

Institutional Equity Research

KEC International

Capital Goods | India

Company Update | April 27, 2020

CMP* (Rs)	178
Upside/ (Downside) (%)	84
Bloomberg Ticker	KECI IN
Market Cap. (Rs bn)	46
Free Float (%)	48
Shares O/S (mn)	257

BUY 

2 Year Target Price: Rs.328

Covid-19 Led Disruptions & The Road Ahead

- ▶ KEC international (KECI) has corrected ~50% in last 2 months owing to COVID-led disruptions, which we believe offers a fresh buying opportunity, as the Company has already received approvals from the respective authorities to start operations at a few of its sites albeit in a phased manner.
- ▶ KECI has also sought permission of the relevant authorities for resuming operations at its remaining factories. Its facilities in Brazil and Mexico, which have been identified as essential sector in the respective geographies, have been operational throughout this period.
- ▶ Major chunk of KECI's international T&D project sites are operational, while domestically it has commenced operations at some of its T&D/Railways/Civil sites after receiving the requisite approvals.
- ▶ Current order book stood at Rs210bn, while order inflow for FY20 is seen at Rs110bn (Down 22% YoY). Domestic orders contribute 62% to the order book, while international projects account for ~38%.
- ▶ The Management expects the contribution of non-T&D revenue to increase to 40% in FY21E from 35% in FY20. KECI's business largely depends on large institutions and project funding through multilateral agencies would be relatively less impacted by COVID-led disruptions.

Outlook & Valuation

- ▶ The Management has guided that the revenue is expected to decline marginally (Rs3bn) in 4QFY20. Historically, the last quarter of the fiscal contributes meaningfully in so far as collections and orders inflow are concerned.
- ▶ **We downwardly revise our revenue and earnings estimates by 3%/18%/19% and 5%/31%/27% for FY20E/FY21E/FY22E to factor the near-term impact of COVID-led disruptions and a phased pick-up in execution by 2HFY21E.**
- ▶ **Rolling over our estimate to FY23E, we maintain our BUY recommendation on the stock with a 2-year Target Price of Rs328 (from Rs450 earlier), valuing at 12x FY23E earnings (from 15x FY22E earlier).**

Key Financials (Rs mn)	FY20E	FY21E	FY22E	FY23E
Sales	1,22,027	1,20,337	1,38,015	1,58,382
EBITDA	12,584	11,312	13,249	15,632
EBITDA Margin (%)	10.3	9.4	9.6	9.9
Net profit	5,848	4,759	5,644	7,027
EPS Rs)	22.7	18.5	22.0	27.3
P/E (x)	7.8	9.6	8.1	6.5
P/B (x)	1.6	1.4	1.2	1.0
EV/EBITDA (x)	5.1	5.8	5.1	4.4
ROE (%)	19.9	14.3	14.9	16.0

Source: Company, RSec Research

Share price (%)	1 mth	3 mth	12 mth
Absolute performance	(0.5)	(44.9)	(37.6)
Relative to Nifty	(18.5)	(19.0)	(15.1)

Shareholding Pattern (%)	Sep-19	Dec-19
Promoter	51.6	51.6
Public	48.4	48.4

1 Year Stock Price Performance



Note: * CMP as on April 24, 2020

Change of Estimates (% change)	FY20E	FY21E	FY22E
Revenues	(3.2)	(17.6)	(15.7)
EBITDA	(3.1)	(23.3)	(19.0)
Net profit	(5.0)	(30.8)	(27.1)
EPS	(5.0)	(30.8)	(27.1)

Research Analyst:

Arafat Saiyed

Contact : (022) 4303 4632 / 98195 03007

Email : arafat.saiyed@relianceada.com

Research Associate:

CA Akshay Chaturvedi

Contact : (022) 4303 4626 / 97696 37564

Email : akshay.chaturvedi@relianceada.com

Our Thesis

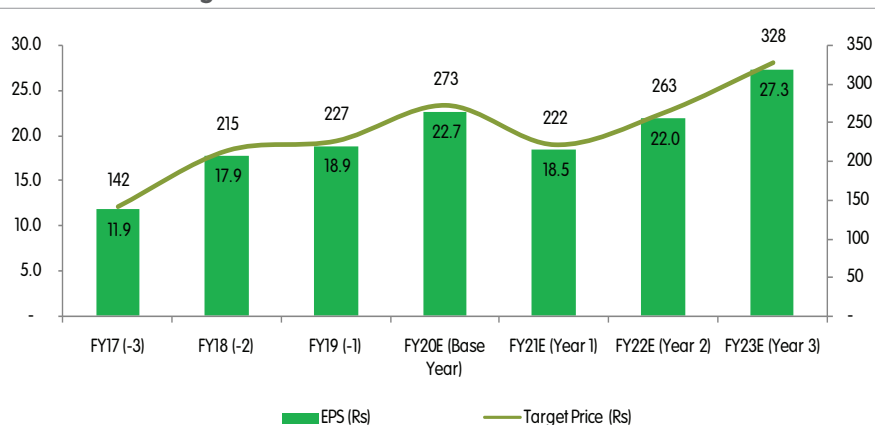
KEC Int (Rs122bn - FY20)

Key Segments	Power T&D	Power T&D (SAE)	Cable	Railway	Civil/Water	Solar
Revenue (Rs mn: FY20)	69,313	14,290	11,275	23,990	3,752	874
Revenue Mix	56%	12%	9%	19%	3%	1%
CAGR (15-19)	-1%	5%	7%	95%	39%	46%
CAGR (20-23E)	11%	11%	-20%	8%	13%	35%

Key Sectoral Theme	Domestic Power T&D: In the 11th and 12th Five Year Plans (2007-2017), investment growth in power T&D was significantly lower compared to generation capacity. The 13th Five Year Plan (2017-2022) brought down the difference in the growth rate of these two. Going forward, we expect more government focus on Power T&D as lower investment in transmission earlier, has resulted in severe grid congestion. Global Power T&D: The global transmission to witness investments of \$1000bn over the next 10 years. Majority of these will be on the creation of new grid infrastructure to connect renewable energy projects.	Railway: Railway Capex has grown considerably over the past few years, from Rs. 940bn in FY16 to Rs. 1580 bn in FY20. Railway Capex for FY21 is estimated at Rs.1610 bn. It is expected to grow at a CAGR of ~11% over the next few years.
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Key Investment Themes	KECI has corrected ~50% in last 2 months owing to COVID-led disruptions, which we believe offers a fresh buying opportunity, as the Company has already received approvals from the respective authorities to start operations at a few of its sites albeit in a phased manner. KECI has also sought permission of the relevant authorities for resuming operations at its remaining factories. Its facilities in Brazil and Mexico, which have been identified as essential sector in the respective geographies, have been operational throughout this period. Major chunk of KECI's international T&D project sites are operational, while domestically it has commenced operations at some of its T&D/Railways/Civil sites after receiving the requisite approvals. Current order book stood at Rs210bn, while order inflow for FY20 is seen at Rs110bn (Down 22% YoY). Domestic orders contribute 62% to the order book, while international projects account for ~38%. The Management expects the contribution of non-T&D revenue to increase to 40% in FY21E from 35% in FY20. KECI's business largely depends on large institutions and project funding through multilateral agencies would be relatively less impacted by COVID-led disruptions. Rolling over our estimate to FY23E, we maintain our BUY recommendation on the stock with a 2-year Target Price of Rs328 (from Rs450 earlier), valuing at 12x FY23E earnings (from 15x FY22E earlier).
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Exhibit 1: EPS & Target Price



Source: Company, RSec Research

Exhibit 2: Price Sensitivity Analysis

	EPS (Rs)	Growth (%)	FWD P/E	10.0	12.0	14.0	16.0	18.0
FY17 (-3)	11.9		15.0	119	142	166	190	213
FY18 (-2)	17.9	50.8	10.0	179	215	250	286	322
FY19 (-1)	18.9	5.8	9.4	189	227	265	303	341
FY20E (Base Year)	22.7	20.2	7.8	227	273	318	364	409
FY21E (Year 1)	18.5	-18.6	9.6	185	222	259	296	333
FY22E (Year 2)	22.0	18.6	8.1	220	263	307	351	395
FY23E (Year 3)	27.3	24.5	6.5	273	328	383	437	492

Source: RSec Research

Key Company Updates

Management Call Highlights

- ▶ KECI's revenue is expected to decline marginally (Rs3bn) in 4QFY20, due to PGCIL's Chinese supply disruptions. The Company has no exposure to Europe, China and Iran. All manufacturing facilities are based in India, Brazil and Mexico.
- ▶ The Management has guided for 15% revenue growth in FY21. The competitive intensity is likely to decrease, as only few players are bidding for large projects
- ▶ Current order book stood at Rs210bn, while order inflow for FY20 is seen at Rs110bn (Down 22% YoY). Domestic orders contributes 62% to the order book, while international projects account for ~38% to KECI's order book (MENA: ~5%, Africa: ~5%, SAARC: ~15%, Far East: ~5% and the Americas: ~5%).
- ▶ Domestic order book stands at Rs130bn including T&D orders worth Rs40bn.
- ▶ Conversion of L1 worth Rs30bn to move in 1QFY21 from Q4FY20 due to COVID-led disruptions.
- ▶ Ordering activity for phase-II of TBCB green energy corridor worth Rs140bn has started by PGCIL and projects worth Rs200bn are also in the pipeline.
- ▶ KECI expects metro orders from Mumbai, Ahmedabad, Patna and Bangalore.
- ▶ The Management expects the contribution of non-T&D revenue to increase to 40% in FY21E from 35% in FY20.
- ▶ KECI's business largely depends on large institutions and project funding through multilateral agencies would be relatively less impacted by COVID-led disruptions.
- ▶ Receivable from Saudi Arabia is normalised with no pending receivable.

Order Inflows Decline in FY20

Order inflow declined by 22% YoY to Rs110bn in FY20, as KECI was expected to secure major chunk of orders in the second fortnight of Mar'20, which got delayed due to the nationwide lockdown. KECI's business largely depends on large institutions like Power Grid Corporation (PGCIL), State Electricity Boards (SEBs), Indian Railways, Metro Rail (domestic orders), and global transmission utilities (international orders). Notably, project funding through multilateral agencies would be relatively less impacted by COVID-led disruptions. Despite some delay in ordering activities in the near-term owing to the current turmoil, we believe KECI remains strong on the back of a healthy order book of Rs220bn (1.8x FY20E revenue), and (L1) worth ~Rs25bn.

Meaningful Decrease in International Exposure

Revenue from international operations had already declined to 30% in 9MFY20 from >50% in FY18. Similarly, the contribution of international business to overall order book and inflow had declined to 35% and 17% in 9MFY20. We expect the travel ban to remain an overhang for the next quarter even after the nationwide lockdown is lifted.

Marginal Impact on Revenue in 4QFY20

The Management has guided that the revenue is expected to decline marginally (Rs3bn) in 4QFY20 led by PGCIL's Chinese supply disruptions. Its domestic order book stood at Rs120bn (execution halted), while international order book stood at Rs80bn. Notably, the Company has no exposure to Europe, China and Iran.

Working Capital – Continues to Remain a Key Concern

We expect KECI's working capital to remain a key concern for the next few years led by the support the Company extended to its vendors, which is likely to offset control on its receivables. We expect KECI's Net Working Capital (NWC) to increase to 35% of sales in FY21E and FY22E compared to 25% in FY19.

Sector Remains Steady

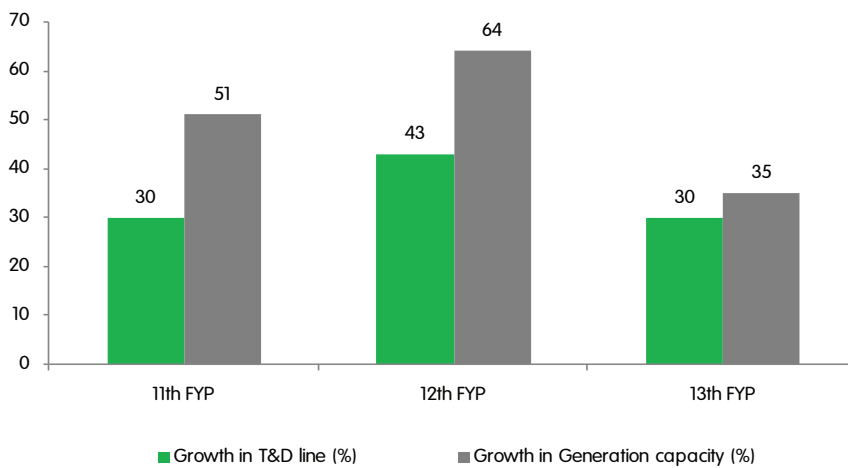
The Power Transmission & Distribution (T&D) and Railways sectors are the two major contributors to KECI's revenue as well as its order book.

Despite the Covid led disruption, these sectors are bound to provide decent growth opportunities as soon as the situation normalizes, as they are backed by strong government commitments.

Higher Capex in Power T&D

The Government is likely invest Rs2,600bn in transmission sector during 13th FYP (2017-2022) out of which ~Rs1,300bn has been allocated for intra-state transmission capacity. Over the past few Five Year Plans (FYPs), Indian power sector has witnessed significant growth in demand, generation capacity addition and T&D networks. While T&D network grew at a

Exhibit 3: Growth in T&D and generation capacity



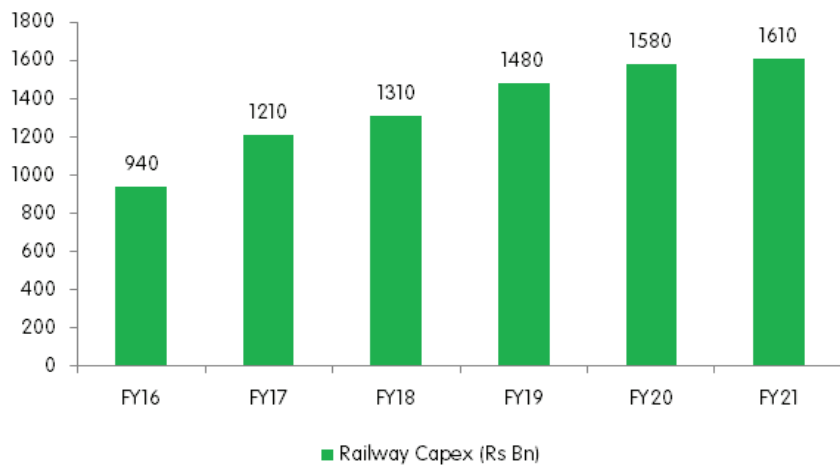
Source: Company, RSec Research

India's energy consumption, which has doubled since in last 2 decades, is likely to witness rapid growth in the coming years. Indian has the 5th largest installed capacity globally, which stands at 368GW currently. The Government of India continued its thrust and embarked on numerous initiatives to achieve the objective of 'Power for All' with special emphasis on rural electrification. The Power Schemes like Deen Dayal Upadhyaya Gram Jyoti Yojana (DDUGJY), Pradhan Mantri Sahaj Bijli Har Ghar Yojana (SAUBHAGYA) and Integrated Power Development Scheme (IPDS) with planned outlay of Rs1,200bn to make power available at all households.

Record Railway Capex Earmarked for FY21

KECI has delivered strong growth in railway segment in past few years. Revenue of Railway contributes ~20% in FY20 from 5% in FY17. With the continued focus on capacity addition through accelerated investments and execution, the government is likely to invest Rs1,610bn in FY21 compared to Rs1,563bn in FY20RE. The capex for Indian Railways has been growing at healthy rate. Expansion, up-gradation and modernisation of the existing infrastructure are underway.

In FY21, the Government plans to add new lines, gauge conversion and doubling/trebling of 3,750 route kms against 3,150 route kms in FY20. Notably, the Government plans to electrify the entire broad gauge network by FY24. It plans to electrify 6,000 route kms in FY21. The Government plans to induct latest technology for signalling and telecommunication system.

Exhibit 4: Railway Capex

Source: Company, RSec Research

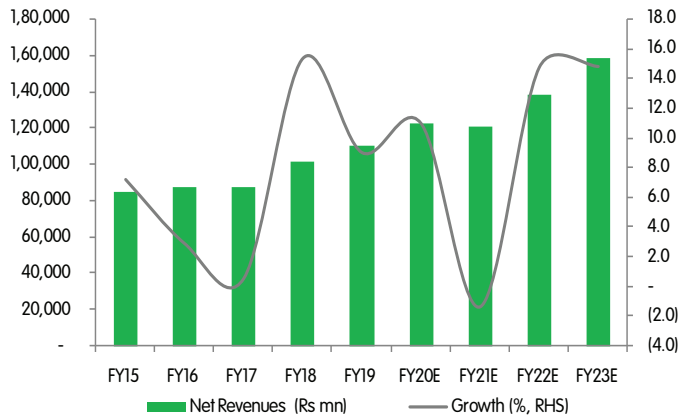
As is evident from Exhibit 2, the Indian Railways Capex has grown at a CAGR of ~11% during FY16-21E. We expect this trend to continue in the next few years as well.

Risks to the View

- ▶ Rising competitive intensity in each business segment.
- ▶ Any major slowdown in T&D spending in its key markets i.e. India, Middle East & Brazil.

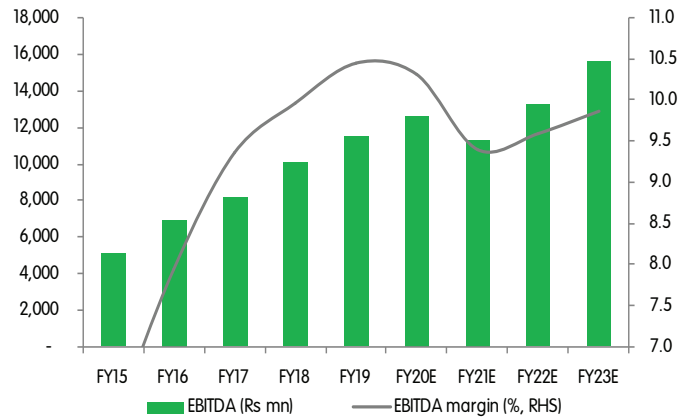
Story in Charts

Exhibit 5: Revenue Trend



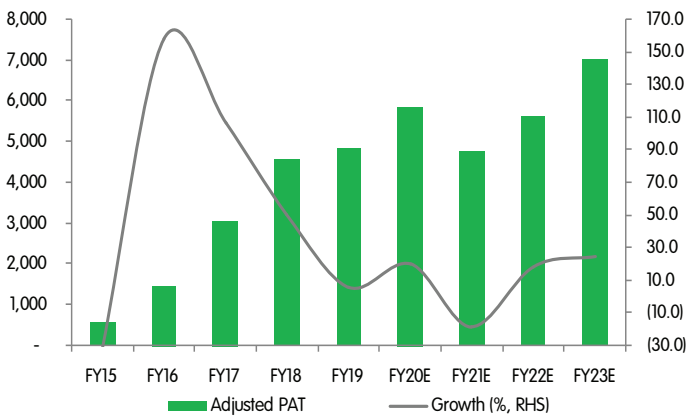
Source: Company, RSec Research

Exhibit 6: EBITDA and Margin



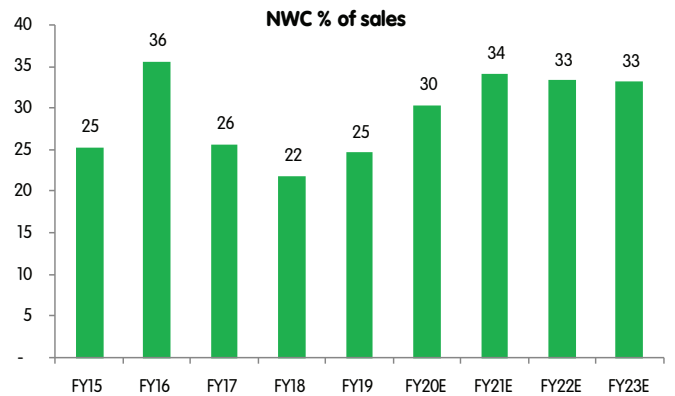
Source: Company, RSec Research

Exhibit 7: PAT trend



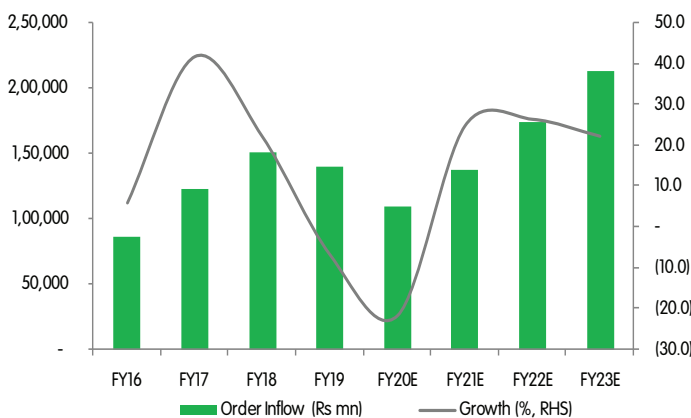
Source: Company, RSec Research

Exhibit 8: Net working Capital to sales



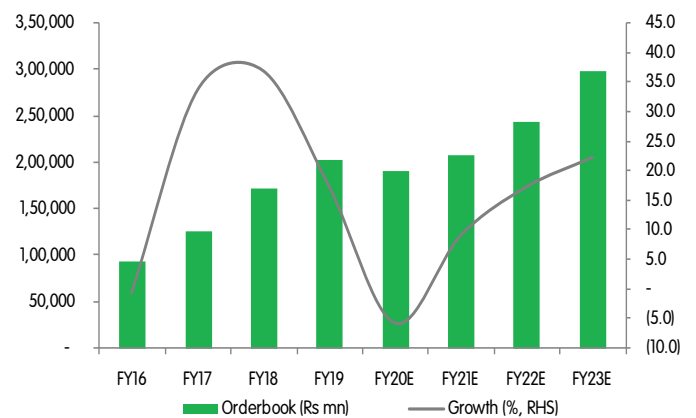
Source: Company, RSec Research

Exhibit 9: Order Inflow trend



Source: Company, RSec Research

Exhibit 10: Order Book trend



Source: Company, RSec Research

Financial Information

Profit & Loss Statement

Y/E Mar (Rs mn)	FY20E	FY21E	FY22E	FY23E
Net Sales	1,22,027	1,20,337	1,38,015	1,58,382
Growth (%)	10.9	(1.4)	14.7	14.8
Total Expenditure	1,09,444	1,09,025	1,24,766	1,42,750
Cost of Materials	85,995	85,439	97,853	1,11,818
Employee costs	11,690	11,432	13,525	15,838
Others	11,758	12,154	13,387	15,094
EBITDA	12,584	11,312	13,249	15,632
Growth (%)	9.4	(10.1)	17.1	18.0
EBITDA Margin (%)	10.3	9.4	9.6	9.9
Depreciation	1,360	1,655	1,837	2,021
EBIT	11,223	9,657	11,412	13,611
Growth (%)	8.7	(14.0)	18.2	19.3
EBIT Margin (%)	9.2	8.0	8.3	8.6
Interest	3,336	3,490	4,002	4,356
Other Income	153	196	136	139
PBT	8,040	6,363	7,545	9,394
Growth (%)	8.1	(20.9)	18.6	24.5
Tax	2,193	1,603	1,901	2,367
Tax rate (%)	27.3	25.2	25.2	25.2
Reported PAT	5,848	4,759	5,644	7,027
Adjusted PAT	5,848	4,759	5,644	7,027
Growth (%)	20.2	(18.6)	18.6	24.5
Net Margin (%)	4.8	4.0	4.1	4.4
Fully Diluted EPS (Rs)	22.7	18.5	22.0	27.3

Balance Sheet

Y/E Mar (Rs mn)	FY20E	FY21E	FY22E	FY23E
Share capital	514	514	514	514
Reserves	28,913	32,773	37,388	43,387
Net worth	29,427	33,287	37,902	43,901
Total borrowings	23,177	24,336	25,553	26,831
Deferred tax	942	848	763	687
Total liabilities	53,547	58,471	64,219	71,419
Gross block	21,056	23,643	26,249	28,875
Less: Acc. depreciation	6,968	8,623	10,461	12,482
Net block	14,087	15,020	15,788	16,393
CWIP	88	105	126	152
Goodwill	2,037	2,037	2,037	2,037
Investments	147	147	147	147
Current assets	1,16,757	1,17,980	1,34,224	1,53,794
Inventories	7,355	7,253	7,941	9,112
Debtors	55,163	56,047	64,281	73,767
Cash	4,091	4,896	3,393	3,657
Loans and advances	50,148	49,783	58,609	67,258
Current liabilities	78,566	75,829	86,968	99,802
Provisions	1,003	989	1,134	1,302
Net current assets	37,189	41,162	46,121	52,690
Total Assets	53,547	58,471	64,219	71,419

Cash Flow Statement

Y/E Mar (Rs mn)	FY20E	FY21E	FY22E	FY23E
Cash flow from operating activity				
PBT	8,040	6,363	7,545	9,394
Add: Depreciation	1,360	1,655	1,837	2,021
Add: Interest	3,336	3,490	4,002	4,356
Less: taxes paid	(2,193)	(1,603)	(1,901)	(2,367)
Add: other adjustments	(105)	(94)	(85)	(76)
Less: working capital changes	(8,610)	(3,168)	(6,462)	(6,305)
Total operating cash flows	1,830	6,642	4,937	7,022
Operating CF w/o WC changes	10,440	9,810	11,399	13,328
Cash flow from investing activity				
Capital expenditure	(2,588)	(2,605)	(2,626)	(2,652)
Change in investments	(15)	-	-	-
Total investing cash flow	(2,602)	(2,605)	(2,626)	(2,652)
Cash flow from financing activity				
Share issuances	-	-	-	-
Change in borrowings	6,209	1,159	1,217	1,278
Dividend	(771)	(900)	(1,028)	(1,028)
Interest payment	(3,336)	(3,490)	(4,002)	(4,356)
Total financing cash flow	2,102	(3,231)	(3,814)	(4,106)
Net change in cash	1,329	806	(1,504)	264
Opening cash & CE	2,761	4,091	4,896	3,393
Closing cash & CE	4,091	4,896	3,393	3,657

Key Ratios

Y/E Mar (Rs mn)	FY20E	FY21E	FY22E	FY23E
Valuation Ratio (x)				
P/E	7.8	9.6	8.1	6.5
P/CEPS	6.3	7.1	6.1	5.1
P/BV	1.6	1.4	1.2	1.0
Dividend yield (%)	1.7	2.0	2.2	2.2
EV/Sales	0.5	0.5	0.5	0.4
EV/EBITDA	5.1	5.8	5.1	4.4
Per Share Data (Rs)				
EPS	22.7	18.5	22.0	27.3
Cash EPS	28.0	25.0	29.1	35.2
DPS	3.0	3.5	4.0	4.0
Book Value	114.5	129.5	147.4	170.8
Returns (%)				
RoCE	21.0	16.5	17.8	19.1
RoE	19.9	14.3	14.9	16.0

Change in Ratings

We have now only **BUY** and **SELL** Recommendation and have discontinued HOLD Recommendation.

We now have **2 Year Target Price** and have discontinued with 1 year Target Price.

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