



3R MATRIX

	+	=	-
Right Sector (RS)	✓	■	■
Right Quality (RQ)	✓	■	■
Right Valuation (RV)	✓	■	■

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS	■	↔	■
RQ	■	↔	■
RV	■	↔	■

Reco/View	Change
Reco: Buy	↔
CMP: Rs. 367	
Price Target: Rs. 435	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

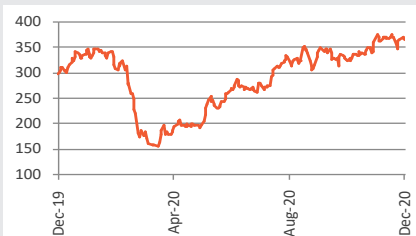
Company details

Market cap:	Rs. 9,422 cr
52-week high/low:	Rs. 384/155
NSE volume: (No of shares)	4.6 lakh
BSE code:	532714
NSE code:	KEC
Free float: (No of shares)	12.4 cr

Shareholding (%)

Promoters	51.8
FII	10.1
DII	26.9
Others	11.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-2	7	36	23
Relative to Sensex	-9	-19	-1	8

Sharekhan Research, Bloomberg

Summary

- We retain a Buy on KEC International Limited (KEC) with an unchanged PT of Rs. 435, considering its improving operations and reasonable valuations.
- Pick-up in execution would ensure better performance in FY2021. Strong YTD order inflows and a Rs. 30,000-crore bidding pipeline offer visibility for remainder of FY21.
- Expect 1.4x and 2.5x y-o-y rise in revenue for rail and civil in FY2021. Rail division continues faster execution, while order tendering is gaining traction for railways and tendering in T&D is largely dominated by international market.
- YTD collections better than last year. Interest outgo contained with lower rate debt.

We interacted with KEC International Limited (KEC) management regarding the recent developments and the outlook for the company and industry. The company expects FY2021 revenue to be higher than that of FY2020 led by a pick-up in execution (almost all of KEC's 220 sites are operational now). On the margin front, company indicated recent increase in raw materials won't affect the margins much as there are hedging policies in place for aluminium and zinc however fluctuations in steel is largely taken care with price variation clause in domestic projects barring international projects which are fixed price. However, price escalation is already taken into account while bidding providing cushion on margins to an extent. Year-to-date (YTD) order inflow stood at Rs. 5,804 crore, while the current order book stands at Rs. 18,500 crore (1.6x on TTM revenue) with L1 status for ~Rs. 6000 crore worth of projects. The tendering pipeline remains healthy wherein KEC has quoted roughly of about Rs 25,000 crore for project in last few months and will be quoting another Rs 30,000 crore worth of projects in next two months, including railways, civil and T&D. KEC has quoted for Rs. 10,000-11000 crore worth projects out of Powergrid's Rs. 12,000-14,000 crore green energy corridor (expects inflows for remaining packages during Q4FY2021). In the railways segment, execution is rapid, while delayed orders are now gaining traction (Rs. 11,000-12,000 crore of orders have already been bidden by KEC). Revenue booking from Rail is expected at ~3,500 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 and postponed in Brazil due to COVID-19, KEC expects one order auction next month. The company expects order inflows in the range of Rs. 1,2000-1,4000 crore for FY2021E. KEC cashflows have been better than last year and the company's average cost of borrowing has been brought down to 5 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

Maintain Buy with an unchanged PT of Rs. 435: The management remains confident of delivering a good performance in FY2021 despite challenges as most projects are operational now. Order inflow visibility remains healthy in railways, international T&D, and civil businesses. The stock of KEC has doubled since April, with good performance in the first half of FY21 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 14.0/12.2x its FY2022E/FY2023E earnings, which is at a discount to its long-term historical average. Given the healthy order backlog, order inflow visibility and KEC's ability to ramp-up execution we maintain our Buy rating on the stock with an unchanged PT of Rs. 435.

Key Risks

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

Valuation (Consolidated)

Particulars	FY20	FY21E	FY22E	FY23E
Revenue	11,965	12,474	13,471	14,958
OPM (%)	10.3	9.1	10.0	10.2
Adjusted PAT	566	524	675	771
% YoY growth	16.3	(7.3)	28.7	14.2
Adjusted EPS (Rs.)	22.0	20.4	26.2	30.0
P/E (x)	16.7	18.0	14.0	12.2
P/B (x)	3.4	2.9	2.4	2.1
EV/EBITDA (x)	9.2	10.0	8.3	7.4
RoNW (%)	21.6	17.2	18.8	18.4
RoCE (%)	24.0	18.9	20.5	21.1

Source: Company; Sharekhan estimates

Execution gathering pace: The company expects FY2021 revenue to be higher than FY2020 on the back of a pick-up in execution (almost all of its 220 sites being operational now). On the margin front, company indicated recent increase in raw materials won't affect the margins much as there are hedging policies in place for aluminium and zinc however fluctuations in steel is largely taken care with price variation clause in domestic projects barring international projects which are fixed price. However, price escalation is already taken into account while bidding providing cushion on margins to an extent. In the railways segment, execution is at a fast pace, while orders delayed earlier are now gaining some traction (Rs. 11,000-12,000 crore orders already bided by KEC). Rail revenue booking is expected at ~3,500 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). KEC cashflows have been better than last year, and the company's average cost of borrowing has been brought down to 5% from 7% last year.

Ordering gains momentum and order book remains healthy: Year-to-date (YTD) order inflow stood at Rs. 5804 crore, while the current order book stands at Rs. 18,500 crore (1.6x on TTM revenue). KEC has the L1 bidder position for ~Rs. 6,000 crore worth of projects. The tendering pipeline remains healthy wherein KEC has quoted roughly of about Rs 25,000 crore for project in last few months and will be quoting another Rs 30,000 crore worth of projects in next two months which includes the railways, civil and T&D segments. KEC has quoted for Rs. 10,000-11000 crore worth projects out of Powergrid's Rs. 12,000 crore-14,000 crore green energy corridor (expects inflows for remaining packages during Q4FY2021). 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 and postponed in Brazil due to COVID-19, it expects one order auction next month.

Key highlights of our interaction with management

Operations in factories and project sites: The company is witnessing a normal business environment with majority of its sites being operational.

Order backlog and L1 position: YTD order inflow stood at Rs. 5,804 crore, while the current order book stands at Rs. 18,500 crore (1.6x on TTM revenue). KEC is L1 bidder in ~Rs. 6000 crore worth of projects.

Tender pipeline: Tendering pipeline remains healthy wherein KEC has quoted roughly of about Rs 25,000 crore for project in last few months and will be quoting another Rs 30,000 crore worth of projects in next two months which includes railways, civil and T&D.

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. 10,000-11000 crore worth projects out of Powergrid's Rs. 12,000-14,000 crore green energy corridor size (expects inflows for remaining packages during Q4FY2021)

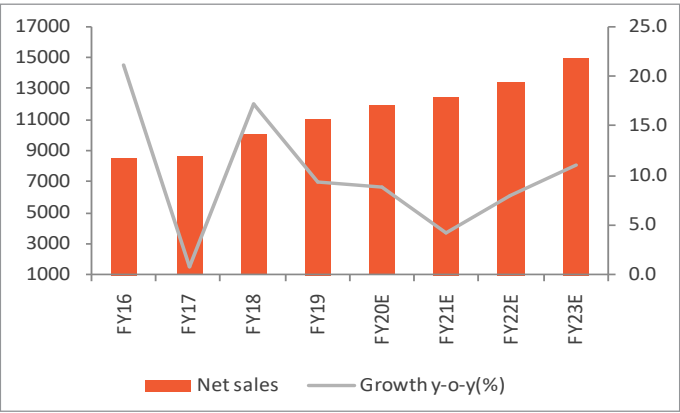
Railways: In the railways segment, execution is at a fast pace, while orders delayed earlier are now gaining some traction (Rs. 11,000-12,000 crore orders already quoted by KEC and will be bidding). Rail revenue booking is expected at Rs. 3,000-3,500 crore for FY2021 (up from Rs. 2,500 crore in FY2020).

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 2-3 years on the same line as railways. The company has good order pipeline visibility with new opportunities in the warehousing, logistics, defense, and civil segments. In the civil segment, KEC expects ~Rs. 1,000 crore in revenue in FY2021 (up from Rs. 400 crore in FY2020).

Cashflows: 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.

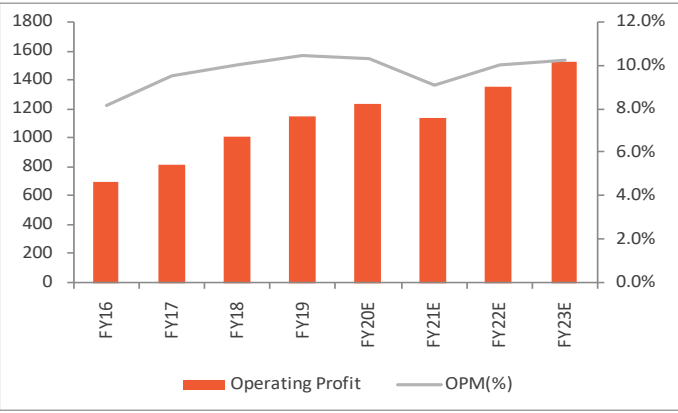
Financials in charts

Revenue trend



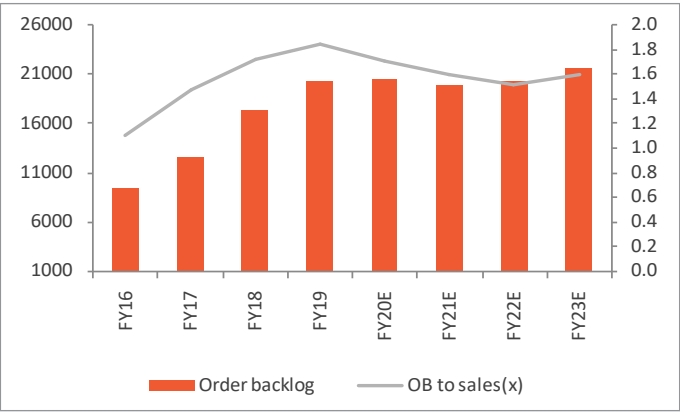
Source: Company, Sharekhan Research

EBITDA trend



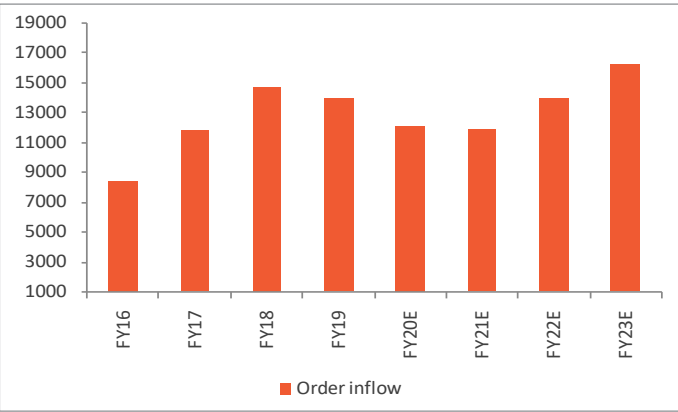
Source: Company, Sharekhan Research

Order book and order book to sales



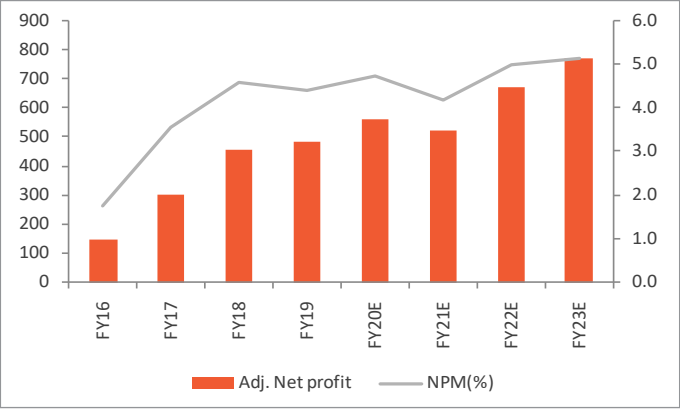
Source: Company, Sharekhan Research

Order inflow trend



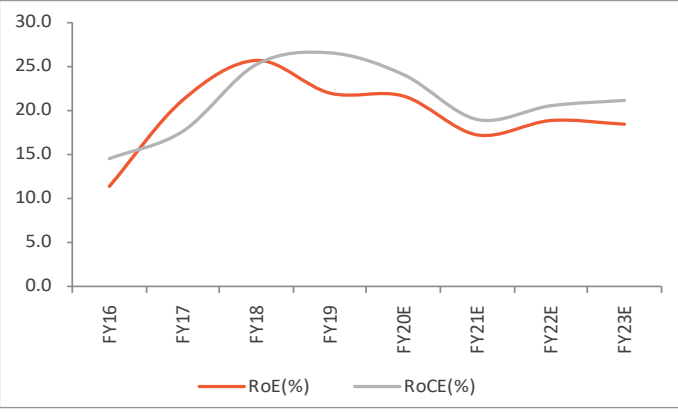
Source: Company, Sharekhan Research

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 of capital expenditure in the infrastructure sector 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.

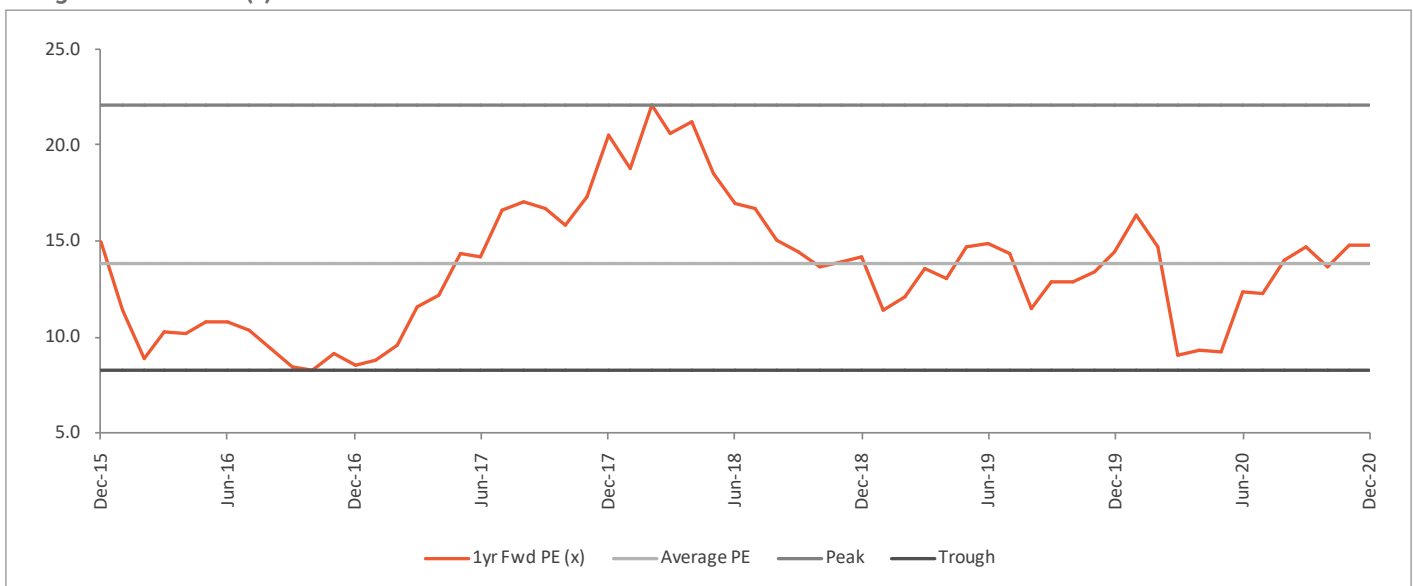
■ Company outlook - Execution and order inflow outlook remains healthy

Ordering activity is gradually gaining momentum with tendering visibility remaining healthy in railways, international T&D, and civil, with the company having bid for Rs. 25,000 crore worth of 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. 10,000-11,000 crore. The company has L1 position for orders worth Rs. 6000 crore (majorly international T&D).

■ Valuation - Maintain Buy with an unchanged PT of Rs. 435

The management remains confident of delivering a good performance in FY2021 despite challenges as most projects are operational now. Order inflow visibility remains healthy in railways, international T&D, and civil businesses. The stock of KEC has doubled since April, with good performance in the first half of FY21 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 14.0/12.2x its FY2022E/FY2023E earnings, which is at a discount to its long-term historical average. Given the healthy order backlog, order inflow visibility and KEC's ability to ramp-up execution we maintain our Buy rating on the stock with an unchanged 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

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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 deteriorating 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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