Sharekhan by BNP PARIBAS

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Stock Update

# KEC International Limited

## Execution and order inflows to gain traction

| Capital Goods | Sharekhan code: KEC | Company Update |
|---|---|---|

| 3R MATRIX | + | = | - |
|---|---|---|---|
| Right Sector (RS) | ✓ | | |
| Right Quality (RQ) | ✓ | | |
| Right Valuation (RV) | ✓ | | |

\+ Positive = Neutral - Negative

| Reco/View | Change |
|---|---|
| Reco: **Buy** | ↔ |
| CMP: **Rs. 347** | |
| Price Target: **Rs. 435** | ↑ |

↑ Upgrade ↔ Maintain ↓ Downgrade

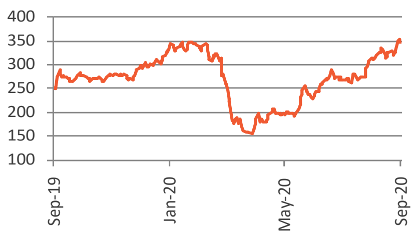
### Company details

| | |
|---|---|
| Market cap: | Rs. 8,916 cr |
| 52-week high/low: | Rs. 358/155 |
| NSE volume: (No of shares) | 4.6 lakh |
| BSE code: | 532714 |
| NSE code: | KEC |
| Free float: (No of shares) | 12.4 cr |

### Shareholding (%)

| | |
|---|---|
| Promoters | 51.7 |
| FII | 8.8 |
| DII | 27.8 |
| Others | 11.8 |

### Price chart




### Price performance

| (%) | 1m | 3m | 6m | 12m |
|---|---|---|---|---|
| Absolute | 10 | 48 | 33 | 39 |
| Relative to Sensex | 8 | 31 | 6 | 32 |

*Sharekhan Research, Bloomberg*


### Summary

- We retain Buy on KEC International Limited (KEC) with a revised PT of Rs. 435, taking into account improving operations and reasonable valuations.
- Execution run-rate and labour availability pick-up to ensure higher y-o-y revenue for Q2FY2021 and FY2021. Strong order inflows YTD along with Rs. 30,000 crore-35,000 crore bidding pipeline visibility over the next three months.
- Expect 1.2x and 2.5x y-o-y rise in revenue for rail and civil in FY2021. Rail division continues faster execution, while order tendering is likely to gain traction. YTD collections better than last year. Interest outgo contained with lower rate debt.
- Dubai unit to commence fully from Q3FY2021, ability to supply Rs. 400 crore-500 crore order p.a. Provides edge in international orders with benefit of freight and exemption of customs duty.


**We interacted with the management of KEC International Limited (KEC) regarding the recent developments and future outlook of the company and industry. The company expects Q2FY2021 revenue to be better y-o-y as execution during July and August was higher y-o-y (almost all of its 220 sites being operational and labour availability at 90% now). Consequently, FY2021 revenue is expected to be higher than FY2020. YTD order inflow stood at Rs. 3,332 crore, taking its current order book at Rs 20,000 crore (1.7x on TTM revenue). KEC is L1 in ~Rs. 4,000 crore worth of projects (~80% T&D). The total bidding pipeline over the next two to three months is at Rs. 30,000 crore-35000 crore (Rs. 12,000 crore-15000 crore in international orders, majorly in T&D). KEC has quoted for Rs. 10,000 crore-11000 crore worth projects out of Powergrid's Rs. 12,000 crore-14,000 crore green energy corridor size (expects inflows during Q3FY2021). In the railways segment, execution is at a fast pace, while orders delayed earlier are now gaining some traction (Rs. 6,000 crore-7,000 crore orders already quoted by KEC and will be bidding for another Rs. 5,000 crore-6,000 crore orders over the next two to three months). Rail revenue booking is expected at Rs. 3,000 crore-3,200 crore for FY2021 (up from Rs. 2,500 crore in FY2020). In the civil space, KEC expects ~Rs. 1,000 crore revenue in FY2021 (up from Rs. 400 crore in FY2020). The slackness seen in domestic T&D project awards is well compensated through opportunities arising in international T&D (MENA region, Bangladesh, Far Eastern regions, and North and West Africa) with a good chunk of tenders being floated. Although tendering remains slow in Brazil and postponed due to COVID-19, it expects $1.5 billion-2.0 billion auction in December. The company's recently acquired tower manufacturing unit (50,000 MTPA facility) in Dubai, taking total capacity to 3,62,200 MPT, will be fully operational from Q3FY2021, giving it benefits in freight and exemption of customs duty for supplying in international markets. Through the Dubai facility it can execute tower supply project of the size of Rs. 400 crore-500 crore. KEC cashflows have been better than last year, with funds flowing to AA-rated companies. The company's average cost of borrowing has been brought down to 5% (increased foreign currency borrowings, at 60% now) from 7% last year. Overall, the outlook for KEC's business segments, viz. T&D international and non-T&D comprising railways, civil, and other businesses remains favourable. We maintain Buy, given the healthy order backlog, order inflow visibility, and KEC's ability to ramp-up execution.**

### Our Call

**Valuation - Maintain Buy with a revised PT of Rs. 435:** The stock of KEC has doubled since April, as it posted outperformance in Q1FY2021 (despite COVID-19 impact) and has since been showing improving trajectory in execution and order inflows. Additionally, its liquidity profile is improving with rising cash flows, better working capital management, and lowering of interest outgo. Currently, the stock is trading at P/E of 14.3x/12.1x its FY2022E/FY2023E earnings, which leaves further room for upside considering a 17% CAGR in net earnings over FY2021E-FY2023E and valuation below its historical (trailing 10-year) average one-year forward P/E multiple. Hence, we continue to maintain Buy on the stock with a revised PT of Rs. 435.

### Key Risks

Slowdown in tendering activities, especially in T&D and railways.

**Valuation (Consolidated)** Rs cr

| Particulars | FY20 | FY21E | FY22E | FY23E |
|---|---|---|---|---|
| Revenue | 11,965 | 12,345 | 13,319 | 14,778 |
| OPM (%) | 10.3 | 9.7 | 10.0 | 10.2 |
| Adjusted PAT | 566 | 540 | 622 | 738 |
| % YoY growth | 16.3 | (4.6) | 15.0 | 18.2 |
| Adjusted EPS (Rs.) | 22.0 | 21.0 | 24.2 | 28.7 |
| P/E (x) | 15.8 | 16.5 | 14.3 | 12.1 |
| P/B (x) | 3.2 | 2.7 | 2.3 | 2.0 |
| EV/EBITDA (x) | 8.8 | 9.1 | 8.0 | 7.1 |
| RoNW (%) | 21.6 | 17.6 | 17.4 | 17.9 |
| RoCE (%) | 24.0 | 20.0 | 20.2 | 20.9 |

*Source: Company; Sharekhan estimates*

**Execution gathering pace post Q1FY2021:** The company is witnessing near normal environment with majority of its sites being operational. The company expects Q2FY2021 revenue to be better y-o-y, as execution during July and August was higher y-o-y (almost all of its 220 sites being operational and labour availability at 90% now). Consequently, FY2021 revenue is expected to be higher than FY2020. Rail revenue booking is expected at Rs. 3,000 crore-3,200 crore for FY2021 (up from Rs. 2,500 crore in FY2020). In the civil space, KEC expects ~Rs. 1,000 crore revenue in FY2021 (up from Rs. 400 crore in FY2020). The company's recently acquired tower manufacturing unit (50,000 MTPA facility) in Dubai, taking total capacity to 3,62,200 MPT will be fully operational from Q3FY2021, giving it benefits in freight and exemption of customs duty for supplying in international markets. Through the Dubai facility, it can execute tower supply project of the size of Rs. 400 crore-500 crore. KEC's cashflows have been better than last year with funds flowing to AA-rated companies. The company's average cost of borrowing has been brought down to 5% (increased foreign currency borrowings, at 60% now) from 7% last year. Overall, the outlook for KEC's business segments, viz. T&D international and non-T&D comprising railways, civil, and other businesses remains favourable.

**Ordering activity gains momentum and order book remains healthy:** YTD order inflow stood at Rs. 3,332 crore, taking its current order book at Rs. 20,000 crore (1.7x on TTM revenue). KEC is L1 in ~Rs. 4,000 crore worth of projects (~80% T&D). Total bidding pipeline over the next two to three months is at Rs. 30,000 crore-35,000 crore (Rs. 12,000 crore-15,000 crore in international orders, majorly in T&D). KEC has quoted for Rs. 10,000 crore-11,000 crore worth projects out of Powergrid's Rs. 12,000 crore-14,000 crore green energy corridor size (expects inflows during Q3FY2021). In the railways segment, execution is fast pace, while orders delayed earlier are now gaining some traction (Rs. 6,000 crore-7,000 crore orders already quoted by KEC and will be bidding for another Rs. 5,000 cr-6,000 crore orders over the next two to three months). The slackness seen in domestic T&D project awards is well compensated through opportunities arising in international T&D (MENA region, Bangladesh, Far Eastern regions, and North and West Africa) with a good chunk of tenders being floated, although tendering remains slow in Brazil and postponed due to COVID-19 (new tenders expected around December).

## Key highlights of our interaction with management

**Operations in factories and project sites:** The company is witnessing near normal environment with majority of its sites being operational. The company expects Q2FY2021 revenue to be better y-o-y, as execution during July and August was higher y-o-y (almost all of its 220 sites are operational and labour availability is at 90% now.)

**Order backlog and L1 position:** YTD order inflow stood at Rs. 3,332 crore, taking its current order book to Rs. 20,000 crore (1.7x on TTM revenue). KEC is L1 in ~Rs. 4,000 crore worth of projects (~80% T&D).

**Tender pipeline:** Total bidding pipeline over the next two to three months is at Rs. 30,000 crore-35,000 crore (Rs. 12,000 crore-15,000 crore in international orders, majorly in T&D). KEC has quoted for Rs. 10,000 crore-11,000 crore worth projects out of Powergrid's Rs. 12,000 crore-14,000 crore green energy corridor size (expects inflows during Q3FY2021). In the railways segment, execution is at a fast pace, while orders delayed earlier are now gaining some traction (Rs. 6,000 crore-7,000 crore orders already quoted by KEC and it will be bidding for another Rs. 5,000 crore-6,000 crore order over the next two to three months).

**T&D:** The slackness seen in domestic T&D project awards is well compensated through opportunities arising in international T&D (MENA region, Bangladesh, Far Eastern regions, and North and West Africa) with a good chunk of tenders being floated.

**Green Energy Corridor Tenders:** KEC has quoted for Rs. 10,000 crore-11,000 crore worth projects out of Powergrid's Rs. 12,000 crore-14,000 crore green energy corridor size (expects inflows during Q3FY2021).

**Railways:** In the railways segment, execution is at a fast pace, while orders delayed earlier are now gaining some traction (Rs. 6,000 crore-7,000 crore orders already quoted by KEC and will be bidding for another Rs. 5,000 crore-6,000 crore orders over the next two to three months. Order book remains healthy in railways.

**Civil:** KEC has been focusing on diversification in sub-segments; it has secured orders in metro. The company has healthy order book in the civil segment and expects this segment to scale up in the next two-three years on the same line as railways. The company has good order pipeline visibility with new opportunities in warehousing, logistics, defense, and civil.

**Focus on mechanisation on digitalisation:** Management highlighted that it has been focusing on mechanisation and digitalisation, which is expected to help in cost optimisation and support margins in the long run.

**Cashflows:** KEC's cashflows have been better than last year with funds flowing to AA-rated companies. The company's average cost of borrowing has been brought down to 5% (increased foreign currency borrowings, at 60% now) from 7% last year.

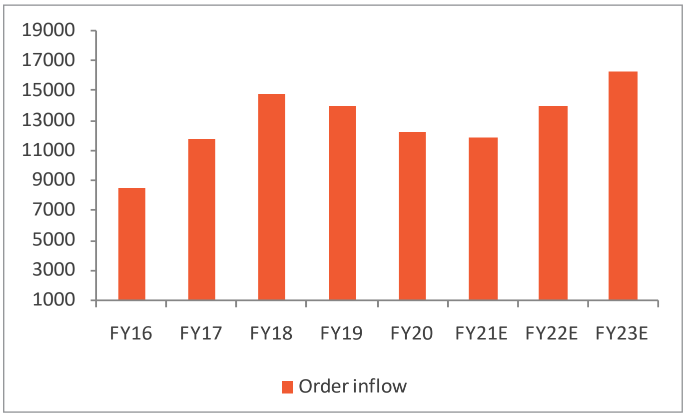
**Dubai plant:** The company's recently acquired tower manufacturing unit (50,000 MTPA facility) in Dubai, taking total capacity to 3,62,200 MPT, will be fully operational from Q3FY2021, giving it benefits in freight and exemption of custom duty for supplying in international markets. Through the Dubai facility, it can execute tower supply project of the size of Rs. 400 crore-500 crore.

## Financials in charts

### Order book and order book to sales

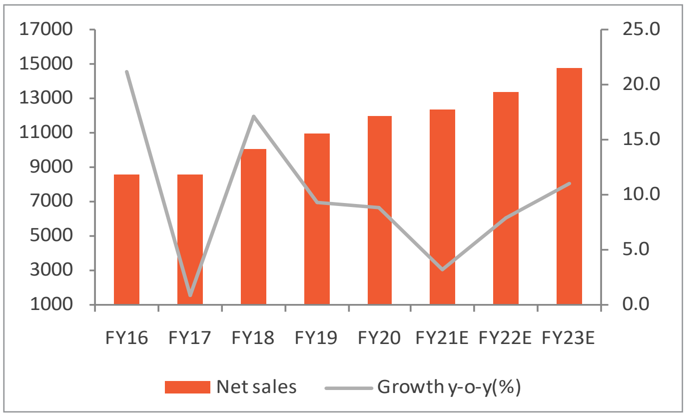

*Source: Company, Sharekhan Research*

### Order inflow trend



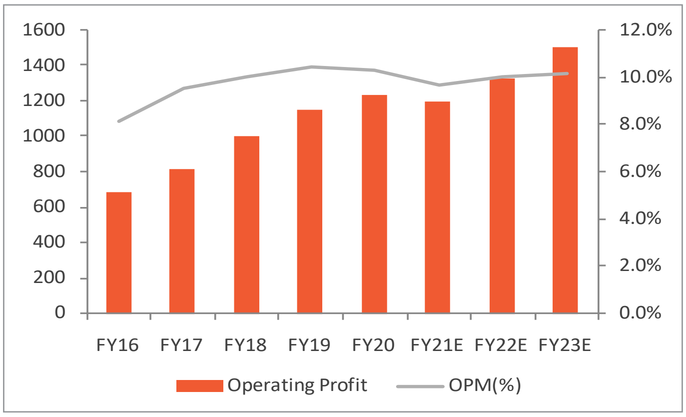

*Source: Company, Sharekhan Research*

### Revenue trend



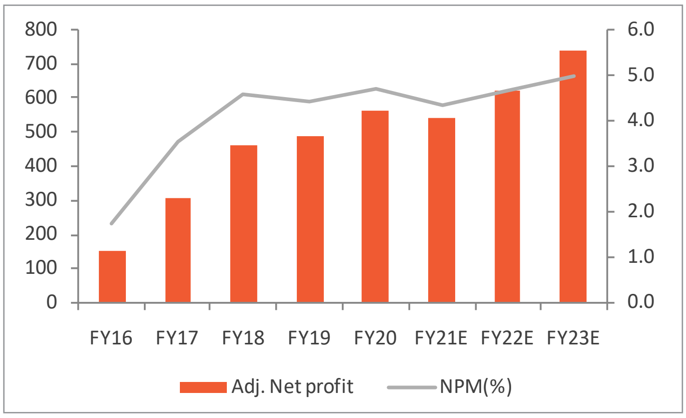

*Source: Company, Sharekhan Research*

### EBITDA trend



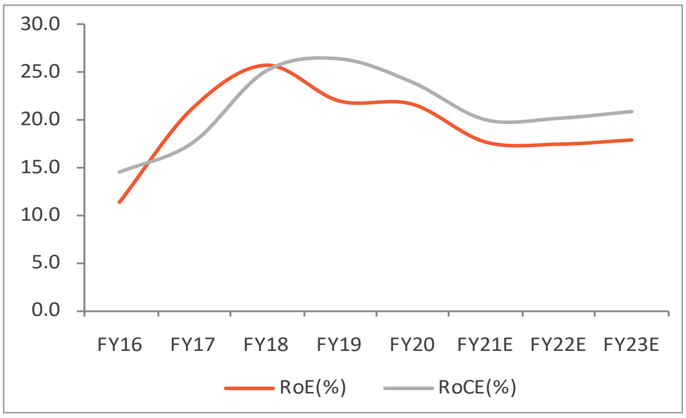

*Source: Company, Sharekhan Research*

### Net profit trend




*Source: Company, Sharekhan Research*

### Return ratios trend




*Source: Company, Sharekhan Research*

## Outlook and Valuation

### ■ Sector view

The government's increasing focus on infrastructure availability, affordable housing, thrust on rural electrification, 100% electrification of railway network by 2025, and increasing metro rail to 25 cities by 2025 are expected to propel growth for user industries. The government has envisaged Rs. 111 lakh crore capital expenditure in the infrastructure sector in India during FY2020 to FY2025. Sectors such as energy (24%), roads (18%), urban (17%), and railways (12%) amount to ~71% of the projected infrastructure investment. The continued thrust of government on infrastructure investment is expected to improve the demand environment across railways, metros, roads, healthcare, and real estates, providing ample opportunities for KEC across the various segments it operates. India's focus on becoming a $5 trillion economy, building industries to drive manufacturing-led growth and goals on sustainable energy will ensure significant investments in the power sector. India's generation capacity is expected to reach 469 GW by 2022 and the development of high voltage transmission grid will need to keep pace with generation capacity. Other factors that will drive growth in the T&D sector are the need for setting-up of interregional grid capacity to ensure seamless flow of power from one region to another, evacuation infrastructure for renewables, and cross-border interconnections with SAARC countries. With the setup of cross-country national grid, huge investments are being planned by states to improve connectivity, reliability, and affordability and there would be increased large-size transmission line as well as substation tenders from state utilities benefitting the companies such as KEC.

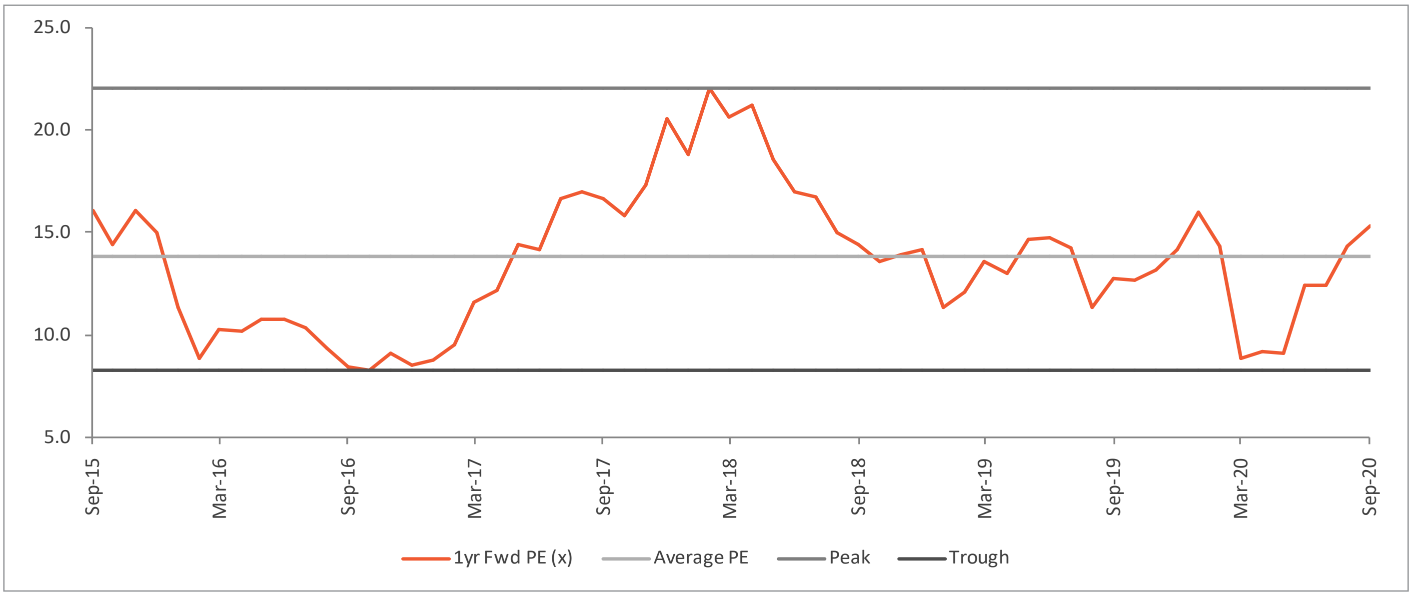
### ■ Company outlook

**Execution and order inflow outlook remains healthy:** Ordering activity is gradually gaining momentum with tendering visibility remaining healthy in railways, international T&D, and civil, with the company having bided for Rs. 30,000 crore-35,000 crore projects. In the railways segment, order momentum, which was slow, has gradually picked up and bids are expected to be awarded soon. The slackness seen in domestic T&D project awards is well compensated through opportunities arising in international T&D (MENA region, Bangladesh, Far Eastern regions, and North and West Africa), with a good chunk of tenders being floated. Tenders in the green energy corridor have been floated and the company has bid for projects worth Rs. 10,000 crore-11,000 crore. The company has L1 position in orders worth Rs. 4,000 crore (majorly international T&D). Management highlighted that it has been focusing on mechanisation and digitalisation, which is expected to help in cost optimisation and support margins in the long run.

### ■ Valuation

**Valuation - Maintain Buy with a revised PT of Rs. 435:** The stock of KEC has doubled since April, as it posted outperformance in Q1FY2021 (despite COVID-19 impact) and has since been showing improving trajectory in execution and order inflows. Additionally, its liquidity profile is improving with rising cash flows, better working capital management, and lowering of interest outgo. Currently, the stock is trading at P/E of 14.3x/12.1x its FY2022E/FY2023E earnings, which leaves further room for upside considering a 17% CAGR in net earnings over FY2021E-FY2023E and valuation below its historical (trailing 10-year) average one-year forward P/E multiple. Hence, we continue to maintain Buy on the stock with a revised PT of Rs. 435.

**One-year forward P/E (x) band**




*Source: Sharekhan Research*

## About company

KEC is a global power transmission infrastructure EPC major. The company is present in the power T&D, cables, railways, renewable (solar energy), smart infra, and civil construction businesses. Globally, the company has powered infrastructure development in more than 61 countries. KEC is a leader in power transmission EPC projects and has more than seven decades of experience. Over the years, the company has grown through the organic as well as the inorganic route.

## Investment theme

T&D spend in India is expected to be around Rs. 2,300 billion over FY2018-FY2023E, up 28%, over FY2012-FY2017. A large part of this spend is likely to come from state electricity boards. Additionally, ordering for the green energy corridor is likely to provide ample opportunities in the domestic market. Moreover, expansion in regional transmission network in Africa, SAARC, and CIS countries is likely to supplement domestic demand and present a large business opportunity. KEC has significantly scaled up the non-T&D segments (railways and civil segments) and margins in these segments have improved significantly. The opportunity size remains high in the non-T&D segment to provide enough opportunity to ramp up its total order outstanding for the business. KEC's order book remains strong, providing strong revenue visibility; and order inflow visibility remains healthy in international T&D and railways segments.

## Key Risks

- Slower-than-expected execution of projects in domestic and international markets due to various reasons is expected to affect performance.
- Slowdown in tendering activities, especially in T&D, railways, and overseas orders.

## Additional Data

**Key management personnel**

| | |
|---|---|
| Mr. Harsh Vardhan Goenka | Non-Executive - Non-Independent Director-Chairperson |
| Mr. Vimal Kejriwal | Executive Director |
| Rajeev Aggarwal | Chief Financial Officer |
| Mr. Ajit Tekchand Vaswani | Non-Executive - Independent Director |

*Source: Company*

**Top 10 shareholders**

| Sr. No. | Holder Name | Holding (%) |
|---|---|---|
| 1 | Swallow Associates Ltd | 26.36 |
| 2 | Summit Securities Ltd | 10.93 |
| 3 | HDFC Trustee Co Ltd/India | 9.25 |
| 4 | HDFC AMC | 9.21 |
| 5 | Instant Holdings Ltd | 8.62 |
| 6 | Kotak Mahindra AMC/India | 3.19 |
| 7 | Aditya Birla Sun Life AMC | 2.97 |
| 8 | LIC of India | 2.67 |
| 9 | IDFC Mutual Fund/India | 2.18 |
| 10 | Reliance Capital Trustee Co | 2.00 |

*Source: Bloomberg*

## Understanding the Sharekhan 3R Matrix

| | |
|---|---|
| **Right Sector** | |
| Positive | Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies |
| Neutral | Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies |
| Negative | Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability. |
| **Right Quality** | |
| Positive | Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance. |
| Neutral | Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable |
| Negative | Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet |
| **Right Valuation** | |
| Positive | Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment. |
| Neutral | Trading at par to historical valuations and having limited scope of expansion in valuation multiples. |
| Negative | Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple. |

*Source: Sharekhan Research*

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