Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

KEI Industries Ltd

Strong show amid cost pressures

Capital Goods	Sharekhan code: KEI
Reco/View: Buy ↔	CMP: Rs. 1,149 / Price Target: Rs. 1,300 ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 24.94

Updated Jan 08, 2022

Medium Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

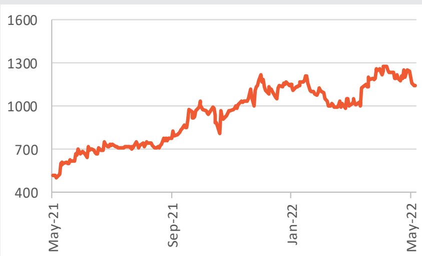
Company details

Market cap:	Rs. 10,353 cr
52-week high/low:	Rs. 1,320 / 505
NSE volume: (No of shares)	2.96 lakh
BSE code:	517569
NSE code:	KEI
Free float: (No of shares)	5.6 cr

Shareholding (%)

Promoters	38.0
FII	25.3
DII	21.5
Others	15.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-10	11	14	120
Relative to Sensex	-2	19	24	110

Sharekhan Research, Bloomberg

Summary

- KEI Industries reported strong numbers for Q4FY2022 led by ~20%/52% volume/value growth in cables and wires segment. However, higher input cost weighed on gross/operating margin which reduced by ~600/140 bps and came in at ~24%/9.6%.
- The management expects a 17-18% revenue CAGR in the next two-three years. It also eyes an operating margin of 10.5-11% and PAT margin of 6.5% on a sustainable basis. KEI's focus continues to be on expanding retail businesses and exiting EPC business.
- De-bottlenecking in existing capacities and greenfield expansion in cables and wires at ~ Rs. 800 crore investment (first phase by 2024E) would help sustain its high-growth trajectory.
- We retain Buy rating on KEI with an unchanged PT of Rs. 1300, factoring in promising growth outlook and compelling valuation.

KEIs' Q4FY22 results beat ours and the street's expectations, barring a miss on the OPM front. KEI's standalone revenue growth of ~44% was primarily led by robust growth of ~52% in cables segment owing to strong B2B sales, while the volumes grew at a healthy pace of ~20% y-o-y during the quarter. Rise in commodity costs and inflationary pressures weighed on profitability as OPM declined by ~140 bps to 9.6% (vs our estimate of 10.6%). EBIT margin declined in Cables segment to 8.1% (vs9.8% in Q4FY21), while turnkey projects segment clocked margin of 11.9% (vs7.8% in Q4FY21) despite decline of ~16% in sales. The decline in turnkey (EPC) sales is in line with the company's strategy to reduce EPC revenue share. Net profit grew by ~35% y-o-y to Rs 116crore (beating our estimate of Rs 97crore) led by strong revenues and higher other income. The management targets to grow its revenues at 17-18% CAGR (retail to grow at 25-30% p.a.) over the next three years. The company would be undertaking greenfield expansion in the cables segment at an investment of ~Rs. 800 crore (land acquisition to be done in next couple of months- first phase by 2024E) to maintain high-growth trajectory.

Key positives

- Fall in net debt (including acceptances) to Rs 270 crore (vs Rs 407 crore in FY21) would reduce interest cost.
- Revenues from dealer/distribution network increased by ~55% y-o-y contributing over 40% to total revenues. Export institutional cables revenue increased over 24% y-o-y during Q4FY22.

Key negatives

- OPM remained under pressure on account of rise in input cost.
- There has been some delay in land acquisition for capacity expansion in LT, HT and EHV cables.

Management Commentary

- The company retained its revenue growth guidance of 17-18% CAGR for the next three years with retail sales growing at 25-30% CAGR.
- The management expects continuous demand generation from government infrastructure spend, private industrial capex and real estate.
- The company is undertaking greenfield capacity expansion in LT, HT and EHV with a capex of ~Rs. 800 crore over 3 years. The land acquisition for the same would be done in couple of months. The annual capex is expected to be around Rs 150-200 crore. The company through debottlenecking would improve capacity utilization of its existing plants by 5-7%.
- The working capital cycle at FY22 end was less than three months.

Revision in estimates – We have largely maintained our estimates for FY2023/FY2024E with minor change in OPM expectations given fluctuations in commodity cost.

Our Call

Valuation – Retain Buy with an unchanged PT of Rs. 1300: KEI's growth outlook is expected to be positive with its diversified user industries, increased focus on retail, high-margin EHV cables business and export sales along with a focused-industry approach as well as utilization-driven capex plans. These are likely to help in sustaining a strong growth trajectory. An uptick in housing demand bodes well for KEI given its increased focus on brand-building, distribution expansion & increasing B2C sales. Further, institutional segment is also expected to do well on account of increase in government and private capex. The stock is currently trading at a P/E of ~18x its FY2024E EPS, thereby leaving further headroom for upside. Hence, we maintain a Buy on the stock with an unchanged PT of Rs. 1300.

Key Risks

Fluctuations in raw-material prices could sharply affect margins.

Valuation (Standalone) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	4,181	5,727	6,769	8,023
OPM (%)	10.9	10.3	11.0	11.4
Adjusted PAT	270	376	479	586
% y-o-y growth	*5.7*	*39.6*	*27.2*	*22.3*
Adjusted EPS (Rs.)	30.0	41.8	53.1	65.0
P/E (x)	38.3	27.5	21.6	17.7
P/B (x)	2.0	1.6	1.3	1.1
EV/EBITDA (x)	8.9	7.0	5.2	4.1
RoNW (%)	15.2	17.7	18.5	18.5
RoCE (%)	20.0	22.5	24.1	24.5

Source: Company; Sharekhan estimates

Performance beats expectations barring miss on OPM

KEI Industries' Q4FY22 performance was above our estimates primarily led by robust growth of ~52% in cables and wires segment owing to strong B2B sales. Consequently, its total revenues grew by 44% y-o-y to Rs 1,792 crore beating our estimates of 16% yoy growth. Further, volume growth in cables and wires was also strong at ~20%. Total institutional cable sale including export contributed ~53% in Q4FY22. Rise in commodity cost and inflationary pressures weighed on profitability as gross margins declined by ~600 bps to ~24%. Consequently, operating margin declined by ~140bps to 9.6% (vs our estimate of 10.6%) despite proportionate decline in operating expenses. EBIT margin declined in cables segment to 8.1% (vs9.8% in Q4FY21), while turnkey projects segment clocked margin of 11.9% (vs7.8% in Q4FY21) despite decline of ~16% in sales. Net profit grew by ~35% yoy to Rs 116crore led by strong revenues and higher other income.

Robust growth outlook

The management remains optimistic on expanding its retail franchise through expanding the dealer and distribution base (currently at 1,805 numbers) and expects its retail segment to grow by 25-30% y-o-y. It wants to grab a 10% market share in house wires. Currently, market share in wires is at ~6%, while in cables it has a market share of ~12%. The company expects continuous demand from government infra and private capex and is focused on growing exports too. The company is strategically reducing its exposure to EPC business which is capital intensive and low margin and utilise the funds to channelize the retail segment's growth. The company would be expanding LT, HT and EHV capacity over 3-4 years with an investment of ~ Rs 800 crore to clock an 17-18% CAGR.

KEI Q4FY2022 Conference call highlights:

- **Guidance:** The company retained its retail sales target of over a 50% contribution in the next two years. Increasing contribution of retail segment to total revenues would reduce pricing gap with its competitors. The company targets to grow revenues by 18-20% y-o-y in FY2023 and maintain a 17-18% CAGR in the coming years. The company expects continuous demand from government infrastructure, private capex and real estate projects. It also expects demand for wires and cables to increase given investments and capacity expansion by companies under PLI scheme.
- **Expansion:** The company is undertaking greenfield capacity expansion in LT, HT and EHV with a capex of ~Rs. 800crore over 3-4 years. The company through debottlenecking would also improve capacity utilization of its existing plants by 5-7% per annum.
- **Capex:** The annual capex is expected to be around Rs 150-200 crore over the next two-three years. The capacity utilization in cables is 76% currently.
- **Change in accounting policy for Raw materials:** The ccompany has changed its accounting policy for valuation of raw materials, finished goods, project materials and work in process from First in First Out (FIFO) to the moving weighted average cost method w.e.f. April 01, 2021. The company believes that this change reflects better matching of the actual cost with the physical flow of goods and gives better comparability with industry peers. Its impact on profitability was minor at Rs 3-4 crore during the quarter.
- **Q4 performance:** Robust show in Q4FY22 was led by strong volume growth in cables and wires at ~20% y-o-y combined with price hikes. The margins declined during the quarter on account of sharp fluctuations in input costs despite decline in employee and sub-contracting expenses(EPC business) in proportion to the revenue. The domestic wires & cables revenues were up 40% y-o-y to Rs. 480 crore.
- **Debt and working capital:** Net debt including acceptances stood at Rs. 270 crore versus Rs. 407 crore in Q4FY2021. The working capital cycle currently is less than 3 months while creditors cycle is just about one month.
- **Other highlights:** Order book is at Rs 2,419 crore :- EPC @ Rs. 959 crore, EHV @Rs 224 crore (including L1 of Rs 61 cr), domestic cables @Rs 1,100 crore, exports @Rs 137cr. The company has ~6% market share in wires, while in cables it is ~12%.

Quarterly Results (Standalone) **Rs cr**

Particulars	Q4FY22	Q4FY21	Y-o-Y %	Q3FY22	Q-o-Q %
Revenue	1,791.7	1,246.3	43.8	1,563.8	14.6
Operating profit	171.9	137.4	25.1	156.8	9.6
Other Income	7.8	2.5	213.4	1.7	357.2
Interest	10.0	12.5	(19.8)	9.0	11.8
Depreciation	13.9	14.5	(4.5)	13.7	0.9
PBT	155.8	112.9	38.0	135.8	14.7
Tax	39.9	26.8	49.1	34.6	15.5
Reported PAT	115.9	86.1	34.6	101.2	14.5
Adj. PAT	115.9	86.1	34.6	101.2	14.5
Adj.EPS	12.9	9.6	34.6	11.2	14.5
			BPS		**BPS**
OPM (%)	9.6	11.0	(143)	10.0	(43)
NPM (%)	6.5	6.9	(44)	6.5	(1)
Tax rate	25.6	23.7	190	25.5	16

Source: Company; Sharekhan Research

Outlook and Valuation

Sector View – Ample levers offer scope for growth

Domestic demand is improving with unlocking, infrastructure, and construction back in action with labour issues largely resolved, which provide a positive outlook ahead. The wires and cables industry contributes 40%-45% to India's electrical equipment industry. In terms of volumes, the Indian cables & wires industry (including exports) has grown from 6.3 million kms in FY2014 to 14.5 million kms in FY2018, posting a ~23% CAGR over the period. The industry registered an ~11% CAGR in value terms, from Rs. 34,600 crore in FY2014 to Rs. 52,500 crore in FY2018. The cables & wires industry was expected to register a CAGR of 14.5% from Rs. 52,500 crore in FY2018 to Rs. 1,03,300 crore by FY2023. However, a slowdown in infrastructure growth and uncertainty in real estate will lead to a moderation in growth for the C&W segment. The government has envisaged a Rs. 111 lakh crore capital expenditure in infrastructure sectors 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 investments. The continued thrust of the government on infrastructure investment is expected to improve demand for the W&C industry.

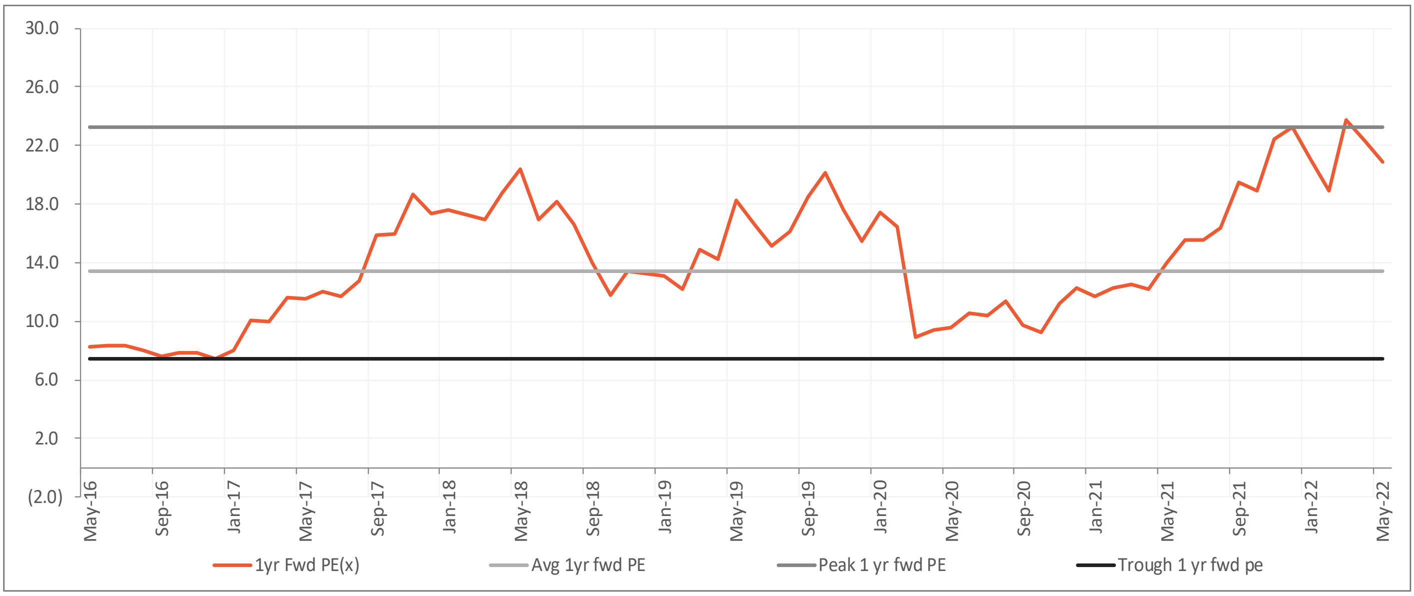
Company Outlook – High growth to be added by capacity expansion plan

The management remains optimistic on the retail and EHV segments in the longer run. It is focused on expanding its retail franchise through expanding its dealer and distribution base (currently at 1,805 and expects it to increase by -20% y-o-y) and expects its retail segment to reach 40-45% of revenue by FY2023. The management will also cut down its EPC business and utilise the money to channelise the retail segment's growth. On the high-margin EHV front, which remains a Rs. 2,000 crore market in India, while the total capacity is Rs. 1,000-1,100 crore between the company and Universal cables and opportunity size remains huge. The company will be undertaking a greenfield capex of ~Rs.800 crore in LT, HT, and EHV over the three-to-four-year period. The management expects 17-18% y-o-y revenue growth CAGR in the next two-three years.

Valuation – Retain Buy with an unchanged PT of Rs. 1300

KEI's growth outlook is expected to be positive with its diversified user industries, increased focus on retail, high-margin EHV cables business and export sales along with a focused-industry approach as well as utilization-driven capex plans. These are likely to help in sustaining a strong growth trajectory. An uptick in housing demand bodes well for KEI given its increased focus on brand-building, distribution expansion & increasing B2C sales. Further, institutional segment is also expected to do well on account of increase in government and private capex. The stock is currently trading at a P/E of ~18x its FY2024E EPS, thereby leaving further headroom for upside. Hence, we maintain a Buy on the stock with an unchanged PT of Rs. 1300.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

KEI is among the top three organised players in the Indian W&C industry and an EPC player in the power T&D segment. KEI has a diversified business model with a significant presence in domestic and international markets. The company services retail and institutional customers and caters to both private and public sector clients. Currently, KEI manufactures and markets power cables and addresses cabling requirements of a wide spectrum of sectors such as power, oil refineries, railways, automobiles, cement, steel, and real estate, etc. KEI has built its manufacturing facilities at Bhiwadi and Chopanki (in Rajasthan) and Silvassa (Dadra and Nagar Haveli). The company is well poised to garner opportunities from power utilities, core infrastructure, and construction projects across the country. The company's prudent foray into the EHV cable for power sector projects has further expanded the opportunity horizon.

Investment theme

Over the years, the company has established its presence in the institutional space by developing the ability to offer various products across locations. KEI has a well-entrenched marketing presence across all states, which increases its ability to deliver products speedily from plants in North and West India. The company has created a presence in building specialized offerings to tap niche segments such as the shipping sector, oil and petroleum plants, etc. The company is now looking at tapping several large realty brands and strengthening all-India presence by embarking on opening new warehouses across India. The retail segment comprises house wires (HW) and a part of low-tension cables (LT) sold through dealers. Given its growing dealer network and brand-building initiatives (advertising and sponsoring), performance-linked schemes, and dealer-electrician meets etc., we expect KEI to increase its retail presence further.

Key Risks

- **Fluctuations in raw-material prices:** Any sharp increase or decrease in key raw materials – copper and aluminium will affect margins sharply.
- **Currency risk:** A decent part of revenue is generated from exports and any fluctuations in forex rates could affect the company's financials.

Additional Data

Key management personnel

Mr. Anil Gupta	Chairman and Managing Director
Mrs. Akshit Diviaj Gupta	Executive Director
Mrs. Archana Gupta	Non-Executive – Non-Independent Director
Mr. Rajeev Gupta	CFO

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Gupta Anil	18.14
2	PROJECTION FIN AND MANAGEM	8.77
3	Smallcap World Fund, Inc	5.02
4	DSP Value Fund	4.21
5	SHUBH LAXMI MOTELS & INNS.	3.86
6	Soubhagya Agency Pvt Ltd	3.47
7	HDFC Trustee Co Ltd	2.97
8	Franklin Build India Fund	2.71
9	Massachusetts Institute Of Technology	2.39
10	Invesco India Small Cap Fund	2.37

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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