



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. 359	
Price Target: Rs. 435	↔

↑ Upgrade
↔ Maintain
↓ Downgrade

Company details

Market cap:	Rs. 9,237 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	9.8
DII	26.0
Others	12.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-2.6	10.2	28.4	4.3
Relative to Sensex	0.2	-6.2	6.8	-8.1

Sharekhan Research, Bloomberg

KEC International Limited

Descent quarter despite challenges, better prospects ahead

Capital Goods

Sharekhan code: KEC

Result Update

Summary

- We retain Buy on KEC International Limited (KEC) with an unchanged PT of Rs. 435, taking into account improving operations and reasonable valuations.
- KEC posted stable results in Q3FY2021, in line with estimates despite challenges. Order book remains strong, providing 1.4x TTM revenue.
- Strong YTD order inflow of Rs. 6,827 crore. Management indicated strong tender pipeline for the remainder of FY2021.
- Dubai unit has commenced fully from Q3FY2021 and has started receiving orders from existing as well as new clients and provides edge in international orders with the benefit of freight and exemption of customs duty.

KEC International Limited (KEC) posted stable Q3FY2021 results despite challenges, which were in-line with estimates. Consolidated revenue for Q3FY2021 improved by 7% y-o-y to Rs. 3,289 crore (in-line with estimates). T&D revenue declined by 11.8% y-o-y to Rs. 1,833 crore mainly due to slow execution in Brazil and overall cautiousness considering the spike in raw-material prices along with unavailability of steel and cement hampered execution (improving gradually). Non T&D business improved by 52% y-o-y (railway revenue improved by 44% y-o-y and civil revenue jumped ~3x y-o-y) in Q3FY2021. Blended operating margin came at 9.1% (down 128 bps y-o-y), largely due to steep depreciation of Brazilian currency and higher sub-contracting costs resulting in operating profit to decline by 6.2% y-o-y to Rs. 299 crore. Higher other income and lower interest cost (down 18.8% y-o-y) led to flat PAT y-o-y to Rs. 145 crore (in-line with estimates). Management refrained from giving any guidance on order inflows, revenue, and margin for FY2021 due to uncertainty led by COVID-19. However, management expects pick-up in execution would ensure better performance in FY2021 and indicated that the company's profitability is unlikely to deteriorate further except for commodity prices. Further, management expects FY2022 to witness double-digit revenue growth because of healthy order book of Rs. 17,918 crore (1.4x TTM consolidated revenue). KEC's YTD order inflow remained strong at Rs. 6,827 crore and is L1 in ~Rs. 6,082 crore worth of projects (majorly international T&D), which remains better on a y-o-y basis. Overall, the tendering pipeline for KEC including T&D, railways, and civil stands at ~Rs. 60,000 crore orders, where KEC has bid recently or is in bidding stage. Hence, management expects strong intake of Rs. 17,000 crore-18,000 crore in FY2022E. Further, in TBCB ordering, green corridor, SEB orders from Rajasthan, Kerala, Tamil Nadu, etc. are likely to drive T&D orders in 4QFY21/FY2022 and green energy EPC orders announcements are likely in the next month for the first few packages post auction, wherein KEC remains favourably placed. In the railways segment, execution is at a fast pace and strong growth in the current as well as next year is expected. On the civil business front, KEC has been focusing on diversification in sub-segments and has secured orders in metro. The company has healthy order book in the civil segment and expects this segment to scale up (expect 35%+ growth over the next few years on low base and large opportunities and build up in execution). The company's Dubai unit has commenced fully from Q3FY2021. It has started receiving orders from existing as well as new clients and provides edge in international orders with benefit of freight and exemption of customs. Working capital has increased due to build up in some inventory of RM considering the hike in prices as also availability and taken strategic view to expand WC, especially in view of lower interest costs (expects interest cost as % of sales to be at ~2% for FY2021E). However, it expects to normalise by the end of Q4FY2021E. Overall, the outlook for KEC's business segments, viz. T&D international and non-T&D comprising railways, civil, and other businesses remain favourable. We have fine-tuned our earnings estimates for FY2021-FY2022. 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 positives

- Strong execution in the civil business (revenue up 3x y-o-y) with strong growth visibility.
- KEC is L1 in projects worth Rs. 6,082 crore, along with strong YTD order inflow of Rs. 6,827 crore providing healthy order inflow visibility.
- Tender pipeline remains strong across businesses.

Key negatives

- OPM was lower due to steep depreciation of Brazilian currency and faster ramp-up of non-T&D revenue is reflected in higher sub-contracting costs.

Our Call

Maintain Buy with unchanged PT of Rs. 435: 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 FY2021 and has since been showing improving trajectory in execution and order inflows. Additionally, its liquidity profile is improving with rising cash flows and lowering of interest outgo. Currently, the stock is trading at P/E of 14x/12x 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 risk

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

Valuations (Consolidated)

	Rs cr			
Particulars	FY20	FY21E	FY22E	FY23E
Revenue	11,965	12,474	13,471	14,958
OPM (%)	10.3	9.1	9.9	10.1
Adjusted PAT	566	524	665	760
% YoY growth	16.3	(7.3)	26.8	14.3
Adjusted EPS (Rs.)	22.0	20.4	25.9	29.6
P/E (x)	16.3	17.6	13.9	12.2
P/B (x)	3.3	2.8	2.4	2.1
EV/EBITDA (x)	9.0	9.9	8.2	7.3
RoNW (%)	21.6	17.2	18.6	18.2
RoCE (%)	24.0	18.9	20.3	20.9

Source: Company; Sharekhan estimates

Descent quarter: KEC posted stable Q3FY2021 results despite challenges, which were in-line with estimates. Consolidated revenue for Q3FY2021 improved by 7% y-o-y to Rs. 3,289 crore (in line with estimates) where T&D revenue declined by 11.8% y-o-y to Rs. 1,833 crore mainly due to slow execution in Brazil and overall cautiousness considering the spike in raw-material prices along with unavailability of steel and cement hampered execution (improving gradually). Non-T&D business improved by 52% y-o-y (railway revenue improved by 44% y-o-y and civil revenue jumped by ~3x y-o-y) in Q3FY2020. Blended operating margin came at 9.1% (down 128 bps y-o-y) largely due to COVID-19 related expenses plus steep depreciation of Brazilian currency and higher sub-contracting costs resulting in operating profit to decline by 6.2% y-o-y to Rs. 299 crore. Higher other income and lower interest cost (down 18.8% y-o-y) led to flat PAT y-o-y to Rs. 145 crore (in-line with estimates). Management has refrained from giving any guidance on order inflows, revenue, and margin for FY2021 due to uncertainty led by COVID-19. However, management expects pick-up in execution would ensure better performance in FY2021 and indicated that the company's profitability is unlikely to deteriorate further except for commodity prices. Further, management expects FY2022 to witness double-digit revenue growth due to healthy order book. The company's recently acquired tower manufacturing unit (50,000 MTPA facility) in Dubai, taking total capacity to 3,62,200 MPT, is fully operational and started receiving orders from existing as well as new clients, giving it benefits in freight and exemption of customs duty for supplying in international markets.

Order win momentum remains strong: KEC's YTD order inflow remained strong at Rs. 6827 crore and is L1 in ~Rs. 6,082 crore worth of projects (majorly international T&D), which remains better on a y-o-y basis. Overall, the tendering pipeline for KEC including T&D, railways, and civil stands at ~Rs. 60,000 crore orders, where KEC has bid recently or is in bidding stage. Hence, management expects strong intake of Rs. 17,000 crore-18,000 crore in FY2022E. Further, in TBCB ordering, green corridor, SEB orders from Rajasthan, Kerala, Tamil Nadu, etc. are likely to drive T&D orders in 4QFY2021/FY2022 and green energy EPC orders announcements are likely in the next month for the first few packages post auction, wherein KEC remains favourably placed. In the railways segment, execution is at a fast pace and strong growth in the current as well as next year is expected. On the civil business, KEC has been focusing on diversification in sub-segments and has secured orders in metro, chemicals, and water. The company has healthy order book in the civil segment and expects this segment to scale up (expect 35%+ growth over the next few years on low base and large opportunities and build up in execution).

Key Conference call takeaways

- ♦ **Performance for Q3FY2021:** T&D's topline growth was lower mainly due to slow execution in Brazil and overall cautiousness considering the spike in raw-material prices. Availability of steel and cement was also an issue; steel availability is improving gradually. Railways saw some impact of farmers' agitation. Profitability impacted due to cost overruns in Brazil – likely to be completed by Q1FY2022/QFY2022.
- ♦ **Dubai plant commissioned in Q3:** KEC has started receiving orders from existing as well as new clients.
- ♦ **Execution pick-up:** There is progressive uptick in execution in domestic and international projects.
- ♦ **Delay in some projects:** Some delay in international T&D in Africa and Middle East due to visa/work permit delay and stringent quarantine norms; however, it should ease gradually.
- ♦ **Profitability:** The company's profitability is unlikely to deteriorate further, except for commodity prices.
- ♦ **Civil segment:** The segment is likely to witness 35%+ growth over the next few years on low base and large opportunities and build-up in execution.

- ♦ **Overall ordering pipeline:** Overall, there are ~Rs. 60,000 crore orders where KEC has bid recently or is in the bidding stage. Hence, strong intake of Rs. 17,000 crore-18,000 crore expected in FY2022E. TBCB ordering, green corridor, SEB orders from Rajasthan, Kerala, Tamil Nadu, etc. to drive T&D orders in 4QFY2021/FYFY2022. Green order EPC orders are likely in the next month for the first few packages post auction winner announcement.
- ♦ **International T&D:** Continues to see continued traction from MENA.
- ♦ **Competition:** Increasing small-size projects due to lower bank guarantee requirements; in case of big projects, large players are getting competitive.
- ♦ **Working capital:** Working capital has increased due to build up in some inventory of RM considering the hike in prices as also availability and taken strategic view to expand WC, especially in view of lower interest costs (expects interest cost as % of sales to be at ~2% for FY2021E). However, it expects to normalise by the end of Q4FY2021E
- ♦ **Interest costs:** The company expects interest cost as percentage of sales to be at ~2% for FY2021E.

Results - Quarterly

Particulars	Q3FY21	Q3FY20	YoY	Q2FY21	QoQ %
Net Sales	3,289	3,073	7.0%	3,258	1%
Net raw material	1,370	1,439	-5%	1,520	-10%
Erection and subcontracting charges	1,007	703	43%	835	21%
Employee cost	294	301	-2%	270	9%
Other Expenditure	320	311	3%	339	-6%
Operating Profit	299	319	-6%	293	2%
Other Income	4	2	91%	7	-42%
Depreciation	38	37	4%	37	2%
Interest	66	81	-18.8%	67	-2%
PBT	199	203	-2%	195	2%
Tax Expenses :	54	58	-7%	52	2%
Reported PAT	145	145	0.1%	143	2%
Exceptional items	-	-		-	
Adj PAT	145	145	0.1%	143	2%
OPM %	9.1	10.4	(128)	9.0	8.3
NPM %	4.4	4.7	(31)	4.4	3.5
Tax rate %	27.0	28.5	-	26.9	-

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Continued government focus on infrastructure pending to provide growth opportunities

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 in. 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 companies such as KEC.

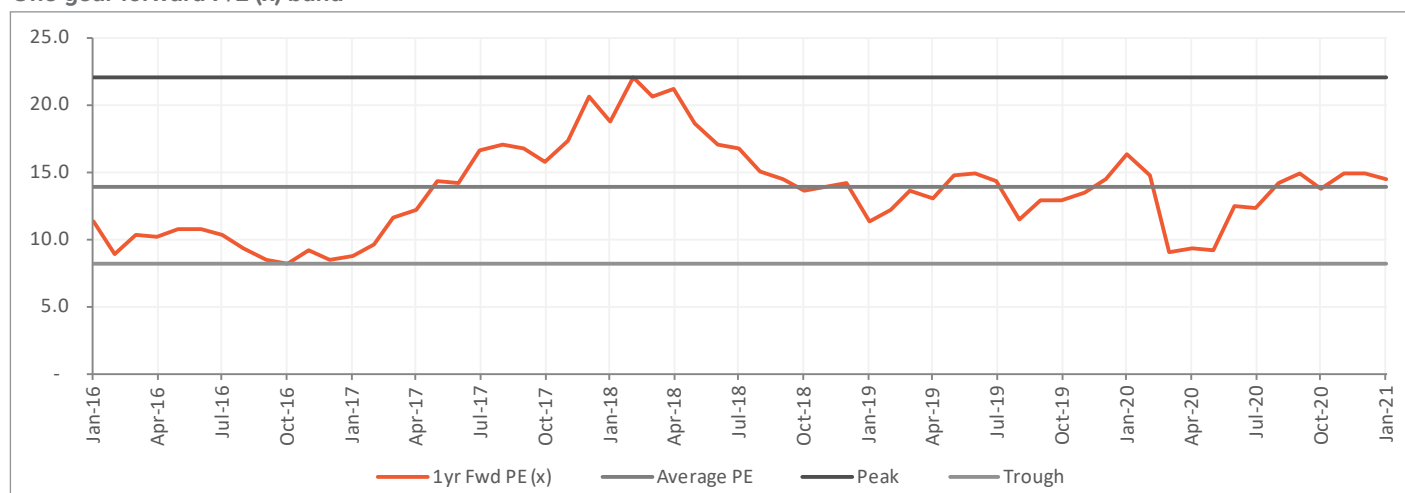
■ Company Outlook – Execution and order inflow outlook remains healthy

Ordering activity is gradually gaining momentum with tendering visibility remaining healthy in railways, international T&D, and civil. Overall, the tendering pipeline for KEC including T&D, railways, and civil stands at ~Rs. 60,000 crore orders, where KEC has bid recently or is in bidding stage. Hence, management expects strong intake of ~Rs. 17,000 crore -18,000 crore in FY2022E. Further, in TBCB ordering, green corridor, SEB orders from Rajasthan, Kerala, Tamil Nadu, etc. are likely to drive T&D orders in 4QFY2021/FY2022 and green energy EPC orders announcements are likely in the next month for the first few packages post auction, wherein KEC remains favourably placed. 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, wherein opportunity remains bright for the company.

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

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 FY2021 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 14x/12x 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 the 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 Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Swallow Associates Ltd	26.36
2	Summit Securities Ltd	10.86
3	HDFC Trustee Co Ltd/India	9.25
4	HDFC AMC	9.21
5	Instant Holdings Ltd	8.56
6	Kotak Mahindra AMC/India	3.19
7	Aditya Birla Sun Life AMC	2.97
8	LIC of India	2.74
9	IDFC Mutual Fund/India	2.36
10	Reliance Capital Trustee Co	2.29

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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