

Equity Research

January 31, 2021

BSE Sensex: 46286

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Q3FY21 result review and earnings revision

Capital Goods

Target price: Rs426

Earnings revision

(%)	FY21E	FY22E
Sales	↓ 2.7	↑ 1.6
EBITDA	↓ 8.7	↑ 2.5
EPS	↓ 11.9	↑ 4.5

Target price revision

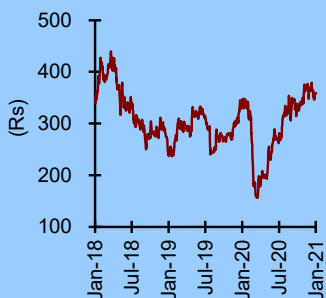
Rs426 from Rs435

Shareholding pattern

	Jun '20	Sep '20	Dec '20
Promoters	51.7	51.7	51.8
Institutional investors	36.5	36.5	35.9
MFs and other	22.8	22.8	20.9
FIs/Banks	0.0	0.0	0.0
Insurance	4.3	4.3	4.4
FII	9.4	9.4	10.6
Others	11.8	11.8	12.3

Source: NSE

Price chart



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INDIA

KEC International

BUY

Maintained

Rs360

Muted T&D execution impacts earnings

Weak execution under Latin American subsidiary SAE and slippage in some domestic projects due to farmer agitation impacted KEC International's overall execution in Q3FY21. However, railways (up 44% YoY) and civil (up 206% YoY) supported the overall growth of 7% (YoY). Margins were subdued due to cost escalation in SAE and higher mix of low margin in non-T&D contribution. Around Rs60bn of L1 position and strong orderbook of Rs179bn (1.4x TTM sales) lend growth visibility. Increase in commodity prices may impact margins going forward and working capital is high due to delay in certain collections and inventory stocking given high raw material prices. Factoring muted recovery in near-term execution, we cut FY21E earnings by 12% and expecting recovery, we raise FY22E earnings by 4.5% and maintain BUY with a revised target price of Rs426 (previously: Rs435).

- ▶ **Muted T&D execution impacts overall growth:** Weakness in the Brazilian market, delay in some domestic projects due to farmer agitation impacted the overall growth. Given the high commodity prices, the company is expecting normalisation of the same before providing thrust towards ramp up of the execution. However, strong growth in railways and civil supported the overall revenue and this trend is likely to continue.
- ▶ **Higher mix in non-T&D and high commodity prices impact margins:** EBIDTA margin declined 130 bps YoY to 9.1% impacted by higher mix of relatively low margin non-T&D contribution. Commodity price has increased recently and hence, overall margins are likely to be impacted, especially the fixed price contracts. Management believes prices will normalise and hence, it is trying to time the overall execution to limit the damage to margins.
- ▶ **Healthy order pipeline:** Overseas order prospects are healthy and overall the company has bid ~Rs300bn worth of projects currently with ~Rs200bn future bids in pipeline.
- ▶ **Maintain BUY on healthy growth prospects:** Railways and civil segments are expected to be in high growth phase in near to medium term. Normalisation of margins, control on working capital and lower interest rates will support earnings growth. Factoring recovery in muted near-term execution, we cut FY21E earnings by 12% and expecting recovery, we raise FY22E earnings by 4.5% and maintain BUY with a revised target price of Rs426 (previously: Rs435).

Market Cap	Rs92bn/US\$1.3bn	Year to March	FY20	FY21E	FY22E	FY23E
Reuters/Bloomberg	KECL BO/KECI IN	Revenue (Rs mn)	1,19,654	1,31,807	1,48,813	1,63,697
Shares Outstanding (mn)	257.1	Adjusted NI (Rs mn)	5,655	5,601	7,796	9,051
52-week Range (Rs)	379/157	DEPS (Rs)	22.0	21.8	30.3	35.2
Free Float (%)	48.2	% Chg YoY	16.3	(1.0)	39.2	16.1
FII (%)	10.6	P/E (x)	16.4	16.5	11.9	10.2
Daily Volume (US\$'000)	1,549	CEPS (Rs)	27.7	27.6	36.2	41.1
Absolute Return 3m (%)	47.6	EV/E (x)	9.0	9.2	7.2	6.3
Absolute Return 12m (%)	1.0	Dividend Yield	0.9	1.0	1.1	1.4
Sensex Return 3m (%)	22.4	RoCE (%)	16.0	14.2	16.7	17.0
Sensex Return 12m (%)	3.4	RoE (%)	20.2	17.1	19.8	19.2

Please refer to important disclosures at the end of this report

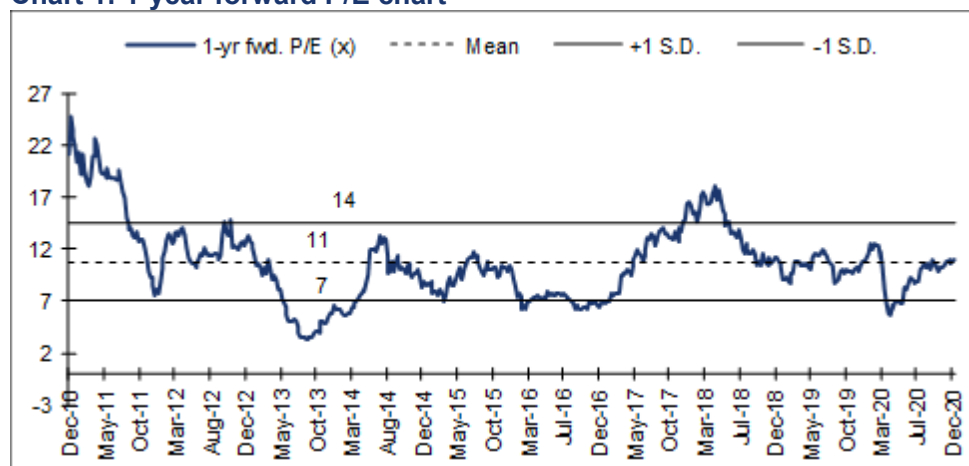
Valuation and outlook

The stock is currently trading at 11.9x FY22E earnings and 10.2x FY23E. We believe, the company's healthy orderbook, stable traction from railways and focus on debt reduction will support earnings CAGR of 17% during FY20-FY23E.

Increase in commodity prices may impact margins going forward and working capital is high due to delay in certain collections and inventory stocking given high raw material prices. Given lower execution, subdued margins and higher working capital, we cut our earnings multiple to 13x Sep'22E earnings from 15x FY22 earnings previously. We also introduce FY23 estimates.

Factoring muted near-term execution, we cut FY21E earnings by 12% and expecting recovery, we raise FY22E earnings by 4.5%. KEC is better placed vs peers and the competitive intensity from unorganised sector may reduce due to covid slowdown. Given the company's focus on cashflow improvement and earnings growth, we maintain BUY with a revised target price of Rs426 (previously: Rs435).

Chart 1: 1-year forward P/E chart



Source: Bloomberg, I-Sec research

Table 1: Earnings revision (consolidated)

(Rs mn)

Rs mn	FY21E			FY22E		
	Earlier	Revised	YoY (%)	Earlier	Revised	YoY (%)
Revenue	1,35,489	1,31,807	(2.7)	1,46,438	1,48,813	1.6
EBIDTA	13,100	11,966	(8.7)	15,026	15,403	2.5
PAT	6,360	5,601	(11.9)	7,456	7,796	4.5

Source: Company data, I-Sec research

Table 2: Financial highlights

(Rs mn)	Q3FY20	Q3FY21	YoY(%)	Q2FY21	QoQ(%)	Isec Est	Var (%)	9MFY20	9MFY21	YoY(%)
Net Sales	30,731	32,892	7.0	32,577	1.0	35,326	(6.9)	82,944	87,537	5.5
EBITDA	3,185	2,987	(6.2)	2,931	1.9	3,471	(14.0)	8,636	7,867	(8.9)
Margin	10.4	9.1	-130bps	9.0	8bps	9.8	-75bps	10.4	9.0	
Depreciation	367	380	3.6	374	1.6	385	(1.4)	1,080	1,145	6.0
Finance Cost	811	658	(18.8)	674	(2.4)	689	(4.5)	2,428	1,995	(17.8)
Other Income	21	39	90.7	68	(42.2)	20	95.5	84	176	110.2
Extraordinary income	-	-		-		-		-	-	
PBT	2,028	1,988	(2.0)	1,950	1.9	2,417	(17.8)	5,212	4,903	(5.9)
Tax	579	537	(7.2)	525	2.4	677	(20.6)	1,486	1,318	(11.3)
Tax rate (%)	28.5	27.0	-150bps	26.9	11bps	28.0		28.5	26.9	
Reported PAT	1,449	1,451	0.1	1,426	1.8	1,740	(16.6)	3,726	3,584	(3.8)
Adjusted PAT	1,449	1,451	0.1	1,426	1.8	1,740	(16.6)	3,726	3,584	(3.8)
Margin(%)	4.7	4.4	-30bps	4.4	3bps	4.9	-52bps	4.5	4.1	
EPS	5.6	5.6		5.5		6.8		14.5	13.9	
Order intake	60,540	24,610	(59.3)	24,350	1.1			98,200	68,270	(30.5)
Orderbook	2,20,110	1,79,180	(18.6)	1,95,150	(8.2)			2,20,110	1,79,180	(18.6)

Source: Company data, I-Sec research

Table 3: Segmental revenue breakup

(Rs mn)	Q3FY20	Q3FY21	YoY(%)	Q2FY21	QoQ(%)	Isec Est	Var (%)	9MFY20	9MFY21	YoY(%)
T&D (excl. SAE)	17,030	16,130	(5.3)	16,210	(0.5)	18,350	(12.1)	46,190	44,100	(4.5)
T&D - SAE	4,320	2,700	(37.5)	3,560	(24.2)	3,000	(10.0)	10,930	9,040	(17.3)
T&D	21,350	18,830	(11.8)	19,770	(4.8)	21,350	(11.8)	57,120	53,140	(7.0)
Cables	2,490	3,050	22.5	2,490	22.5	2,490	22.5	7,610	7,130	(6.3)
Railways	6,010	8,660	44.1	8,210	5.5	8,414	2.9	16,910	22,080	30.6
Civil	870	2,670	206.9	2,120	25.9	2,610	2.3	2,040	5,820	185.3
Solar	420	370	(11.9)	670	(44.8)	462	(19.9)	950	1,230	29.5
Total	31,140	33,580	7.8	33,260	1.0	35,326	(4.9)	84,630	89,400	5.6

Source: Company data, I-Sec research

Table 4: Segmental assumptions

Rs mn	FY17	FY18	FY19	FY20	FY21E	FY22E	FY23E
Revenues	87,540	1,00,900	1,10,010	1,19,650	1,31,807	1,48,813	1,63,697
Power T&D (excl SAE)	-	67,890	63,380	66,360	68,351	75,186	82,704
Power T&D (SAE)	-	10,250	9,670	15,390	12,312	12,312	12,928
Power T&D	70,310	78,140	73,050	81,750	80,663	87,498	95,632
Cables	10,540	10,090	11,830	9,790	9,790	10,769	11,307
Railway	4,460	8,440	19,180	25,510	31,122	36,724	40,397
Water /civil	860	2,680	4,980	3,760	8,796	12,314	14,777
Solar	1,590	2,880	3,420	1,260	1,436	1,508	1,584
Growth YoY (%)	0.5	15.3	9.0	8.8	10.2	12.9	10.0
Power T&D (excl SAE)			(6.6)	4.7	3.0	10.0	10.0
Power T&D (SAE)			(5.7)	59.2	(20.0)	-	5.0
Power T&D	(2.5)	11.1	(6.5)	11.9	(1.3)	8.5	9.3
Cables	(5.7)	(4.3)	17.2	(17.2)	-	10.0	5.0
Railway	112.4	89.2	127.3	33.0	22.0	18.0	10.0
Water /civil	(16.5)	211.6	85.8	(24.5)	133.9	40.0	20.0
Solar	71.0	81.1	18.8	(63.2)	14.0	5.0	5.0
Order Inflow	1,23,580	1,50,980	1,40,840	1,13,310	1,19,655	1,35,540	1,47,625
Power TD	92,685	96,627	87,321	44,191	57,448	66,065	73,993
Cables	9,886	10,569	9,859	9,065	9,065	9,971	10,470
Railway	14,830	39,255	30,985	31,727	33,313	37,311	39,176
Water	6,179	4,529	2,817	27,194	19,036	21,320	23,026
Growth YoY (%)	41.8	22.2	(6.7)	(19.5)	5.6	13.3	8.9
Power TD	30.5	4.3	(9.6)	(49.4)	30.0	15.0	12.0
Cables	3.2	6.9	(6.7)	(8.1)	-	10.0	5.0
Railway	175.4	164.7	(21.1)	2.4	5.0	12.0	5.0
Water	448.9	(26.7)	(37.8)	865.4	(30.0)	12.0	8.0

Source: Company data, I-Sec research

Concall highlights

Ordering status and outlook

- Management expects Rs10-20bn worth orders from GEC in next 10-15 days. Currently there are Rs300bn tenders to be bid in pipeline. Overall ordering pipeline (T&D and non-T&D) is Rs600bn for both quoted and non-quoted tenders
- The state that are seeing activity on SEB side include Bihar, TN, Karnataka, Kerala, Rajasthan. Also activity in Mumbai, on the private side, as Adani and TATA have floated few tenders
- Company is L1 orders in Rs60bn orders, contributed equally by T&D and non T&D business

Operations

- Standalone KEC margins have been at Double Digits (DD) and overall T&D margin impact has been due to Brazil. Cost time escalations in Brazil along with commodity price increase globally has impacted margins. Total there are three projects in SAE – one got completed in Dec'20 while from the 2 projects: one is expected to complete in Q1FY21 and second in in early Q2FY21
- Given the pressure in margins from commodity price rise, management highlighted that although most of the international T&D are fixed price, entire railways business and significant portion of L1 has variable pricing. Steel contributes 15-16% of a usual T&D order and 25%-30% of overall annual steel consumption (200,000 tonnes) is on T&D. the company fast tracks the execution of projects on basis of movement in steel prices

Guidance – Management guided for DD revenue growth in Q4FY21, however doesn't expect DD margins for Q4FY21 or FY21. It is hopeful of DD revenue growth in FY22 (50% growth in civil and 20% growth in railways in FY22).

Railways – The company received its first private order which includes a composite doubling project including track linking, signalling and OHE. Also it secured Rs5bn orders from the new growth areas – 1. metro electrification from DMRC 2. Ballast-less tracks work for Kochi metro 3. Signalling work for DFCC. Overall it has Rs70bn of orderbook including L1

Civil – The margins here are currently high teens and the company's target is to reach DD margins once the business reaches a threshold. It has received orders from chemical, pipeline and cement (repeat customer) and the growth is expected to come from 1. Data centre 2. hydrocarbon and 3. urban infra. L1 order in 1st public order. OB + L1 = 35bn.

Others

- The transmission tower Dubai facility has been commissioned in Q3FY21
- Net debt at Q3FY21 stood at Rs26.4bn and the company considers 1.8-2% as the sustainable Interest rate going forward.
- Company realised FX gain of Rs70-80mn in Q3FY21
- Working capital days increased from 132 days to 144days as 1. company stocked up inventory due to increase in commodity prices 2. 1-2 customers had payment issues in Dec'20 end.
- Competition in T&D had gone down in Q1FY21 and Q2FY21 and increased in Q3FY21 (as govt relaxed BG requirements). Small railway orders of order Rs1bn see higher competition while large order >Rs5bn see less competition (3-4 players)

Financial summary

Table 5: Profit & loss statement

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
Total Income	1,19,654	1,31,807	1,48,813	1,63,697
Operating Expenses	1,07,310	1,19,841	1,33,411	1,46,207
EBITDA	12,344	11,966	15,403	17,489
% margins	10.3	9.1	10.4	10.7
Depreciation & Amortisation	1,472	1,487	1,502	1,517
EBIT	10,872	10,479	13,901	15,973
Gross Interest	3,080	2,900	3,274	3,601
Other Income	111	200	200	200
PBT before exceptionals	7,903	7,779	10,827	12,572
Add:				
Extraordinary/Exceptionals	-	-	-	-
Add: Share in associates	-	-	-	-
PBT	7,903	7,779	10,827	12,572
Less: Taxes	2,248	2,178	3,032	3,520
Less: Minority Interests	-	-	-	-
Net Income (Reported)	5,655	5,601	7,796	9,051
Adjusted Net Income	5,655	5,601	7,796	9,051

Source: Company data, I-Sec research

Table 6: Balance sheet

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
Assets				
Total Current Assets	1,12,731	1,26,088	1,43,308	1,61,102
of which cash & cash eqv.	1,637	3,096	1,653	3,451
Total Current Liabilities & Provisions	77,969	83,818	94,534	1,04,810
Net Current Assets	34,762	42,270	48,774	56,293
Investments	225	225	225	226
Other Non-Current Assets	2,226	2,226	2,226	2,226
Net Fixed Assets	10,662	7,890	8,188	8,472
Goodwill	1,470	1,470	1,470	1,470
Total Assets	49,345	54,080	60,883	68,686
Liabilities				
Borrowings	20,618	20,618	20,618	20,618
Deferred Tax Liability	751	788	828	869
Minority Interest	-	-	-	-
Equity Share Capital	514	514	514	514
Face Value per share (Rs)	2.00	2.00	2.00	2.00
Reserves & Surplus	27,462	32,160	38,923	46,685
Net Worth	27,976	32,674	39,437	47,199
Total Liabilities	49,345	54,080	60,883	68,686

Source: Company data, I-Sec research

Table 7: Cashflow statement

(Rs mn, year ending March 31)

	FY20	FY21E	FY22E	FY23E
Operating Cashflow	5,975	11,263	14,571	16,399
Working Capital Changes	(5,101)	(6,048)	(7,948)	(5,720)
Capital Commitments	(1,085)	(1,900)	(1,800)	(1,800)
Free Cashflow	(210)	3,314	4,823	8,879
Cashflow from Investing Activities	(93)	-	-	(1)
Issue of Share Capital	-	-	-	-
Buyback of shares	-	-	-	-
Inc (Dec) in Borrowings	3,650	-	-	-
Interest paid	(3,080)	(2,900)	(3,274)	(3,601)
Dividend paid	(718)	(839)	(1,057)	(903)
Extraordinary Items/Others	(674)	1,884	(1,935)	(2,576)
Chg. in Cash & Bank balance	(1,125)	1,459	(1,443)	1,798

Source: Company data, I-Sec research

Table 8: Key ratios

(Year ending March 31)

	FY20	FY21E	FY22E	FY23E
Per Share Data (in Rs.)				
Diluted adjusted EPS	22.0	21.8	30.3	35.2
Recurring Cash EPS	27.7	27.6	36.2	41.1
Dividend per share (DPS)	3.4	3.5	4.0	5.0
Book Value per share (BV)	108.8	127.1	153.4	183.6
Growth Ratios (%)				
Operating Income	8.8	10.2	12.9	10.0
EBITDA	7.3	(3.1)	28.7	13.5
Recurring Net Income	16.3	(1.0)	39.2	16.1
Diluted adjusted EPS	16.3	(1.0)	39.2	16.1
Diluted Recurring CEPS	18.1	(0.6)	31.2	13.7
Valuation Ratios				
P/E	16.4	16.5	11.9	10.2
P/CEPS	13.0	13.1	10.0	8.8
P/BV	3.3	2.8	2.3	2.0
EV / EBITDA	9.0	9.2	7.2	6.3
EV / Operating Income	0.9	0.8	0.7	0.7
EV / Op. FCF (pre-capex)	127.3	21.1	16.8	10.3
Operating Ratios				
Raw Material/Sales (%)	46.7	47.5	47.5	47.5
SG&A/Sales (%)	10.1	10.2	9.9	9.7
Other Income / PBT (%)	1.4	2.6	1.8	1.6
Effective Tax Rate (%)	28.4	28.0	28.0	28.0
NWC / Total Assets (%)	67.1	72.4	77.4	76.9
Inventory Turnover (days)	23.7	24.0	26.0	27.0
Receivables (days)	165.5	165.0	170.0	171.0
Payables (days)	152.7	150.0	150.0	151.0
Debt/Equity (x)	0.7	0.6	0.5	0.4
Profitability Ratios (%)				
Recurring Net Income				
Margins	4.7	4.2	5.2	5.5
RoCE	16.0	14.2	16.7	17.0
RoNW	20.2	17.1	19.8	19.2
Dividend Payout Ratio	15.5	16.1	13.2	14.2
Dividend Yield	0.9	1.0	1.1	1.4
EBITDA Margins	10.3	9.1	10.4	10.7

Source: Company data, I-Sec research

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