

KEC International

Building on diversification

We attended the KEC International (KECI) Annual Investor Conference 2021 on 16 June 2021. We note the following key takeaways from the call: (1) YTD order inflow is at INR 30bn. T&D and non-T&D businesses could see INR 80-90bn ordering each in FY22; (2) While domestic T&D ordering is expected to remain muted, the MENA region is seeing increased traction; (3) KEC wants to transform itself into an engineering major rather than just being an EPC company; (4) Civil business could grow 100%/50% in FY22/23, while railways could grow 30% in FY22; (5) Margin profile would change once civil achieves scale; (6) KECI would drive productivity through digitisation, mechanisation and automation; (7) Working capital could be trimmed by 15-20% (to sub 100days) as civil business grows. With strong prequalification in domestic and international markets across sectors, KECI is well-placed for a rerating. We have a BUY rating on the stock with a target price of INR 452/sh (14x Mar-23 EPS).

- FY22 could see sharp jump in ordering:** KECI is targeting order inflow of INR 160-180bn in FY22, a 35-52% jump over INR 119bn orders in FY21. Of its target, the company has already received INR 30bn in FY22. Its current bid pipeline stands at INR 650bn. While domestic T&D ordering is expected to remain subdued, we believe increased traction in MENA and a few SAARC nations would help fetch INR 80-90bn T&D orders. Government's focus on infrastructure, revival in private Capex, company venturing into new oil and gas pipeline business, and capabilities across sectors would drive growth in non-T&D. KECI is targeting another INR 80-90bn order wins from it.
- Civil to take over the baton of growth from railways:** Revenue from the railways business has grown at 75% CAGR over FY16-21. However, given the increased scale and recent slowdown in awarding, growth is expected to taper off to 30% for FY22. On the other hand, civil business grew 3x in FY21 and is expected to grow by 100/50% in FY22/23. KECI has been building capabilities in the civil business and is now present in industrial, residential, urban infrastructure, airports, and defense sectors. Presence across various verticals makes it one of the largest beneficiaries of the increase in Capex.
- Transforming KECI into an engineering major:** The management wants to position the company as an engineering major, and not just an EPC company. In the T&D space, it has proved its mettle. However, it is trying to build similar capabilities in the non-T&D segment. It wants to be the first port of call for the engineering part of the EPC business. Once it gets into engineering, the per client quantum of ordering would increase substantially. As per management, the company will drive this transformation organically.

Consolidated Financial Summary

(INR mn)	FY16	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Net Revenues	85,178	85,844	1,00,580	1,10,005	1,19,654	1,31,142	1,47,669	1,65,927
EBITDA	6,923	8,179	10,062	11,499	12,344	11,412	12,172	15,888
APAT	1,479	3,048	4,604	4,864	5,655	5,527	5,738	8,294
Diluted EPS (INR)	5.8	11.9	17.9	18.9	22.0	21.5	22.3	32.3
P/E (x)	71.1	34.5	22.8	21.6	18.6	19.0	18.3	12.7
EV/EBITDA (x)	20.6	16.2	14.0	11.5	11.1	11.9	11.0	8.4
RoE (%)	22.9	21.2	25.7	21.9	21.6	18.0	15.7	19.1

Source: Company, HSIE Research

BUY

CMP (as on 16 June 21)	INR 403
Target Price	INR 452
NIFTY	15,768

KEY CHANGES	OLD	NEW
Rating	BUY	BUY
Price Target	INR 452	INR 452
EPS change %	FY22E	FY23E
	-	-

KEY STOCK DATA

Bloomberg code	KECI IN
No. of Shares (mn)	257
MCap (INR bn) / (\$ mn)	104/1,392
6m avg traded value (INR mn)	164
52 Week high / low	INR 486/221

STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	(12.2)	6.9	75.6
Relative (%)	(16.5)	(5.6)	19.4

SHAREHOLDING PATTERN (%)

	Dec-20	Mar-21
Promoters	51.82	51.82
FIs & Local MFs	25.31	24.92
FPIs	9.84	10.75
Public & Others	13.03	12.51
Pledged Shares	-	-

Source : BSE

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Key call takeaways

- While KECI does not have any specific mandate for RoE from the parent, it does expect it in the 18-20% range. However, the company does stray away from its target time to time to capitalise on the growth opportunities.
- Digitisation is difficult when the model is asset light. However, vendors have been very receptive of ideas and incorporate suggestions. KECI itself is also investing in the digitisation efforts.
- In industrial projects, once it is awarded, the client wants it to be delivered way ahead of time. Hence, at the beginning of the civil business, KECI faltered on a few occasions. But KECI has built up the capabilities, especially on human resources side, which will help the company deliver projects on client expectations.
- KECI wants to position itself as an engineering major, rather than being just another EPC company. In T&D, it gets calls from clients for help with designing. However, the same is not true for the other businesses. KECI wants to be the first port of call for engineering part of the EPC business. Once KEC gets into engineering side, the per client quantum of ordering would increase substantially. As per management, the company will drive this transformation organically.
- On domestic T&D awarding, KECI is not positive and is uncertain on tendering of large projects. Currently, the government is focusing on the north-east region and Rajasthan state government is looking at TBCB model. Big projects could also come up on the Leh-Ladakh route, if the renewable power plants are developed there. Overall, KECI expects flattish ordering in domestic T&D.
- Despite the competition in the civil business, KEC believes it can grow the business just like it has done with the railways over the years. While there is competition from local players in smaller projects, larger projects in residential, industrial and infrastructure see limited competition. Industrial clients prefer large and reputed developers over small players as they want project delivery on time. KECI will be particular in choosing clients and type of work.
- Civil business grew 3x in FY21. While we believe it would be difficult for the company to replicate the same growth this year, the company is looking at 100% growth this year and 50% next year. Given the growth in the business, civil could see double-digit margin by next year.
- KECI is venturing into the oil and gas pipeline segment and has already started bidding for the projects in it. While process and refineries are a part of the oil and gas business, it is already being looked after in the civil segment; in this segment, the company would focus on crude and product pipelines. There has been increased focus on the sector from the government as it is looking to increase the share of gas in the energy mix. KECI is currently in the 'wait and watch' mode before it decides to invest too much capital in the business. Oil and gas business in general has better EBITDA margin and the company initially would focus on obtaining a double-digit margin.
- KECI has also ventured into the solar business; however, it has been a mixed opportunity so far. KECI has been selective and takes only 2-3 projects a year. It is completely hedged in terms of cost as it buys the panels on the day it receives order. Due to policy uncertainty, KEC is unsure about sectors growth path and will wait and watch.
- KECI wants to be amongst the top-3 civil contactors in the next 4-5 years, in terms of revenue. As of now, it has invested INR 12bn in the railways and INR 2.5bn in

the civil business. Out of INR 14.5bn invested in civil and railways, INR 3bn is in fixed assets. Just like other businesses, KECI does subcontracting in railways and civil too. In general, the approach has been to hire the equipment and ask subcontractors to operate it. It has learnt its lesson from the experience of companies that invested heavily in equipment and went bust later on.

- The management is not looking for an INR 25-30bn worth of single order. In the metros, the largest order that the KEC has is of INR 10bn. Apart from that, it is comfortable with orders of INR 5-6bn size.
- In FY21, KEC received INR 75bn worth of orders in T&D. Its current bid pipeline seems stronger, except from India. The company already has few L1 positions in T&D and might close FY22 with INR 80-90bn orders. However, it will depend on the performance in SAARC and ME region. Most of the tenders are in the INR 8-9bn range.
- For the non-T&D business also, KECI is expecting INR 80-90bn order inflow. There is no intention of going into roads sector, from which it will stay away for the time being.
- Payments have been steady despite the challenges faced by the clients. There is not a single instance of the client not having paid. There has been a cash flow mismatch but no non-payment issues.
- In general, margins in T&D line for solar are higher because clients want to fast-track the orders, given that solar plants get ready in 15 months. There are not many other players who can build on a constrained timeline. Hence, the competitive intensity is low, leading to better margins for KECI. Most of the tendering has already been done. So, there are not many opportunities left in the transmission for renewable segment.
- Revenue has been low in the substation business in the past 1-2 years due to cancellation of a few orders. Currently, the order book is INR 13bn. While India is shifting to GIS, the Middle East is completely on GIS. Africa is majorly on AIS. It is more about the cost and land availability. GIS is typically costlier than the AIS.
- Basis management commentary, KECI is not vulnerable to shift in the short term interest rate. Currently, most of the debt is working capital and the company can always draw in more from working capital, which costs equivalent to CP market rate of 4.5% and blended borrowing cost from banks are coming in at 5.5%.
- As far as the fixed-price contracts are concerned, KECI has a hedging policy. It hedges the aluminium exposure as and when the company gets the orders. As steel cannot be hedged through any instruments, KECI has to depend on suppliers. It keeps inventory of 45-60 days and puts advance orders. Hence, steel prices can be hedged for a maximum of up to 90 days.
- Once civil business rises significantly, margin profile of KECI would change. T&D has been delivering steady margins for some years. Railways are already doing double-digit margin, which could improve from here. Civil touched INR 10bn revenue milestone in FY21. KECI expects double-digit margin once it reaches scale.
- Working capital for civil has been the best in the sector. KEC has been doing a lot of work in metros, where working capital intensity is low. Metro authorities give advances for Capex and material procurement. If a project is moving well, it could be a negative working capital business. KEC has guided for INR 25bn working capital borrowing despite 10-15% growth in the topline. There is room to reduce working capital requirement by 15-20%.

- The Supreme Court ruling to take transmission lines underground in certain areas of Rajasthan and Gujarat would have a positive impact on cabling division and is negative for the T&D business, as per KECI management. Not many companies can produce the cable required for underground transmission lines. KECI has products suitable for underground cabling.
- KECI believes margins are driven more by competition than commodity prices. Competitors also take commodity prices into account while bidding. Recent bidding has considered the higher prices, so it could be a blessing in disguise as prices trend down. Competitive intensity has increased as government has relaxed the qualification criteria. While small tenders have attracted much competition, large tenders have not seen much increase in competition.
- Currently, KECI has L1 in a country bordering with Europe. But it is not looking at Europe. It could look at some EPC projects in North America, as it has a factory in Mexico. However, this would be an opportunity and not really its main focus.

Financials

Standalone Income Statement

Year ending March (INR mn)	FY17	FY18	FY19	FY20	FY21	FY22E	FY23E
Net Revenues	85,844	1,00,580	1,10,005	1,19,654	1,31,142	1,47,669	1,65,927
<i>Growth (%)</i>	<i>0.8</i>	<i>17.2</i>	<i>9.4</i>	<i>8.8</i>	<i>9.6</i>	<i>12.6</i>	<i>12.4</i>
Material Expenses	59,489	72,716	81,230	84,182	96,076	1,09,751	1,19,008
Employee Expenses	7,327	7,984	8,322	11,044	11,151	12,862	13,634
Other Operating Expenses	10,849	9,819	8,954	12,084	12,503	12,884	17,398
EBIDTA	8,179	10,062	11,499	12,344	11,412	12,172	15,888
<i>EBIDTA (%)</i>	<i>9.5</i>	<i>10.0</i>	<i>10.5</i>	<i>10.3</i>	<i>8.7</i>	<i>8.2</i>	<i>9.6</i>
<i>EBIDTA Growth (%)</i>	<i>18.1</i>	<i>23.0</i>	<i>14.3</i>	<i>7.3</i>	<i>(7.5)</i>	<i>6.7</i>	<i>30.5</i>
Depreciation	1,297	1,097	1,171	1,472	1,525	1,633	1,783
EBIT	6,882	8,964	10,328	10,872	9,887	10,539	14,105
Other Income (Incl. EO Items)	289	404	226	111	299	143	145
Interest	2,536	2,466	3,119	3,080	2,627	2,890	2,921
PBT	4,634	6,902	7,435	7,903	7,559	7,793	11,329
Tax	1,587	2,298	2,571	2,248	2,032	2,055	3,036
RPAT	3,048	4,604	4,864	5,655	5,527	5,738	8,294
APAT	3,048	4,604	4,864	5,655	5,527	5,738	8,294
<i>APAT Growth (%)</i>	<i>106.1</i>	<i>51.1</i>	<i>5.7</i>	<i>16.3</i>	<i>(2.3)</i>	<i>3.8</i>	<i>44.5</i>
EPS	11.9	17.9	18.9	22.0	21.5	22.3	32.3
<i>EPS Growth (%)</i>	<i>106.1</i>	<i>51.1</i>	<i>5.7</i>	<i>16.3</i>	<i>(2.3)</i>	<i>3.8</i>	<i>44.5</i>

Source: Company, HSIE Research

Standalone Balance Sheet

As at March (INR mn)	FY17	FY18	FY19	FY20	FY21	FY22E	FY23E
SOURCES OF FUNDS							
Share Capital	514	514	514	514	514	514	514
Reserves	15,349	19,460	23,837	27,462	33,083	39,094	46,555
Total Shareholders Funds	15,864	19,975	24,351	27,976	33,597	39,608	47,069
Minority Interest							
Long Term Debt	7,757	7,384	5,411	3,069	2,187	5,411	5,411
Short Term Debt	22,014	31,036	24,976	30,201	31,507	25,626	25,626
Total Debt	29,771	38,421	30,386	33,270	33,694	31,036	31,036
Other Non Current Liabilities	146	177	139	1,280	1,270	139	139
Deferred Taxes	1,240	1,007	1,183	527	(68)	1,183	1,183
TOTAL SOURCES OF FUNDS	47,020	59,579	56,060	63,052	68,493	71,967	79,428
APPLICATION OF FUNDS							
Net Block	9,577	9,202	9,787	11,292	11,821	9,679	9,648
CWIP	51	781	73	840	179	118	133
Goodwill	1,910	1,920	2,037	2,226	2,154	2,037	2,037
Other Non Current Assets	2,718	4,779	3,223	3,902	4,918	3,223	3,223
Total Non-current Assets	14,257	16,681	15,120	18,260	19,072	15,058	15,041
Inventories	3,947	6,274	6,410	7,758	8,422	9,953	9,790
Debtors	42,268	50,444	48,753	54,448	55,668	65,541	75,008
Cash & bank balances	2,080	2,313	2,762	1,637	2,502	2,439	2,627
ST Loans & Advances	624	604	336	1,130	1,129	1,118	1,196
Other Assets	23,973	28,808	43,251	45,313	53,067	55,701	59,600
Total Current Assets	72,891	88,443	1,01,511	1,10,285	1,20,789	1,34,751	1,48,222
Creditors	39,101	44,713	60,068	64,747	67,640	77,354	83,346
Other Current Liabilities & Provns	1,027	833	503	746	3,727	503	503
Total Current Liabilities	40,128	45,546	60,572	65,493	71,367	77,857	83,850
Net Current Assets	32,763	42,897	40,939	44,792	49,422	56,894	64,372
TOTAL APPLICATION OF FUNDS	47,020	59,579	56,060	63,052	68,493	71,967	79,428

Source: Company, HSIE Research

Standalone Cash Flow

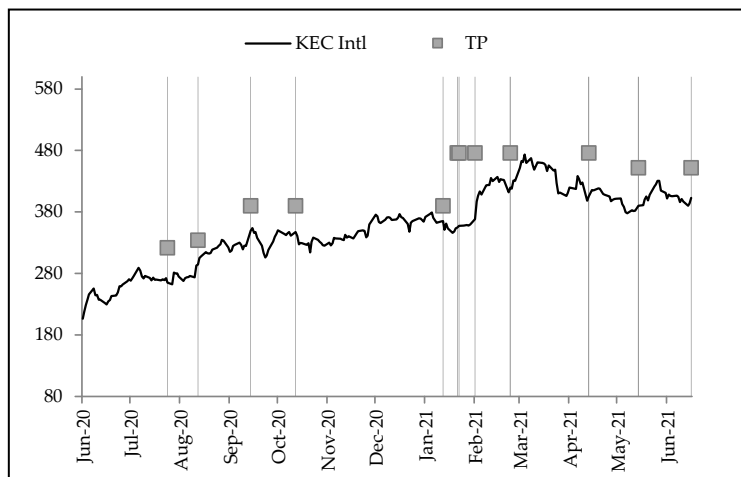
Year ending March (INR mn)	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
PBT	4,634	6,902	7,476	7,903	5,527	7,793	11,329
Non-operating & EO items	2,159	764	(1,015)	637	3,102	-	-
Interest expenses	2,536	2,466	3,119	3,080	2,627	2,890	2,921
Depreciation	1,297	1,097	1,171	1,472	1,525	1,633	1,783
Working Capital Change	7,034	(2,338)	(5,787)	(8,670)	(2,249)	(6,107)	(7,290)
Tax paid	(1,044)	(2,296)	(2,977)	(3,493)	(2,088)	(2,055)	(3,036)
OPERATING CASH FLOW (a)	16,616	6,596	1,987	929	8,445	4,153	5,707
Capex	(670)	(1,355)	(1,083)	(2,065)	(1,137)	(1,566)	(1,766)
Free cash flow (FCF)	15,946	5,241	905	(1,136)	7,308	2,587	3,941
Investments	(1,050)	911	835	(93)	214	-	-
Non operating income	(111)	400	(446)	79	(351)	-	-
INVESTING CASH FLOW (b)	(1,831)	(45)	(695)	(2,079)	(1,274)	(1,566)	(1,766)
Share capital Issuance	-	-	-	-	-	-	-
Debt Issuance	(11,223)	(3,765)	2,282	4,589	(3,083)	(1,100)	-
Dividend Payment	(11)	(411)	(614)	(1,558)	(5)	(832)	(832)
Others	-	-	-	(316)	-	-	-
Interest expenses	(2,556)	(2,205)	(3,167)	(2,689)	(3,551)	(2,890)	(2,921)
FINANCING CASH FLOW (c)	(13,790)	(6,382)	(1,499)	25	(6,639)	(4,822)	(3,753)
NET CASH FLOW (a+b+c)	995	170	(206)	(1,125)	532	(2,235)	188
Opening Cash & Equivalents	853	2,080	2,313	2,762	1,637	2,502	2,439
Adj - EO Items	232	63	655		333	2,172	
Cash from Acq of Subsidiary							
Adj - Treasury Investments							
Closing Cash & Equivalents	2,080	2,313	2,762	1,637	2,502	2,439	2,627

Key Ratios

	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
PROFITABILITY (%)							
GPM	30.7	27.7	26.2	29.6	26.7	25.7	28.3
EBITDA Margin	9.5	10.0	10.5	10.3	8.7	8.2	9.6
EBIT Margin	8.0	8.9	9.4	9.1	7.5	7.1	8.5
APAT Margin	3.6	4.6	4.4	4.7	4.2	3.9	5.0
RoE	21.2	25.7	21.9	21.6	18.0	15.7	19.1
Core RoCE	9.8	12.6	13.2	14.5	12.2	12.2	14.8
RoCE	9.8	12.0	12.2	13.6	11.6	11.4	14.0
EFFICIENCY							
Tax Rate (%)	34.2	33.3	34.6	28.4	26.9	26.4	26.8
Asset Turnover (x)	5.5	6.3	6.3	6.3	6.4	6.7	7.0
Inventory (days)	17	23	21	24	23	25	22
Debtors (days)	180	183	162	166	155	162	165
Other Current Assets (days)	105	107	145	142	151	140	134
Payables (days)	166	162	199	198	188	191	183
Other Current Liab (days)	4	3	2	2	10	1	1
Net Working Capital Cycle (Days)	130	147	127	132	131	135	136
Debt/EBITDA (x)	3.6	3.8	2.6	2.7	3.0	2.5	2.0
Net D/E	1.7	1.8	1.1	1.1	0.9	0.7	0.6
Interest Coverage	2.7	3.6	3.3	3.5	3.8	3.6	4.8
PER SHARE DATA							
EPS (Rs/sh)	11.9	17.9	18.9	22.0	21.5	22.3	32.3
CEPS (Rs/sh)	16.9	22.2	23.5	27.7	27.4	28.7	39.2
DPS (Rs/sh)	1.6	2.4	2.7	2.7	2.7	2.7	2.7
BV (Rs/sh)	61.7	77.7	94.7	108.8	130.7	154.1	183.1
VALUATION							
P/E	34.5	22.8	21.6	18.6	19.0	18.3	12.7
P/BV	6.6	5.3	4.3	3.8	3.1	2.7	2.2
EV/EBITDA	16.2	14.0	11.5	11.1	11.9	11.0	8.4
OCF/EV (%)	12.5	4.7	1.5	0.7	6.2	3.1	4.3
FCF/EV (%)	12.0	3.7	0.7	(0.8)	5.4	1.9	3.0
FCFE/Market Cap (%)	4.5	1.4	3.0	3.0	4.0	1.4	3.7
Dividend Yield (%)	0.4	0.6	0.7	0.7	0.7	0.7	0.7

Source: Company, HSIE Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
15-Jul-20	269	BUY	265
27-Jul-20	265	BUY	322
12-Aug-20	292	BUY	334
14-Sep-20	327	BUY	390
12-Oct-20	345	BUY	390
12-Jan-21	365	BUY	390
21-Jan-21	353	BUY	476
23-Jan-21	412	BUY	476
1-Feb-21	360	BUY	476
23-Feb-21	412	BUY	476
13-Apr-21	406	BUY	476
14-May-21	382	BUY	452
17-Jun-21	403	BUY	452

Rating Criteria

BUY: >+15% return potential

ADD: +5% to +15% return potential

REDUCE: -10% to +5% return potential

SELL: > 10% Downside return potential

Disclosure:

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