

KEC International

SAE impacts profitability, guidance intact

OUTPERFORMER

3 November 2014

BSE Sensex: 27860

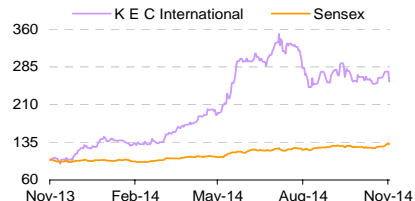
Sector: Power Equipment

Stock data

CMP (Rs)	102
Mkt Cap (Rsbn/USDm)	26.2 / 427
Target Price (Rs)	114
Change in TP (%)	-16
Potential from CMP (%)	+11
Earnings change (%)	
FY15E	-25
FY16E	-15

Bloomberg code	KECI IN
1-yr high/low (Rs)	155/37
6-mth avg. daily volumes (m)	0.58
6-mth avg. daily traded value (Rsm/US\$m)	65.5 / 1.07
Shares outstanding (m)	257.1
Free float (%)	50.0
Promoter holding (%)	50.0

Price performance – relative and absolute



(%)	3-mth	6-mth	1-yr
K E C International	(9.9)	31.9	151.5
BSE Sensex	9.3	24.4	31.2

Q2FY15 result highlights

- ♦ **PAT fell 8% yoy to Rs203mn:** led by lower margins and higher interest costs. Tax write back arrested PBT decline of 72%.
- ♦ **Strong revenue growth at Rs21.7bn (+22%yoy):** led by 22%yoy revenue growth in T&D (excl. SAE) and cable (+72%yoy; pick up in distribution). SAE revenues remained flat yoy due to delay in deliveries (expected to pick up in 3QFY15).
- ♦ **Margins declined 70bps yoy to 5.6%:** due to EBITDA break even at SAE (delay in shipments) and Rs200mn losses from legacy orders (Rs140mn in 2Q14). Margins were also impacted due to adverse revenue mix (higher proportion of cable revenue at 11%). Overall EBITDA increased 8% yoy to Rs1.2bn.
- ♦ **Interest cost at Rs910mn (+40%yoy):** led by loan restructuring (Rs60m), higher inventory cost (Rs60m) at SAE and lower advances (+Rs100mn).
- ♦ **Rs11bn order intake (-37%yoy):** with 74% from transmission. Hence, order backlog fell 9% yoy to Rs93.2bn (89% transmission). L1 orders of Rs25bn

Key positives: Maintained guidance of 200bp margin improvement over FY14-16.

Key negatives: Higher interest cost, Rs240mn loss in SAE.

Impact on financials: 25%/15% downgrade in FY15 /FY16 EPS to Rs4.6/ Rs8.1 largely led by higher interest charges and tax provision.

Valuations & view

With transmission orders forming ~89% of the order book and completion of low-margin legacy orders (Rs900mn backlog), we expect margins to expand by 180bp to 7.8% and thereby drive 57% earnings CAGR over FY14-16E. Given the strong earnings growth and improvement in return ratios as also Rs1.7bn (net of tax proceeds) from Thane land sale in 2HFY15, valuations of 12.6x FY16E earnings are attractive. Maintain Outperformer.

Consolidated financials (quarterly)

(Rs m)	2QFY14	1Q15	2Q15	% ch qoq	% ch yoy	% var from est
Net sales	17,780	17,207	21,727	26.3	22.2	16.4
EBITDA	1,119	1,017	1,208	18.8	8.0	2.7
OPM (%)	6.3	5.9	5.6	-35bp	-73bp	-74bp
Other inc.	25	15	11	(26.8)	(56.7)	(45.5)
Interest	648	660	910	37.9	40.3	31.8
Depreciation	184	210	222	6.0	20.8	3.4
PBT	311	163	87	(46.4)	(72.0)	(70.0)
PAT	221	114	203	78.7	(8.1)	5.7
Reported PAT	221	114	203	78.7	(8.1)	5.7
EPS (Rs)	0.9	0.4	0.8	78.7	(8.1)	5.7

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Consolidated quarterly results: Detailed

(Rs mn)	1QFY14	2QFY14	3QFY14	4QFY14	FY14	1Q15	2Q15	Remarks
Net Sales	17,464	17,780	22,016	21,759	79,018	17,207	21,727	Growth in T&D (Excl SAE; +22%yoy); Cable +72%yoy
Total Expenses	16,584	16,661	20,597	20,245	74,086	16,190	20,519	
EBITDA	881	1,119	1,419	1,514	4,933	1,017	1,208	Nil SAE margins (earlier 13%); Rs200m losses in legacy orders
<i>OPM (%)</i>	<i>5.0</i>	<i>6.3</i>	<i>6.4</i>	<i>7.0</i>	<i>6.2</i>	<i>5.9</i>	<i>5.6</i>	
Other Income	57	25	24	32	138	15	11	
Interest	588	648	724	673	2,633	660	910	Gross debt of Rs26bn; SAE restructuring cost (Rs60mn), higher inventory (Rs60m) & lower client advances (Rs100m)
Depreciation	166	184	179	176	705	210	222	
PBT	183	311	541	697	1,733	163	87	
Tax	117	91	258	383	883	49	(116)	
<i>Tax Rate (%)</i>	<i>63.7</i>	<i>29.1</i>	<i>47.7</i>	<i>55.0</i>	<i>51.0</i>	<i>30.3</i>	<i>(132.3)</i>	Tax credit of Rs120mn
PAT	67	221	282	314	849	114	203	
Extra -ordinary items	(155)	0	(91)	30	(216)	0	0	
Reported PAT	(88)	221	191	344	633	114	203	
% chg yoy								
Sales	28	7	23	1	13	(1)	22	
EBITDA	(15)	30	37	70	29	16	8	
Other Income	106	64	(65)	(35)	(14)	(74)	(57)	
Interest	47	46	37	18	35	12	40	
Depreciation	35	34	23	13	26	26	21	
PBT	(66)	7	26	226	18	(11)	(72)	
PAT	(80)	34	(4)	(327)	30	70	(8)	
Reported PAT	(127)	34	(35)	(347)	(3)	(229)	(8)	
Equity	257.1	257.1	257.1	257.1	257.1	257.1	257.1	
EPS	0.3	0.9	1.1	1.2	3.3	0.4	0.8	
PER (x)	98.3	29.7	23.2	20.9	30.9	57.7	32.3	

Break up of consolidated revenues

	Revenues (Rs m)			% of total	
	2Q15	2QFY14	% yoy	2Q15	2QFY14
Transmission & Distribution (Incl.PS)*	16,920	13,520	25.1	78	76
Transmission SAE	1,840	1,840	0.0	8	10
Railways	290	550	(47.3)	1	3
Water	300	480	(37.5)	1	3
Cables	2,370	1,380	71.7	11	8
Total	21,720	17,770	22.2	100	100

* includes domestic, international, power systems and telecom segment

Trend in order backlog and booking

(Rs m)	1QFY14	2QFY14	3QFY14	4QFY14	FY14	1Q15	2Q15
Order backlog	100,560	102,000	102,500	102,000	102,000	103,250	93,220
Orders booked	21,850	17,580	25,570	19,820	84,820	18,920	11,000
% yoy growth							
Order backlog	6.3	8.7	1.0	7.7	7.7	2.7	(8.6)
Orders booked	8.2	19.6	11.7	16.3	13.3	(13.4)	(37.4)
Book to bill ratio (x)	1.4	1.5	1.3	1.3	1.3	1.2	1.1

Order backlog break up – 89% from transmission segment

Order backlog	Rs mn	% of total
Transmission & Distribution (Incl.PS)	73,644	79
Transmission SAE	9,322	10
Railways	2,797	3
Water	4,661	5
Cables	2,797	3
Total	93,220	100

Key conference call highlights

- **Strong revenue growth:** led by 22%yoy growth in T&D (excl. SAE) as execution cycle of orders has reduced from about 18 months to 15 months. Cable revenue increased by 72%yoy due to pick in volume from distribution space. SAE revenue remained flat yoy due to delay in deliveries of shipments to clients (as also seen in 1QFY15). However management mentioned that deliveries for the same have started since September end and should be reflected in 3QFY15 revenues. Revenue from water segment increased at 109%yoy.
- **Margin lower than estimated at 5.6%**
 - **SAE** reported breakeven at EBITDA level (as against Rs240mn in 2QFY14; 13% OPM) due to delay in deliveries of shipments to clients. However management expects margins (post the delivery of shipments in 3QFY15) to revert to 8-9% level by FY16 led by execution of high margin order of Rs15bn.
 - **Adverse revenue mix:** Margins during the quarter were also impacted due to higher contribution from low margin cables segment at ~11% in 2Q15 vs 8% in 2Q14.
 - **Legacy orders continue to make losses:** while losses from water and railway segment increased at Rs200mn for 2QFY15 (vs Rs140mn in 2QFY14), management expects incremental losses from legacy orders to be at ~Rs200mn. Loss making legacy orders at end of 2QFY15 stand at Rs900mn.
- **Order inflows:** Management expects order inflow to the extent of Rs15bn in 2HFY15 led by strong L1 orders of Rs20bn. Order inflow is expected to strong from SEB's like AP, Rajasthan in domestic market while international market continues to be strong.
- **Working capital:** has increased to 111days vs 92 days in end FY14 largely led by increase in inventories in SAE and lower client advances by Rs2.9bn. Management expects that as order inflow improves (L1 of Rs20bn), client advances are expected to increase thereby reducing the working capital cycle going forward.
- **Update on Thane land sale:** The thane land sale receipts are expected to accrue in November end and will help in reduction of debt from current levels of Rs26bn. Effective tax rate for the proceeds would be 20%.
- **Guidance:** Revenues likely to be at 8-10% range, while margin improvement to continue: FY15:+100bps (7%), FY16:+100bps (8.0%). SAE margins likely to be at 8-9% in FY16.

Income statement (Consolidated)

Year to 31 Mar (Rs m)	FY13	FY14	FY15E	FY16E	FY17E
Net sales	72,578	82,835	85,972	93,688	102,149
% growth	24.8	14.1	3.8	9.0	9.0
Operating expenses	65,981	74,086	80,129	86,356	93,435
EBITDA	6,598	8,749	5,843	7,332	8,714
% change	40.0	32.6	(33.2)	25.5	18.9
Other income	160	138	75	100	100
Net interest	(1,944)	(2,633)	(3,086)	(3,236)	(3,608)
Depreciation	561	705	880	940	1,010
Pre-tax profit	4,253	5,549	1,952	3,255	4,196
Deferred tax	108	(107)	217	267	345
Current tax	710	991	541	902	1,128
Profit after tax	3,435	4,666	1,194	2,085	2,724
Non-recurring items	(1)	(182)	-	-	-
Net profit after non-recurring items	3,434	4,484	1,194	2,085	2,724
% change	64.1	30.6	(73.4)	74.7	30.6

Balance sheet (Consolidated)

As on 31 Mar (Rs m)	FY13	FY14	FY15E	FY16E	FY17E
Paid-up capital	514	514	514	514	514
Reserves & surplus	10,958	11,402	12,225	13,848	15,955
Total shareholders' equity	11,472	11,916	12,739	14,362	16,469
Total current liabilities	33,365	40,194	39,729	43,148	47,041
Total debt	16,690	21,273	24,489	27,594	30,448
Deferred tax liabilities	804	731	948	1,216	1,560
Other non-current liabilities	199	-	-	-	-
Total liabilities	51,058	62,198	65,167	71,958	79,049
Total equity & liabilities	62,530	74,114	77,906	86,320	95,518
Net fixed assets	10,196	9,937	10,131	10,277	10,383
Total current assets	47,993	59,087	62,585	70,553	79,344
Other non-current assets	4,341	5,090	5,190	5,490	5,790
Working capital	14,628	18,893	22,856	27,405	32,304
Total assets	62,530	74,114	77,906	86,320	95,518

Cash flow statement (Consolidated)

Year to 31 Mar (Rs m)	FY13	FY14	FY15E	FY16E	FY17E
Pre-tax profit	4,253	5,549	1,952	3,255	4,196
Depreciation	561	705	880	940	1,010
Chg in Working capital	(5,298)	(5,161)	(4,019)	(3,813)	(4,186)
Total tax paid	(710)	(991)	(541)	(902)	(1,128)
Ext ord. Items & others	(73)	(381)	-	-	-
Operating cash Inflow	(1,268)	(278)	(1,727)	(520)	(107)
Capital expenditure	(1,538)	(445)	(1,075)	(1,087)	(1,117)
Free cash flow (a+b)	(2,806)	(723)	(2,802)	(1,606)	(1,223)
Debt raised/(repaid)	5,550	4,583	3,217	3,105	2,854
Dividend (incl. tax)	(360)	(150)	(180)	(370)	(463)
Misc	(2,857)	(3,826)	-	-	-
Net chg in cash	(473)	(116)	234	1,128	1,167

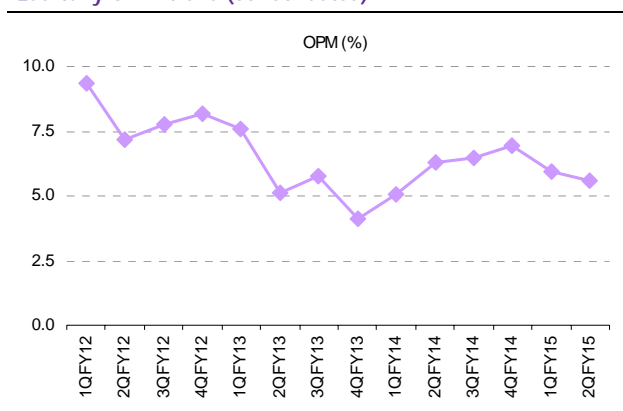
Key ratios (Consolidated)

Year to 31 Mar	FY13	FY14	FY15E	FY16E	FY17E
EBITDA margin (%)	9.1	10.6	6.8	7.8	8.5
EBIT margin (%)	8.3	9.7	5.8	6.8	7.5
PAT margin (%)	4.7	5.6	1.4	2.2	2.7
RoE (%)	30.5	39.9	9.7	15.4	17.7
RoCE (%)	23.1	25.5	13.8	15.7	16.8
Gearing (x)	1.3	1.7	1.8	1.7	1.6

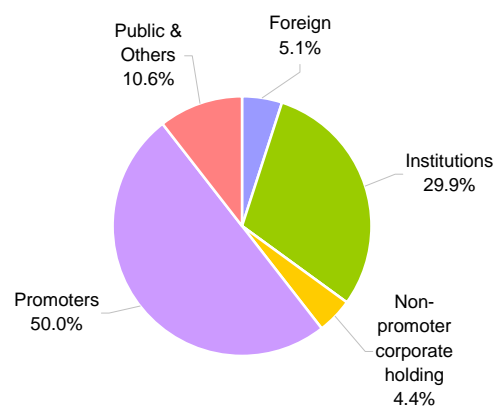
Valuations (Consolidated)

Year to 31 Mar	FY13	FY14	FY15E	FY16E	FY17E
Reported EPS (Rs)	13.4	17.4	4.6	8.1	10.6
Adj. EPS (Rs)	13.4	18.1	4.6	8.1	10.6
PE (x)	7.6	5.6	21.9	12.5	9.6
Price/ Book (x)	2.3	2.2	2.1	1.8	1.6
EV/ Net sales (x)	0.6	0.6	0.6	0.5	0.5
EV/ EBITDA (x)	6.3	5.3	8.4	6.9	6.0
EV/ CE (x)	1.4	1.4	1.3	1.2	1.1

Quarterly OPM trend (consolidated)



Shareholding pattern



As of September 2014

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| 2. Neutral | : | Within 0-5% (upside or downside) to Index |
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