Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

KEI Industries Ltd

On sustainable growth trajectory

Capital Goods	Sharekhan code: KEI
Reco/View: Buy ↔	CMP: Rs. 3,120 / Price Target: Rs. 3,600 ↑

↑ 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 Updated Aug 08, 2023	22.29

Medium Risk

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

Source: Morningstar

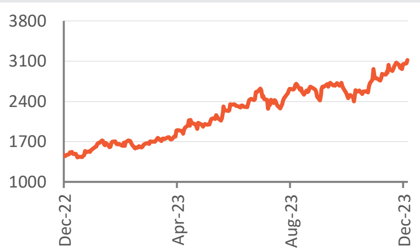
Company details

Market cap:	Rs. 28,154 cr
52-week high/low:	Rs. 3,197 / 1,412
NSE volume: (No of shares)	3.8 lakh
BSE code:	517569
NSE code:	KEI
Free float: (No of shares)	5.7 cr

Shareholding (%)

Promoters	37.1
FII	29.6
DII	17.6
Others	15.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	13.1	17.4	34.5	112.7
Relative to Sensex	4.2	7.4	21.8	94.5

Sharekhan Research, Bloomberg

Summary

- Pick up in government infrastructure spending, particularly in the power sector as well as expansion in the core sector's capacity will help KEI in achieving its revenue growth guidance of 15-16% growth over next few years.
- Focus on capacity addition will maintain the growth momentum, as KEI plans to add new greenfield capacity, which is expected to come online in a phased manner by FY2026 and can generate revenue of Rs. 4,500 crore at full utilisation.
- Export is expected to provide another growth lever as China +1 policy, lack of production capacity, and increased spending in power distribution infrastructure in the developed market will help KEI to increase its export to developed market.
- We retain Buy rating on KEI Industries Limited (KEI) with a revised PT of Rs. 3,600. The increase in PT reflects higher PE multiple given strong earnings outlooks supported by tailwinds from power sector.

The wire and cable segment is expected to experience strong growth due to the government's efforts to increase power-generation capacity, higher infrastructure capex, and focus on affordable housing. Private players, particularly in the core sector, are also investing to expand their capacity, which will further increase demand for wires and cables. Management expects the company to grow at a faster rate than the industry as many smaller players lack capital and management bandwidth to sustain the industry's growth rate. The company plans to increase its capacity through brownfield and greenfield expansion with additional revenue potential of ~Rs. 5,500 crore at full utilisation by FY2026. The company anticipates achieving decent capacity utilisation for greenfield/brownfield capacity by FY2027, which will provide operating leverage benefit to the company, resulting in a 100-150bps improvement in its EBITDA margin in the medium term. The company plans to increase the share of exports revenue by adding more geographies to its sales network.

- **Strong growth outlook for the wire and cable segment:** Recent government initiatives to enhance power production capacity and prioritise affordable housing are likely to drive significant growth in the wire and cable market. Key players in core sectors like cement, steel, power, and pharma are also increasing their capacity, which will further increase wire and cable consumption. In the medium term, management expects KEI's revenue to post a 15-16% CAGR, much above the expected industry CAGR of 12-13% mainly due KEI's new capacities and lack of capital and management bandwidth of smaller players. The China +1 policy and investment in domestic manufacturing will also contribute to increased consumption of wires and cables. The company has expanded its business across various industries, reducing its dependency on top 10 customers to 15% of total revenue in FY2023 vs. 23% in FY2019.
- **Capacity addition will maintain the growth momentum:** The company plans to increase its wire and cable capacity as cable capacity is running at 97% utilisation and the wire segment is running at 70% utilisation. To meet the growing demand for wires and cables and prevent capacity constraints, the company plans to add new greenfield capacity in a phased manner, which can generate revenue of Rs. 4,500 crore at full utilisation. The company is also doing brownfield capacity expansion, which is expected to generate additional revenue of ~Rs. 1,000 crore at full utilisation.
- **Export to provide growth lever:** Earlier the company was able to generate 13% of its revenue from overseas markets, which declined to 10% during the pandemic. However, overseas revenue has since recovered, and management expects to increase its exports to 15-17% of total sales in the next two years mainly by adding new geographies to its sales network. The company plans to primarily export cables as the developed market lacks local cable manufacturing capacity, which results in lower competition. The company has made inroads in the U.S. cable market and is expected to register healthy growth due to increased spending on power distribution infrastructure and a stagnant manufacturing base for cable manufacturing.

Our Call

Valuation: Retain Buy with a revised PT of Rs. 3,600: KEI is on a healthy and sustainable growth trajectory as it is catering to diversified user industries, increasing its focus on the retail segment, strengthening its high-margin EHV, and carrying out capex to meet the rising demand. Additionally, the company has been gaining significant traction in exports. Operating margin is expected to increase on account of operating leverage, increasing proportion of retail sales and exports in total revenue, and higher sales of EHV cables post capacity expansion. We believe the company is on a healthy and sustainable growth trajectory. Management has provided an optimistic demand outlook for both the retail and institutional segments, driven by private capex and increased government spending, respectively. We expect a revenue/PAT CAGR of 17%/~21% over FY2023-FY2026E. The stock is currently trading at a P/E of ~34x its FY2026E EPS. Considering the economic upcycle and strong earnings outlook, we assign a target multiple of ~39x its FY2026E. We reiterate our Buy rating on the stock with a revised price target (PT) of Rs. 3,600.

Key Risks

Volatile 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

Valuations	FY23	FY24E	FY25E	FY26E
Net sales (Rs cr)	6,912	8,131	9,541	11,105
OPM (%)	10.2	10.6	10.9	11.1
Net profit (Rs cr)	477	585	705	837
Adjusted EPS (Rs)	52.9	64.8	78.2	92.8
Growth (YoY) %	26.9	22.5	20.6	18.7
PER (x)	59.0	48.2	39.9	33.6
P/B (x)	9.4	7.8	6.4	5.3
EV/EBIDTA (x)	39.4	32.1	26.5	22.2
RoCE (%)	24.6	24.8	25.1	24.9
Core RoE (%)	18.4	18.6	18.4	18.1

Source: Company; Sharekhan estimates

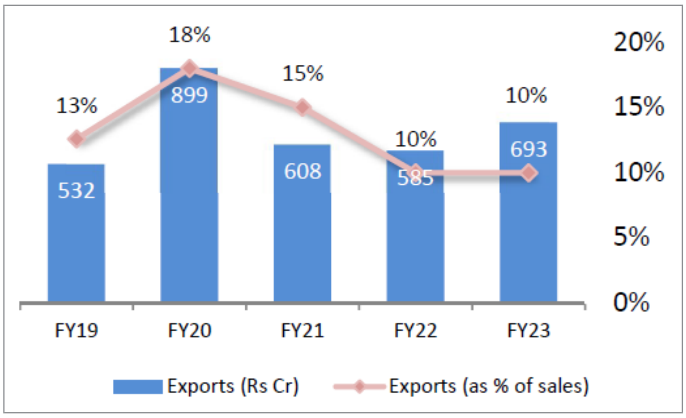
Strong growth outlook: The government's focus on increasing power-generation capacity through both renewable as well as thermal will increase the overall demand for wires and cables. Moreover, higher infrastructure capex and focus on affordable housing by the government will further boost sales of wires and cables. Higher investment in the core sector (cement, steel, power, and pharma) by key players will further increase the consumption of wires and cables. Management expects the wires and cables industry to grow 12-13% annually. KEI is expected to generate higher growth, as smaller players lack management bandwidth and scarcity of capital to grow their revenue in double digits. Management believes KEI can register 15- 16% revenue growth over the next few years. China +1 policy and investment from overseas investors in domestic manufacturing will increase the consumption of wires and cables.

Future capex plan: The company's cable segment is currently running at 97% capacity utilisation, whereas the wire segment is currently running at 70% capacity utilisation. As the company plans to grow at an annual growth rate of 15-16% for the next few years, it plans to add capacity to prevent capacity constraints on growth. The company is coming up with a new greenfield capacity to meet the growing demand for wires and cables. This new capacity can generate revenue of ~Rs. 4,000-4,500 crore at its full utilisation. Greenfield capacity Phase-1 is expected to come online by the end of FY2025 and is expected to generate revenue of Rs. 2,000 crore at full capacity. Greenfield capacity Phase-2 of this capacity has the potential to add another Rs. 2,500 crore in FY2026. The company added capacity (Rs. 240 crore potential revenue) in October 2023, another capacity (Rs. 240 crore potential revenue) will come online in December 2023. Further, the company plans to commission additional brownfield capacity of potential revenue of Rs. 300 crore and Rs. 240 crore in March and October 2024, respectively.

Improvement in EBITDA margin over the long term: By FY2027, the company expects to achieve decent capacity utilization for all the additional greenfield/brownfield capacity, which will provide operating leverage benefit to the company. So, in the medium term, we can expect the company to improve its EBITDA margin by 100-150bps.

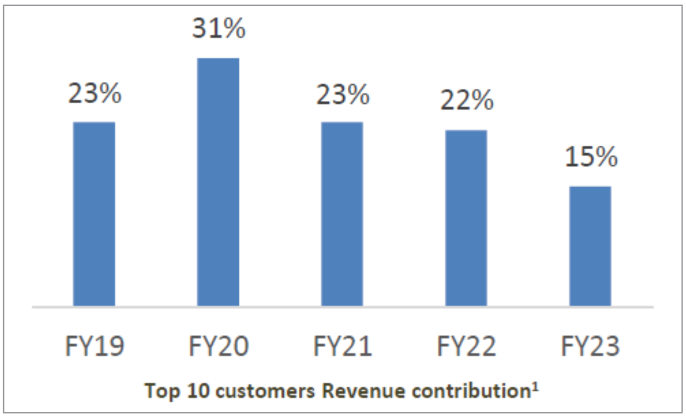
Diversification of business: The company has diversified across industries as its products are finding application in various industries, including power, real estate, cement, railways, automobiles, steel, and fertilisers. The company has de-risked its business as top-10 customer concentration has come down to 15% in FY2023 (vs. 23% in FY2019).

Export contribution declined during pandemic



Source: Company, Sharekhan Research

Decline in customer concentration risk

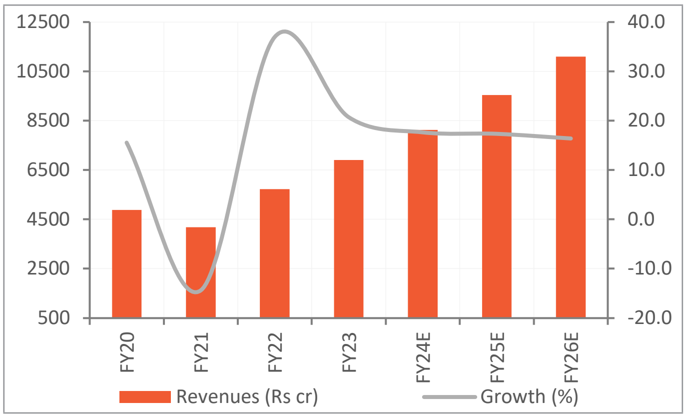


Source: Company, Sharekhan Research

Export to add another growth lever: Pre-covid company used to generate 13% of its revenue from overseas; however, due to the pandemic, export sales contribution went down to 10% in FY2023. The company's export sales was able make sharp recovery in the post pandemic environment. Over the next two years, the company plans to grow its sales to 15-17% of total sales as its marketing team was able to add more geographies to new countries to its export list. The company primarily exports cables as wires have lot of local capacity and competition. The company is steadily making inroads in the U.S. cable market due higher spending on power distribution infrastructure and stagnant industrial base for cable manufacturing.

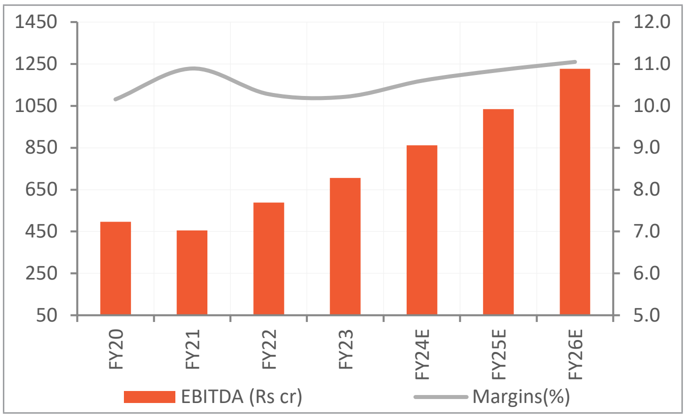
Financials in charts

Revenue growth trend



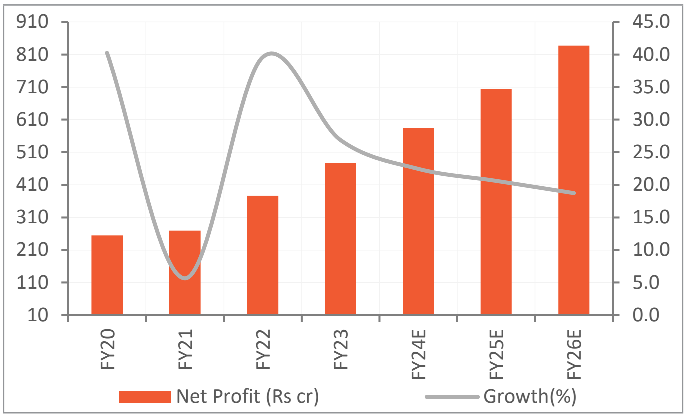
Source: Company, Sharekhan Research

Steady EBITDA Margin



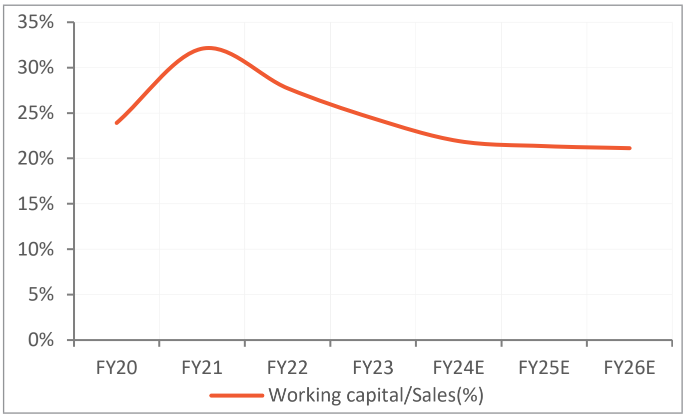
Source: Company, Sharekhan Research

PAT growth trend



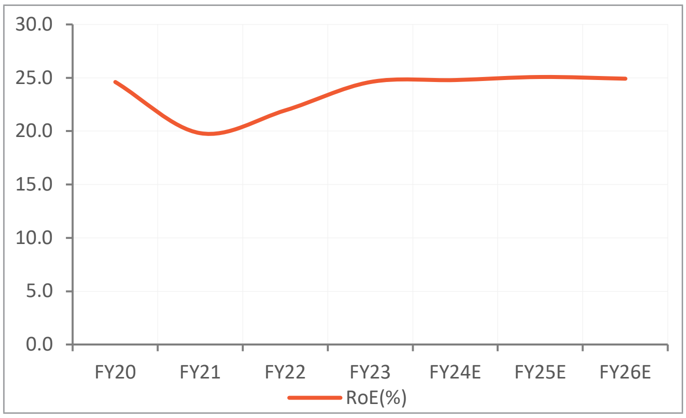
Source: Company, Sharekhan Research

Efficient working capital utilization



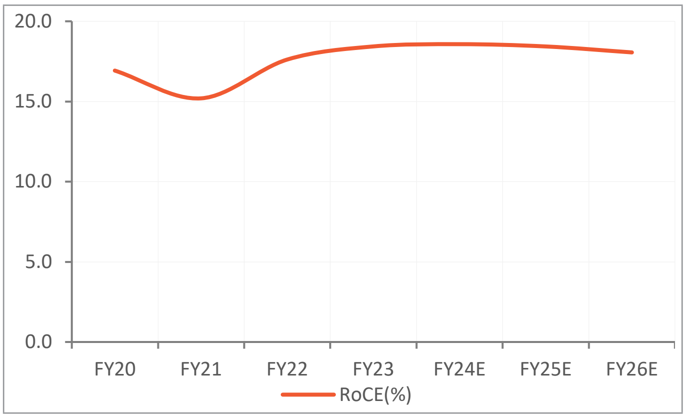
Source: Company, Sharekhan Research

RoE Trend



Source: Company, Sharekhan Research

RoCE Trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector View – Ample levers offer scope for growth

Domestic demand is improving with increasing spends on infrastructure and construction. The wires and cables market is estimated to be worth Rs. 60,000-65,000 crore, accounting for around two-fifths of the domestic electrical industry. The Indian wires and cables market is projected to grow to Rs. 90,000-95,000 crore by FY2026. Sectors like power, railways, infrastructure, oil and gas, telecom, real estate, renewables, defence, automobiles, etc. are the largest demand drivers. The domestic wires and cables 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, the government's continued thrust on infrastructure investment is expected to improve demand for the wires and cables industry.

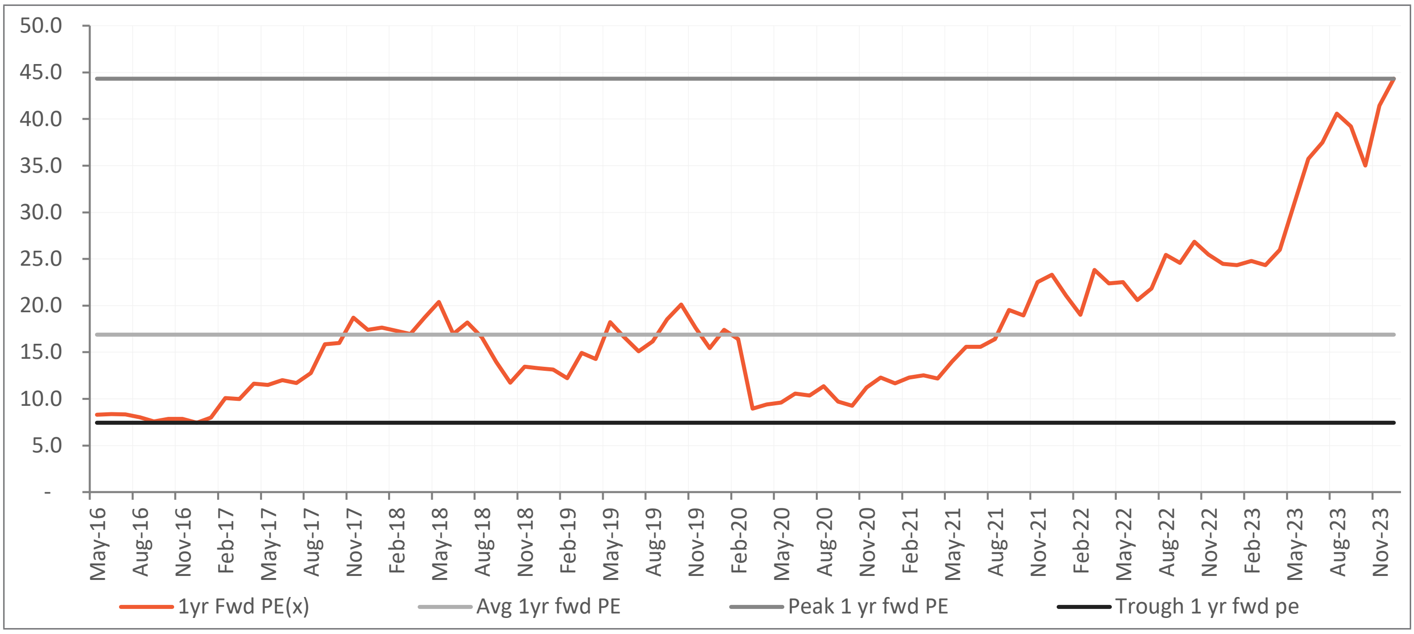
■ Company Outlook – Capacity expansions to keep growth elevated

Management remains optimistic about the retail and EHV segments in the longer run. The company 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. KEI will be undertaking a greenfield capex of over ~Rs. 900 crore in LT, HT, and EHV over a three-year period. Management expects a 15-16% revenue CAGR in 2-3 years.

■ Valuation – Retain Buy with a revised PT of Rs. 3,600

KEI is on a healthy and sustainable growth trajectory as it is catering to diversified user industries, increasing its focus on the retail segment, strengthening its high-margin EHV, and carrying out capex to meet the rising demand. Additionally, the company has been gaining significant traction in exports. Operating margin is expected to increase on account of operating leverage, increasing proportion of retail sales and exports in total revenue, and higher sales of EHV cables post capacity expansion. We believe the company is on a healthy and sustainable growth trajectory. Management has provided an optimistic demand outlook for both the retail and institutional segments, driven by private capex and increased government spending, respectively. We expect a revenue/PAT CAGR of 17%/~21% over FY2023-FY2026E. The stock is currently trading at a P/E of ~34x its FY2026E EPS. Considering the economic upcycle and strong earnings outlook, we assign a target multiple of ~39x its FY2026E. We reiterate our Buy rating on the stock with a revised PT of Rs. 3,600.

One-year forward P/E (x) band



Source: Sharekhan Research

About company

KEI is among the top three organised players in the Indian wires and cables 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 specialised 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	SMALL CAP WORLD FUND INC	4.0
2	Morgan Stanley	2.9
3	Vanguard Group Inc/The	2.5
4	Canara Robeco Asset Management Co	2.3
5	HDFC Asset Management Co Ltd	2.1
6	Franklin Resources Inc	1.8
7	L&T Mutual Fund Trustee Ltd/India	1.7
8	William Blair & Co LLC	1.4
9	BlackRock Inc	1.2
10	Dimensional Fund Advisors LP	1.2

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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