

CAPITAL GOODS

Q2FY24 Review

15 November 2023

Order outlook bright

- Q2 revenue for our capital goods coverage grew 17% YoY (+11% ex-LT) on strong execution; EBITDA margin stayed flat (+60bps ex-LT)
- Inflows swelled 55% YoY led by LT (-13% ex-LT); commentaries indicate a strong ordering environment (rail, power, digitalization)
- We remain positive on the sector; prefer LT, KKC and AIAE

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LT leads order inflows: Capital goods players under our coverage displayed impressive project execution in Q2FY24, which underpinned revenue growth of 17% YoY (11% ex-LT). Aggregate order inflow surged 55% YoY, albeit propelled mainly by LT which attracted flows of Rs 892bn (+72% YoY). Excluding LT, order inflow for the rest of our coverage declined 13% YoY.

Margins remain strong: Our coverage universe demonstrated operating leverage on the back of improved project execution. Ex-EPC (engineering, procurement, and construction) players, gross margin expanded by 70bps YoY in Q2. The aggregate EBITDA margin was flat YoY while the ex-EPC margin increased 60bps YoY.

Strong order outlook: Most management commentaries point to a strong ordering environment for capital goods companies. LT has retained its guidance of revenue and order inflow growth of 12-15% YoY and 10-12% YoY respectively for FY24, even hinting at the probability of surpassing the upper end of these bands. LT's addressable pipeline for H2FY24 totals Rs 8.8tn, spurred by demand for hydrocarbons and infrastructure. Similarly, other players such as KECI retained the FY24 guidance given at the beginning of the fiscal. TMX continues to have a mixed outlook on inflows as refining and petrochemical orders are yet to pick up.

Mixed bag for product companies: KKC saw faster adoption of the newer CPCB-IV products than anticipated and hinted at a strong outlook for H2FY24. AIAE expects a drop in revenue for the second half, with ~5% of the expected FY24 volumes likely spilling over to FY25. Hitachi has deferred its margin target as it continues to battle chip shortages and now expects to exit FY25 at double-digit operating margins rather than achieving the same sometime during the fiscal.

Maintain positive sector view: The capital goods sector has strong growth visibility considering the government's capex thrust and carries scope for gradual margin improvement as supply bottlenecks ease. We anticipate structural demand tailwinds in the areas of automation, digitalisation and electrification, and retain our bullish view on LT (BUY, TP Rs 3,500), KKC (BUY, TP Rs 2,200), and AIAE (BUY, TP Rs 4,200).

Recommendation snapshot

Ticker	Price	Target	Rating
ABB IN	4,263	4,700	HOLD
AIAE IN	3,597	4,200	BUY
KECI IN	572	670	HOLD
KKC IN	1,778	2,200	BUY
LT IN	3,049	3,500	BUY
POWERIND IN	4,363	4,200	HOLD
TMX IN	2,901	3,000	HOLD

Price & Target in Rupees | Price as of 13 Nov 2023 | POWERIND = Hitachi

Capital goods: Q2 result reviews

Company	Result review link
ABB IN	Sprinting along
AIAE IN	Volume spillover to FY25
KECI IN	Interest cost mars quarter; strong pipeline for H2
KKC IN	Strong operating performance; maintain BUY
LT IN	Strong run continues; maintain BUY
POWERIND IN	Chip constraints receding
TMX IN	Sound operations, measured commentary

Source: BOBCAPS Research



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BUY – Expected return >+15%

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Note: Recommendation structure changed with effect from 21 June 2021

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