

23 September 2020

## KEC International

*Regional diversification, strong bids augur well; retaining a Buy*

Given its ~Rs250bn well-diversified (region-, segment-wise) OB, strong bid pipeline with ability to bag orders despite tough times, proven execution track record and healthy balance sheet, we are positive on KEC and maintain our Buy rating. Its domestic T&D could see minor hiccup in ordering, likely to be balanced by strong traction overseas. We expect it to surprise in full-year execution due to its strong Q1 and ramp-up in inflow compared to peers. We roll forward our estimates to FY23 and forecast 12%/17.3% growth in revenue/PAT. We retain our Buy, with a higher TP of Rs398, at 13x FY23e (earlier Rs364).

**Focus on geographic diversification.** KEC has been in the forefront of expanding internationally, thereby mitigating geographic-concentration risks. It recently acquired a 50,000tpa plant in Dubai. KEC has increased operations in over 100 countries. Exports contributed 44% to revenue in FY20, up from 36% in FY19. Amid the pandemic, it moderated execution risk in domestic market by focusing on international execution. Also, international T&D ordering opportunities are healthier than in the domestic market.

**Strong bid/tender pipeline.** The strong OB (Rs197bn + L1 of Rs50bn), offers robust revenue assurance. KEC recently bid for orders of Rs250bn-300bn; in coming months it will bid for orders of Rs300bn, domestic and international. The international T&D pipeline (Mid-East, Far East, Africa, Bangladesh) is healthy. In its home market, opportunities in Railways, civil and smart infra are strong.

**Outlook.** Strong order pipeline, lower debt, softening interest costs and a stable working-capital cycle give us the required assurance of strong future execution and earnings. We roll over our estimates to FY23 and expect 12%/17% revenue/PAT growth y/y. We value KEC at 13x FY23e EPS, with a higher target of Rs398 (earlier Rs364). **Risks:** Slowdown in orders and pace of execution.

Key financials (YE Mar)	FY19	FY20	FY21e	FY22e	FY23e
Sales (Rs m)	1,10,005	1,19,654	115,580	133,610	149,703
Net profit (Rs m)	4,864	5,655	5,290	6,706	7,868
EPS (Rs)	18.9	22.0	20.6	26.1	30.6
PE (x)	15.8	14.8	15.8	12.5	10.6
EV / EBITDA (x)	7.9	8.3	8.7	7.4	6.5
PBV (x)	3.2	3.0	2.6	2.3	1.9
RoE (%)	21.9	21.6	17.6	19.4	19.6
RoCE (%)	26.1	23.5	19.4	21.5	22.1
Dividend yield (%)	0.9	1.2	1.5	1.9	2.3
Net debt / equity (x)	0.6	0.7	0.5	0.4	0.4

Source: Company, Anand Rathi Research

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Rating: **Buy**

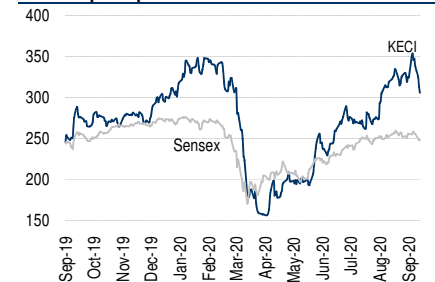
Target Price: Rs398

Share Price: Rs306

Key data	KECI IN / KECL.NS
52-week high / low	Rs360 / 154
Sensex / Nifty	37668 / 11132
3-m average volume	\$2m
Market cap	Rs79bn / \$1069.3m
Shares outstanding	257m

Shareholding pattern (%)	Jun'20	Mar'20	Dec'19
Promoters	51.7	51.7	51.6
- of which, Pledged	-	-	-
Free float	48.3	48.3	48.4
- Foreign institutions	13.7	13.2	7.6
- Domestic institutions	22.8	22.9	27.8
- Public	11.8	12.2	13.0

### Relative price performance



Source: Bloomberg

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## Quick Glance – Financials and Valuations (consolidated)

**Fig 1 – Income statement (Rs m)**

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
T&D order book	2,03,070	2,02,980	212,847	237,039	276,575
Net revenues	1,10,005	1,19,654	115,580	133,610	149,703
Growth (%)	9.4	8.8	-3.4	15.6	12.0
Material cost	81,230	84,182	82,403	93,795	105,092
Employee & other expense	17,276	23,128	21,675	26,228	29,282
<b>EBITDA</b>	<b>11,499</b>	<b>12,344</b>	<b>11,502</b>	<b>13,588</b>	<b>15,330</b>
EBITDA margins (%)	10.5	10.3	10.0	10.2	10.2
- Depreciation	1,171	1,472	1,553	1,739	1,941
Other income	226	111	117	131	146
Interest expenses	3,119	3,080	2,719	2,665	2,606
PBT	7,435	7,903	7,347	9,314	10,928
Effective tax rate (%)	34.6	28.4	28.0	28.0	28.0
+ Associates / (Minorities)	-	-	-	-	-
Net Income	4,864	5,655	5,290	6,706	7,868
Adjusted income	4,864	5,655	5,290	6,706	7,868
WANS	257	257	257	257	257
FDEPS (Rs / sh)	18.9	22.0	20.6	26.1	30.6
EPS growth (%)	6.1	16.3	-6.5	26.8	17.3

**Fig 3 – Cash-flow statement (Rs m)**

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
PBT	7,435	7,903	7,347	9,314	10,928
+ Non-cash items	4,064	4,441	4,156	4,273	4,401
Oper. prof. before WC	11,499	12,344	11,502	13,588	15,330
- Incr. / (decr.) in WC	6,555	6,054	1,742	3,572	4,114
Others incl. taxes	2,346	2,994	2,057	2,608	3,060
Operating cash-flow	2,653	3,107	7,693	7,397	8,146
- Capex (tang. + intang.)	1,048	3,744	1,020	2,320	2,520
Free cash-flow	1,604	-637	6,673	5,077	5,626
Acquisitions	-	-	-	-	-
- Div.(incl. buyback & taxes)	843	1,222	1,269	1,610	1,888
+ Equity raised	-	-	-	-	-
+ Debt raised	574	3,650	-1,291	-200	-200
- Fin investments	261	-93	-23	-25	-27
- Misc. (CFI + CFF)	626	3,516	3,148	3,084	3,015
Net cash-flow	449	-1,632	987	209	550

Source: Company, Anand Rathi Research

**Fig 5 – Price movement**


Source: Bloomberg

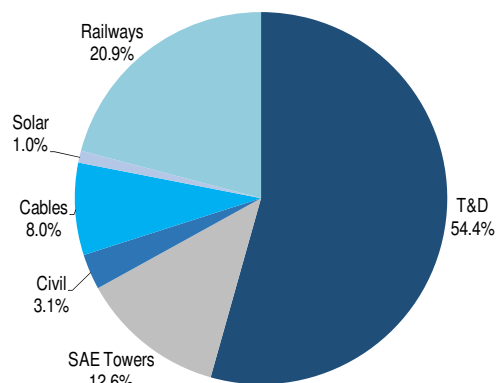
**Fig 2 – Balance sheet (Rs m)**

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
Share capital	514	514	514	514	514
Net worth	24,351	27,976	31,996	37,093	43,073
Debt	16,968	20,618	19,327	19,127	18,927
Minority interest	-	-	-	-	-
DTL / (Assets)	1,497	751	751	751	751
<b>Capital employed</b>	<b>42,816</b>	<b>49,344</b>	<b>52,073</b>	<b>56,970</b>	<b>62,750</b>
Net tangible assets	8,666	8,942	8,389	8,950	9,509
Net intangible assets	1,121	2,350	2,360	2,370	2,380
Goodwill	2,037	2,226	2,226	2,226	2,226
CWIP (tang. & intang.)	73	840	850	860	870
Other Non-current assets	3,537	4,201	4,711	5,221	5,731
Investments (financial)	132	225	248	272	299
Current assets (ex-cash)	98,617	1,08,856	107,050	123,018	138,655
Cash	2,762	1,130	2,117	2,326	2,876
Current liabilities	74,129	79,425	75,877	88,272	99,796
Working capital	24,488	29,431	31,174	34,746	38,860
<b>Capital deployed</b>	<b>42,816</b>	<b>49,344</b>	<b>52,073</b>	<b>56,970</b>	<b>62,750</b>
Contingent liabilities	11,814	-	-	-	-

**Fig 4 – Ratio analysis**

Year-end: Mar	FY19	FY20	FY21e	FY22e	FY23e
P/E (x)	15.8	14.8	15.8	12.5	10.6
EV / EBITDA (x)	7.9	8.3	8.7	7.4	6.5
EV / Sales (x)	0.8	0.9	0.9	0.7	0.7
P/B (x)	3.2	3.0	2.6	2.3	1.9
RoE (%)	21.9	21.6	17.6	19.4	19.6
RoCE (%) - after tax	26.1	23.5	19.4	21.5	22.1
RoIC (%) - after tax	19.4	18.5	15.1	16.9	17.4
DPS (₹ / sh)	2.7	4.0	4.9	6.3	7.3
Dividend yield (%)	0.9	1.2	1.5	1.9	2.3
Dividend payout (%) – incl. DDT	17.3	21.6	24.0	24.0	24.0
Net debt / equity (x)	0.6	0.7	0.5	0.4	0.4
Receivables (days)	272	277	281	281	284
Inventory (days)	21	24	26	25	24
Payables (days)	178	170	165	168	171
CFO : PAT%	54.5	54.9	145.4	110.3	103.5

Source: Company, Anand Rathi Research

**Fig 6 – Revenue break-up (FY20)**


Source: Company, Anand Rathi Research

### Execution returning to normal

Management said current labour available is 90% (the 27,000 labour force that had gone down to 15,000 earlier). Operational sites are ~220 (95%) with no major execution challenges. Activity at some sites is not yet normal due to local lockdown-related issues. Barring this, execution was healthy at various international sites. Domestic execution was healthy in railway, civil and smart infra orders, while execution in other segments is ramping up. KEC also surprised with better-than-expected execution in Q1 FY21, which we believe would continue with increasing labour and a ramp-up in execution across the sites.

### Robust T&D opportunities internationally

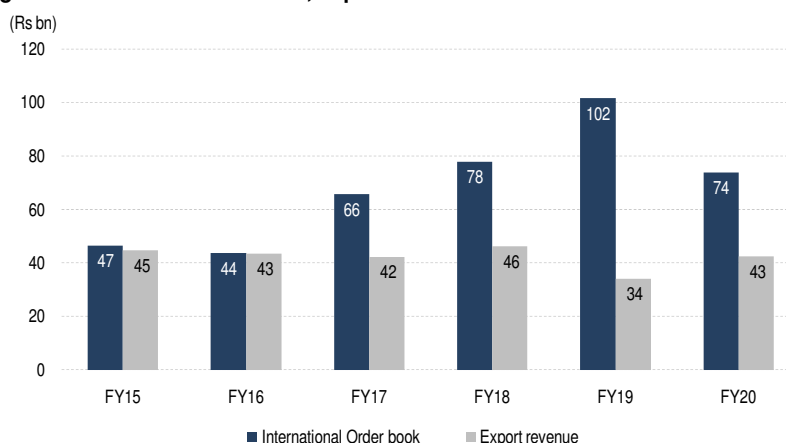
The T&D business, domestic and international, accounted for 67% of FY20 revenue and 55% of the order book (in Jun'20). While some delay could arise in awarding in the domestic market (on the re-bidding of many contracts), international regions show strong traction. The international pipeline (Mid-East, Far East, Africa, Bangladesh, Nepal) is healthy. The current L1 status (Rs50bn) largely is on international T&D orders from the Middle East (Saudi Arabia, Dubai, Abu Dhabi, Oman), North Africa (Morocco), West Africa and Bangladesh (financed by the government of India) and Thailand and Malaysia. Of the order inflows announced in the Q1 FY21 results, international orders made up 35%, largely T&D.

**Fig 7 – Region-wise investment in T&D network**

Region (\$ bn)	2020-24	2025-29	Total
North America	90-100	90-100	180-200
Latin America	38	23	61
Asia Pacific	375	354	729
Europe	125	106	232
Middle East	18	18	37
Africa	46	33	79
<b>Total</b>	<b>692-702</b>	<b>625-635</b>	<b>1,317-1,337</b>

Source : Industry, Anand Rathi Research

**Fig 8 – International order book, export revenue over FY15-20**

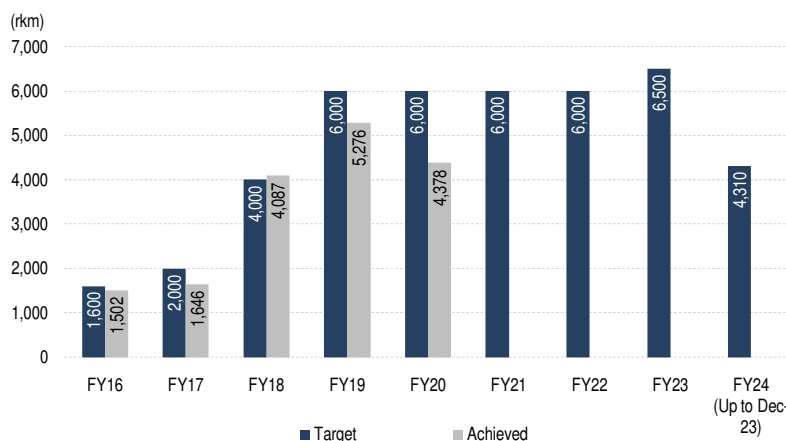


Source : Company, Anand Rathi Research

### Railway electrification continues to drive growth

KEC is one of the leaders in railway electrification, which segment has been one of its biggest growth drivers. Over FY16-20, its railway business clocked an 87% CAGR in revenue. We expect the momentum to continue supported by the government’s focus on 100% railway electrification by Dec’23, up-grading existing lines (for speed) and rolling out semi-high-speed tracks to connect cities within a state. Besides this, management is positive on expected ordering in the new technological areas of metro-rail. In Q1 FY21, the Railways had postponed awarding of orders (expected in Q1) to Q2 and Q3 FY21. The tender pipeline is a sturdy Rs100bn.

**Fig 9 – 100% railway electrification by Dec’23**

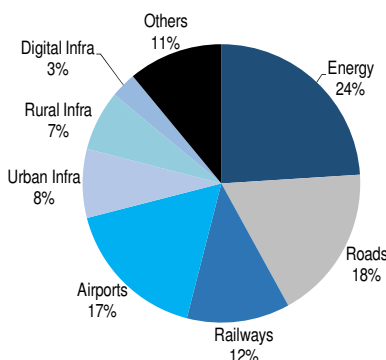


Source : Company, Anand Rathi Research

### Civil business to be a key growth driver in the coming period

The company’s civil business has been showing significant signs of a scale-up in order inflows and execution. Its strategy to target the mid-size market has been delivering results. Besides commercial buildings, airports and water, it has made inroads in industrial-building and high-rise residential projects. The NIP task force is projecting Rs111trn infrastructure investment over FY20-25, with 40% projects under implementation. This throws up huge opportunities in civil infrastructure in the long run. The company recently won data-centre orders from the Defence sector, marking a foray into this fast-emerging space, expected to triple to 1,078MW by 2025, from 375MW now. With its current order book of Rs27.6bn (14% of the order book), we expect the segment to register an 88% revenue CAGR over FY20-23.

**Fig 10 – Allocation of Rs111trn over FY20-25, by sector**



Source : Company, Anand Rathi Research

### Strong bids could lead to robust order inflows

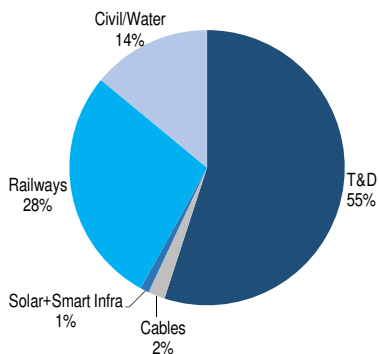
The company recently bid for orders of ₹250bn-300bn. The pipeline is strong with management expecting to bid for orders of a further ₹300bn in the next two months, domestically and internationally. International T&D ordering is healthy. In the short term, however, domestic T&D tendering would be slow. A few recently finalised domestic T&D orders will be re-floated on account of the greater government focus on sourcing materials locally. These orders would be finalised in the next couple of quarters. Railway tenders, postponed in Q1, have already been floated and will be closed by Q2 or Q3 FY21. Healthy opportunities can be seen in the Railways segment, with strong traction from metro-rail projects. With digital adaptation picking up pace, the private sector has started ordering in civil and TBCB. Internationally, ordering would be strong from regions such as Africa, MENA and the Far East. Expected order inflows opportunity size-wise in FY21, is Railways, international T&D, civil infrastructure from SAARC, India and SAE.

**Fig 11 – Order inflows, CY20 now**

Month	Segment	Order	Value (Rs m)
Jan-20	T&D business & SAE Towers	T&D projects in Africa, the Middle East and the Americas	5,100
	Railways	Overhead electrification (OHE) works and associated civil works in India	4,490
	Civil	Residential and industrial projects in India	1,610
	Cables	Various types of cables / cabling projects	1,350
Mar-20	T&D business & SAE Towers	T&D projects: India, SAARC, ME, Africa	6,690
	Civil	Defence (data centre), residential projects in India	1,530
	Solar	Solar projects in ME and India	1,040
	Cables	Cabling projects	1,210
May-20	T&D business & SAE Towers	T&D Projects in India, Bangladesh, Africa and the Americas	9,170
	Civil	Industrial civil works for FGD project and residential projects in India	1,760
	Cables	Cabling projects	1,100
Aug-20	T&D business & SAE Towers	T&D projects in India, SAARC, Malaysia, Africa and the Americas	8,210
	Urban infra	Kochi Metro-Rail (KMR) to construct a viaduct along with station for the Phase1 extension of the Kochi metro-rail	1,460
	Civil	Infra works for warehouses in India	570
	Cables	Various types of cables /cabling projects in India	1,680
Sep-20	T&D business & SAE Towers	T&D projects from Oman Electricity Transmission Co. (OETC), The Power Grid Corporation of India (PGCI) and other customers	11,430
	Railways	Overhead Electrification (OHE) / civil works in India	1,200
	Smart infra	Defence segment	480
	Cables	Supply of various types of cables / cabling projects in India and overseas	900

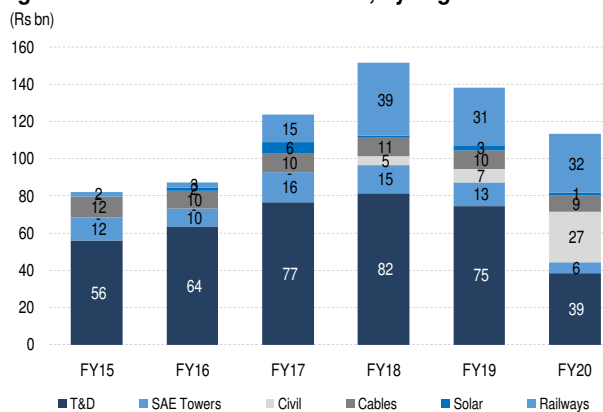
Source : Company, Anand Rathi Research

**Fig 12 – Order book, by segment (by Jun'20)**



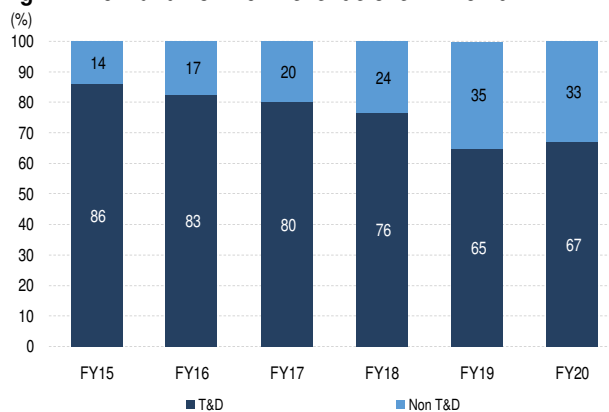
Source: Company, Anand Rathi Research

**Fig 13 – Order inflows over FY15-20, by segment**



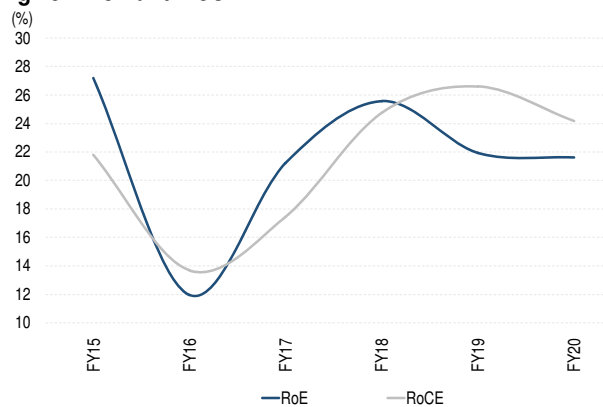
Source: Company, Anand Rathi Research

**Fig 14 – T&D and non-T&D revenue over FY15-20**



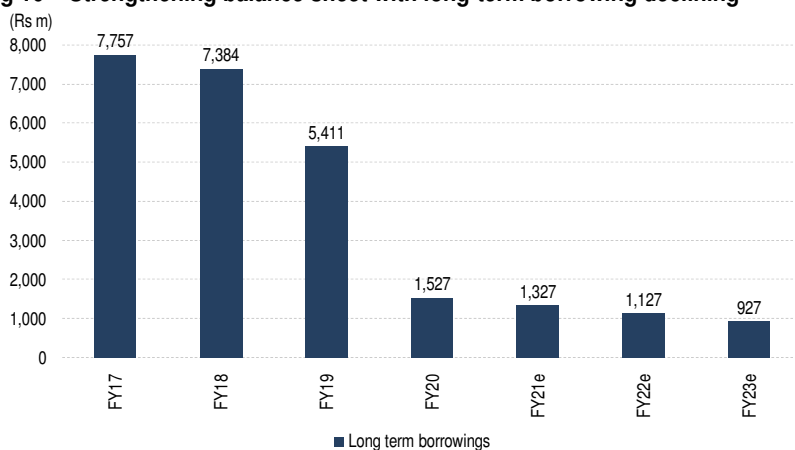
Source: Company, Anand Rathi Research

**Fig 15 – RoE and RoCE**



Source: Company, Anand Rathi Research

**Fig 16 – Strengthening balance sheet with long-term borrowing declining**



Source: Company, Anand Rathi Research

## Valuation

With its strong order book and healthy L1 orders, KEC’s revenue assurance is sound. Promising prospects are being seen in the railways and civil businesses. However, the pace of execution and order inflow would be key points to monitor. A significant scale-up internationally for various businesses has started paying off well, with the company seeing robust order inflows from various regions. We roll forward our estimates to FY23, forecasting 12%/17% revenue/PAT growth y/y and a 10.2% EBITDA margin. The stock trades at 15.8x/12.5x/10.6x FY21e/22e/23e. We maintain our Buy rating, with a revised TP of ₹398 (13x FY23e earnings).

**Fig 17 – One-year-forward PER**



Source: Company, Anand Rathi Research

### Key risks

- Slowdown in orders awarded.
- Slower pace of execution.

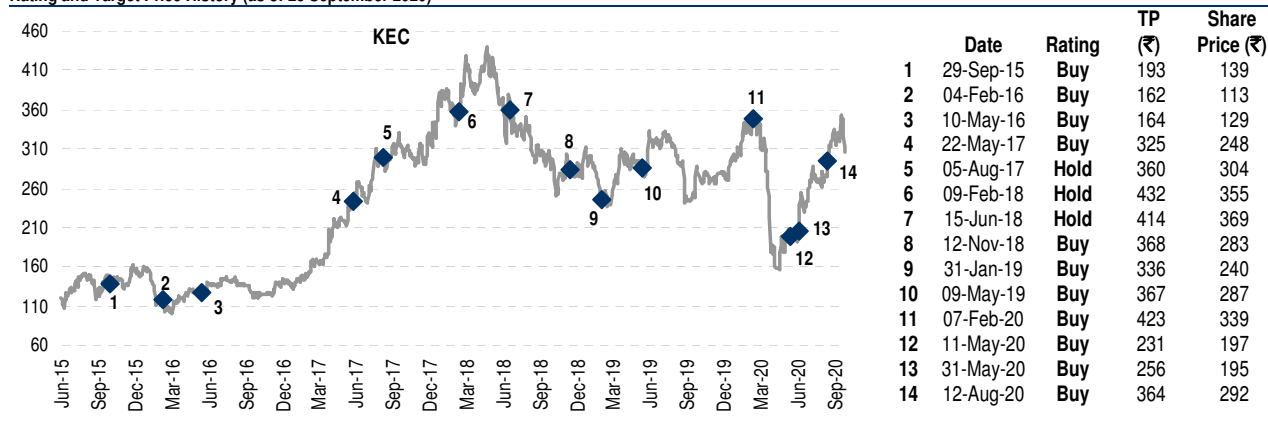
## Appendix

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