Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

KEI Industries

Decent Q2, positive outlook

Capital Goods	Sharekhan code: KEI	Result Update

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. 464**	
Price Target: **Rs. 540**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

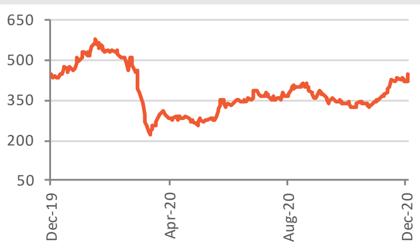
Company details

Market cap:	Rs. 4,171 cr
52-week high/low:	Rs. 573 / 208
NSE volume: (No of shares)	1.1 lakh
BSE code:	517569
NSE code:	KEI
Free float: (No of shares)	5.4 cr

Shareholding (%)

Promoters	40.3
FII	16.3
DII	23.5
Others	19.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-4	37	28	-17
Relative to Sensex	-1	20	6	-30

Sharekhan Research, Bloomberg

Summary

- We retain Buy rating KEI Industries Limited (KEI) with an unchanged PT of Rs. 540, given positive outlook going ahead and reasonable valuation.
- Q3FY2021 was a descent quarter. Revenue and PAT came on expected lines, while margins were slightly lower than estimates on higher input cost.
- Management expects FY2021 revenue to be at 87% of pre-COVID levels and expects 11% margin for FY2021. However, there should not be any constraint for FY2022 growth and management expects growth of 18%-20% for FY2022 and a similar range in consecutive years with sustainable margins of 11%.
- Working capital cycle is expected to normalise by year-end as payments are getting back on track; the company is likely to get retention money worth Rs. 150 crore-200 crore by March end, which would further strengthen the balance sheet.

KEI Industries Limited (KEI) posted decent Q3FY2021 results despite challenges. Revenue and net profit remained on expected lines, while OPM was marginally below estimates. Revenue declined by 12.3% y-o-y, (in-line with estimates), wherein the cables business saw a decline of 10% y-o-y, while the EPC business declined by 26.5% (higher base of last year due to execution of large Dangote order). Cost-optimisation initiatives along with lower ad expenses and reduced employee costs led to 53 bps y-o-y improvement in OPM to 11.1% (marginally lower than estimates). Accordingly, operating profit came at Rs. 128 crore (down 7.9% y-o-y). Lower interest cost (-60.4% y-o-y) along with higher other income (up 16% y-o-y) led to 10.1% y-o-y growth in net profit to Rs. 80 crore (in-line with estimates). The company is witnessing m-o-m improvement in W&C, specially in housing wires (+18% growth in Q3FY2021) both from institutional as well as dealers. The company is eyeing export markets such as Australia, Middle East, and Africa. However, due to travelling constraints and absence of large orders (Dangote in the previous year), exports have been slower; but going ahead, export revenue is expected to grow, as the situation normalises and travelling resumes (expect to normalise in the next six months). To compensate for export shortfall, the company is eyeing domestic markets, where it is seeing orders from metro projects, fertilisers, domestic refineries, railways, and wind and solar projects. Further, the company is seeing good traction from Tier 3-4 cities and rural areas (in 9MFY2021, metros contributed 37%, Tier 2 comprised 18%, and Tier 3 cities comprised 46% of revenue) and is expanding its reach in these areas. The working capital cycle is expected to normalise by year-end as payments get normalised and retention money (Rs. 150 crore-200 crore) is received by March 2021 end, which would further strengthen the balance sheet. KEI does not expect major impact of rise in commodity prices, especially copper, as prices are revised every 15 days in the retail segment; while for institutional business, it maintains sufficient inventory for execution. Management also highlighted that it is focused on expanding its retail franchise through expanding the dealer and distribution base (currently at 1,645 numbers and expects it to increase by 10%-12% y-o-y) and expects its retail segment to reach ~40% of revenue by FY2022/FY2023 from 34% currently. The company will also cut down its EPC business from earlier levels of Rs. 1,000 crore to ~Rs 500 crore and utilise the money to channelise the retail segment's growth. On capacity expansion, the company will be doing capex of Rs. 175 crore in LT, HT, and EHV in FY2022. Revenue from capex is expected from H2FY2023. Going ahead, the company will be doing Rs. 150 crore-170 crore capex per annum for the next four years. The company expects to generate 5x-6x of revenue from capex. Phase I of capex would be completed in one and a half year. Management indicated that it expects FY2021 revenue to be at 87% of pre-COVID level, with 11% margin (expect better cost rationalisation and product mix). However, there should not be any constraint for FY2022 growth and the company expects revenue growth of ~20% for FY2022 and in a similar range for consecutive years with sustainable 11% margins. We believe KEI's diversified user industries, increased focus on retail, high-margin EHV cables, and export sales along with focused industry approach as well as utilisation-driven capex plans will help propel the company in the current environment. We have fine-tuned our estimates for FY2021E-FY2022E. The stock is currently trading at a P/E of 13x/10.8x its FY2022E/FY2023E EPS. Hence, we retain Buy on the stock with an unchanged price target (PT) of Rs. 540.

Key positives

- EHV cables and housing wires registered 15% and 18% growth y-o-y.
- Working capital expected to normalise by year end, as payments are coming on time and the company is expected to get retention money worth Rs. 150 crore-200 crore by March-end, which would further strengthen the balance sheet.

Key negatives

- EPC revenue declined by 26.5% y-o-y due to absence of large Dangote orders in Q3FY2020 (high base).

Our Call

Valuation: Retain Buy with an unchanged PT of Rs. 540: KEI's outlook is expected to be positive with its diversified user industries, increased focus on retail, high-margin EHV cables, and export sales along with focused industry approach as well as utilisation-driven capex plans likely to help in sustaining strong growth trajectory. We expect revenue and PAT to report a CAGR of 18% and 24%, respectively, during FY2021-FY2023E. The stock is currently trading at a P/E of 13x/10.8x its FY2022E/FY2023E EPS. Hence, we retain Buy on the stock with an unchanged PT of Rs. 540.

Key Risks

Fluctuations in raw-material prices could sharply affect margins.

Valuations (Standalone) Rs cr

Particulars	FY20	FY21E	FY22E	FY23E
Revenue	4,884	4,210	4,937	5,886
OPM (%)	9.9	10.8	11.1	11.2
Adjusted PAT	243	249	319	385
% YoY growth	35.8	2.3	28.1	20.6
Adjusted EPS (Rs.)	27.2	27.8	35.6	43.0
P/E (x)	17.1	16.7	13.0	10.8
P/B (x)	2.3	2.0	1.7	1.4
EV/EBITDA (x)	8.4	8.3	7.0	5.8
RoNW (%)	16.2	14.3	15.6	16.0
RoCE (%)	24.0	20.0	21.3	22.0

Source: Company; Sharekhan estimates

Decent show: KEI posted decent Q3FY2021 results despite challenges. Revenue and net profit remained on expected lines, while OPM was marginally below estimates. Revenue declined by 12.3% y-o-y (in-line with estimates), wherein the cables business saw a decline of 10% y-o-y, while the EPC business declined by 26.5% (higher base of last year due to execution of large Dangote order). Cost-optimisation initiatives along with lower ad expenses and reduced employee cost led to 53 bps y-o-y improvement in OPM to 11.1% (marginally lower than estimates). Accordingly, operating profit came at Rs. 128 crore (down 7.9% y-o-y). Lower interest cost (-60.4% y-o-y) along with higher other income (up 16% y-o-y) led to 10.1% y-o-y growth in net profit to Rs. 80 crore (in-line with estimates). The company is witnessing m-o-m improvement in W&C, specially in housing wires (+18% growth in Q3FY2021) both from institutional as well as dealers. The company is eyeing export markets such as Australia, Middle East, and Africa. However, due to travelling constraints and absence of large orders (Dangote in the previous year), exports have been slower; but going ahead, it expects export revenue to the grow, as the situation normalises and travelling resumes (expected to normalise in the next six months). To compensate for export shortfall, the company is eyeing domestic markets where it is seeing orders from metro projects, fertilisers, domestic refineries, railways, and wind and solar projects. Further, the company is seeing good traction from Tier 3-4 cities and rural areas (in 9MFY2021, metros contributed 37%, Tier 2 comprised 18%, and Tier 3 cities comprised 46% of revenue) and is expanding its reach in these areas. The working capital cycle is expected to normalise by year-end as payments get normalised and retention money (Rs. 150 crore-200 crore) is received by March 2021 end, which would further strengthen the balance sheet. The company does not expect major impact of rise in commodity prices especially copper, as prices are revised every 15 days in the retail segment; while for the institutional business, it maintains sufficient inventory for execution.

Focus remains on retail and EHV: Management is optimistic about the retail and EHV segments in the longer run. Management is focused on expanding its retail franchise through expanding the dealer and distribution base (currently at 1,640 numbers and expect to increase it by 10%-12% y-o-y) and expects its retail segment to reach ~40% of revenue by FY2022 (34% currently) and FY2023. The company will also cut down its EPC business from earlier levels and utilise the money to channelise the retail segment's growth. The high-margin extra high voltage (EHV) front remains a Rs. 2,000 crore market in India, while total capacity is Rs. 1,000 crore-1,100 crore between the company and Universal cables and the opportunity size remains huge. It expects Rs. 475 crore revenue from EHV in FY2021 and Rs. 525 crore in FY2022 further to boost after new capacity is added.

KEI Q3FY2021 Conference call highlights

- **Current scenario:** The company is witnessing m-o-m improvement in W&C, specially in housing wires (+18% growth in Q3FY2021) both from institutional as well as dealers.
- **Guidance:** Management expects FY2021 revenue to be at 87% of pre-COVID levels and expects 11% margin for FY2021. However, there should not be any constraint for FY2022 growth and expects growth of 20% for FY2022 and a similar range in consecutive years with sustainable 11% margins.
- **Exports:** Shortfall in exports due to absence of large orders (Dangote in the previous year) to be compensated from domestic markets (metro projects, fertilisers, domestic refineries, railways, solar power projects). Management expects exports to comeback in the next six months (some weakness seen in Africa and Middle East).
- **EPC focus to come down:** As reiterated previously as well, the company will be focusing more on its retail wires and cables and expects it to reach 40% of sales in couple of years and will lower down its EPC contraction from earlier levels of Rs. 1,000 crore to ~Rs. 500 crore (slow recovery from the government has been an issue) and utilise the money to channelise the retail segment's growth.
- **Expansion of the retail business:** The retail business largely comprises housing wires and is expected to grow by 20%-25% in Q4FY2021 and by 30-35% in FY2022. The industry grew by almost 15% in Q3FY2021, wherein KEI in housing wires grew by 18% y-o-y.
- **Regional mix:** The company's regional revenue mix in 9MFY2021 is 37% North, 28% West, 20% South, and 14% East, while metros contribute 37%, Tier 2 comprise 18%, and Tier 3 cities comprise 46% of revenue.

- **Capacity expansion:** The company will be doing capex of Rs. 175 crore in LT, HT, and EHV in FY2022. Revenue from capex is expected from H2FY2023. Going ahead, the company will be doing Rs. 150 crore-170 crore capex per annum for the next four years. The company expects to generate 5x-6x of revenue from capex. Phase I of capex would be completed in one and a half year.
- **Commodity risk:** Rise in commodity prices especially copper is revised monthly in the retail segment (revising after every 15 days and accordingly taking price hikes). While for the institutional business, it works as a natural hedge. The company keeps on an average three-month inventory, which sufficiently executes institutional projects having around same gestation period. Hence, rise in copper price does not impact the institutional business.
- **Working capital:** Working capital is expected to normalise by year-end as payments are getting normalised.
- **Interest cost reduction:** The company's current interest outgo has reduced and the company expects it to be around Rs. 60 crore for FY2022.
- **Capacity utilisation in 9MFY2021:** Cables: 57%, housing wires: 61%, SS wire: 87%.
- **Order book:** The order book stands at Rs. 2,611 crore and L1 order for EHV cable at Rs. 130 crore.
- **Dealer expansion:** The company's current dealer/distributor network is 1,645 (1,600 in Q2FY2021), which will be increased at 10%-12% per annum along with increased area coverage.

Results (Standalone) Rs cr

Particulars	Q3FY21	Q3FY20	YoY %	Q2FY21	QoQ %
Revenue	1,153	1,314	-12.3%	1,037	11.2%
Operating profit	128	139	-7.9%	118	8.4%
Other income	5.3	4.6	16.0%	4	47.6%
Interest	13	33	-60.4%	15	-12.7%
Depreciation	15	14	2.9%	14	2.4%
PBT	106	97	9.5%	93	14.2%
Tax	26	25	7.7%	25	7.3%
EO	-	-		-	
Reported PAT	80	72.3	10.1%	68	16.7%
Adj. PAT	80	72	10.1%	68	16.7%
Adj. EPS (Rs.)	8.86	8.04	10.1%	7.6	16.7%
Margin			**BPS**		**BPS**
OPM (%)	11.1	10.6	53	11.4	(29)
NPM (%)	6.9	5.5	141	6.6	33
Tax rate	24.9	25.3	-	26.5	-

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view – Ample levers offer scope for growth

Domestic demand side 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 wires and cables 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 C&W 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, slowdown in infrastructure growth and uncertainty in real estate will lead to moderation in growth for the C&W segment. A gradual resumption of normal economic activity and infrastructure projects will push the recovery to H2FY2021. 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.

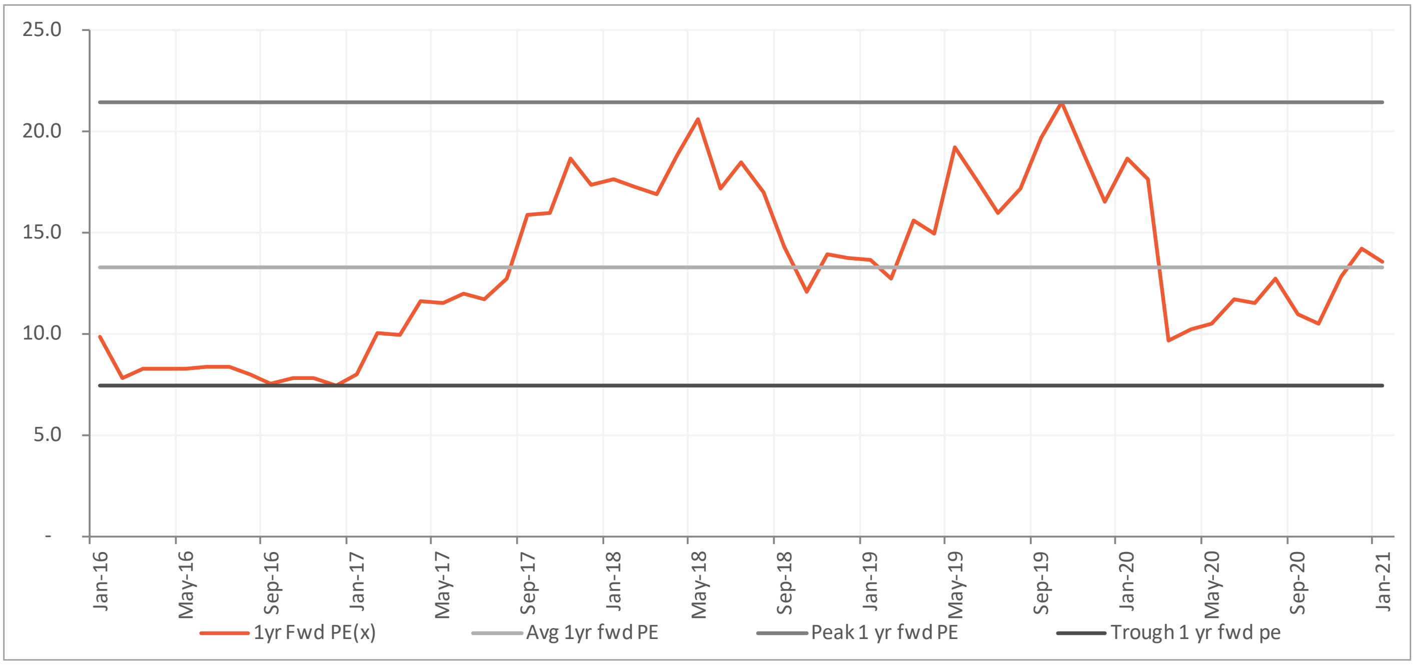
■ Company outlook - Going back to business

Management remains optimistic on the retail and EHV segments in the longer run. Management is focused on expanding its retail franchise through expanding its dealer and distribution base (currently at 1,600 numbers and expects it to increase by 10%-12% y-o-y) and expects its retail segment to reach 38%/40% of revenue by FY2022 and FY2023. Management will also cut down its EPC business from earlier levels 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 crore-1,100 crore between the company and Universal cables and opportunity size remains huge. The company will be doing Greenfield capex of Rs. 175 crore in LT, HT, and EHV in FY2022 (to be funded through internal accruals) and revenue from capex to accrue from H2FY2023. Going ahead, the company will be doing Rs. 150 crore-170 crore capex per annum and expects to generate 5x-6x of revenue from capex. Phase 1 of capex would be completed in one and a half year. Management reiterated its guidance that FY2021 revenue is likely to be at 87% of pre-COVID levels and expects 11% margin for FY2021. However, there should not be any constraint for FY2022 growth and expects growth of 18%-20% for FY2022 and a similar range in consecutive years with sustainable margins of 11%. On the exports front, revenue remains focused and is expected to improve in the next six months as travel restrictions ease further.

■ Valuation - Maintain Buy with unchanged PT of Rs 540

KEI's outlook is expected to be positive with its diversified user industries, increased focus on retail, high-margin EHV cables, and export sales along with focused industry approach as well as utilisation-driven capex plans likely to help in sustaining the strong growth trajectory. We expect revenue and PAT to report a CAGR of 18% and 24%, respectively, during FY2021-FY2023E. The stock is currently trading at a P/E of 13x/10.8x its FY2022E/FY2023E EPS. Hence, we retain Buy on the stock with an unchanged PT of Rs. 540.

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 and EPC services 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 specialised 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. Total retail revenue has registered a CAGR of ~31% FY2014-FY2018. On account of a 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. Government initiatives such as 'Housing for All by 2022', affordable housing under 'Pradhan Mantri Awas Yojana,' etc., could boost growth in HW and LT cables segments.

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	Executive Director-Chairperson
Mrs. Akshit Diviaj Gupta	Executive Director
Mrs. Archana Gupta	Non-Executive – Non-Independent Director
Mr. Rajeev Gupta	Executive Director

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Gupta Anil	23.06
2	PROJECTION FIN AND MANAGEM	9.94
3	Franklin Resources Inc	6.09
4	HDFC Asset Management Co Ltd	5.06
5	SHUBH LAXMI MOTELS & INNS.	4.38
6	Soubhagya Agency Pvt Ltd	3.93
7	KEI CABLES PVT LTD	1.98
8	VANTAGE EQUITY FUND	1.95
9	Sundaram Asset Management Co Ltd	1.57
10	Dimensional Fund Advisors LP	1.56

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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