

March 18, 2020

Oil prices, Corona to have adverse impact...

Capital Goods – T&D, EPC & Product Companies

Companies like Larsen & Toubro and KEC with exposure to Middle East and North Africa (MENA) region are expected to get moderately impacted by the recent more than 30% fall in crude oil prices to US\$35/barrel. This is expected to impact overall orders/awarding from MENA region. Companies like Elgi Equipments, AIA Engineering, Thermax, Engineers India and Kalpataru Power with exposure to international geographies like Europe, Middle East, China for sales or essential raw material may get impacted. Accordingly, we have tried to factor in the additional risk and revised our estimates, target prices and ratings for respective companies.

Oil price crash to impact companies exposed to Middle East

The recent fall in crude oil prices of more than 40% to US\$30/barrel is expected to impact overall orders/awarding from the MENA region owing to demand destruction fears amid excess supply. Companies like L&T and KEC with exposure to MENA region are expected to be moderately impacted. The Middle East region contributes ~13% to the order book and 14% to consolidated revenues of L&T. KEC International has exposure of ~₹ 2100 crore order book from MENA region, which is 9.5% of order book and 10% to revenue. However, Engineers India had around 25% overseas revenue in FY19 while 54% of 9MFY20 order inflow came in from overseas market.

Corona to impact companies with international exposure

Total 42% of Kalpataru Power's order book, (mainly T&D) is exposed to international markets while more than 70% of AIA Engineering's revenue comes from exports markets. Rest of the world contributed 47% to Elgi Equipment's FY19 revenue mainly from Europe, US and Australia, which was substantially impacted and is facing a lockdown situation due to the ongoing Coronavirus situation. Total ~30-40% of Thermax' revenue comes from exports business with operational and sales exposure in countries like Denmark, Europe, Indonesia, etc, which could get impacted by disruption due to the Coronavirus outbreak across major economies globally.

Valuation & Outlook

It is difficult to assess the real magnitude of the Coronavirus outbreak and oil price crash at the moment as it is yet to peak out. However, it is likely to have a negative impact on companies dependent on or with exposure to countries in Europe, Middle East and China with uncertainty in the near future posing higher risk. Accordingly, we have tried to factor in the additional risk and revised our estimates, target prices and ratings for companies like L&T, KEC, Kalpataru, Elgi Equipments, Thermax, AIA and Engineers India with operational and sales exposure to these geographies.

Revised targets: Capital Goods – T&D, EPC and Product companies

Company	Previous			Now		
	Target Price	Rating	CMP	Target Price	Rating	
L&T	1740	Buy	976	1370	Buy	
KEC	415	Buy	263	335	Buy	
Thermax	1170	Hold	770	910	Buy	
Kalpataru Power	570	Buy	249	285	Hold	
AIA Engineering	1770	Hold	1540	1605	Hold	
Elgi Equipment	230	Hold	160	180	Hold	
Engineers India	105	Hold	56	52	Reduce	

Source: Company, ICICI Direct Research

Key Highlights

- The recent fall in crude oil prices of more than 40% to US\$30 per barrel is expected to impact overall orders/awarding from MENA region
- The impact of Coronavirus outbreak and decline in crude oil prices will be negative for companies having dependence or exposure to countries in Europe, Middle East, China and uncertainty in near future posing higher risk
- Declining auto sales to affect demand from OEMs, thus impacting the profitability of bearing companies

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Capital Goods – Bearings, Defence

Weak global macros to impact demand...

The Coronavirus continued to impact the global economy leading to a disruption in supply chain across industries including auto-ancillaries where demand is expected to have a negative impact, the quantum of which would be dependent on how the global macros pan out, going ahead. Accordingly, we revise and roll over our estimates to FY22E with revised target prices for our companies in the bearings space.

Muted auto sales to impact bearing companies...

Monthly auto data showed a 19% decline in auto sales across various categories in February. The overall volatility in the environment has had a negative influence on consumer sentiment and demand. With visible challenges in the near term, the performance of the auto segment of the business for bearing companies is likely to get impacted in the short to medium term. We expect sluggish demand in the auto sector to remain a key overhang for bearing companies.

Corona outbreak to hamper exports...

Exports are likely to suffer on account of the Coronavirus outbreak that has disrupted the global supply chain affecting economies in an unparalleled fashion. This outbreak is posing a serious risk to the global macro economy. Coupled with a fall in crude oil prices, this has further weakened the demand scenario. Spillover effects of Chinese production halt will be diverse across our capital goods coverage. Among our bearings coverage universe, NRB, SKF and Timken have ~23%, 10% and 20% share of exports in topline. Solar Industries has ~40% share of exports and overseas in the topline. We expect companies with a higher share of exports to get negatively impacted in the current scenario. However, the quantum of the impact can only be assessed in coming quarters.

Revised targets: Capital Goods – Bearing, Defence

Company	Previous		CMP	Now	
	Target Price	Rating		Target Price	Rating
SKF	1840	Reduce	1668	1500	Reduce
Timken India	1020	Buy	873	1005	Buy
NRB Bearings	90	Hold	68	70	Hold
Solar Industries	1075	Reduce	1030	970	Reduce

Source: ICICI Direct Research, Company

Larsen & Toubro (L&T)

Currently, the Middle East region contributes ~13% to the order book and 14% to consolidated revenues of L&T. The international order book (including Middle East) contributes ~23% to the order book with exposure to Middle East, African countries, Bangladesh and Sri Lanka. The recent crude oil price crash by more than 30% to sub-US\$35 per barrel is expected to impact the future hydrocarbon ordering pipeline in the Middle East. Subsequently, it may have an adverse impact on order intake, order book, execution in Middle East, which could have a spiralling effect with an increase in working capital and receivables in the region amid economic slowdown, tight liquidity and vendor support. On the other hand, operations and revenue of IT subsidiaries of L&T (LTTS, MindTree, L&T Infotech) with exposure to Europe, US and China are likely to get impacted. Subsequently, we revise our estimates factoring in the additional risk. We revise our target price to ₹ 1370/share (standalone business at 17.0x FY21E EPS) and maintain **BUY** rating.

Exhibit 1: L&T Middle East Exposure

Middle East Region	FY18	FY19	9MFY20
Middle East Revenue (₹ Crore)	24571.7	24394.2	14168
As % of Total revenue	20.5%	17.3%	14.0%
Middle East Order Book (₹ Crore)	44202	34037.5	39819
As % of Total Order book	16.8%	11.6%	13.0%
International order book (Incl. ME)	62500.0	63300.0	72600
International order book (Incl. ME) as % of Total OB	23.8%	21.6%	23.7%

Source: Company, ICICI Direct Research

Exhibit 2: SoTP valuation of L&T

Company (₹ per share)	Bull case % of total		Base Case % of total		Bear Case % of total	
Base Business	1226	67.4	1016.6	74.1	687.7	73.8
L&T Finance Holdings	76	4.2	38	2.8	46	4.9
L&T IT Subsidiaries	207	11.4	124	9.1	82.9	8.9
L&T Power Development	18	1.0	11.5	0.8	7.7	0.8
L&T MHI JV	13	0.7	7.6	0.6	5.7	0.6
L&T IDPL	176	9.7	102.2	7.5	56.2	6.0
Other E&C, MIP & E&E S	29	1.6	19.8	1.4	15.0	1.6
Hydrocarbon	30	1.7	16	1.2	11	1.2
Mindtree	43.0	2.4	35.3	2.6	20.2	2.2
Total	1818	100.0	1371	100.0	932	100.0

Source: Company, ICICI Direct Research

Exhibit 3: Key Financial Summary

Particulars (₹ crore)	FY17	FY18	FY19	FY20E*	FY21E*	CAGR (FY19-FY21E)*
Net Sales	66,301.4	74,454.4	86,987.9	92,053.1	99,189.0	6.8%
EBITDA	6,425.2	7,407.7	8,498.6	9,131.5	9,722.2	7.0%
EBITDA Margin (%)	9.7	9.9	9.8	9.9	9.8	
Net Profit	5,453.8	5,387.1	6,677.9	8,507.9	8,298.2	11.5%
EPS (₹)	39.3	38.8	48.1	61.3	59.8	
P/E (x)	24.8	25.1	20.3	15.9	16.3	
RoNW (%)	11.9	11.0	12.7	14.7	13.2	
RoCE (%)	9.2	10.6	11.8	11.6	11.4	

Source: Company, ICICI Direct Research, * L&T standalone numbers Adjusting for E&A Business

KEC International

KEC International has exposure of ~₹ 2100 crore order book to the MENA region, which is 9.5% of the order book and 10% to revenue, which is likely to have an impact on the near term order intake and execution. Subsequently, the interest to sale, working capital may get impacted by the delay in execution or awarding in these markets. We revise our target price to ₹ 335/share, which is at 12x on FY21E EPS. We maintain **BUY** rating.

Exhibit 4: KEC's MENA and international exposure

MENA Exposure	FY18	FY19	9MFY20
MENA Revenue	1009	1100	-
MENA as % of Total revenue	10%	10%	-
Total order book (₹ Crore)	17298	20307	22011
MENA Order Book (₹ Crore)	1383.8	1401.2	2100
MENA order book as % of Total OB	8.0%	6.9%	9.5%
International Order Book as % of Total OB	45%	50%	35%

Source: Company, ICICI Direct Research

Exhibit 5: Key financial summary

Particulars (₹ crore)	FY19	FY20E	FY21E	FY22E	CAGR (FY20-FY22E)
Net Sales	11,000.9	12,708.9	14,099.3	16,587.2	14.2%
EBITDA	1,149.7	1,324.0	1,460.5	1,713.9	13.8%
EBITDA Margin (%)	10.5	10.4	10.4	10.3	
Net Profit	494.2	639.8	721.0	900.5	18.6%
EPS (₹)	19.2	24.9	28.0	35.0	
P/ E (x)	13.8	10.6	9.5	7.6	
RoNW (%)	20.1	21.8	20.5	20.8	
RoCE (%)	24.8	24.4	24.1	24.7	

Source: Company, ICICI Direct Research

Kalpataru Power

Total 42% of Kalpataru Power's (KPTL) order book, (mainly T&D) is exposed to international markets like Europe, Middle East, Americas, Australia, Africa and neighbouring countries. This could likely impact working capital, receivables, interest cost over the next year. Overall, delays in project awarding and execution are expected to impact the working capital management. We revise KPTL's target price to ₹ 285 per share (which is at 8.0x FY21E EPS) and revise our rating from **BUY** to **HOLD**.

Key risk: Project delays, slower order intake, working capital increase, 22.5% of the total shareholding is pledged by promoters (41% of 54.4% promoter holding is pledged) amounting to ~ ₹ 930 crore, which could pose liquidity issues amid weak domestic and global market conditions.

Exhibit 6: Valuation matrix

	Basis of Valuation	Multiple	Total Value (₹ crore)	Per share value(₹)
Base Business	P/E	8.0x	3,887	251
JMC Projects	50% Holdco discount on market Cap	67.2% stake	271	18
Other JV's/Investment in BOOT projects	Equity Invested	0.4x	184	12
Investment in Linjemontage (85% Stake)	Book Value	0.4x	71	5
Total			4,341	285

Source: Company, ICICI Direct Research

Exhibit 7: Key financial summary

Particulars (₹ crore)	FY18	FY19	FY20E	FY21E	FY22E	CAGR (FY20-FY22E)
Net Sales	5,741.1	7,115.1	8,400.0	8,701.9	10,610.4	12.4%
EBITDA	631.2	778.2	906.5	882.7	1,120.1	11.2%
EBITDA Margin (%)	11.0	10.9	10.8	10.1	10.6	
Net Profit	321.9	401.3	544.3	485.9	691.1	12.7%
EPS (₹)	21.0	26.1	35.2	31.4	44.7	
P/ E (x)	11.9	9.5	7.1	7.9	5.6	
RoNW (%)	11.6	12.7	13.9	11.5	14.1	
RoCE (%)	17.0	19.6	18.9	16.4	19.1	

Source: Company, ICICI Direct Research

Thermax

Total ~30-40% of Thermax' revenue comes from the exports business with operational and sales exposure in countries like Denmark, Europe, Indonesia, etc. This could get impacted by the disruption due to Coronavirus outbreak across major economies of the worlds. The order finalisation is likely to get delayed as customer enquiries have fallen or been postponed. Consequently, international order inflows may get impacted and would impact an already ailing order backlog. However, a strong balance sheet along with some improvement in margins would aid performance amid a challenging environment. We revise our target price to ₹ 910/share (which is at 26.5x FY21E EPS) and change our rating from HOLD to **BUY**.

Exhibit 8: Valuation Matrix

	Parameter	Value	₹ Per share
Standalone	26.5x FY21E EPS	10,412	874
Equity Invested in Subsidiaries	0.8x Equity	614	39
Total	Rounded off	11,026	911

Source: Company, ICICI Direct Research

Exhibit 9: Key Financial Summary

Particulars (₹ crore)	FY17*	FY18*	FY19*	FY20E	FY21E	CAGR (FY19-FY21E)
Net Sales	3,841.7	3,867.9	5,175.4	6,130.2	6,161.2	9.1%
EBITDA	373.8	371.4	418.9	513.1	539.4	13.5%
EBITDA Margin (%)	9.7	9.6	8.1	8.4	8.8	
Net Profit	144.8	238.3	275.4	325.7	392.9	19.4%
EPS (₹)	12.2	20.0	23.1	27.3	33.0	
P/E (x)	63.6	38.7	33.4	28.3	23.4	
RoNW (%)	8.9	9.9	11.2	10.9	12.0	
RoCE (%)	16.6	15.3	18.0	16.7	16.3	

Source: Company, ICICI Direct Research

* Numbers till FY19 includes standalone business with Boiler & Heater business of Thermax which is now classified as discontinued operations from standalone and transferred to its subsidiary TBWES with effect from 1st October 2019 and hence will not be reflected in standalone numbers, instead will be reflected in consolidated numbers and therefore will not be comparable. Hence, we have changed our presentation of forward numbers to consolidated and valued accordingly.

Elgi Equipments

The rest of the world contributed 47% to Elgi Equipment's FY19 revenue mainly from Europe, US, Australia, which was substantially impacted and is facing a lockdown situation due to the ongoing Coronavirus situation. Going ahead, international market slowdown substantially impacted the overall growth, which has already slowed due to the domestic slowdown in India. We revise our target price to ₹ 180/share (which is at 25x FY21E EPS of ₹ 7.2 per share) and maintain our **HOLD** rating.

Key risk: Cost overhang and delay in revival of India business

Exhibit 10: Key Financial Summary

(₹ crore)	FY19	FY20E	FY21E	FY22E	CAGR (FY20-22E)
Revenue	1,863.5	1,910.1	2,034.2	2,298.7	9.7%
EBITDA	191.8	171.9	213.6	271.2	25.6%
EBITDA Margin (%)	10.3	9.0	10.5	11.8	
Net Profit	103.1	70.3	114.2	151.4	46.7%
EPS (₹)	6.5	4.4	7.2	9.6	
P/E (x)	24.6	36.0	22.2	16.7	
EV/EBITDA (x)	13.8	15.5	12.2	9.5	
RoCE (%)	13.8	10.6	14.2	17.2	
RoE (%)	13.4	9.1	13.6	16.2	
Growth	36.0	2.5	6.5	13.0	

Source: Company, ICICI Direct Research

Engineers India

However, Engineers India had around 25% overseas revenue in FY19 while 54% of 9MFY20 order inflow came in from overseas market. We expect revenue and EBITDA growth to witness short-term moderation and margin stress due to higher contribution from the turnkey segment and likely slowdown in overseas consultancy market amid global crude oil price crash, which would impact the international and domestic hydrocarbon market and oil demand. We revise our target price to ₹ 52 per share (that is at 8.5x on FY21E EPS) and change our rating from HOLD to **REDUCE**.

Key risks: Any project related headwinds or delays in turnkey segment may further impact revenue growth.

Exhibit 11: Key financial summary

(₹ crore)	FY18	FY19	FY20E	FY21E	FY22E	FY20-22E
Net Sales	1,788	2,444	2,895	2,823	3,190	
Revenue	1,788	2,444	2,895	2,823	3,190	5.0
EBITDA	413	366	411	353	478	7.9
Net Profit	378	370	408	386	520.6	12.9
EPS (₹)	6.0	5.9	6.5	6.1	8.2	
P/E (x)	9.4	9.6	8.7	9.2	6.8	
Price / Book (x)	1.6	1.6	1.5	1.5	1.4	
EV/EBITDA (x)	2.7	2.4	1.8	2.2	1.0	
RoCE (%)	23.2	21.3	22.3	18.2	22.3	
RoE (%)	16.7	16.3	17.5	16.1	20.8	

Source: Company, ICICI Direct Research

AIA Engineering

More than 70% of AIA Engineering's revenue comes from exports markets, which could get impacted by the slowdown due to lockdown of several markets in Europe due to the Coronavirus outbreak amid the domestic economic slowdown. Some concerns already remain on AIA for its cautious stance and volume loss of 20000 MT to 25000 MT from a couple of mining customers abroad. Accordingly, working capital management may get impacted. We revise our target price to ₹ 1605 per share (which is at 25x FY21E EPS) and maintain our **HOLD** rating.

Exhibit 12: Key Financial Summary

Particulars (₹ crore)	FY17	FY18	FY19	FY20E	FY21E	CAGR (FY19-FY21E)
Net Sales	2,246.0	2,445.1	3,069.5	2,978.0	3,206.1	2.2%
EBITDA	634.7	535.7	660.4	684.3	735.4	5.5%
EBITDA Margin (%)	28.3	21.9	21.5	23.0	22.9	
Net Profit	457.2	443.6	513.2	595.7	582.1	6.5%
EPS (₹)	48.5	47.0	54.4	63.2	61.7	
P/ E (x)	31.8	32.7	28.3	24.4	25.0	
RoNW (%)	16.8	14.7	14.6	15.0	13.3	
RoCE (%)	22.7	18.4	18.8	17.6	16.4	

Source: Company, ICICI Direct Research

SKF

Weakness in the domestic OEM segment is expected to take a toll on the auto segment amid disruptions in the global supply chain, which could negatively impact the industrial segment. The stock price has corrected by ~20% from our previous report wherein we iterate our **REDUCE** rating on the stock with a target price of ₹ 1840. We roll over our estimates to FY22E, to arrive at a revised target price of ₹ 1500.

Exhibit 13: Key Financial Summary

	FY18	FY19	FY20E	FY21E	FY22E	CAGR FY20-22E
Revenue (₹ crore)	2,750.4	3,034.5	2,970.1	2,974.2	3,036.6	1.1
EBITDA (₹ crore)	434.8	485.9	412.8	419.4	431.2	2.2
EBITDA margin	15.8	16.0	13.9	14.1	14.2	
Net Profit (₹ crore)	295.9	335.8	319.8	311.5	309.3	(1.7)
EPS (₹)	57.6	67.9	64.7	63.0	62.6	
P/E (x)	28.9	24.6	25.8	26.5	26.7	
EV/EBITDA (x)	17.5	15.8	18.2	17.5	16.8	
RoCE (%)	23.7	29.4	22.3	19.9	18.1	
RoE (%)	16.1	19.8	16.5	14.5	13.1	

Source: Company, ICICI Direct Research

Timken India

Timken India registered strong numbers for Q3FY20, albeit on the back of improved margins as well as on account of decent traction from the railways & export businesses. However, going ahead, we expect demand to remain muted. While there is still uncertainty about the quantum of impact of Covid-19 on the bearing industry, the most recent statistics as well as consumer sentiment point to a downturn. Thus, we roll over our estimates to FY22E to arrive at a target price of ₹ 1005/share with a **BUY** rating.

Exhibit 14: Key Financial Summary

(₹ Crore)	FY18	FY19	FY20E	FY21E	FY22E	CAGR (FY20-22E)
Net Sales	1,234.0	1,664.4	1,795.6	1,885.4	2,074.0	7.5
EBITDA	163.3	288.6	348.4	380.9	427.2	10.7
EBITDA margin (%)	13.2	17.3	19.4	20.2	20.6	
Net Profit	92.0	148.6	195.2	210.1	252.3	13.7
EPS (₹)	13.5	19.8	25.9	27.9	33.5	
P/E (x)	64.5	44.2	33.6	31.2	26.0	
P/BV	8.5	4.9	4.3	3.8	3.4	
EV/EBITDA (x)	36.3	22.7	18.4	16.4	14.3	
RoCE (%)	18.9	15.7	18.1	17.3	17.0	
RoE (%)	13.1	11.1	12.8	12.2	12.9	

Source: Company, ICICI Direct Research

NRB Bearings

NRB Bearings is expected to continue its muted performance due to weak sentiments in the auto sector amid constrained economic expansion. The overall volatility in the environment has had a negative influence on consumer sentiment and demand. While the long term outlook remains positive, there are clear challenges in the immediate short-term. We roll over our estimate to FY22E, to arrive at a revised target price of ₹ 70 per share with a **HOLD** rating.

Exhibit 15: Key Financial Summary

(₹ Crore)	FY18	FY19	FY20E	FY21E	FY22E	CAGR (FY20-22E)
Revenue	855.1	964.9	768.9	792.4	824.9	3.6%
EBITDA	168.3	185.1	84.6	99.0	113.0	15.6%
EBITDA margin (%)	19.7	19.2	11.0	12.5	13.7	
Net Profit	90.7	108.2	32.2	39.7	45.0	18.1%
EPS (₹)	9.4	11.2	3.3	4.1	4.6	
P/E (x)	7.2	6.0	20.1	16.4	14.4	
EV/EBITDA	4.7	4.7	10.1	8.5	7.4	
RoCE (%)	26.7	21.0	8.9	9.7	10.6	
RoE (%)	24.0	19.5	6.6	7.7	8.3	

Source: Company, ICICI Direct Research

Solar Industries

Exports and overseas form 40% share in the topline of Solar Industries. The recent fall in crude prices and overall weakness in global markets are expected to keep the explosive business muted. We trim down our estimates and revise our target price to ₹ 970 valuing the company at 28x FY21E EPS with a **REDUCE** rating on the stock.

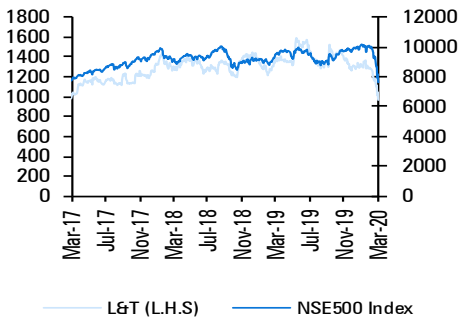
Exhibit 16: Key Financial Summary

	FY17	FY18	FY19	FY20E	FY21E	CAGR (FY19-21E)
Revenue	1,580.0	1,916.1	2,461.6	2,354.7	2,722.3	5.2%
EBITDA	323.9	411.6	501.9	489.8	571.7	6.7%
EBITDA margin (%)	20.5	21.5	20.4	20.8	21.0	
Net Profit	186.5	220.6	267.7	264.9	313.3	8.2%
EPS (₹)	20.6	24.4	29.6	29.3	34.6	
P/E (x)	50.0	42.3	34.8	35.2	29.7	
EV/EBITDA (x)	29.9	23.5	19.3	19.8	17.2	
RoCE (%)	20.4	21.8	23.8	23.1	24.4	
RoE (%)	20.1	20.3	21.6	21.4	24.1	

Source: Company, ICICI Direct Research

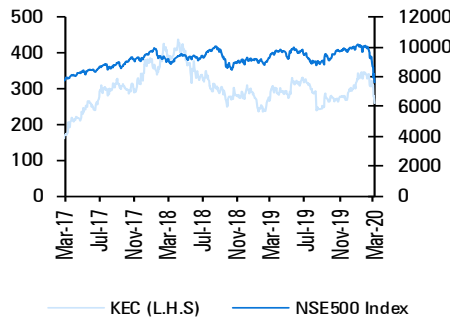
Exhibit 17: Price Charts

Larsen & Toubro



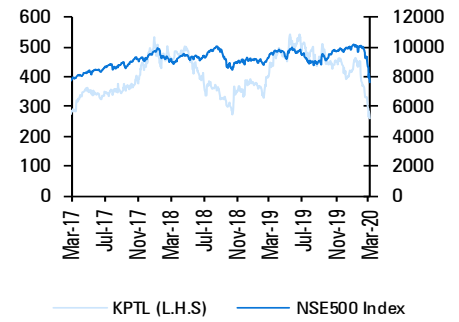
Source: Bloomberg, ICICI Direct Research

KEC International



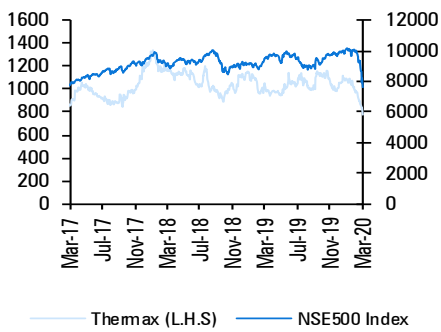
Source: Bloomberg, ICICI Direct Research

Kalpataru Power



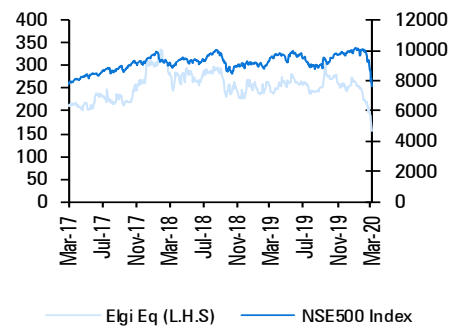
Source: Bloomberg, ICICI Direct Research

Thermax



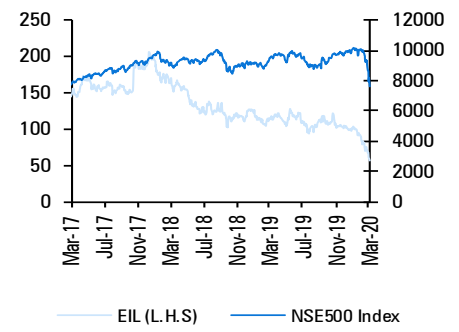
Source: Bloomberg, ICICI Direct Research

Elgi Equipments



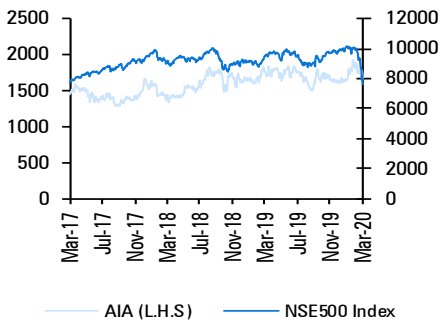
Source: Bloomberg, ICICI Direct Research

Engineers India



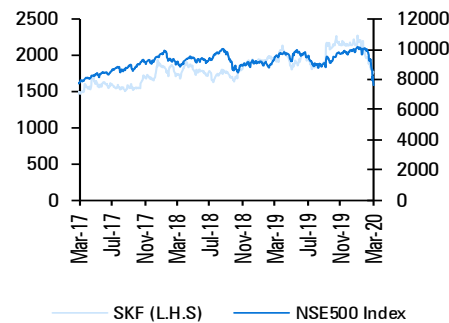
Source: Bloomberg, ICICI Direct Research

AIA Engineering



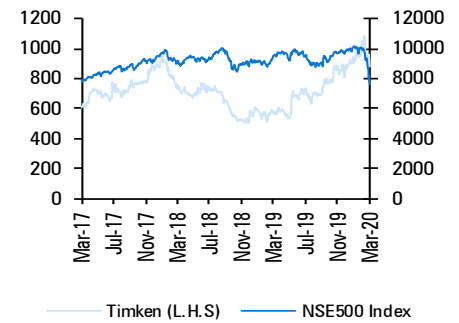
Source: Bloomberg, ICICI Direct Research

SKF India



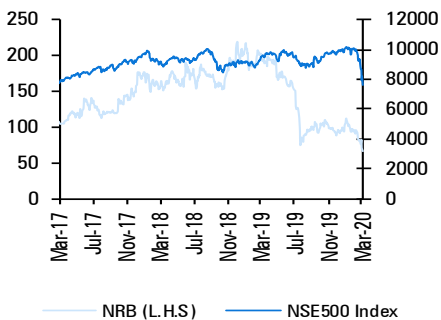
Source: Bloomberg, ICICI Direct Research

Timken India



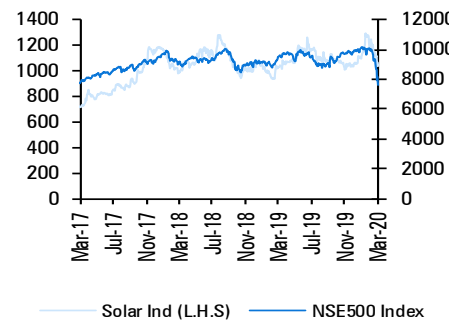
Source: Bloomberg, ICICI Direct Research

NRB Bearings



Source: Bloomberg, ICICI Direct Research

Solar Industries



Source: Bloomberg, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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