Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

KEI Industries Ltd

Mixed bag Q1, capex holds key to growth

Capital Goods	Sharekhan code: KEI
Reco/View: Buy ↔	CMP: Rs. 2,270
	Price Target: Rs. 2,665 ↔

↑ 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 22.29
Updated Jul 08, 2023

Medium Risk

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

Source: Morningstar

Company details

Market cap:	Rs. 20,473 cr
52-week high/low:	Rs. 2,815/1,221
NSE volume: (No of shares)	2.4 lakh
BSE code:	517569
NSE code:	KEI
Free float: (No of shares)	5.7 cr

Shareholding (%)

Promoters	37.1
FII	27.7
DII	19.6
Others	15.7

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	-1.1	20.6	36.7	80.9
Relative to Sensex	-3.0	12.3	25.4	66.5

Sharekhan Research, Bloomberg

Summary

- A 20% volume growth in Q1FY24 lagged its peers due to capacity constraints. Further, despite in-line revenue and net profit, OPM contracted y-o-y basis due to higher ad spends.
- Management expects brownfield and greenfield capacity expansions would ensure a 17-18% revenue CAGR for the long-term. Management expects OPM to inch up by 100-150 bps by FY25-FY26E.
- KEI's leading position in the W&C industry and strengthening retail business would help it leverage on ample growth opportunities if the company is able to scale up its capacities in timely manner.
- We retain a Buy rating on KEI Industries Limited (KEI) with an unchanged PT of Rs. 2,665, as we believe capacity expansion across its product categories and strong demand momentum would drive growth.

KEI Industries lagged peers in terms of volume growth in Q1FY24 due to capacity constraints despite robust demand. Consequently, results were a mixed bag, wherein revenue and net profit were largely in-line with estimates, albeit OPM came lower than estimates. Volumes rose 22% y-o-y, while revenues grew by ~14% y-o-y to Rs 1,783 crore. Revenue growth was driven by domestic institutional, retail wire & cables business and exports; while EHV cables reported a dip in revenues. Despite an increase in gross margin, OPM declined by 20 bps y-o-y to 10% vs (our estimate of 10.7%) largely due to increase in advertisement & promotion expenses. Net profit grew by ~17% y-o-y to Rs 121 crore led by increase in other income, and lower interest as well as depreciation cost. Sales through dealer/ distribution market increased by 22% y-o-y and contributed 44.6% to overall sales in Q1FY24 as against 41.7% in Q1FY23.

Key positives

- W&C volumes rose 22%.
- Net cash stood at ~Rs 24 crore.
- Revenues from dealer/distribution network increased by ~22% y-o-y, contributing ~ 45% to total revenue.
- Demand outlook is promising in both public and private sectors.

Key negatives

- A 20 bps y-o-y decline in operating margin due to additional advertisement and promotion expenditure of Rs. 10 crore w.r.t to IPL, which was missing in the last year's corresponding quarter.
- Domestic institutional EHV cables revenue came lower at Rs. 50 crore in Q1FY24 vs. Rs. 100 crore in Q1FY23.

Management Commentary

- Management has guided for a 16-17% revenue growth and ~20% volume growth in FY24 and expects a 17-18% revenue CAGR in the next few years.
- Company plans to invest over Rs. 900 crore to increase its capacity to cater to increasing demand across its product categories. Total FY24E capex is likely to be at Rs. 400 crore, including brownfield expansion.
- Total active working dealer base was 1,925 in numbers.
- Exports outlook is promising as the company is gaining traction with existing customers as well newer geographies.
- Company has guided for OPM increase of 100-150 bps in the next three years and aims to achieve 11% by FY25E.
- Demand momentum is expected to continue from manufacturing, infrastructure development projects as well as real estate.

Our Call

Valuation: Retain Buy with an unchanged PT of Rs. 2,665: KEI's Q1FY24 performance has been impacted by capacity constraints and therefore timely brownfield and greenfield expansion would drive future growth. Additionally, the company has been gaining significant traction in the exports. Operating margin is expected to increase on account of operating leverage, increasing proportion of retails sales and exports in total revenues and higher sales of EHV cables post capacity expansion. We believe the company is on a healthy and sustainable growth trajectory. The management has provided an optimistic demand outlook in both the retail and institutional segments, driven by private capex and increased government spending, respectively. We expect a revenue/PAT CAGR of 17.5%/~23% over FY23-FY25E. The stock is currently trading at a P/E of ~29x its FY25E EPS. Considering the economic upcycle and strong earnings outlook, we assign a target multiple of ~33x its FY25E. We reiterate our Buy rating on the stock with an unchanged price target (PT) of Rs. 2,665.

Key Risks

Volatility in input costs may adversely hit margin guidance. Revenue is partially generated from exports and any fluctuations in forex rates could affect the company's financials.

Valuation (Standalone) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenue	5,727	6,912	8,131	9,541
OPM (%)	10.3	10.2	10.6	11.1
Adjusted PAT	376	477	585	719
% y-o-y growth	39.6	26.9	22.5	23.1
Adjusted EPS (Rs.)	41.8	52.9	64.8	79.8
P/E (x)	54.4	42.9	35	28.5
P/B (x)	8.3	6.9	5.7	4.6
EV/EBITDA (x)	34.7	28.5	23.1	18.8
RoNW (%)	17.6	18.4	18.6	18.7
RoCE (%)	22	24.6	24.8	25.5

Source: Company Data; Sharekhan estimates

Capacity constraints restrict growth

Q1FY24 performance was a mixed bag as revenue and net profit were largely in-line with estimates, albeit OPM came lower than estimates. Volumes rose 22% y-o-y and revenues grew by ~14% y-o-y to Rs 1,783 crore. Despite robust demand environment, the company's growth was lower than its peers due to capacity constraints. Revenue growth was driven by domestic institutional, retail wire & cables business and exports; while EHV cables reported a dip in revenues. Despite an increase in gross margin, OPM declined by 20 bps y-o-y to 10% vs (our estimate of 10.7%) largely due to increase in advertisement and promotion expenses. Net profit grew by ~17% y-o-y to Rs 121 crore led by increase in other income, and lower interest as well as depreciation cost. Sales through dealer/ distribution market increased by 22% y-o-y and contributed 44.6% to overall sales in Q1FY24 as against ~41.7% in Q1FY23.

Capacity expansion and sector tailwinds to drive growth

KEI targets a 17-18% revenue CAGR in the coming years. The company wants to increase its market share in house wires to 8% (currently ~6%); while in the cables segment, the company has a market share of ~12%. The company expects the retail segment to contribute over 50% to the total revenue in 2-3 years. Increasing contribution of the retail segment to total revenue would reduce the pricing gap with its competitors. The institutional segment is witnessing strong demand from oil and gas, refinery, railways, metro rail projects, transmission, solar projects, cement, steel, and real estate. The company would be undertaking greenfield expansion in the cables segment at an investment of over Rs. 900 crore (Rs. 300-350 crore capex p.a.) in the coming years to meet the growing demand and maintain a high-growth trajectory in the long term.

Conference Call and Investor Update Highlights

- **Volume growth for Q1FY24:** Volume growth in W&C in terms of cables and wires consumption stood at 22% y-o-y, largely led by strong volumes in wires. The absolute revenue growth was restricted to 14% due to decline in realizations.
- **Eyeing 20% volume growth in FY24:** The company has guided for 20% y-o-y volume growth in FY24.
- **Volume growth restricted due to capacity constraints:** Despite robust environment, KEI's volume growth was lower in comparison to its peers due to capacity constraints.
- **Significant reduction in creditors:** The company has used available cash to pay its creditors. Hence, payables days have reduced significantly from 44 days to 30 days on y-o-y basis.
- **OPM margin contraction is largely due to higher A&P expenses:** The advertisement cost was higher by at least Rs. 10 crore as the company spent during IPL in Q1FY24. The company expects advertisement and promotion expenses to be ~Rs. 35 crore in FY24.
- **Exports' contribution rising in total revenues:** Exports contributed ~17% to total revenues in Q1FY24. The current order book in the exports is Rs. 236 crore which includes LT, HT and small part of EHV cables. The company admitted that it is receiving lots of enquiries and the exports are expected to grow substantially as China+1 strategy comes into play. Exports margin are 1% higher than domestic margins in W&C space. Demand in export markets is coming from existing customers and the company is also witnessing traction from new customers and geographies.
- **Strong retail sales:** Sales through dealer/distribution channel increased by ~22% y-o-y in Q1FY24. Sales through dealer/ distribution contributed ~45% to overall sales in Q1FY24.
- **Update on the EHV segment's performance:** Domestic institutional EHV sales stood at Rs. 50 crore (down ~51% y-o-y) due to capacity constraints.

- **Capex guidance:** The company would undertake a brownfield capex of Rs. 45 crore in its Silvassa plant for increasing capacity of LT power cables in FY24. This shall help the company earn revenue of Rs. 500 crore and enable 16-17% revenue growth in FY24. KEI has already spent Rs. 114 crore in FY24. The company is doing greenfield expansion in its Gujarat plant and production would commence in 18 months from the end of September/December 2024. The company plans to undertake Rs. 300-350 crore capex p.a. in the next three years to achieve a 17-18% revenue CAGR in the long term.
- **Margin guidance:** Company expects OPM to increase by 100-150 bps in the next three years from 10-10.5% currently. In retail, OPMs are ~11%, while in institutional sales its ~10-10.5%.
- **Healthy industry outlook:** Industry outlook is promising as there is demand emanating from manufacturing sectors like steel, oil & gas, cement, and miscellaneous industries. Further, infrastructure-development projects (metro, highways, and railways) and real estate look promising. Increasing private capex in iron, steel, aluminium and fertilisers also present ample growth opportunities. Solar energy projects have also picked up and, therefore, the company is seeing strong growth from solar developers.
- **Dealer count to increase every year:** The total active working dealer strength of the company is 1,925 dealers. Dealer expansion is underway and addition of 100-150 dealers is targeted every year, with a focus on increasing revenue per dealer.
- **Cash & bank balance:** Net cash is Rs. 24 crore against Rs. 180 crore in Q4FY23. Acceptances are at Rs. 151 crore. Other income includes interest income of Rs. 5.9 crore. Total borrowings is ~Rs. 135 crore.

Results (Standalone) Rs cr

Particulars	Q1FY24	Q1FY23	YoY%	Q4FY23	QoQ%
Net Sales	**1,783**	**1,565**	**13.9**	**1,955**	**(8.8)**
Operating Profit	**178**	**160**	**11.6**	**204**	**(12.5)**
Other Income	8	4	136.0	5	64.7
Interest	9	9	(3.1)	10	(11.3)
Depreciation	15	14	5.6	14	2.3
PBT	**163**	**140**	**16.4**	**184**	**(11.6)**
Tax	42	36	14.7	46	(10.2)
Adjusted PAT	**121**	**104**	**16.9**	**138**	**(12.1)**
Adj. EPS (Rs.)	13.5	11.5	16.9	15.3	(12.1)
Margin (%)			*BPS*		*BPS*
OPM	10.0	10.2	*(20)*	10.4	*(43)*
NPM	6.8	6.6	*18*	7.1	*(26)*
Tax rate	25.5	25.9	*(37)*	25.1	*40*

Source: Company Data; Sharekhan Research

Outlook and Valuation

■ Sector View – Ample levers offer scope for growth

Domestic demand is improving with increasing spend on infrastructure and construction. The wires and cables (W&C) market is estimated to be worth around Rs. 600 billion-650 billion, accounting for around two-fifths of the domestic electrical industry. The Indian W&C market is projected to grow to Rs. 900-950 bn by FY2026. Sectors like power, railways, infrastructure, oil & gas, telecom, real estate, renewables, defence, automobiles, etc. are the largest demand drivers for the industry. The domestic W&C business has grown at a strong pace, mostly due to greater realisation because of inflation. The government has envisaged Rs. 111 lakh crore capital expenditure in infrastructure sectors in India from FY2020 to FY2025. Hence, continued thrust of the government on infrastructure investment is expected to improve demand for the W&C industry.

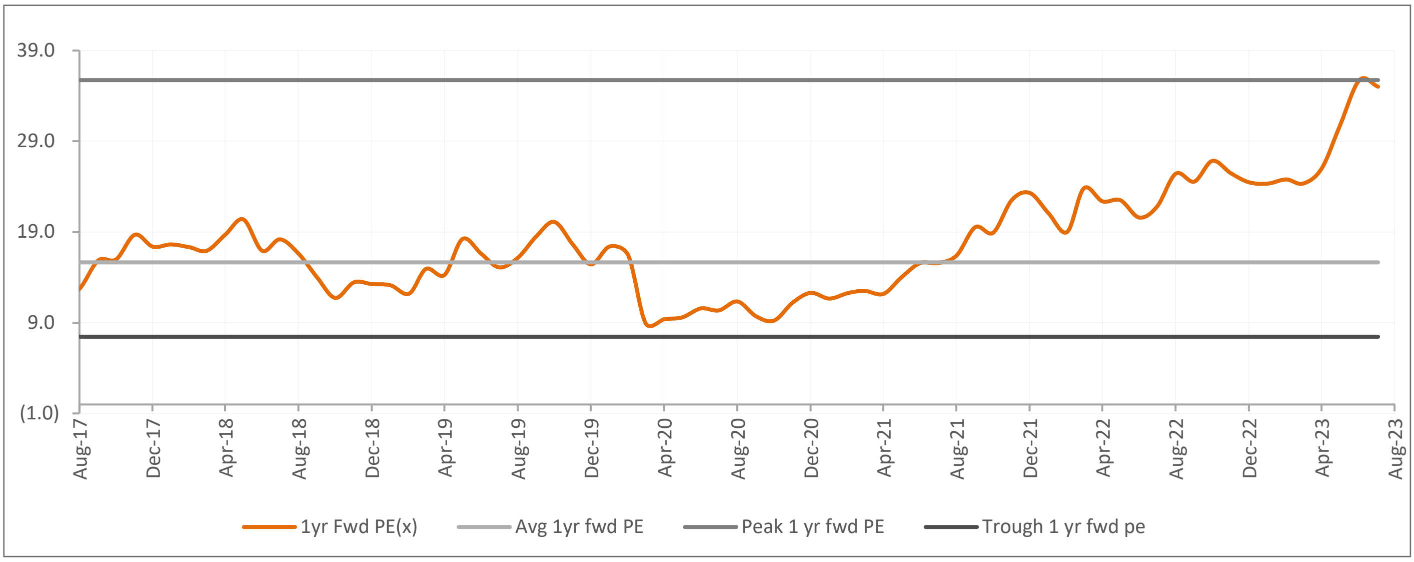
■ Company Outlook – High growth to be added by capacity expansion plan

The management remains optimistic about the retail and EHV segments in the longer run. Management is focused on expanding its retail franchise through its dealer and distribution base (currently at 1,925 and expects it to increase by 10% y-o-y) and expects its retail segment to contribute more than 50% to revenue going forward. 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, the total capacity is Rs. 1,000-1,100 crore between the company and Universal Cables. The company will be undertaking ggreenfield capex of over ~Rs. 900 crore in LT, HT, and EHV over a three year period. Management expects a 17-18% y-o-y revenue CAGR in 2-3 years.

■ Valuation – Retain Buy with an unchanged PT of Rs. 2,665

KEI's Q1FY24 performance has been impacted by capacity constraints and therefore timely brownfield and greenfield expansion would drive future growth. Additionally, the company has been gaining significant traction in the exports. Operating margin is expected to increase on account of operating leverage, increasing proportion of retails sales and exports in total revenues and higher sales of EHV cables post capacity expansion. We believe the company is on a healthy and sustainable growth trajectory. The management has provided an optimistic demand outlook in both the retail and institutional segments, driven by private capex and increased government spending, respectively. We expect a revenue/ PAT CAGR of 17.5%/~23% over FY23-FY25E. The stock is currently trading at a P/E of ~29x its FY25E EPS. Considering the economic upcycle and strong earnings outlook, we assign a target multiple of ~33x its FY25E. We reiterate our Buy rating on the stock with an unchanged price target (PT) of Rs. 2,665.

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 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. KEI has built its manufacturing facilities in Rajasthan and Silvassa (Dadra and Nagar Haveli). The company is poised to garner opportunities from power utilities, core infrastructure, and construction projects across the country. The company's presence in EHV cables for power sector projects has 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 by building specialized offerings to tap niche segments such as real estate, shipping, oil, and petroleum plants. 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, dealer-electrician meets, etc., we expect KEI to deepen its retail presence and gain market share.

Key Risks

- Volatility in input cost may adversely impact its margin guidance.
- A part of its revenue is generated from exports, and any fluctuations in forex rates could affect the company's financials.

Additional Data

Key management personnel

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

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Projection Financial & Management Consultants	8.76
2	Capital Group Cos Incorporation	4.63
3	Subhlaxmi Motels & Inns	3.86
4	Morgan Stanley	3.51
5	Soubhagya Agency	3.46
6	Canara Robeco Asset Management	2.46
7	HDFC Asset Management	2.41
8	Franklin Resources Incorporation	2.30
9	FIL	2.30
10	Invesco Asset Management India	2.05

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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