Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

KEC International Ltd

Time to deliver on the optimism

Capital Goods	Sharekhan code: KEC
Reco/View: Buy ↔	CMP: **Rs. 657**

Price Target: **Rs. 770** ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- We maintain a Buy on KEC International Limited (KEC) with an unchanged PT of Rs. 770; as we expect strong execution and profitability driven by a robust order book and improving working capital cycle.
- Ample opportunities exist in all key segments - T&D, civil, oil & gas driven by government capex in domestic and international regions such as the Middle East, SAARC, and the CIS region.
- KEC has a ,substantial, diversified order book of Rs. 35,000 crore, including L1 orders. The company has so far achieved ~30% of the expected order inflow of Rs. 25,000 crore for FY24.
- The stock trades at ~17xFY25E EPS. We build in Revenue CAGR of ~15%. PAT is expected to grow ~139% over FY23-25E, driven by significant margin expansion and stabilisation of interest cost as all legacy orders are executed by H1FY24 end.

KEC International Limited (KEC)'s future growth would be driven by solid execution backed by a robust order book and margin expansion. Normalisation of its working capital cycle and reduction in its leveraged position driven by the completion of legacy orders in Brazil by H1FY24 would drive the profitability. KEC has a strong order book of Rs. 35,000 crore, including L1 orders and therefore, the company expects revenue to cross the Rs. 20,000 crore mark and register ~15% y-o-y growth. Order inflow guidance is Rs. 25,000 crore in FY24 (+11% y-o-y), out of which its year-to-date (YTD) announced order inflow has surpassed Rs. 7,500 crore, a robust growth of 30% vs last year. Further, lesser competitive intensity in specialised products/projects like GIS substations and strong order prospects bode well for future growth. In the international market, the company continues to witness opportunities in the Middle East, SAARC, and the CIS region. In addition, successful diversification into other high-growth potential segments such as civil, railways, and oil and gas has helped to scale up its business substantially.

- **A strong order pipeline is building in the T&D biz:** In India, the power T&D sector is on a solid growth spree as transmission infrastructure is being strengthened for major renewable energy zones such as Rajasthan, Gujarat, Andhra Pradesh and Tamil Nadu to support the target of achieving 500 GW of non-fossil fuel power by 2030. KEC has already secured some of these orders in the T&D segment. The company has also increased its focus on the renewable energy segment, especially solar. The near-term opportunity in FY24 stands at ~Rs. 20,000-25,000 crore coming from private developers and Power Grid Corporation of India Ltd. (PGCIL). Off late, KEC has won every 1 out of 6 tenders floated by PGCIL. In International markets, the company continues to witness opportunities in the Middle East, SAARC (Nepal and Bangladesh), and the CIS region. The company currently has an order book (including L1) of Rs. 18,000 crore in T&D, and given an increase in tendering activities across areas, the business would gain further momentum.
- **Civil and Oil & Gas to drive non-T&D biz:** Civil business has an order book of ~Rs–11,000 crore including L1 in the industrial, residential, and commercial building segments. The industry has also widened its presence by securing composite orders, including mechanical, electric, and plumbing works (MEP). The company has also undertaken data centre projects and aims to scale up in this high-growth segment. The water business alone contributes over 40% to the civil order book. The Oil and gas market is limited in size at Rs. 5,000-6,000 crore, and competition has intensified in this space. Hence, the company is focusing on building required pre-qualifications to increase the addressable market size. The business has an order book and L1 of Rs. 1,000 crore comprising government and private orders.
- **Substantial revenue and margin guidance:** Given the strong order backlog, management has guided revenue growth of 15% and expects OPM to be at ~7% for FY24. The company expects order inflows of ~Rs–25,000 crore (+11% y-o-y) for FY24. Order prospects are bright, with an order pipeline of Rs. 1,00,000 crore. SAE Brazil has turned PBT positive and will likely turn PAT positive as old loans are refinanced at better terms. The company has reduced its net working capital from about 22 days to 126 days, and it is further expected to come down to 110 days in FY24. We believe increasing the share of non-T&D businesses; remarkably civil which has better payment cycle, would also help bring down working capital days. Net debt, including acceptances, stand at Rs. 5,714 crore as of June 30, 2023 and is expected to remain at these levels despite the increase in revenues.

Revision in estimates - We have marginally tweaked our estimates for FY2024/FY2025.

Our Call

Maintain Buy with an unchanged PT of Rs. 770: KEC had been grappling with margin pressures and lower profitability due to legacy orders despite solid revenue growth, led by a healthy order book and robust order prospects across its various businesses. However, losses have been shrinking in SAE towers in Brazil, which has turned PBT positive. The company has guided for 15% revenue growth for FY2024 and expects a sequential improvement in its margins given reduced losses in SAE, Brazil and higher profitability in international orders. KEC trades at ~17xFY25E EPS. Given the strong order book, improving margin trajectory, and working capital cycle, we maintain Buy with an unchanged price target (PT) of Rs. 770.

Key Risks

A slowdown in tendering activities could impact its execution. Further, escalation in input costs and supply-side constraints are vital challenges.

Valuation (Consolidated) Rs cr

Particulars	FY22	FY23	FY24E	FY25E
Revenue	13,742	17,282	20,032	23,000
OPM (%)	6.6	4.8	7.2	9.0
Adjusted PAT	376	176	543	1,004
% YoY growth	(32.0)	(53.1)	208.6	84.9
Adjusted EPS (Rs.)	14.6	6.8	21.1	39.1
P/E (x)	45.0	96.0	31.1	16.8
P/B (x)	4.7	4.5	4.0	3.3
EV/EBITDA (x)	21.6	23.8	13.6	9.5
RoNW (%)	10.8	4.8	13.6	21.4
RoCE (%)	13.0	10.4	18.7	25.5

Source: Company; Sharekhan estimates

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 36.2

Updated Aug 08, 2023

High Risk

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

Source: Morningstar

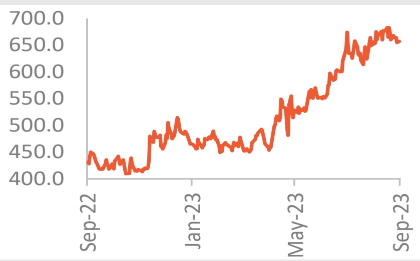
Company details

Market cap:	Rs. 16,899 cr
52-week high/low:	Rs. 748/405
NSE volume: (No of shares)	7.81 lakh
BSE code:	532714
NSE code:	KEC
Free float: (No of shares)	12.4 cr

Shareholding (%)

Promoters	51.9
FII	11.6
DII	26.7
Others	9.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	0.5	19.0	44.0	52.4
Relative to Sensex	-1.1	14.2	29.5	36.9

Sharekhan Research, Bloomberg

A strong order pipeline is building in the T&D biz

The domestic power T&D sector is on a solid growth spree as transmission infrastructure is being strengthened for major renewable energy zones such as Rajasthan, Gujarat, Andhra Pradesh and Tamil Nadu to support the target of achieving 500 GW of non-fossil fuel power by 2030. KEC has already secured some of these orders in the T&D segment. The company has also increased its focus on the renewable energy segment, especially solar. The near-term opportunity in FY24 stands at ~Rs20,000-25,000 crore, from private developers and Power Grid Corporation of India Ltd. (PGCIL). KEC has been winning every 1 out of 6 tenders floated by PGCIL at any given time. In International markets, the company continues to witness opportunities in the Middle East, SAARC (Nepal and Bangladesh), and the CIS region. The company currently has an order book (including L1) of Rs. 18,000 crore, and given an increase in tendering activities across areas, T&D would gain further momentum.

Civil and Oil & Gas to drive non-T&D biz

Civil business has an order book of ~Rs—11,000 crore including L1 in the industrial, residential, and commercial building segments. The industry has also widened its presence by securing composite orders, including mechanical, electric, and plumbing works (MEP). The company has also undertaken data centre projects and aims to scale up in this high-growth segment. The water business is the single-largest contributor with a ~40% civil business order book share. The Oil and gas market is limited in size at Rs. 5,000-6,000 crore, and competition has intensified in this space. Hence, the company is focusing on building required pre-qualifications to increase the addressable market size. The business has an order book and L1 of Rs. 1,000 crores comprising government and private orders.

Railway business to have muted order intake

Railway business secured orders of over Rs. 750 crore; strong growth of ~80% on a y-o-y basis in Q1FY24. To leverage on the government's focus on spending on increasing the capacity, speed and safety of the Indian railway network, the business has forayed into automatic block signalling ABS to strengthen its presence in the promising speed up-gradation segment. However, for the rest of FY24, the company expected muted order intake in standard railway business due to increased competitive intensity.

Substantial revenue and margin guidance

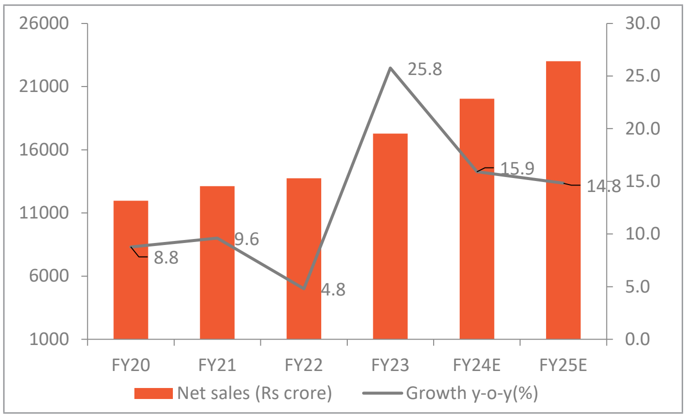
Given the strong order backlog, management has guided revenue growth of 15% and expects OPM to be at ~7% for FY24. The company expects order inflows of ~Rs—25,000 crore (+11% y-o-y) for FY24. Order prospects are bright, with an order pipeline of Rs. 1,00,000 crore. SAE Towers, Brazil has turned PBT positive and will likely turn PAT positive as old loans are refinanced at better terms. The company has reduced its net working capital from about 22 days to 126 days, and it is further expected to come down to 110 days in FY24. We believe increasing the share of non-T&D businesses; particularly civil, which has better payment cycle would also help bring down working capital days .

Debt levels to remain at the same levels

Net debt, including acceptances, stands at Rs. 5,714 crore as of June 30, 2023 and is expected to remain at these levels despite the increase in revenues.

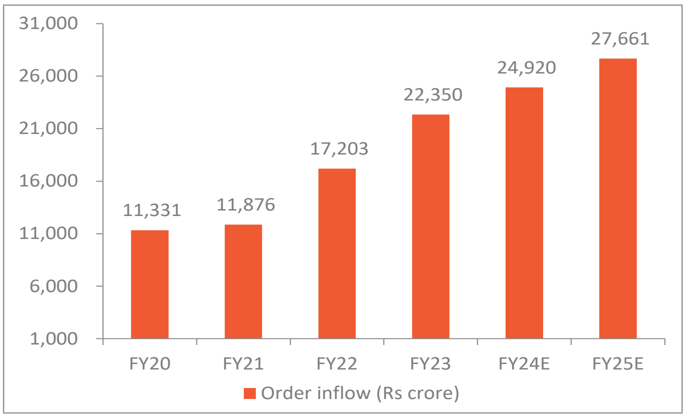
Financials in charts

Net sales growth trend



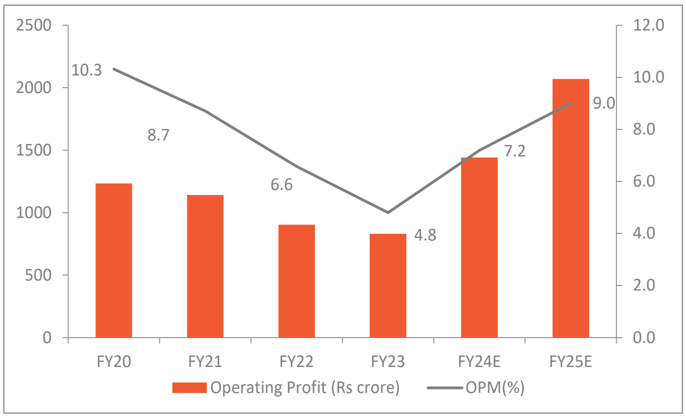
Source: Company, Sharekhan Research

Order inflows ternd



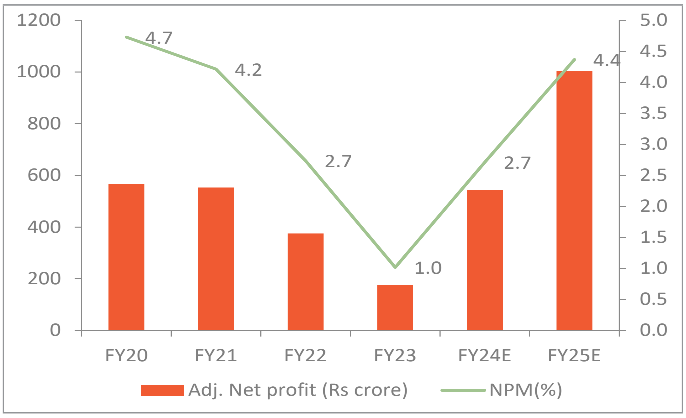
Source: Company, Sharekhan Research

Operating profit and margin trend



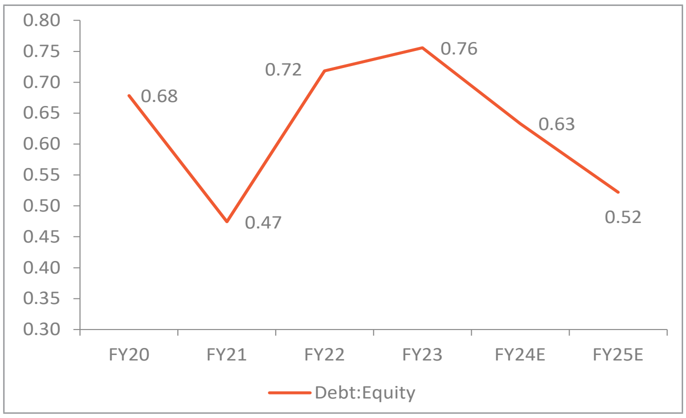
Source: Company, Sharekhan Research

Net profit and margin trend



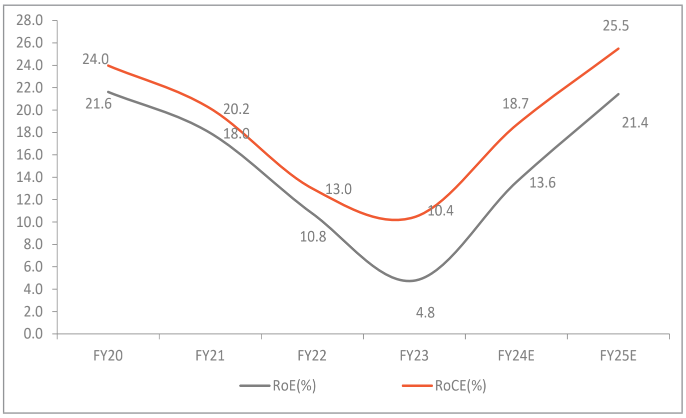
Source: Company, Sharekhan Research

Debt/Equity status



Source: Company, Sharekhan Research

Return ratios trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector Outlook – Ample levers offer scope for growth

The government's increasing focus on infrastructure availability, affordable housing, thrust on rural electrification, 100% electrification of the railway network by 2025, and growing 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 from FY2020 to FY2025. Sectors such as energy (24%), roads (18%), urban (17%), and railways (12%) amount to ~71% of projected infrastructure investments. The government's continued thrust on infrastructure investment is expected to improve the demand environment across railways, metros, roads, healthcare, and real estate, providing ample opportunities for KEC across 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 power generation capacity is expected to reach 469GW by 2022, and developing a 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 to set up inter-regional 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 setting up of the cross-country national grid, states are planning huge investments to improve connectivity, reliability, and affordability. An increase in large-size transmission lines, as well as substation tenders from state utilities, can, thus, benefit companies such as KEC.

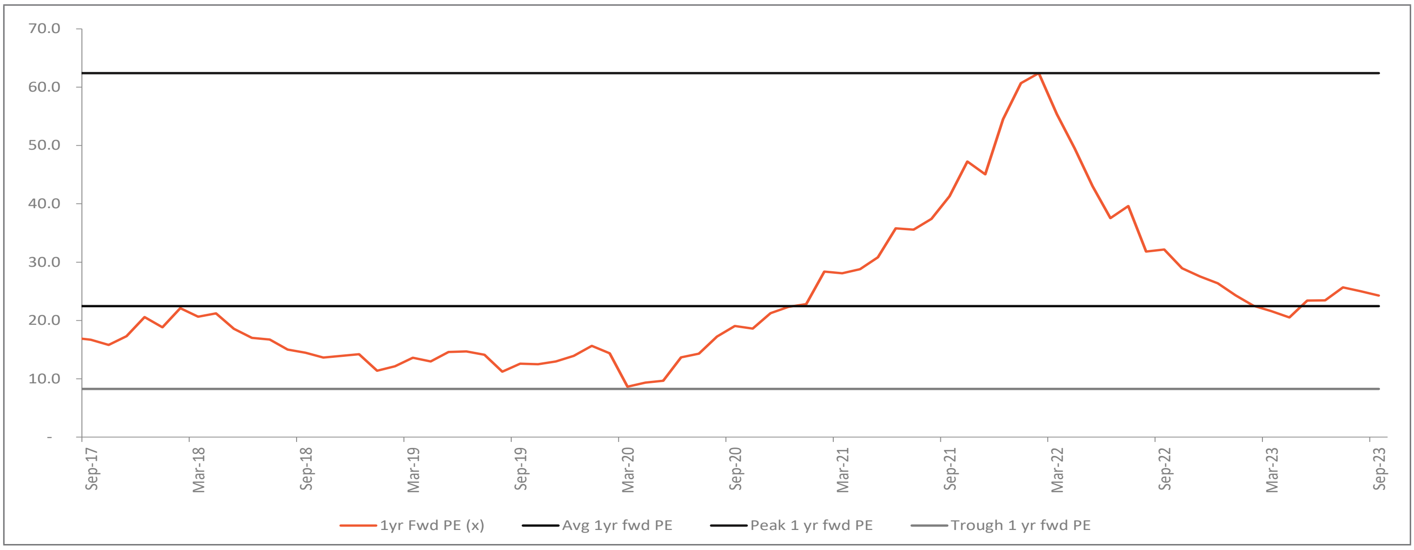
■ Company Outlook – Better prospects in the long term

Ordering activity continues to gain momentum, with tendering visibility remaining healthy in railways, international T&D, and civil. Management sees a Rs. 1,00,000 crore project pipeline across businesses. The International T&D pipeline is very strong in the Middle East, the Americas, Nepal, Bangladesh, and the Far East. The company expects execution to pick up going ahead for FY2023, with scale-up in execution in international T&D orders, civil, and oil and gas. In the domestic region, the green energy corridor is also a potential business opportunity for the company.

■ Valuation – Maintain Buy with an unchanged PT of Rs. 770

KEC had been grappling with margin pressures and lower profitability due to legacy orders despite solid revenue growth, led by a healthy order book and robust order prospects across its various businesses. However, losses have been shrinking in SAE towers in Brazil, which has turned PBT positive. The company has guided for 15% revenue growth for FY2024 and expects a sequential improvement in its margins given reduced losses in SAE, Brazil and higher profitability in international orders. KEC trades at ~17xFY25E EPS. Given the strong order book, improving margin trajectory, and working capital cycle, we maintain Buy with an unchanged price target (PT) of Rs. 770.

One-year forward P/E (x) band



Source: Company Data; Sharekhan Research

About the company

KEC is a global power transmission infrastructure EPC major. The company is 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 power transmission EPC project leader with over seven decades of experience. Over the years, the company has grown through the organic and inorganic routes.

Investment theme

T&D spend in India was expected to be around Rs. 2,300 billion over FY2018-FY2023, up 28% over FY2012-FY2017. Much of this spending came from state electricity boards. Additionally, ordering the Green Energy Corridor will likely provide ample opportunities in the domestic market. Moreover, expansion in the regional transmission network in Africa, SAARC, and CIS countries will probably supplement domestic demand and present a large business opportunity. KEC has significantly scaled up the non-T&D segments (railways, civil, and cables segments), and margins in these segments have improved considerably. 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, railways, and civil segments. Improvement and sustainability in the margins going forward would be a key re-rating trigger for the stock.

Key Risks

- Slower-than-expected project execution in domestic and international markets for various reasons is expected to affect performance.
- Slowdown in tendering activities, especially in T&D, railways, and overseas orders.

Additional Data

Key management personnel

Harsh Vardhan Goenka	Chairman
Vimal Kejriwal	Managing Director & CEO
Rajeev Aggarwal	Chief Financial Officer
Neeraj Nanda	President – South Asia (T&D, Solar & Smart Infra)

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Swallow Associates Limited	26.4
2	Summit Securities Limited	11.0
3	HDFC Asset Management Company Limited	9.2
4	Instant Holdings Limited	8.7
5	DSP Investment Managers Private Limited	3.5
6	Kotak Mahindra Asset Management Company	3.2
7	FIL Limited	3.0
8	Fidelity Funds SICAV	2.3
9	Royal Bank of Canada	2.0
10	STEL Holdings Limited	2.0

Source: Bloomberg old data

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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Other registrations of Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669.

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