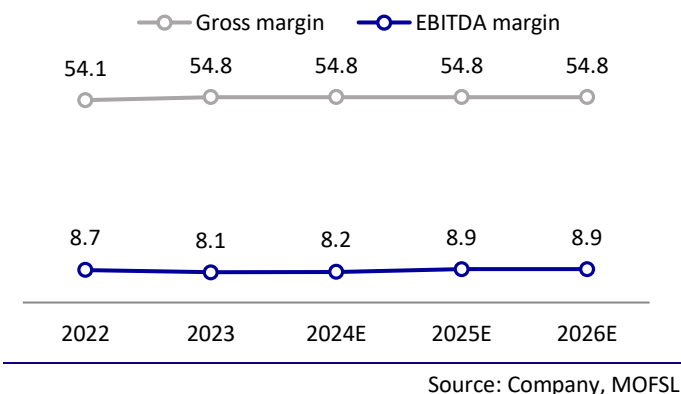


Exhibit 375: Interest as % of sales is still lower than peers

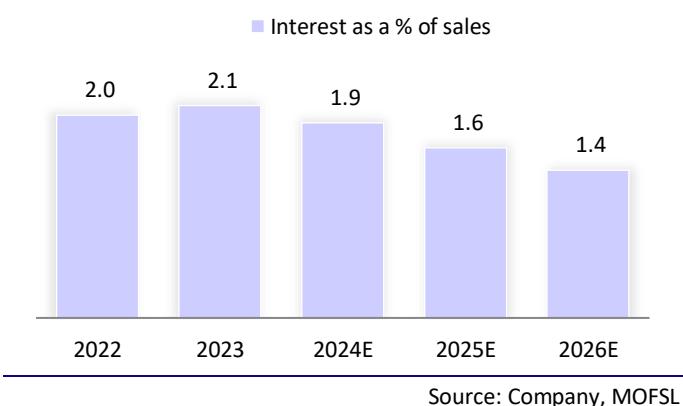
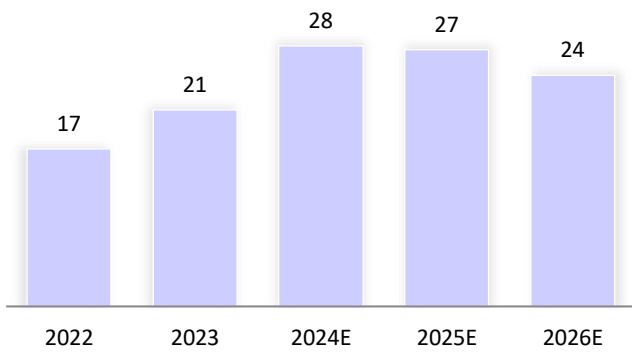
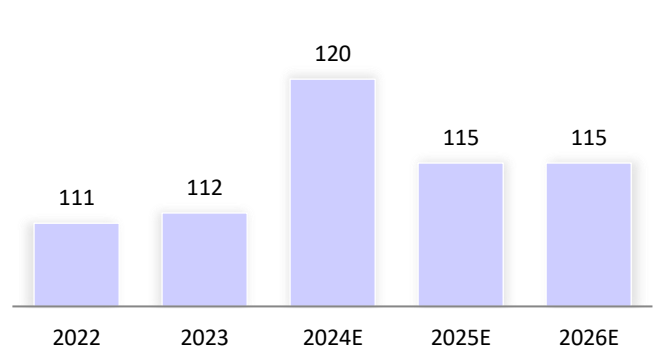


Exhibit 376: Net debt is at comfortable levels (INR b)



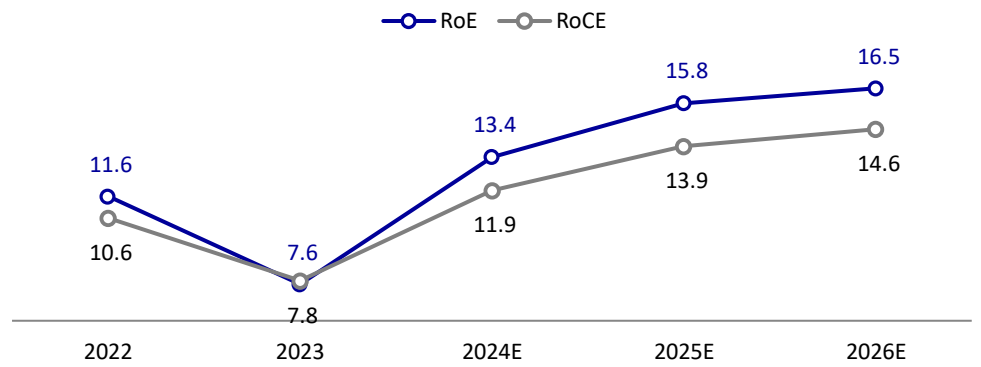
Source: Company, MOFSL

Exhibit 377: Net working capital to remain 115-120 days



Source: Company, MOFSL

Exhibit 378: We expect return ratios poised to improve on improved profitability (%)

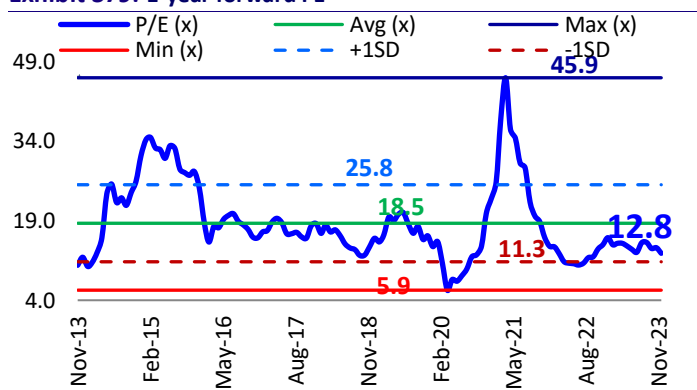


Source: Company, MOFSL

Valuation and recommendation

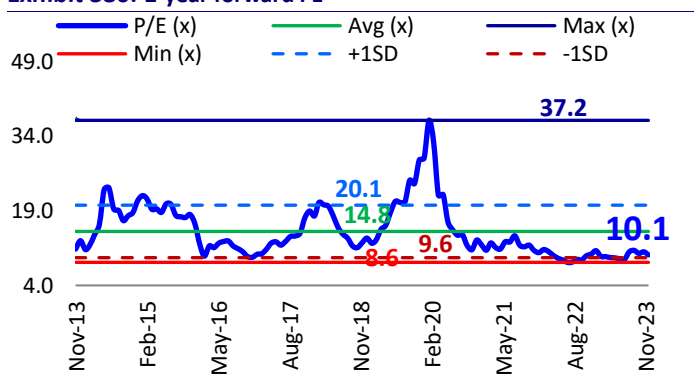
KPIL is currently trading at 18.4x/12.0x FY24/25E earnings – at a sharp 35% discount to its nearest peer, KEC. We value the company at 13x two-year forward estimated earnings, which models a revenue CAGR of ~19% and EBITDA margin of 8.2%/8.9%/9.0% over FY24-26E. This discount in valuation vs. peer is due to the risks associated with promoter pledging as well as real estate exposure. However, we believe that as sales improve within the real estate segment, the level of promoter pledge will gradually decline over the next 1-2 years. **We initiate coverage on KPIL with a BUY rating and a TP of INR820 based on SOTP methodology.** Any reduction in the level of promoter pledge will result in re-rating of the stock.

Exhibit 379: 1-year forward PE



Source: Bloomberg, MOFSL

Exhibit 380: 2-year forward PE



Source: Bloomberg, MOFSL

Exhibit 381: SOTP valuation

	Earnings/book Valn multiple		Value		KPTL share		Value for KPTL share		Per share value		Valuation basis
	INR m	(X)	INR m	(%)	INR m	INR	INR m	INR			
Kalpataru consolidated valuation											
Core construction business	9,457	13.0	128,150	100.0	128,150	784	128,150	784	13X two-year fwd EPS		
Investments in subsidiaries			6,125		6,125		6,125	37			
Road projects total			(789)		(789)		(789)	(5)			
Total value			133,477		133,477		133,477	815			

Source: MOFSL

Exhibit 382: Scenario analysis - Bear/Base/Bull case valuation

	Bear case	Base case	Bull case	Rationale
Core business earnings (INR m)	8,872	9,858	10,843	❖ 10% sensitivity of earnings
Valuation multiple (X)	10	13	15	❖ 12-20% sensitivity of multiples
Valuation of subsidiaries (INR m)	5,336	5,336	5,336	
Total (INR m)	94,055	1,33,486	1,67,988	
Value per share (INR)	575	815	1027	

Source: MOFSL

Key risks and concern

Key downside risks: 1) slowdown in order inflows, 2) sharp rise in commodity prices, 3) higher crude prices, 4) higher inflation, 5) increase in receivables and working capital, and 6) intensified competition.

SWOT analysis

- ❖ Global Footprint in 70 Countries; Live projects in 30+ countries
- ❖ Established Local presence in major EPC-markets
- ❖ The merger with JMC Projects created one of India's largest listed engineering and construction firms.

S
STRENGTH



- ❖ Exposure towards businesses having high working capital requirements.
- ❖ Exposure towards commodity price risks.

W
WEAKNESS



- ❖ Shift towards renewable sources of power will require enhanced investments on transmission infrastructure where company can benefit.
- ❖ Expanding presence across other high growth areas
- ❖ Merged entity can target wider large sized opportunities

O
OPPORTUNITY



- ❖ Increased competition.
- ❖ Higher commodity prices
- ❖ Slowdown in spending across domestic as well as international
- ❖ Aggressive bidding

T
THREATS



Management profile



Mr. Manish Mohnot (Managing Director & CEO)

Mr. Manish Mohnot is a qualified Chartered Accountant and a Cost Accountant. He has also done an advanced management program from Harvard University, U.S. He has more than two decades of experience in areas related to power, oil and gas, infrastructure, consulting, banking and business development.



Mr. Amit Uplenchwar (Director – Group Strategy & Subsidiaries Operation)

Mr. Uplenchwar has done his Bachelor of Engineering in Mechanical from Nagpur University and Master of Business administration in Finance & IT from Maastricht University, Netherlands. He has also successfully completed a leadership course from Harvard. Mr. Uplenchwar has rich and varied experience in Corporate Strategy, Operations, Business Development, Mergers & Acquisitions with serving sectors of Transportation, Power, Water, Oil & Gas, Aerospace & Defense and Logistics.



Mr. Rajeev Dalela (President – T&D, India & SAARC)

Bachelor of Science and MBA from Institute of Management Technology, Ghaziabad and has rich experience in Profit Center Management, Tendering, Business Development, Project Management, Strategic Planning and Execution within Transmission business.

Financials and valuation

Standalone - Income Statement

(INR Million)

Y/E March	FY22	FY23	FY24E	FY25E	FY26E
Total Income from Operations	1,24,071	1,43,370	1,77,310	2,13,410	2,41,437
Change (%)	NA	15.6	23.7	20.4	13.1
Raw Materials	57,001	64,750	80,078	96,382	1,09,040
Gross Profit	67,071	78,620	97,232	1,17,028	1,32,397
Employee Costs	9,169	10,340	12,788	15,391	17,413
Other Expenses	47,095	56,670	69,858	82,590	93,436
Total Expenditure	1,13,265	1,31,760	1,62,724	1,94,364	2,19,889
% of Sales	91.3	91.9	91.8	91.1	91.1
EBITDA	10,807	11,610	14,586	19,047	21,548
Margin (%)	8.7	8.1	8.2	8.9	8.9
Depreciation	2,720	2,950	3,776	3,976	4,381
EBIT	8,087	8,660	10,810	15,071	17,167
Int. and Finance Charges	2,436	2,940	3,340	3,508	3,453
Other Income	984	1,120	1,048	692	746
PBT bef. EO Exp.	6,635	6,840	8,518	12,256	14,460
EO Items	-1,632	540			
PBT after EO Exp.	5,003	7,380	8,518	12,256	14,460
Total Tax	1,491	2,070	2,578	3,137	3,702
Tax Rate (%)	29.8	28.0	30.3	25.6	25.6
Minority Interest					
Reported PAT	3,512	5,310	5,940	9,118	10,759
Adjusted PAT	4,657	4,921	5,940	9,118	10,759
Change (%)	NA	5.7	20.7	53.5	18.0
Margin (%)	3.8	3.4	3.4	4.3	4.5

Standalone - Balance Sheet

(INR Million)

Y/E March	FY22	FY23	FY24E	FY25E	FY26E
Equity Share Capital	298	325	325	325	325
Total Reserves	49,073	52,872	58,997	67,314	77,410
Net Worth	49,371	53,197	59,322	67,639	77,735
Minority Interest					
Total Loans	26,551	29,346	31,386	32,386	30,386
Deferred Tax Liabilities	-880	-1,338	-1,338	-1,338	-1,338
Capital Employed	75,042	81,206	89,370	98,687	1,06,783
Gross Block	23,789	27,708	32,708	35,708	38,708
Less: Accum. Deprn.	10,574	10,941	14,717	18,692	23,074
Net Fixed Assets	13,214	16,767	17,991	17,016	15,634
Goodwill on Consolidation	201	201	201	201	201
Capital WIP	203	484	484	484	484
Total Investments	8,929	8,741	8,741	8,741	8,741
Curr. Assets, Loans&Adv.	1,22,897	1,47,237	1,77,781	2,11,658	2,39,444
Inventory	9,193	10,874	13,449	16,187	18,312
Account Receivables	43,239	51,246	65,807	76,281	86,299
Cash and Bank Balance	9,886	8,581	3,872	5,264	5,945
Loans and Advances	8,163	8,608	10,646	12,813	14,496
Other Current Assets	52,416	67,928	84,008	1,01,112	1,14,391
Curr. Liability & Prov.	70,401	92,224	1,15,829	1,39,412	1,57,720
Account Payables					
Other Current Liabilities	65,676	87,673	1,10,200	1,32,637	1,50,056
Provisions	4,725	4,551	5,629	6,775	7,664
Net Current Assets	52,496	55,012	61,952	72,246	81,723
Misc Expenditure					
Appl. of Funds	75,042	81,205	89,369	98,688	1,06,783

Financials and valuation

Ratios

Y/E March	FY22	FY23	FY24E	FY25E	FY26E
Basic (INR)					
EPS	28.5	30.1	36.3	55.8	65.8
Cash EPS	45.1	48.1	59.4	80.1	92.6
BV/Share	301.9	325.3	362.8	413.6	475.4
DPS	6.5	7.0	7.0	7.0	7.0
Payout (%)	30.3	21.4	19.1	12.5	10.6
Valuation (x)					
P/E	23.5	22.2	18.4	12.0	10.2
Cash P/E	14.8	13.9	11.2	8.3	7.2
P/BV	2.2	2.1	1.8	1.6	1.4
EV/Sales	1.0	0.9	0.8	0.6	0.6
EV/EBITDA	11.6	11.1	9.3	7.1	6.2
Dividend Yield (%)	1.0	1.0	1.0	1.0	1.0
FCF per share	10.1	-9.1	-37.9	28.7	41.6
Return Ratios (%)					
RoE	10.7	9.6	10.6	14.4	14.8
RoCE	9.2	8.9	9.5	12.3	12.8
RoIC	10.1	10.4	10.8	14.0	14.5
Working Capital Ratios					
Fixed Asset Turnover (x)	5.2	5.2	5.4	6.0	6.2
Asset Turnover (x)	1.7	1.8	2.0	2.2	2.3
Inventory (Days)	27	28	28	28	28
Debtor (Days)	127	130	135	130	130
Creditor (Days)	0	0	0	0	0
Leverage Ratio (x)					
Current Ratio	1.7	1.6	1.5	1.5	1.5
Interest Cover Ratio	3.3	2.9	3.2	4.3	5.0
Net Debt/Equity	0.2	0.2	0.3	0.3	0.2

Standalone - Cashflow Statement

(INR Million)

Y/E March	FY22	FY23	FY24E	FY25E	FY26E
OP/(Loss) before Tax	3,504	5,320	8,518	12,256	14,460
Depreciation	2,720	2,948	3,776	3,976	4,381
Interest & Finance Charges	2,436	2,939	3,340	3,508	3,453
Direct Taxes Paid	-2,067	-2,534	-2,578	-3,137	-3,702
(Inc)/Dec in WC	-5,355	-4,512	-14,260	-8,902	-8,797
CF from Operations	1,236	4,160	-1,204	7,700	9,796
Others	2,529	1,434	0	0	0
CF from Operating incl EO	3,765	5,594	-1,204	7,700	9,796
(Inc)/Dec in FA	-2,113	-7,078	-5,000	-3,000	-3,000
Free Cash Flow	1,653	-1,485	-6,204	4,700	6,796
(Pur)/Sale of Investments	-712	-269	0	0	0
Others	-37	2,880	0	0	0
CF from Investments	-2,862	-4,467	-5,000	-3,000	-3,000
Issue of Shares	0	0	0	0	0
Inc/(Dec) in Debt	4,908	2,460	2,040	1,000	-2,000
Interest Paid	-2,517	-3,120	-3,340	-3,508	-3,453
Dividend Paid	-261	-1,022	-1,137	-1,137	-1,137
Others	859	-549	0	0	0
CF from Fin. Activity	2,989	-2,231	-2,437	-3,645	-6,590
Inc/Dec of Cash	3,892	-1,104	-8,641	1,055	206
Opening Balance	5,995	9,685	12,513	4,209	5,738
Closing Balance	9,887	8,581	3,872	5,264	5,945

Hitachi Energy

BSE SENSEX
67,481S&P CNX
20,268

CMP: INR4,733

TP: INR4,150 (-11%)

Sell



Bloomberg	POWERIND IN
Equity Shares (m)	42
M.Cap.(INRb)/(USDb)	200.6 / 2.4
52-Week Range (INR)	4948 / 2906
1, 6, 12 Rel. Per (%)	7/12/54
12M Avg Val (INR M)	133
Free float (%)	25.0

Financials & Valuations (INR b)

Y/E Mar	2023	2024E	2025E
Sales	44.7	49.5	65.1
EBITDA margin	5.3	6.0	8.8
Adj. PAT	0.9	1.2	3.2
EPS (INR)	22.1	28.4	74.5
EPS Gr. (%)	-44.0	28.1	162.5
BV/Sh. (INR)	286.6	315.0	389.5

Ratios

RoE (%)	7.7	9.0	19.1
RoCE (%)	8.4	10.1	18.8
Payout (%)	13.5	-	-

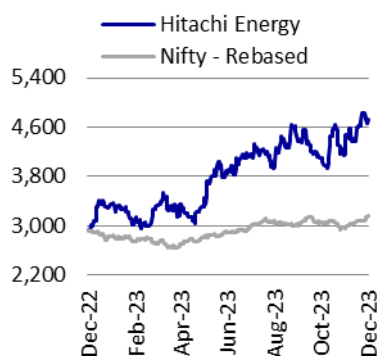
Valuations

P/E (x)	213.7	166.8	63.5
P/BV (x)	16.5	15.0	12.2
EV/EBITDA (x)	85.5	68.2	35.1
EV/Sales (x)	4.5	4.1	3.1

Shareholding pattern (%)

As On	Sep-23	Jun-23	Sep-22
Promoter	75.0	75.0	75.0
DII	8.0	8.1	7.1
FII	4.3	4.5	4.9
Others	12.6	12.4	12.9

FII Includes depository receipts

Stock's performance (one-year)**Tech-led play on T&D, railways, EV, data centre**

Hitachi Energy, with its diverse product portfolio, is likely to be a key beneficiary of the expected spend in transmission, railways, data center, and EV. With a variety of technology-driven solutions addressing transmission, grid stability, railways, data centers, etc., the company has an edge over its peers. We expect the company's revenue/PAT to report a CAGR of 20%/70% over FY23-26. This would be led by order inflow growth of 7% and margin improvement of 475bp over the same period. We expect margin improvement to be driven by moderating supply chain issues and higher share of services and exports. We value the stock on DCF basis at INR4,150 implying a 41x P/E on two-year forward. This takes into account 17% decadal revenue growth and EBITDA margin improvement to 10% from current levels of 4.4%. We also bake in EBITDA margin to improve to 10% by FY26. We initiate coverage on the stock with a SELL rating as current valuations are already baking in potential positives from strong addressable market and margin improvement. We would look for better entry points in the stock.

Potential beneficiary of a large addressable market

The government's strategic efforts are aimed to drive the transition to clean energy and create an environment for integrating renewable grids, developing data centers, promoting e-mobility, and adopting smart grid technologies. To meet its renewable energy goals, CEA has already identified INR2.4t in capital expenditures that would be made through FY30. To balance the large-scale solar and wind energy being added into the national grid, the Battery Energy Storage Systems (BESS) will be critical by enabling time-shifting of power dispatch. India is projected to be a global leader in battery storage capacity, adding 140-200GW by 2040, according to the Institute for Energy Economics and Financial Analysis. CRISIL expects data center capacity to become nearly 2X over the next 2-3 years entailing an investment of USD4-5b. Hitachi Energy has presence across all these segments and will benefit from this uptick in investments.

Wide portfolio of products for each segment

Hitachi Energy is looking for opportunities across segments through four key business units – grid automation, grid integration, high voltage unit and transformer business unit. It also has a wide product range that caters to different segments and sets it ahead of its peers. These products include a range of transformers, HVDC products (such as HVDC light, HVDC classic), products for railways (such as Scott transformers), grid automation solutions, and data center solutions. All these products serve a wider basket of segments that are currently expanding based on the government's plan until FY30.

Strong presence in HVDC power transmission projects

The company has a high market share in HVDC projects with 7 out of 15 HVDC projects being powered by Hitachi Energy's solutions. It has achieved localization of HVDC and STATCOM converter valves at Chennai and stands to benefit from the upcoming projects on transmission and HVDC. It also has unique solutions (such as OceaniQ product) for offshore wind farms to be set up (10 GW). The company also stands to benefit from the incremental requirements of transformers, switchgear, and GIS. We thus expect Hitachi Energy to be a key beneficiary of the likely spends of INR2.4t in the transmission sector.

Technology-driven solutions across segments place it ahead of peers

Hitachi Energy is leveraging global technology and customer experiences to provide tech-enabled products that are tailored to unique consumer needs. The company uses a variety of technology-driven products to deliver solutions to end-consumers across various segments. Its technology-driven products include HVDC Light, HVDC Classic, OceaniQ, Lumada for the transmission sector, E-Mesh power store and energy management system for data centers, SCADA, Relion RER670 for railways, and Grid-eMotion Fleet and Flash for EV mobility, putting it ahead of competitors.

Plans to expand its geographical presence

Hitachi Energy India is well-positioned to expand its service portfolio in India, thanks to its extensive installed base. The company's goal is to increase its share of service orders by offering a wide range of digitalized classic services, as well as advanced solutions like retrofits and spares. Last year, the company experienced a 10% growth in services revenue, and it expects to see a 15% growth going forward. With its strong manufacturing capabilities, Hitachi Energy India is also able to effectively tap into the export market, with exports accounting for nearly 25% of its order book. The company already has a presence in export markets such as Nepal, Bhutan, Middle East, Africa, and the Americas and has plans to expand further.

Scope of margin expansion

Company's margins were impacted over last few quarters on non-availability of semiconductors required for grid automation as well as supply chain issues. These issues are expected to be resolved over the next 2-3 quarters, and the management expects margins to reach 10% by FY25-end. We also expect margins to expand driven by: a) improved operating leverage as revenues scale up, and b) a higher share of exports and services.

Financial outlook

We expect Hitachi Energy's sales/EBITDA/PAT to post 20%/49%/70% CAGR over FY23-26. This would enable the ROE to expand sharply to 22% by FY26. We expect OCF/FCF to improve over next three years on improved working capital cycle.

Key risks and concerns

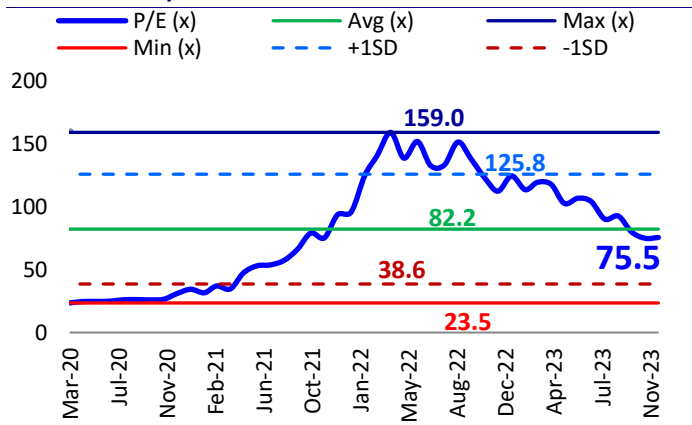
Key downside risks: 1) Slowdown in order inflows from key government-focused segments (such as transmission and railways) due to election schedule. 2) aggression in bids to procure large-sized projects, 3) sharp rise in commodity prices, particularly steel and 4) delays in finalization of large-sized HVDC tenders.

Key upside risks: 1) Earlier than expected recovery in margins and better than expected order inflows pose upside risks to our estimates

Valuation and view

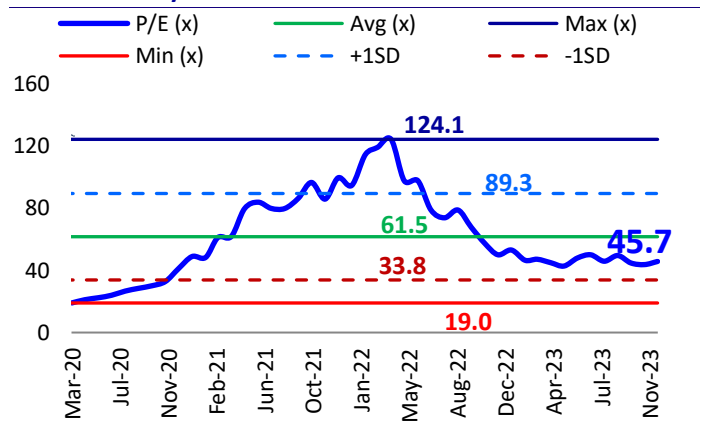
We value the stock on DCF basis at INR4,150 implying a 41x P/E on two-year forward. This takes into account 15% decadal revenue growth and EBITDA margin improvement to 10% from current levels of 4.4%. We also bake in EBITDA margin to improve to 10% by FY26. We initiate coverage on the stock with a SELL rating as current valuations are already baking in potential positives from strong addressable market and margin improvement. We would look for better entry points in the stock.

Exhibit 383: 1-year forward PE



Source: Bloomberg, MOFSL

Exhibit 384: 2-year forward PE



Source: Bloomberg, MOFSL

STORY IN CHARTS

High growth areas identified by the company

Opportunities	Key areas
HVDC and STATCOM	<ul style="list-style-type: none"> ❖ 22,500 MW of HVDC projects planned for Green Energy Evacuation by 2030 ❖ Visibility of atleast 7 STATCOM projects ❖ Hitachi is doing localization of HVDC & STATCOM convertor valve at Chennai
Off-shore Wind	<ul style="list-style-type: none"> ❖ 10 GW of Offshore Wind Farms planned in TN and Gujarat ❖ Hitachi Energy has an innovative OceaniQ portfolio for offshore solutions
HV products, transformers, GIS	<ul style="list-style-type: none"> ❖ Increased demand for transformers and HV products ❖ Increased demand for GIS substations as compared to Air Insulated substations

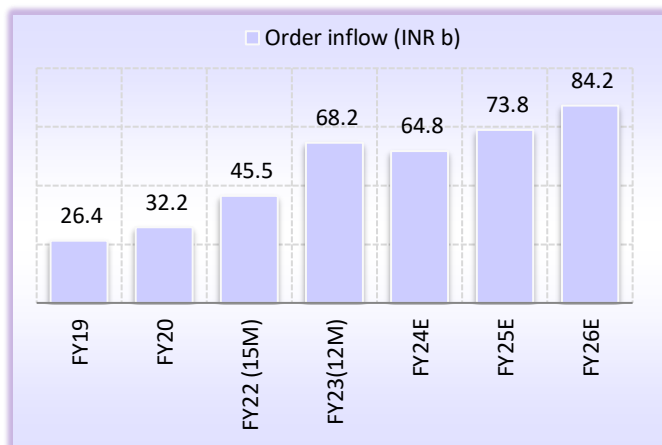
Source: MOFSL, Company

Hitachi Energy India's different product offerings in their respective segments

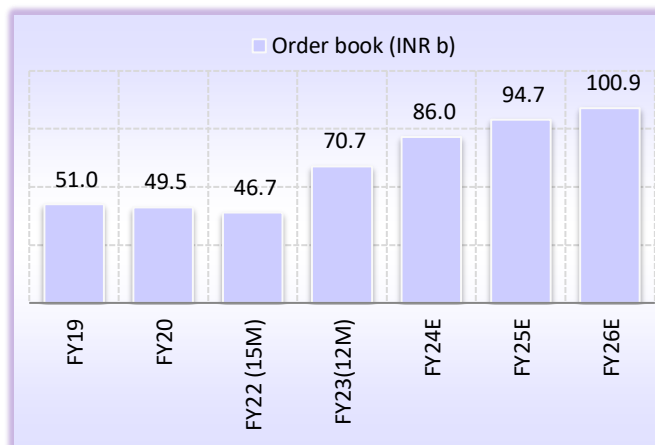
Segments	Solutions
Transformers	<ul style="list-style-type: none"> ❖ Green Transformers - Uses biodegradable ester fluids and works under higher workloads ❖ Txpert Dry Transformer - Digital Dry transformer with Txpert solution enhance operational reliability ❖ Rail Electrification - Offers Scott and V-Connected transformers, utilizing green fluids, used in rail electrification
HV products	<ul style="list-style-type: none"> ❖ Offers switchgear, generator circuit-breakers, surge arrestors, instrument transformers, circuit breakers, power quality products, disconnectors, HV service
Grid integration	<ul style="list-style-type: none"> ❖ STATCOM Utility, STATCOM Renewables, SVC industry, Hybrid synchronous condenser, Fixed series compensation, static frequency convertors, Thyristor controlled series compensation
HVDC	<ul style="list-style-type: none"> ❖ HVDC light and HVDC Classic
Grid Automation Solutions	<ul style="list-style-type: none"> ❖ Automation and communication for network control, Lumada platform for asset and work management, distribution automation, hybrid wireless solution, IoT solution for condition monitoring of network
Rail Solutions	<ul style="list-style-type: none"> ❖ Traction transformer, dry transformer, SCADA, Switch gear and power quality products
E-mobility	<ul style="list-style-type: none"> ❖ Grid e-Motion Fleet
Data centers	<ul style="list-style-type: none"> ❖ Network studies, high-voltage switchgear, power transformers, MV switchgear, cable connections, safety measures, station auxiliaries, electrical and mechanical integration, protection systems, and grounding and lightning protection design.

Source: Company, MOFSL

We expect order inflows to grow to INR84 b in next 2-3 years Order book to be buoyant over FY23-26E

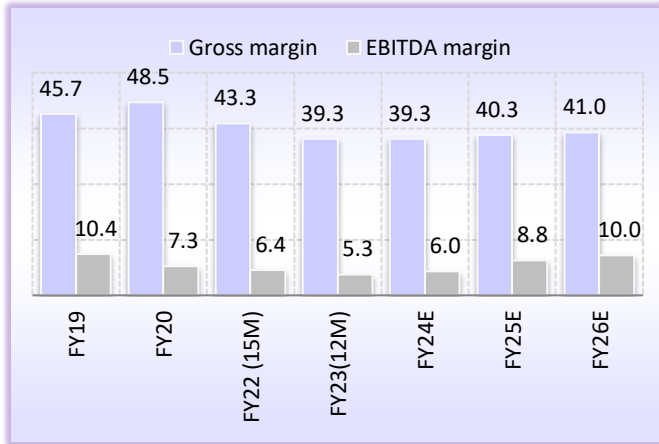


Source: Company, MOFSL



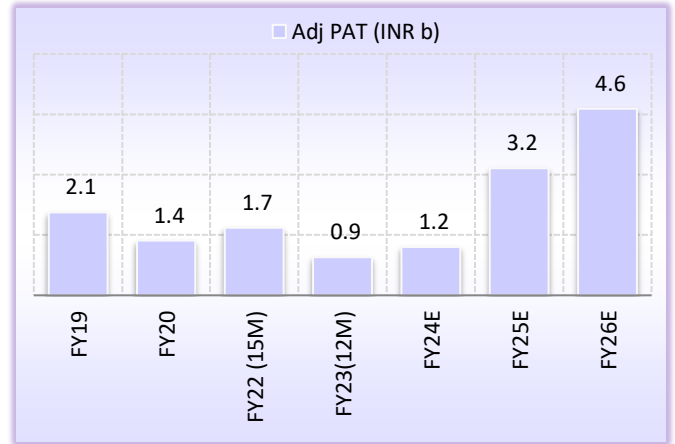
Source: Company, MOFSL

We expect double-digit EBITDA margin by FY26E (%)



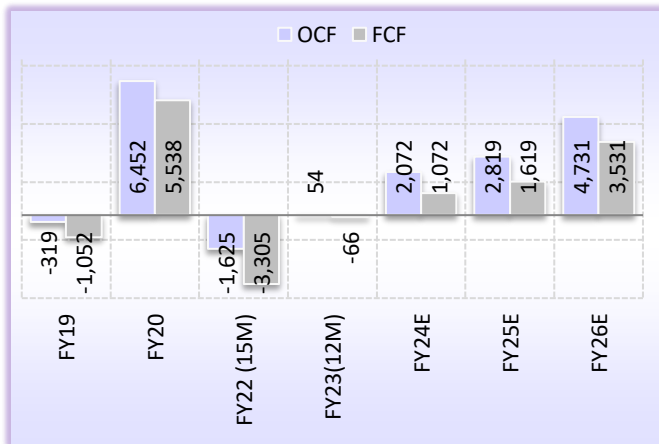
Source: Company, MOFSL

We expect PAT to clock in 70% CAGR over FY23-26E



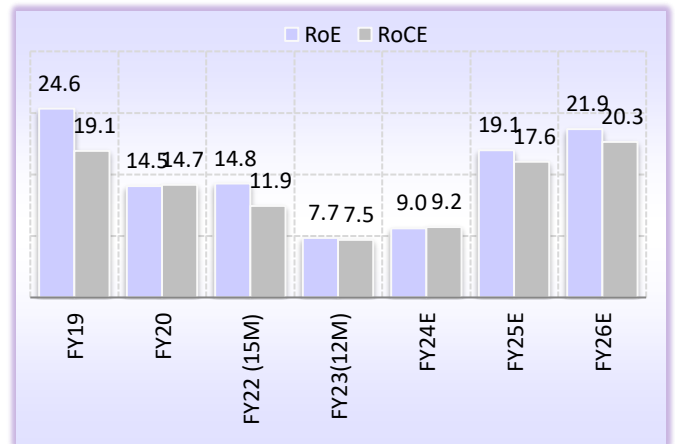
Source: Company, MOFSL

OCF & FCF to be higher led by better operating performance (INR m)



Source: Company, MOFSL

We expect better return ratios led by improved profitability (%)



Source: Company, MOFSL

Potential beneficiary of a large addressable market

The Government’s strategic initiatives aim to drive the transition towards clean energy and create an environment that is favorable for for integrating renewable grids, developing data centers, promoting e-mobility, and adopting smart grid technologies. To meet its renewable energy goals, CEA has already identified INR2.4 t in capital expenditures that would be made through FY30. To balance the large-scale solar and wind energy being added into the national grid, the Battery Energy Storage Systems (BESS) will be critical by enabling time-shifting of power dispatch. India is projected to be a global leader in battery storage capacity, adding 140-200GW by 2040, according to the Institute for Energy Economics and Financial Analysis. CRISIL expects data center capacity to become nearly 2x over the next 2-3 years entailing an investment of USD4-5b. The Indian Railways too is undergoing a massive upgradation and expansion fueled by electrification of rail and adoption of an energy-efficient system. The Railways already announced various sizeable tenders for high-density corridors/ Mission Raftaar. Hitachi Energy has been a long-term partner of Indian Railways and expects significant opportunity here for its products and services. Hitachi Energy has presence and products available to cater to these segments.

Exhibit 385: High growth areas identified by the company

Opportunities	Key areas
HVDC and STATCOM	<ul style="list-style-type: none"> ❖ 22,500 MW of HVDC projects planned for Green Energy Evacuation by 2030 ❖ Visibility of atleast 7 STATCOM projects ❖ Hitachi is doing localization of HVDC & STATCOM convertor valve at Chennai
Off-shore Wind	<ul style="list-style-type: none"> ❖ 10 GW of Offshore Wind Farms planned in TN and Gujarat ❖ Hitachi Energy has an innovative OceaniQ portfolio for offshore solutions
HV products, tranformers, GIS	<ul style="list-style-type: none"> ❖ Increased demand for transformers and HV products ❖ Increased demand for GIS substations as compared to Air Insulated substations

Source: MOFSL, Company

Exhibit 386: Hitachi Energy India is in a strong position to capitalize on opportunities across different business segments

Segments	Growth Drivers	Solutions
Renewables	<ul style="list-style-type: none"> ❖ Government plans to take renewable energy to 500GW from current levels of 166GW 	<ul style="list-style-type: none"> ❖ Hitachi Energy has a range of solutions for the renewable market such as Electrical Balance of System Optimization, Evacuation S/S, energy & grid management automation, Dry Type Transformers and more
Data centre market	<ul style="list-style-type: none"> ❖ Data Centers is expected to increase six fold capacity to 4,900-5,000 MW in the next six years from the current <1,000 MW. The growth in data centers will require a reliable and sustainable source of electricity 	<ul style="list-style-type: none"> ❖ The Company provides S/S, GIS, Automation, Dry transformers solutions for datacenters.
Rail Electrification	<ul style="list-style-type: none"> ❖ Indian Railway has announced various sizeable tenders for high density corridors or Mission Raftaar. Indian Railways is upgrading and expanding by electrification of railways and adoption of energy efficient system 	<ul style="list-style-type: none"> ❖ Hitachi Energy India is a long-term partner of Indian Railways, company can provide products and services such as adoption of energy-efficient systems, open avenues for high-density corridors and other rail infrastructure
Leveraging exports	<ul style="list-style-type: none"> ❖ Global supply chain constraints and geopolitical issues has made global customers to look at India as an alternate option for supply chain routes and partners. Orders are already flowing in from established export markets of Nepal, Bhutan, Middle East, Africa and the Americas. 	<ul style="list-style-type: none"> ❖ Hitachi is catering to several orders for capacitor banks, Bay Equipment, GIS switchgear and other substation components, from utilities and EPCs.
EV Mobility	<ul style="list-style-type: none"> ❖ EV has been an another growth driver for the company as country targets 80 million EV's on Indian roads by 2030 	<ul style="list-style-type: none"> ❖ Hitachi's Grid-eMotion Flash charging solutions has offerings for urban mass transit, large and heavy batteries, which limit greenhouse gas and noise emissions

Source: Company, MOFSL

Wide portfolio of products for each segment

Hitachi Energy is looking for opportunities across segments through four key business units – grid automation, grid integration, high voltage unit and transformer business unit. It also has a wide product range that caters to different segments and sets it ahead of its peers.

Exhibit 387: Hitachi Energy India's Business Units

Business Units	Solutions
Grid Automation	❖ Company offers substation automation, communication networks, grid automation services, and grid edge solutions to enterprise software solutions as well as full range of services.
Grid Integration	❖ The Business Unit incorporates integrated systems, solutions, and services from the Company's DC and AC fields, including HVDC (High Voltage Direct Current), Grid Edge, Substations, and Power Quality solutions. Business unit also offers offshore wind connections, semiconductors, and power consulting services for key segments in the energy system, such as renewables, transmission distribution, and e-transportation solutions.
High Voltage Products	❖ Hitachi Energy India is leading in providing high-voltage technology, offering a wide range of high-voltage products for both AC and DC systems up to 1,200 kilovolts (kV) and 1,100 kV, respectively. Its primary offerings includes switchgear, circuit-breakers, generator circuit breakers, power quality products, surge arresters, disconnectors, instrument transformers, and high-voltage services.
Transformers	❖ This business unit includes power transformer, dry transformers, traction transformers, insulation and components, digital sensors, and transformer services. These transformers are being used across power generation, transmission, and distribution to metals and mining, oil and gas, commercial and infrastructure projects, and railways.

Source: Company, MOFSL

Exhibit 388: Hitachi Energy India's different product offerings in their respective segments

Segments	Solutions
Transformers	❖ Green Transformers - Uses biodegradable ester fluids and works under higher workloads
	❖ Txpert Dry Transformer - Digital Dry transformer with Txpert solution enhance operational reliability
	❖ Rail Electrification - Offers Scott and V-Connected transformers, utilizing green fluids, used in rail electrification
HV products	❖ Offers switchgear, generator circuit-breakers, surge arrestors, instrument transformers, circuit breakers, power quality products, disconnectors, HV service
Grid integration	❖ STATCOM Utility, STATCOM Renewables, SVC industry, Hybrid synchronous condenser, Fixed series compensation, static frequency convertors, Thyristor controlled series compensation
HVDC	❖ HVDC light and HVDC Classic
Grid Automation Solutions	❖ Automation and communication for network control, Lumada platform for asset and work management, distribution automation, hybrid wireless solution, IoT solution for condition monitoring of network
Rail Solutions	❖ Traction transformer, dry transformer, SCADA, Switch gear and power quality products
E-mobility	❖ Grid e-Motion Fleet
Data centers	❖ Network studies, high-voltage switchgear, power transformers, MV switchgear, cable connections, safety measures, station auxiliaries, electrical and mechanical integration, protection systems, and grounding and lightning protection design.

Source: Company, MOFSL

Strong presence in HVDC power transmission projects

Hitachi Energy India has a strong market presence and expertise in high-voltage power technology and has a full range of Transmission and Distribution (T&D) solutions including HVDC transmission corridors, innovative transformers, power quality products and automation which transmits energy from renewable energy sources efficiently. It has a high market share in HVDC projects with 7 out of 15 HVDC projects being powered by Hitachi Energy's solutions.

There are 22,500 MW of HVDC projects planned for Green Energy Evacuation and there is a visibility of at least seven STATCOM projects by 2030. Company has achieved localization of HVDC and STATCOM converter valves at Chennai and stands to benefit from the upcoming projects on transmission and HVDC. It also has unique solutions (such as OceaniQ product) for offshore wind farms to be set up (10 GW). The company also stands to benefit from the incremental requirements of transformers, switchgear, and GIS.

Exhibit 389: Key projects done or undertaken by the company over years on HVDC and HVDC offerings

Location	Projects
Vindhyachal	❖ Commissioned HVDC transmission link for NTPC at Vindhyachal for connecting northern and western grids in 1989
NE-Agra	❖ Commissioned the world's first UHVDC link - 6000MW, 800kV DC link from NE to Agra in 2017
Raigarh-Pugalur	❖ Hitachi Energy India commissioned, its sixth HVDC installation in India
Mumbai	❖ Company also secured another HVDC project from Adani Electricity Mumbai Infra Ltd which links Kudus to Mumbai
Rihand-Dadri	❖ Company established remote operation of +/- 500 kV 1500 MW HVDC Rihand Dadri Bi-Pole Terminals from National Transmission Asset Management Center, Manesar.
Chennai	❖ Company launched an advanced power system factory in Chennai which will launch: 1) HVDC Light: based on Voltage Sourced Converter (VSC) technology, is designed to transmit power underground and underwater, as well as over long distances. 2) HVDC Classic: primarily used for Grid interconnection and DC links in AC grid, overland or subsea, where conventional AC methods cannot be used.

Source: Company, MOFSL

Technology-driven solutions place it ahead of peers

Hitachi Energy is leveraging global technology and customer experiences to provide tech-enabled products that are tailored to unique consumer needs. The company uses a variety of technology-driven products to deliver solutions to end-consumers across various segments. We highlight below the key solutions provided by company:

Exhibit 390: Key technology led solutions provided by the company across areas

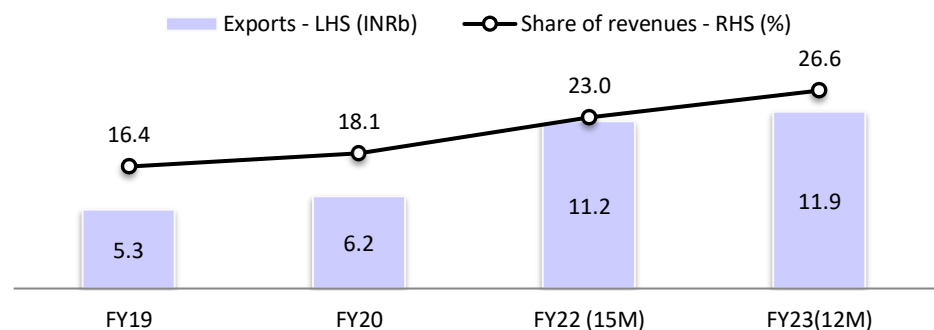
Segment	Product
Renewables	
OceaniQ	❖ OceaniQ technology combines knowledge and skills from two different industries power and marine sector and provide solutions for fixed platforms, floating structures and sub-sea power systems for wind, marine and other offshore operators.
Grid-eXpand	❖ This is a solution for range of modular and preassembled grid connection solutions that make it faster, simpler and more efficient to expand power grid capacity
Lumada	❖ Lumada uses features such as machine learning, AI, advanced data analytics, hybrid cloud management and cybersecurity for managing this energy evacuation in an efficient and timely manner.
HVDC	❖ HVDC light and HVDC classic
Data centres	
E-mesh and E-mesh Powerstore	❖ The Hitachi Energy e-mesh™ platform allows the PowerStore™ to connect with various power sources such as power grids, fossil fuel generators, renewable generators to provide intelligent and efficient power management system to ensure high-quality power. It offers an intelligent control system for both grid-connected and off-grid systems.
E-mesh control	❖ The e-mesh™ portfolio is a scalable, vertically integrated digital ecosystem to manage and optimize energy at all levels
E-mesh energy management solution	❖ E-mesh energy management system is flexible and scalable and can be extended to integrate renewables, conventional power generation sources, and loads like EV chargers
E-mesh Monitor	❖ E-mesh™ Monitor is a cloud-based digital platform, exclusively designed to aggregate data from distributed energy assets and turn that into actionable business insights
Rail electrification	
Network manager SCADA	❖ SCADA is a real time, cyber secure platform designed for applications that demand high performance and availability, such as power generation, transmission and distribution systems, and electrical networks for railways and airports
Relion RER670	❖ Relion protects transmission lines or power transformer in solidly, compensated and high impedance earthed networks control solutions
EV-Mobility	
Grid-eMotion Fleet™	❖ Offers large-scale EV charging of smart public and commercial transport
Grid-eMotion Flash™	❖ Offers Flash Charging technology for fleet operators

Source: Company, MOFSL

Plans to expand its geographical presence

Hitachi Energy India is well-positioned to expand its service portfolio in India owing to its extensive installed base. The company's goal is to increase its share of service orders by offering a wide range of digitalized classic services, as well as advanced solutions like retrofits and spares. Its services revenue registered a growth of 10% last year and company expects to grow it by 15% going forward. With its strong manufacturing capabilities, Hitachi Energy India is also able to effectively tap into the export market, with exports accounting for nearly 25% of its order book. The company already has a presence in export markets such as Nepal, Bhutan, Middle East, Africa, and the Americas and has plans to expand further. Exports formed 26.6% of overall sales in FY23.

Exhibit 391: Share of exports is continuously moving up for the company



Source: Company, MOFSL

Exhibit 392: Export orders received by Hitachi Energy India during 1HFY24

Country	Orders
Singapore	❖ 400kV GIS order from power utility
Greece	❖ 400kV GIS order from agri-tech manufacturer
Tanzania	❖ 245kV AIS switchgear order for railways
Morocco	❖ Transformers order for wind farm
Bhutan	❖ 66/33/11kV GIS S/S order from Bhutan Power
Indonesia	❖ Order from HE Indonesia for AIS switchgear for PLN Indonesia
UAE	❖ 132kV Harmonic Filter order for UAE Transco
Tanzania	❖ Automation package from LinxonSweden for Tanzania SGR
Bhutan	❖ SCADA EMS System at NLDC Bhutan from Bhutan Power System Operator
Guyana	❖ Largest single order for supply of disconnector from KPTL for Guyana project

Source: Company, MOFSL

The company has effectively provided comprehensive services to various segments. It has posted 10% YoY growth in its service portfolio covering a mix of retrofits, spares and digitalization. The company's key offerings in services include:

- First factory repairs of traction transformers
- Overhauling of Generator Circuit Breaker HEC7
- Replacing third-party SCADA and controls to life cycle service orders for grid automation from heavy industries such as auto, steel, cement, oil & gas, ceramics, and utility customers
- Orders for GIS bay extension and Substation Automation Systems (SAS).
- Maintenance of Rihand-Dadri HVDC project with technical support for 30 years
- Service orders from PSTCL, Vardhman, and ST Telemedia (new customers).
- Modular Switchgear Monitoring (first order) for Hitachi Japan and for servicing the group company's GIS switchgear as well.

Scope of margin expansion

Company’s margins were impacted over last few quarters on non-availability of semiconductors required for grid automation as well as supply chain issues. These issues are gradually expected to sort out over next 2-3 quarters and company expects margins to move to 10% by FY25-end. We also expect margins to expand driven by: a) improved operating leverage as revenues scale up, and b) a higher share of exports and services. Hitachi Energy India also pays royalty fees to Hitachi Global for using its technical know-how; the current level of royalty is hovering between 3.5% and 4.0%. Royalty fees paid by Hitachi Energy are fixed in nature and may not reduce because energy ecosystem is changing radically and requires a lot of investments from the perspective of technology, investment in R&D, innovation, etc. By paying royalty, Hitachi Energy has access to the latest state-of-the-art technology, enabling the company to support its customers in India.

Exhibit 393: We expect the company to achieve double-digit EBITDA margin by FY26E

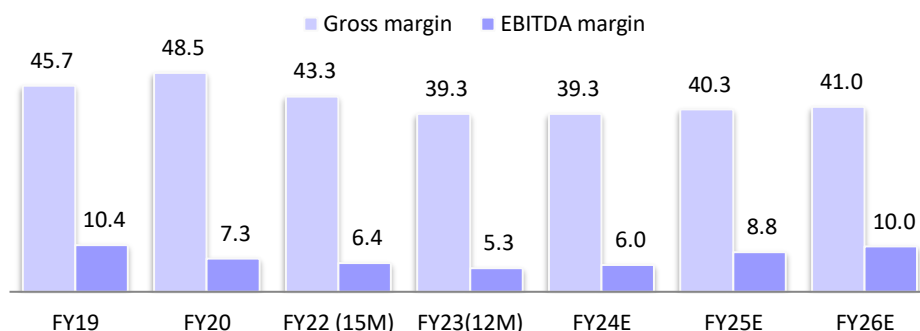
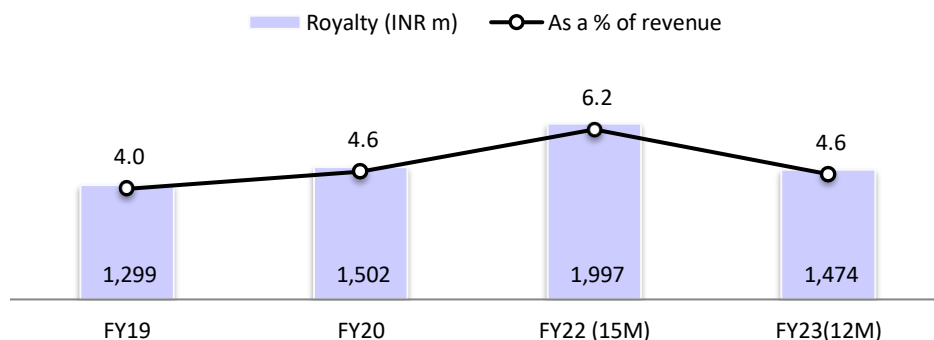


Exhibit 394: Royalty outgo to parent has come down after a sharp uptick in FY22



Source: Company, MOFSL

Exhibit 395: New product launches by the company in FY23

Products	Solutions
TRO600	❖ These wireless routers enable 5G for essential industrial and utility operations, ensuring reliability and resilience. The TRO600 uses the closest wired or wireless backhaul interconnect to provide cost effective solutions for extending localized services.
TXpert™ Hub	❖ This technology is the heart of TXpert™ Ecosystem for transformer digitalization. It enables the aggregation and analysis of data from digital transformer sensors, offering digital connectivity, monitoring, and optimization capabilities
OceaniQ™	❖ This product designed for offshore wind energy includes solutions for fixed platforms, floating structures, and sub-sea power systems. OceaniQ™ will result in greater volumes of wind power being efficiently harvested and integrated into the world’s energy system.
Lumada	❖ Lumada provides inspection insights into the health and risk profiles of assets and infrastructures with the help of AI.

Source: Company, MOFSL

Expansion plan to cater to future demand requirements

Hitachi Energy's portfolio is 80% localized, while the company's manufacturing facility in India also supplies five products to international markets. The company has also doubled its capacity of power quality manufacturing with the establishment of a Greenfield project in Doddaballapur, and the new HVDC factory in Chennai to meet the rising domestic and export market demand.

Exhibit 396: Hitachi Energy India's expansion done in last two years

Timeline	Product	Functions
May, 2022	❖ Resin Impregnated Paper bushings up to 400kV voltage level	❖ Resin Impregnated Paper bushings offer an improvement over traditional oil-based alternatives by preventing moisture ingress, oil leakage and reducing risks of fire in case of failure
Aug, 2022	❖ Greenfield project in Doddaballapur for High Voltage Power Quality products such as advanced capacitor units and other products	❖ These products find application in power utilities, industries, renewables and transportation segments to improve efficiency and reduce energy waste
Aug, 2022	❖ Production of operating Mechanism of circuit breaker in Maneja, Vadodara	❖ For catering increasing demand from global and local customers for operating mechanism like FSA and BLG (industry standards of drives), which have a wide range of applications in various circuit breakers all over the world.
FY23	❖ Launched the advanced power system factory in Chennai for HVDC Light, HVDC Classic and STATCOM with MACHTM control and protection system	❖ For catering to the rising number of high-voltage transmission projects in India and export to support global HVDC installations.

Source: Company, MOFSL

Exhibit 397: Company also invested in expanding global feeder factories too for catering to parent's demand for other countries

Facility	Requirements
Global feeder factory for switchgear at Vadodara	<ul style="list-style-type: none"> ❖ Established in 2020 for supplying modules to Hitachi Energy group factories ❖ Continuously expanding - New manufacturing facilities for Operating mechanism & 550kV Dead Tank Breakers
Additional requirements from Indian factories	<ul style="list-style-type: none"> ❖ Global market allocation for Dead Tank Breakers, PASS, Instrument Transformers & Disconnectors

Source: Company, MOFSL

SWOT analysis

- ❖ The company supports the nation's ambitious renewable energy goals.
- ❖ The company's offerings align perfectly with data center operator needs.
- ❖ Hitachi Energy India can aid Indian Railways' electrification and efficiency goals.
- ❖ Hitachi Energy India's installed base in India enables service expansion.
- ❖ Hitachi Energy India leverages manufacturing for effective export.

S

STRENGTH



- ❖ Supply chain interruptions are disrupting production and delivery schedules, impacting business operations.
- ❖ Global growth slowdown impacts private investment and demand recovery.

W

WEAKNESS



- ❖ The government allocated INR350 b for energy transition in the budget.
- ❖ Government boosts infrastructure and manufacturing for Atmanirbhar Bharat and global supply chain role.
- ❖ The company identifies opportunities for HVDC station upgrades and inter-regional links.

O

OPPORTUNITY



- ❖ Cyberthreats can disrupt power companies, jeopardizing operations and infrastructure security.
- ❖ Fluctuations in demand, exchange rates, and raw material prices can negatively impact the supply chain.

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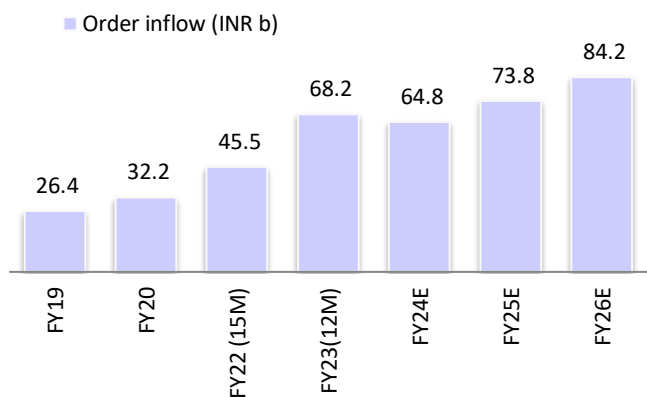
THREATS



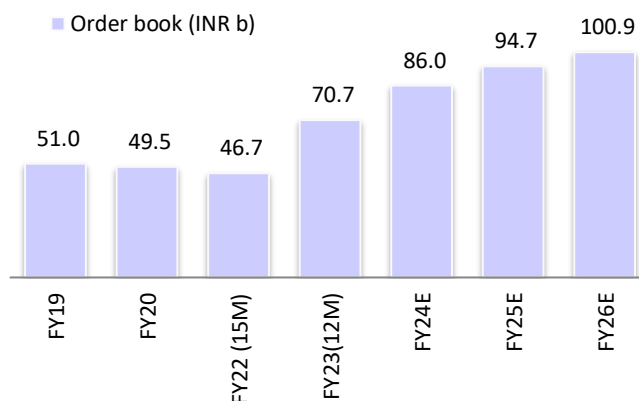
Financial outlook

We expect Hitachi Energy's sales/EBITDA/PAT to post 20%/49%/70% CAGR over FY23-26. As a result, we expect its ROE to expand sharply to 22% by FY26. Over the next three years, we project its OCF/FCF to improve due to an improved working capital cycle.

Exhibit 398: We expect strong order inflows in next 2-3 years **Exhibit 399: Order book to be buoyant over FY23-26E**

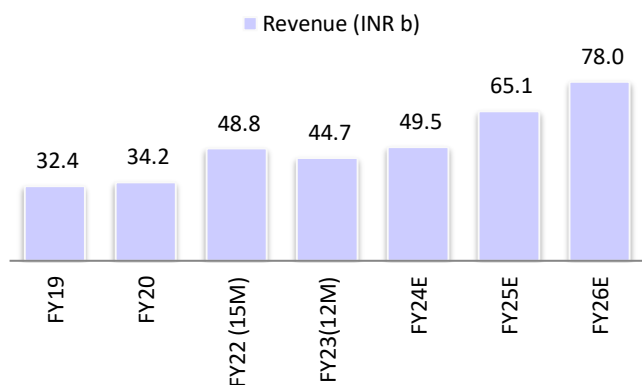


Source: Company, MOFSL

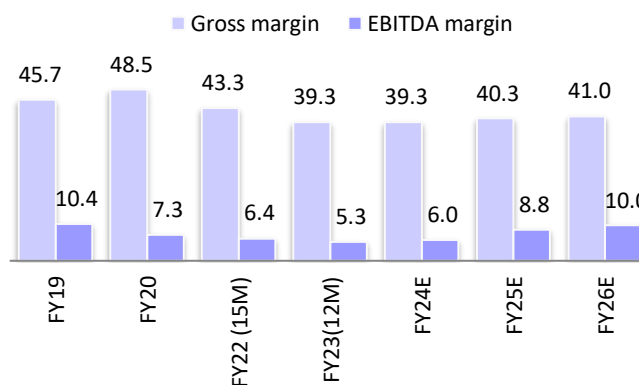


Source: Company, MOFSL

Exhibit 400: We expect revenue to scale up sharply by FY26 **Exhibit 401: We expect double-digit EBITDA margin by FY26E**

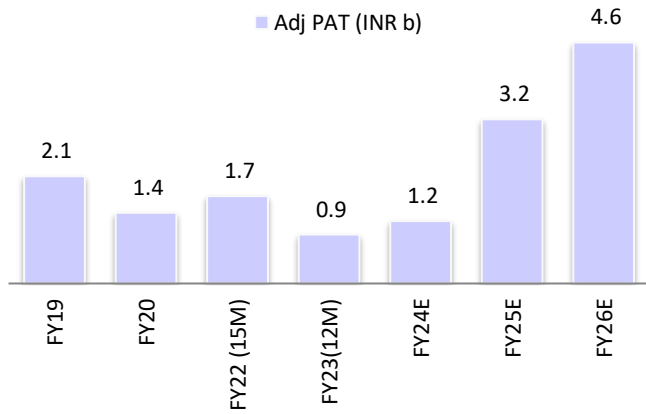


Source: Company, MOFSL



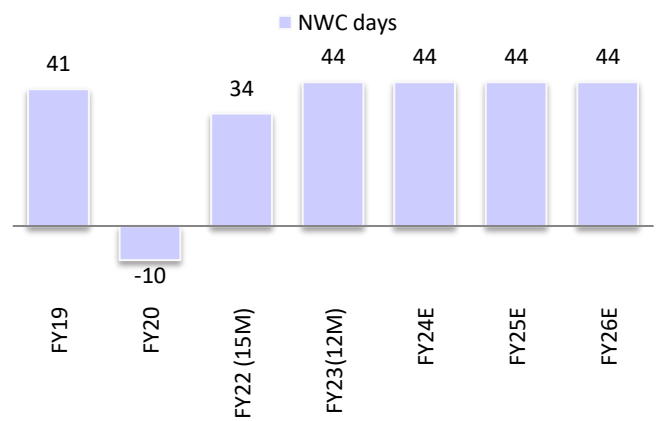
Source: Company, MOFSL

Exhibit 402: We expect PAT to clock in 70% CAGR over FY23-26E



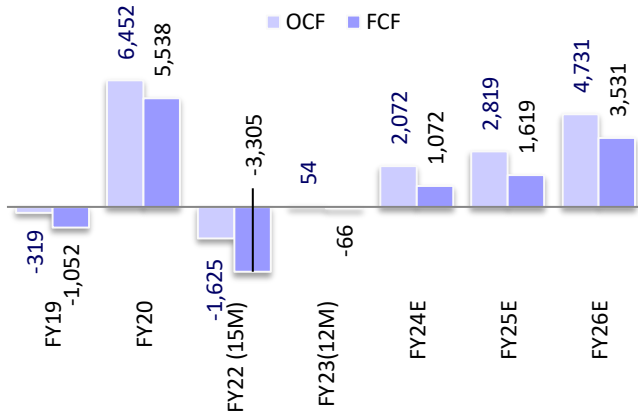
Source: Company, MOFSL

Exhibit 403: We expect NWC days to be in a stable range (days)



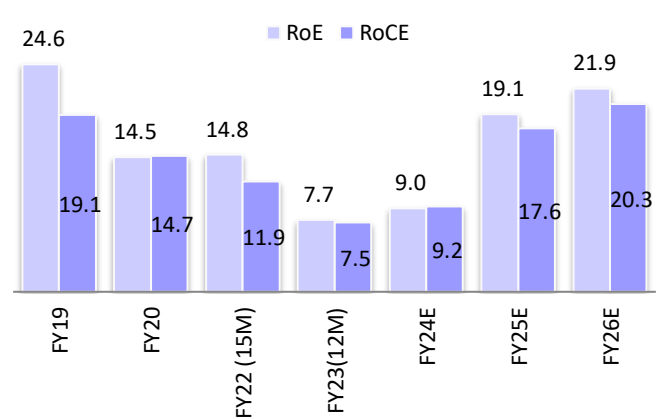
Source: Company, MOFSL

Exhibit 404: OCF & FCF to be higher led by improving operating performance (INR m)



Source: Company, MOFSL

Exhibit 405: We expect better return ratios led by improved profitability (%)



Source: Company, MOFSL

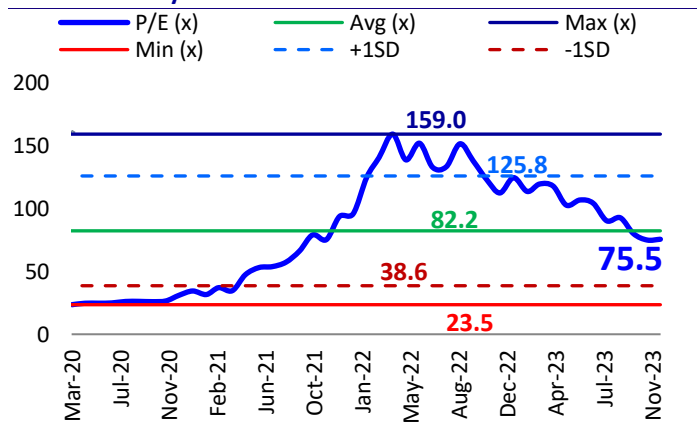
Key risks and concerns

- **Key downside risks:** 1) Slowdown in order inflows from key government-focused segments (such as transmission and railways) due to election schedule. 2) aggression in bids to procure large-sized projects, 3) sharp rise in commodity prices, particularly steel and 4) delays in finalization of large-sized HVDC tenders.
- **Key upside risks:** 1) Earlier than expected recovery in margins and better than expected order inflows pose upside risks to our estimates

Valuation and view

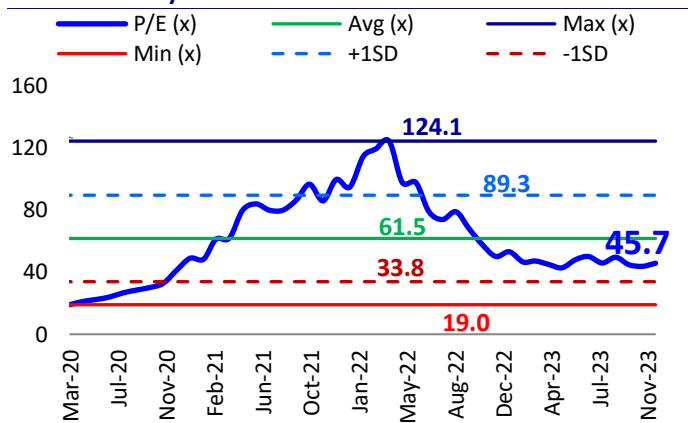
We value the stock on DCF basis at INR4,150 implying a 41x P/E on two-year forward earnings. This takes into account 17% decadal revenue growth and EBITDA margin improvement to 10% from current levels of 4.4%. We also bake in EBITDA margin to improve to 10% by FY26. We initiate coverage on the stock with a SELL rating as current valuations are already baking in potential positives from strong addressable market and margin improvement. We would look for better entry points in the stock.

Exhibit 406: 1-year forward PE



Source: Bloomberg, MOFSL

Exhibit 407: 2-year forward PE



Source: Bloomberg, MOFSL

Exhibit 408: Sensitivity analysis - Bear, Base and bull case valuations

	Bear case	Base case	Bull case	Rationale
Core business	3,841	4,267	4,694	❖ 10% sensitivity of Dec, 25 earnings
Valuation multiple	37	41	45	❖ 10% sensitivity of multiples
Core business valuation	1,41,988	1,75,294	2,12,106	
Price per share	3,349	4,134	5,002	

Source: MOFSL

Management profile



Venu Nuguri (Managing Director and CEO)

Venu Nuguri is Managing Director and CEO of Hitachi Energy in India and Head of Region South Asia, Hitachi Energy. Venu has a degree in Electrical Engineering from the NIT Warangal, and he has also attended management courses at the Indian Institute of Management-Ahmedabad (IIMA), Indian School of Business-Hyderabad (ISB), and International Institute of Management Development-Switzerland (IIMD).



Ajay Singh (Chief Financial Officer)

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Financials and valuation

Income Statement							(INR M)
Y/E March	2019	2020(12M)	2022(15M)	2023(12M)	2024E	2025E	2026E
Net Sales	32,361	34,204	48,840	44,685	49,484	65,139	77,955
Change (%)	NA	5.7	42.8	-8.5	10.7	31.6	19.7
Raw Materials	17,583	17,606	27,712	27,110	30,021	38,867	45,993
Gross Profit	14,778	16,599	21,128	17,576	19,463	26,272	31,962
Subcontracting charges	2,695	2,668	2,865	1,506	1,667	2,195	2,549
Staff Cost	2,552	3,694	4,868	4,173	3,959	5,211	6,236
Other Expenses	6,174	7,728	10,289	9,538	10,886	13,158	15,357
EBITDA	3,358	2,509	3,107	2,359	2,950	5,708	7,819
% of Net Sales	10.4	7.3	6.4	5.3	6.0	8.8	10.0
Depreciation	484	772	955	802	890	977	1,072
Interest	264	204	414	401	551	551	551
Other Income	5	185	669	151	168	221	264
PBT	2,614	1,718	2,407	1,308	1,676	4,400	6,460
Tax	553	365	732	369	473	1,242	1,823
Rate (%)	21.1	21.2	30.4	28.2	28.2	28.2	28.2
Extra-ordinary Inc.(net)	-408	-355	359	0	0	0	0
Reported PAT	1,654	998	2,034	939	1,203	3,158	4,637
Change (%)	NA	-39.7	103.8	-53.8	28.1	162.5	46.8
Adjusted PAT	2,062	1,353	1,676	939	1,203	3,158	4,637
Change (%)	NA	-34.4	23.8	-44.0	28.1	162.5	46.8

Balance Sheet (Standalone)							(INR M)
Y/E March	2019	2020(12M)	2022(15M)	2023(12M)	2024E	2025E	2026E
Share Capital	85	85	85	85	85	85	85
Reserves	8,313	9,240	11,239	12,068	13,271	16,430	21,067
Net Worth	8,398	9,325	11,324	12,153	13,356	16,514	21,152
Loans	3,476	0	1,250	2,750	2,750	2,750	2,750
Deferred Tax Liability	42	-219	-348	-319	-319	-319	-319
Capital Employed	11,916	9,107	12,226	14,584	15,788	18,946	23,583
Gross Fixed Assets	7,319	8,779	9,547	10,802	11,802	13,002	14,202
Less: Depreciation	1,922	2,568	3,355	3,998	4,888	5,865	6,937
Net Fixed Assets	5,397	6,211	6,192	6,805	6,914	7,137	7,265
Capital WIP	567	324	1,183	487	487	487	487
Goodwill and intangibles	397	348	334	329	329	329	329
Investments	0	0	0	0	0	0	0
Curr. Assets	28,045	27,931	27,182	31,246	34,948	46,390	57,863
Inventory	4,932	4,951	7,073	8,179	9,057	11,923	14,269
Debtors	17,829	15,845	14,187	15,278	16,918	22,271	26,653
Cash & Bank Balance	1,880	3,190	859	1,633	2,154	3,222	6,201
Loans & Advances	129	163	54	57	63	83	99
Other Current Assets	3,275	3,783	5,009	6,100	6,755	8,892	10,642
Current Liab. & Prov.	22,490	25,706	22,665	24,282	26,890	35,397	42,361
Creditors	13,771	15,780	16,190	15,146	16,773	22,079	26,423
Other Liabilities	7,326	8,044	4,732	7,184	7,955	10,472	12,532
Provisions	1,393	1,882	1,743	1,952	2,162	2,846	3,405
Net Current Assets	5,555	2,225	4,517	6,964	8,058	10,994	15,502
Application of Funds	11,916	9,107	12,226	14,584	15,788	18,946	23,583

Financials and valuation

Ratios

Y/E March	2019	2020(12M)	2022(15M)	2023(12M)	2024E	2025E	2026E
Basic (INR)	39.0	23.5	48.0	22.1	28.4	74.5	109.4
Adjusted EPS	48.6	31.9	39.5	22.1	28.4	74.5	109.4
Growth (%)	-	-34.4	23.8	-44.0	28.1	162.5	46.8
Cash EPS	60.0	50.1	62.0	41.1	49.4	97.5	134.6
Book Value	198.1	219.9	267.1	286.6	315.0	389.5	498.9
DPS	0.0	0.0	2.0	3.0	0.0	0.0	0.0
Payout (incl. Div. Tax.)	0.0	0.0	5.0	13.5	0.0	0.0	0.0
Valuation (x)							
P/Sales	6.1	5.8	4.1	4.4	4.0	3.0	2.5
P/E (standalone)	96.2	146.6	118.4	211.3	164.9	62.8	42.8
Cash P/E	77.9	93.4	75.4	114.0	94.8	48.0	34.8
EV/EBITDA	59.6	77.8	64.0	84.6	67.4	34.7	24.9
EV/Sales	6.2	5.7	4.1	4.5	4.0	3.0	2.5
Price/Book Value	23.6	21.3	17.5	16.3	14.9	12.0	9.4
Dividend Yield (%)	0.0	0.0	0.0	0.1	0.0	0.0	0.0
Profitability Ratios (%)							
RoE	24.6	14.5	14.8	7.7	9.0	19.1	21.9
RoCE	19.0	16.6	16.1	8.4	10.1	18.8	21.3
RoIC	22.6	23.1	13.2	8.6	10.8	21.6	27.9
Turnover Ratios							
Debtors (Days)	201	169	106	125	125	125	125
Inventory (Days)	56	53	53	67	67	67	67
Creditors. (Days)	155	168	121	124	124	124	124
Asset Turnover (x)	2.7	3.8	4.0	3.1	3.1	3.4	3.3
Leverage Ratio							
Net Debt/Equity (x)	0.2	-0.3	0.0	0.1	0.0	0.0	-0.2

Cash Flow Statement

(INR M)

Y/E March	2019	2020(12M)	2022(15M)	2023(12M)	2024E	2025E	2026E
PBT before EO Items	2,614	1,718	2,407	1,308	1,676	4,400	6,460
Add : Depreciation	484	772	955	802	890	977	1,072
Interest	259	189	405	395	551	551	551
Less : Direct Taxes Paid	737	454	928	666	473	1,242	1,823
(Inc)/Dec in WC	2,782	-3,787	4,447	1,817	573	1,868	1,529
Others	-157	440	-17	32	0	0	0
CF from Operations	-319	6,452	-1,625	54	2,072	2,819	4,731
(Inc)/Dec in FA	-732	-906	-1,675	-120	-1,000	-1,200	-1,200
Free Cash Flow	-1,051	5,547	-3,300	-66	1,072	1,619	3,531
(Pur)/Sale of Investments	0	0	0	0	0	0	0
Others	5	16	5	2	0	0	0
CF from Investments	-728	-890	-1,670	-118	-1,000	-1,200	-1,200
(Inc)/Dec in Net Worth	0	0	0	0	0	0	0
(Inc)/Dec in Debt	3,476	-3,572	1,104	1,364	0	0	0
Less : Interest Paid	142	327	414	401	551	551	551
Dividend Paid	0	0	84	127	0	0	0
Others	-408	-355	358	2	0	0	0
CF from Fin. Activity	2,927	-4,253	964	839	-551	-551	-551
Inc/Dec of Cash	1,880	1,309	-2,331	775	521	1,067	2,980
Add: Beginning Balance	0	1,880	3,189	858	1,633	2,154	3,222
Closing Balance	1,880	3,189	858	1,633	2,154	3,222	6,201

E: MOFSL Estimates

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One 97 Communications

Get Set PAY!

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