Indiabulls

KIRLOSKAR BROTHERS LTD
RESEARCH

EQUITY RESEARCH | **June 29, 2007**

INITIATING COVERAGE

Share Data

Market Cap	Rs. 45.9 bn
Price	Rs. 434
BSE Sensex	14650.51
Reuters	KRBR.BO
Bloomberg	KKB IN
Avg. Volume (52 Week)	0.03 mn
52-Week High/Low	Rs. 460.05/287
Shares Outstanding	105.76 mn

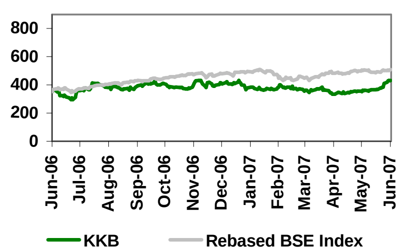
Valuation Ratios

Year to 31 March	2008E	2009E
EPS (Rs.)	16.4	18.8
+/- (%)	12.5%	14.2%
PER (x)	26.4x	23.1x
EV/ Sales (x)	2.1x	1.8x
EV/ EBITDA (x)	20.7x	17.3x

Shareholding Pattern (%)

Promoters	62
FIIs	2
Institutions	11
Public & Others	25

Relative Performance



Kirloskar brothers limited — Hold

No room for more upside

Kirloskar Brothers Limited (KBL), the flagship company of the Kirloskar group (India), is a leading manufacturer and exporter of pumps in India. Recently, KBL sold its entire stake in Kirloskar Copland limited (KCL) to concentrate on its core business of manufacturing pumps. In order to achieve synergy benefits, the company has recently acquired 100% stake in Aban Constructions Pvt Ltd, which is a step towards its entry in engineering, procurement & construction (EPC) businesses in the oil and gas markets. However, sharp increase in the prices of raw materials is a cause for concern.

Key Figures

Year to March	FY05	FY06	FY07	FY08E	FY09E	CAGR (%)
(Figures in Rs mn, except per share data)						(FY07-09E)
Net Sales	13,071	14,883	17,819	21,925	26,310	21.5%
Adj. EBITDA	963	1,807	1,875	2,270	2,724	20.5%
Adj. Net Profit	655	1,557	1,819	1,738	1,984	4.4%
Margins(%)						
Adj.EBITDA	7.4%	12.1%	10.5%	10.4%	10.4%	
Adj.NPM	5.0%	10.0%	8.7%	7.9%	7.5%	
Per Share Data (Rs.)						
Normalised EPS	6.2	14.1	14.6	16.4	18.8	13.3%
PER (x)	70.3x	30.7x	29.7x	26.4x	23.1x	

- We expect KBL's revenues to grow from Rs. 17.8 bn in FY07 to Rs. 26.3 bn in FY09E, reflecting a CAGR of 21.5%, driven by increased government thrust on agriculture & infrastructure sector and major domestic & export orders received by the company.
- EBITDA margins and NPM are expected to go down by 10 bps and 120 bps respectively from FY07 to FY09E.
- At the current price of Rs. 434, the stock trades at a forward PE of 26.4x FY08 earnings and at 23.1x FY09 earnings. We feel that the stock is fully priced. However, given the significant planned investment in the long run in irrigation and infrastructure, the stock seems attractive for long run.

Rationale

Strong global presence and exports thrust

Increased global presence likely to boost top line

Presently, KBL has a presence in over 70 countries. Of late, the company has expanded its operations in various parts of Africa such as its contract with the government of Angola for the supply of diesel driven pump sets. The company has also bagged several projects financed by international financing agencies such as World Bank and Islamic Development Bank. Moreover, KBL has received export orders from various countries in South America. On the back of increased global presence and export orders, we expect the company to increase its global presence and exports in future.

Strong inflow of domestic orders will boost growth

Major domestic orders to boost company's revenues

KBL won a contract from Andhra Pradesh for investigation, design, supply and erection of components to lift water from the Narmada river. The company also bagged a contract from NTPC Electric Supply Company for supply of equipments for rural electrification in Jharkhand for Rs. 815.5 mn. With a strong order book of over Rs. 10 bn, the company is expected to achieve a significant growth in its revenues over the next two years.

Government emphasis on agriculture will drive growth of company

Favourable government policies towards agriculture

KBL derives demand for its products from various sectors like agriculture, irrigation and power. Government's pro-agriculture policies such as increased allocation for irrigation, are expected to boost demand for agricultural equipment. KBL, being the industry leader in this segment, stands to gain from this initiative.

KBL likely to benefit from synergies arising from the EPC work

Entry into EPC work would provide synergy benefits

KBL acquired Aban Construction in FY06. This has given KBL an entry point in the engineering, procurement and construction (EPC) business in the oil and gas markets. The company is likely to be positively affected as the civil works in irrigation and water supply projects which were earlier subcontracted to construction companies, can now be done in-house.

Facilitating drinking water would leverage the business

In India around 10% of the urban population still does not have access to drinking water. As per government's estimates, providing drinking water access to this 10% population would require a capital outlay of at least Rs. 3000 bn. This is required to be spent on installation of pumps and other related equipment. KBL is well positioned to gain from this development.

Commencement of Phase I of Mumbai Metro Train

Phase I of the Mumbai Metro Train has been given the go-ahead by the government and is likely to commence in the near future. We expect that given KBL's track record of providing pumps and other equipment to the DMRC, it is well suited to gain from this project.

Key Risks

Existence of unorganised sector

30-40% less prices in unorganised sector could pose threat to KBL

The pump industry in India is characterized by the organised as well as the unorganised sector. The unorganised sector has an edge in agriculture as its prices are at least 30-40% lower as compared to those of organised sector. This could prove to be a hindrance in the growth of the players in the organised sector.

Delay in implementation of development programmes

The pump business depends on the growth in core sectors such as agriculture and power. Though a lot of development programmes have been announced by the Indian government, any unexpected delay in their implementation could adversely affect the performance of the company.

Outlook

Power and agriculture are the biggest drivers of the pump industry in India. Due to rapid urbanisation, the requirement for supply of safe drinking water and treatment of waste water in Asian developing countries has increased considerably. With the increased government thrust on irrigation, the outlook for KBL looks promising.

We expect net sales of the company to grow from Rs. 17.8 bn in FY07 to Rs. 26.3 bn in FY09E reflecting a CAGR of 21.5%, on the back of the receipt of major domestic and export orders by the company. EBITDA margins and NPM are expected to go down by 10 bps and 120 bps respectively from FY07 to FY09E. At a current price of Rs. 434, the stock trades at a forward PE of 26.4x FY08 earnings and at 23.1x FY09 earnings. We feel that the stock is fully priced and has little possibility for further appreciation. Thus, we recommend hold on stock.

Company Background

Kirloskar Brothers Limited (KBL), incorporated in 1920 is the flagship company of Kirloskar group. KBL is engaged in manufacturing power driven pumps, valves, turbines, electric motors, anti-corrosion products and alloy iron castings. The company offers solutions to improve the pumping efficiency and prevent corrosion in the pumping system through anti-corrosion coating products. It has five strategic business units (SBUs), namely industrial pumps business group, projects and engineered pumps group, agricultural and domestic pumps group, infrastructural pumps group, and valves business group.

KBL has manufacturing facilities at five locations in states of Madhya Pradesh (Dewas) and Maharashtra (Kirloskarvadi, Konhapuri and Shirval). The company has large and established distribution network consisting 16 regional offices and 830 dealers in India, and 5 offices & 45 dealers overseas. The company's customers include South Eastern coalfields, DMRC, Jindal Vijyanagar Steel, Hindustan Petroleum Corporation, Electrosteel Castings, Northern Coalfields and Essar Steel.

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