India I Equities

Industrials

Initiating Coverage

17 April 2015

KEI Industries

Rating: **Buy**
Target Price: ₹128
Share Price:₹83

Multiple growth levers kicking in; initiating, with a Buy

We initiate coverage on KEI Industries with a Buy and a target price of ₹128. We are upbeat about the company given the greater demand for its products (reflected in its ₹17bn order-book). With its better product-mix (due to high-margin EHV), higher exports and retail sales, we expect robust 18%/82% revenue/PAT CAGRs over FY15-17. Operating leverage and the better product-mix could improve margins by 180bps, in our view. With no major capex until FY17, FCF generation would strengthen the balance sheet, resulting in higher return ratios.

Growth driven by a diversified product-mix. KEI is one of only three companies in the high-margin EHV business. On completion of pre-qualification, we expect its EHV business to grow to ₹2.5bn by FY17, from ~₹0.6bn in FY15e. This segment has a higher, ~15-18%, margin, and its order book is ₹2bn. We expect its turnkey EPC business (15% margin) to grow from ₹2.1bn (net revenue) in FY15e to ₹4.4bn in FY17.

More exports, retail sales would help revenue, margin growth. KEI has chalked out a brand-building strategy (to spend ~₹70m on ad campaigns in FY16). Retail sales now account for 27% of sales, and we expect them to rise to 33% by FY17, following vigorous dealer addition (from 600 to 1,000). We expect exports (7% of sales in FY15e) to climb to 10% by FY17. These segments are low working-capital intensive.

Operating leverage to drive margins. Better utilisation, coupled with higher revenue from retail, exports and EHV, could result in the EBITDA margin rising 179bps over FY15-17. We expect an EBITDA CAGR of 29% over FY15-17.

With no major capex, balance sheet to be strong. Given its rising profitability, we expect an FY17 RoCE of 31.3% (20.7% in FY15e). We estimate working-capital days to drop to 77 in FY17 from 89 in FY15. The minor capex in cables plus the routine capex of ₹300m/yr would be funded internally; hence, we expect the debt-equity ratio to fall to 1.1x by FY17.

Valuation. We expect an 82% PAT CAGR over FY15-17, supported by rising revenue and better margins. We value the stock at an average of PE, EV/EBITDA and P/BV; hence, we derive a target of ₹128. It currently quotes at a PE of 6.1x FY17e EPS. **Risks.** Demand deterioration in infrastructure and higher interest rates.

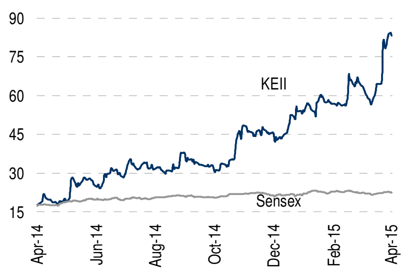
Key financials (YE Mar)	FY13	FY14	FY15e	FY16e	FY17e
Sales (₹ m)	16,584	16,189	20,260	24,461	28,432
Net profit (₹m)	263	116	316	648	1,053
EPS (₹)	3.7	1.6	4.1	8.4	13.6
Growth (%)	8.2	(56.0)	172.7	104.8	62.6
PE (x)	24.3	55.3	20.3	9.9	6.1
EV/EBITDA (x)	6.4	7.5	6.0	4.5	3.5
P/B (x)	2.5	2.3	2.1	1.8	1.4
RoE (%)	10.9	4.3	10.9	19.4	25.8
RoCE (%)	20.9	17.3	20.7	26.2	31.3
Dividend yield (%)	0.2	0.3	0.5	1.1	1.6
Net gearing (%)	1.8	1.9	1.7	1.4	1.1

Source: Company, Anand Rathi Research

Key data	KEII IN / KEIN.BO
52-week high/low	₹89 / ₹17
Sensex/Nifty	28666 / 8707
3-m average volume	US$0.8m
Market cap	₹6.4bn / US$103m
Shares outstanding	77m

Shareholding pattern (%)	Mar'15	Dec '14	Sep'14
Promoters	49.4	49.4	49.4
- of which, Pledged			
Free Float	50.6	50.6	50.6
- Foreign Institutions	1.2	1.6	1
- Domestic Institutions	0.2	0.1	0.1
- Public	49.2	48.7	49.4

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY13	FY14	FY15e	FY16e	FY17e
Net revenues	16,584	16,189	20,260	24,461	28,432
Revenue growth (%)	-3.71	-2.38	25.14	20.74	16.24
- Oper. expenses	14,878	14,659	18,328	21,898	25,212
EBITDA	**1,705**	**1,530**	**1,932**	**2,562**	**3,220**
EBITDA margin (%)	10.28	9.45	9.54	10.47	11.33
- Interest expenses	1,094	1,115	1,227	1,320	1,361
- Depreciation	204	210	251	297	313
+ Other income	24	13	18	22	26
- Tax	85	46	156	319	519
Effective tax rate (%)	38.9	46.8	33.0	33.0	33.0
Reported PAT	**263**	**116**	**316**	**648**	**1,053**
+/- Extraordinary items					
Adjusted PAT	263	116	316	648	1,053
PAT growth (%)	8.2	(56.0)	172.7	104.8	62.6
Adj. FDEPS (₹/sh)	3.4	1.5	4.1	8.4	13.6
Adj. FDEPS growth (%)	8.2	(56.0)	172.7	104.8	62.6

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY13	FY14	FY15e	FY16e	FY17e
Share capital	140	147	154	154	154
Reserves & surplus	2,415	2,539	2,861	3,428	4,363
Net worth	2,556	2,731	3,016	3,582	4,518
Total debt	4,736	5,106	5,256	5,306	5,006
Minority interest	0	0	0	0	0
Def. tax liab. (net)	106	160	160	160	160
Capital employed	**7,397**	**7,998**	**8,433**	**9,049**	**9,685**
Net fixed assets	3,115	3,143	3,042	3,045	3,032
Investments	31	31	31	31	31
- of which, Liquid					
Net working capital	4,096	4,778	5,217	5,788	6,382
Cash and bank balance	156	46	142	185	240
Capital deployed	**7,397**	**7,998**	**8,433**	**9,049**	**9,685**
Net debt/ equity (x)	1.8	1.9	1.7	1.4	1.1
WC turn (days)	87	99	89	81	77
Book value (₹/sh)	33	35	39	46	58

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY13	FY14	FY15e	FY16e	FY17e
PAT	263	116	316	648	1,053
+ Non-cash items	287	264	251	297	313
Cash profit	550	380	567	945	1,366
- Incr./(decr.) in WC	194	682	439	571	593
Operating cash-flow	357	(302)	128	374	773
- Capex	136	238	150	300	300
Free cash-flow	**220**	**(540)**	**(22)**	**74**	**473**
- Dividend	16	18	36	81	118
+ Equity raised	59	49	49	0	0
+ Debt raised	(140)	370	150	50	(300)
- Investments	0	0	0	0	0
- Misc. items	11	(28)	44	0	0
Net cash-flow	**113**	**(111)**	**96**	**43**	**55**
Opening cash	44	156	46	142	185
Closing cash	156	46	142	185	240

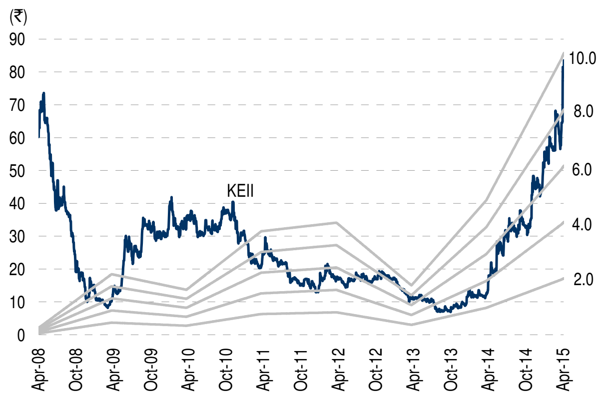
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹83

Year-end: Mar	FY13	FY14	FY15e	FY16e	FY17e
P/E (x)	24.3	55.3	20.3	9.9	6.1
Cash P/E (x)	12.5	18.8	11.3	6.8	4.7
EV/EBITDA (x)	6.4	7.5	6.0	4.5	3.5
EV/sales (x)	0.7	0.7	0.6	0.5	0.4
P/B (x)	2.5	2.3	2.1	1.8	1.4
RoE (%)	10.9	4.3	10.9	19.4	25.8
RoCE (%)	20.9	17.3	20.7	26.2	31.3
Dividend yield (%)	0.2	0.3	0.5	1.1	1.6
Dividend payout (%)	5.3	13.3	9.8	10.7	9.5
Debt to equity (x)	1.9	1.9	1.7	1.5	1.1
Debtor days	98.1	94.5	90.0	88.0	87.0
Inventory days	82.6	93.5	89.0	87.0	86.0
Payables days	109.2	106.5	110.0	111.0	112.0
Working capital days	86.8	98.7	88.8	81.0	77.0
Fixed asset T/O (x)	5.3	5.2	6.7	8.0	9.4

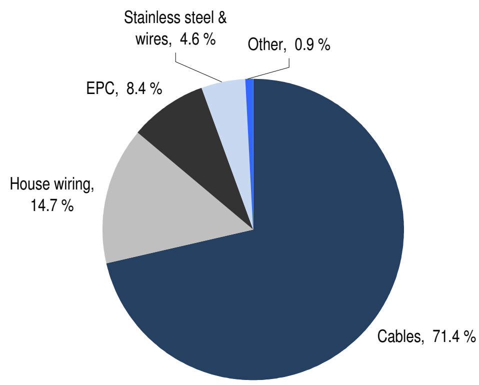
Source: Company, Anand Rathi Research

Fig 5 – PE band



Source: Bloomberg, Anand Rathi Research

Fig 6 – Segment-wise revenue break-up (FY15e)



Source: Company, Anand Rathi Research

Growth led by diversified product-mix

Diversified product-mix, now including EPC

- The diversified product-mix, comprising extra-high-voltage cables (up to and incl. 220 kV), high and medium-voltage cables, low-tension cables, control and instrumentation cables, specialty and rubber cables, stainless steel wires and winding, flexible and housing wires, makes KEI the leader in the domestic cable and wire sector.
- Its recent entry into the EPC segment by executing power-transmission projects (66kV to 400kV sub-stations) on a turnkey basis has enabled the company to gain a competitive edge.
- Being the third-largest producer of EHV cables (in technical collaboration with the Switzerland-based Brugg Kabel AG), KEI has established its position by providing end-users with designs, services, etc.

Strong demand outlook for India's wire and cable sector

- Wires and cables form an integral part of all industrial capex. Based on some estimates, ~3—3.5% of capex cost is on cables and wires; in power distribution, however, this goes as high as 10—12%. The size of the cable sector is estimated at ~₹230bn, growing 12—15%.
- The wire and cable sector in India comprises about a quarter of the total transmission and distribution segment. Demand for wires is expected to register a 13% CAGR over the next 7—8 years owing to the government's investment in power and infrastructure, coupled with dynamic industrialisation and rapid urbanisation.

Some of the largest operators are Polycab, Finolex Cables, Havells, V-Guard, Uniflex Cables and RPG Cables (now with KEC)

- Major expansion in steel, cement, oil & gas, energy, automobiles, highways, ports, airports, SEZs, housing, IT parks, hotels, shopping malls and BPOs would increase demand for cables.
- The government's plan to spend $1trn on infrastructure in the next five years would help growth in this sector.

Fig 7 – Capacity, plant-wise (km)

	Bhiwadi	Silvassa	Chopanki
EHV			600
HT power cables	3,000		2,000
LT power cables	9,000	6,000	7,000
Control cables	16,000	12,000	3,000
Instrumentation cables	10,000	1,000	
Rubber cables	3,000		
Total cable (km)	**41,000**	**19,000**	**12,600**
House wires/ Winding wires (km)	40,000	24,0000	
Stainless steel wire (tonnes)	4,800		

Source: Company

Wide array of products

The diversified product range covers a wide variety of cables, catering to the requirements of both the industrial and household sectors. KEI manufactures all kind of power cables—extra-high-voltage cables up to and including 220kV, high- and medium-voltage cables, low-tension cables, control and instrumentation cables, specialty and rubber cables, winding, flexibles and house wire, and stainless-steel wire.

Its manufacturing plants are located at Bhiwadi, Chopanki and Silvasa. Products are used in different sectors (power, oil refineries, Railways, automobiles, cement, steel, fertilisers, textiles and real estate, among others). Supported by growth in these sectors, cables are likely to benefit, hence leading to growth in the company.

Its clients include Tata Power, the Indian Railways, NTPC, Hindalco, Punj Lloyd, BPC, HPC, Indian Oil, Essar Oil, ONGC, GAIL, BHEL, Reliance Energy, etc.

In FY14, low-tension power/ rubber cables, high-tension power cables, housing, winding and flexible wires and stainless-steel wire contributed 56.7%, 15.7%, 16.8% and 5.7%, respectively, to revenue. We expect these figures to record a 15% CAGR over FY15-17, with margins coming at around 10—11%. The company now operates at around a 75% capacity utilisation, which is likely to go up to 93% in FY17.

Fig 8 – Product Basket

Products	Application
Control Cables	Used for electrical distribution systems such as generating stations, industrial application and indoor and outdoor projects.
Rubber Cables	Rubber cables are used in mines, ships, aircraft, earth-moving equipment, etc.
Power Cables	Used in underground as well as overhead transmission of power in power plants, industries, projects etc.
Instrumental cables	Used to transmit power from the main control room to the machines.
Housing wires	These have application in electrification of residential, commercial and industrial establishments
Winding wires	These are used for submersible pumps and electrical motors
Flexible wires	Used in electrical panel wiring, consumer electrical goods, etc.
Stainless steel wires	Wide application in graded house fasteners, weaving, knitting and other industrial applications

Source: Company

EPC to bolster KEI's growth prospects

Consumption of cables in turnkey EPC power projects accounts for nearly 30% of project cost

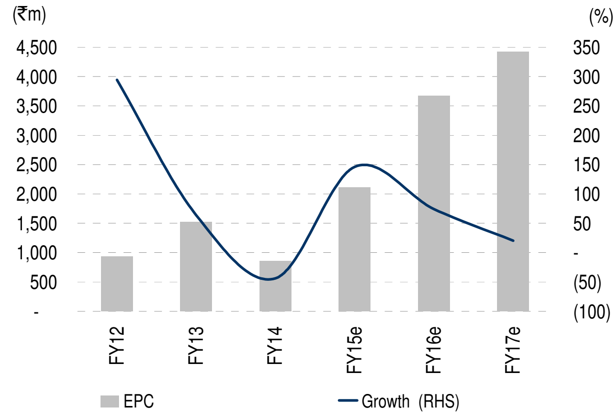
The engineering, procurement and construction (EPC) sector is projected to be a multi-billion-dollar industry due to the vast infrastructure opportunities arising. The company had marked its presence in EPC from FY08. The main services offered by it in EPC constitute execution of power transmission projects (of 66kV to 400kV sub-stations) on a turnkey basis, EPC of EHV and HV cable systems, electrical balance-of-plant for power plants and electrical industrial projects.

In-house manufacturing of EHV/ HV cables gives KEI an added advantage since these cables comprise almost 30% of an EPC project value. Its EPC clients comprise L&T, Siemens, ABB and Areva, etc. It has collaborations with Woosun Electric (Korea) for power projects and with Cobra Engineers (Spain) for sub-station execution.

The EPC segment has registered a 73% CAGR over FY11-15e and we expect a 45% CAGR over FY15-17 with margins of around 15%. The company has been servicing both the government and private sectors at average gestation periods of about a year. Of its present order book of ₹17bn, around ₹8.5bn arises from EPC contracts.

One of the leaders in the EHV sub-segment, KEI is expected to gain substantial market share in the next 2-3 years

Fig 9 – Strong sales growth in the EPC business



Source: Company, Anand Rathi Research

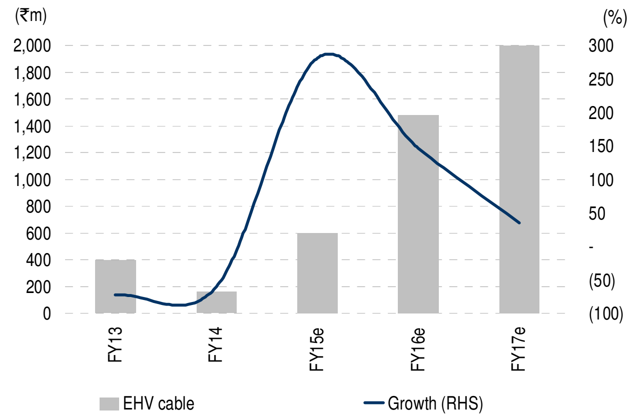
Leading in EHV cables

KEI is the third company in India to commercially produce EHV cables (ranging from 66kV to 220kV). In Nov'10 it commenced production at Chopanki in Rajasthan. In the past, demand for EHV cables was met largely through imports; however, technological collaboration with the Switzerland-based Brugg Kabel AG has enabled KEI to make its presence in EHV cables felt faster.

Brugg has over 100 years' experience and the ability to manufacture cables up to 550kV. It supports KEI by providing designs, process back-up – services sought by end-users such as transmission companies, mega power plants, metropolises, industries such as steel, cement, refineries, petrochemicals, large realty projects such as IT parks, large residential complexes, etc. At present KEI has more than ₹2bn of orders pending for EHV cables. The normal execution time for the cable orders is 6—8 months.

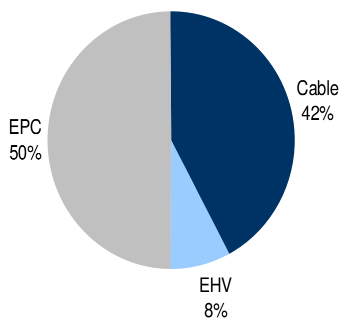
In FY15, EHV cables would have contributed 2.7% to revenue. By FY17 we expect this to increase to 8.2%. We expect revenue from EHV to register a 104% CAGR from ₹0.6bn to ₹2.5bn. The boom in infrastructure, power, transmission and distribution would be huge positives for growth in this segment.

Fig 10 – Strong sales growth in EHV



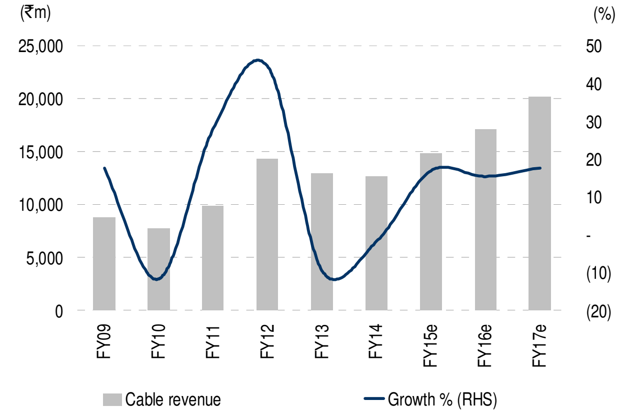
Source: Company, Anand Rathi Research

Fig 11 – Strong order-book position (FY15e)



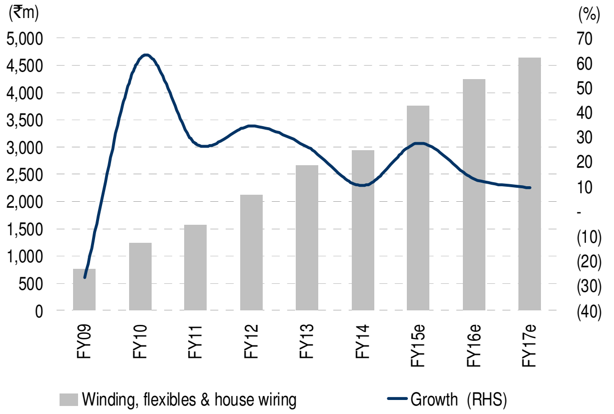
Source: Company

Fig 12 – Strong sales growth in cables



Source: Company, Anand Rathi Research

Fig 13 – Sales growth in housing wire



Source: Company, Anand Rathi Research

Strong retail and export operations

- KEI is positioned as a dominant domestic cable manufacturer, with strong brand equity and a wide distribution network. Its retail segment, comprising wires for domestic use, is expected to widen in the years to come. At present, retail contributes around 27% to its revenue, and we expect this to rise to 33% by FY17 and to over 35% in the next three years.
- With operations in more than 45 countries, KEI's exports have recorded a 24% CAGR over FY13-15e. During FY14, exports had almost doubled; now, with the company's keener focus on exports, we expect this to register a 40% CAGR over FY15-17.

Expanding retail presence

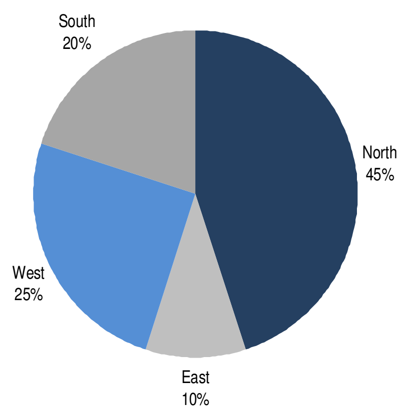
Retail brings in ~27% of revenue. On account of slightly better margins of around 11%, the company's focus on this has risen

KEI's retail division, comprising household wires as well as LT and HT cables, is moving up the value chain, backed by the company's strong brand equity and wide distribution network in India and abroad. Its brand has helped it to position itself as a specialist cable manufacturer. It has a distribution network of about 600 dealers (up from 500 in FY14) and plans to add 200 every year. At present, it is very strong in the north and west, and plans to strengthen its operations in the east and south.

House wire sales have risen at a 30% CAGR over FY09-15e, due to the number of dealers added and vigorous brand building

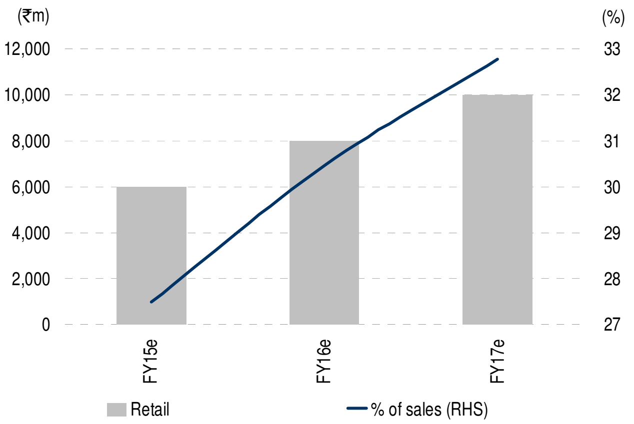
At present its distribution network covers most of India (metros, tier-I and tier-II cities). It is vigorously marketing through brand promotion and communication channels. It has decided to spend ₹70m in FY16 toward advertising in TV and print. KEI has been vigorously promoting its brand through various ad campaigns and outdoor advertising. These have led to increased house wire sales. To increase sales through its retail distribution network, it appointed a retail business head in FY15, with over 20 years' experience in the cable and wire retail business.

Fig 14 – Wide distribution network



Source: Company, Anand Rathi Research

Fig 15 – Retail sales growth



Source: Company, Anand Rathi Research

Robust export growth

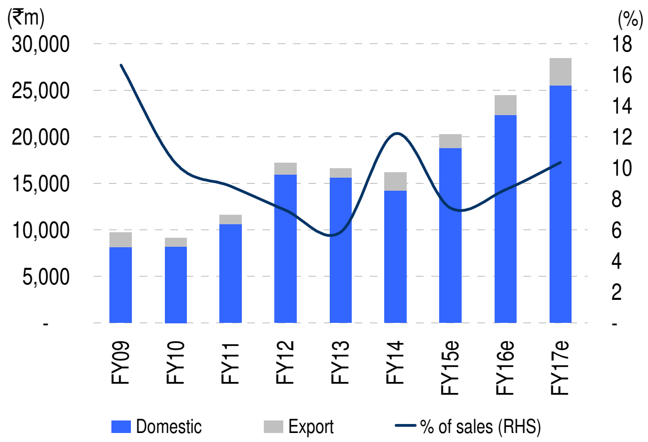
Wide range of cables, and exports to over 45 countries

Cable exports have grown robustly in the past few years. KEI, being a strong and established player in the cable sector at home, has also garnered a decent share of the export market. It exports to more than 45 countries and is poised to benefit from the coming potential. It has been setting up offices all over the country to capture further orders to best utilise the increased manufacturing capacities. It has also set up offices in Singapore, Nigeria and Kazakhstan besides offices in Dubai/ Abu Dhabi. Also, it operates in Korea and Australia through agents.

It sells a wide range of cables: EHV (66kV to 220kV), MV (11kV to 66kV) and LV (<11kV). Also, it has participated in international exhibitions to establish fresh connections in order to expand operations in overseas markets. Competitive prices and its ability to offer customised solutions have helped its export business dramatically in the past two years.

During FY14, its exports doubled from ₹0.97bn to ₹1.97bn, with the proportion of exports to revenue also doubling -- from 6% to 12%. In FY15, however, this slipped to 7% due to disturbances in its target market. With management's strong focus on exports, we expect this percentage to climb to 9.6% by FY17, registering a 40% CAGR over FY15-17. With more exports, profitability and working capital are likely to improve.

Fig 16 – Healthy export growth

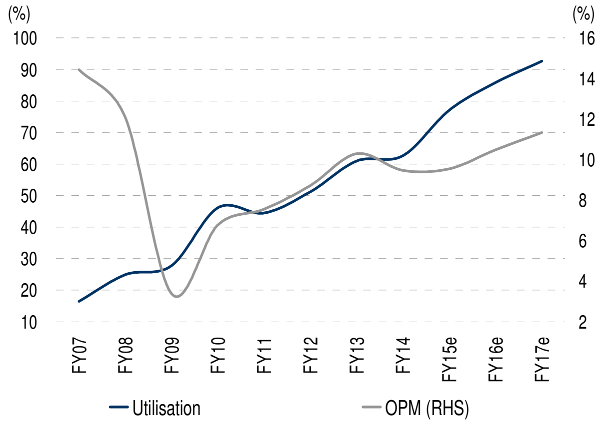


Source: Company, Anand Rathi Research

Operating leverage to drive margins

Over the last few years the company has been operating at sub-optimal levels. In FY15 its cables and wire division operated at ~75% utilisation. Hence, we expect substantial fixed-cost absorption to have occurred and, with no major capex further, we expect the plants to touch 93% utilisation in FY17. The present capacity can generate ₹28bn in revenue. The revenue visibility on account of its strong order book is ~₹17bn and leads us to believe that operating leverage would kick in.

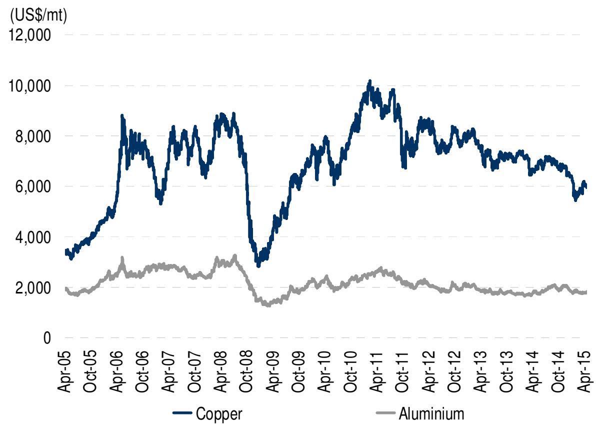
Fig 17 – Higher capacity utilisation leading to higher margin



Source: Company, Anand Rathi Research

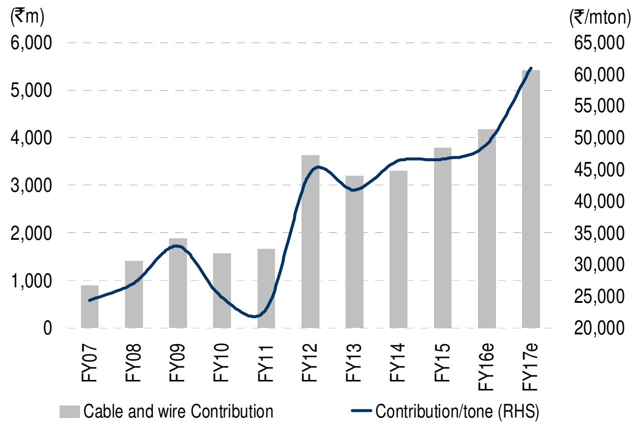
Greater utilisation, coupled with higher revenue from retail, exports and EHV, would result in a 179-bp better EBITDA margin over FY15-17. We expect an EBITDA CAGR at 29% over FY15-17.

Fig 18 – Price trends in copper and aluminium (LME)



Source: Bloomberg

Fig 19 – Contribution/ tonne of cable and wire



Source: Company, Anand Rathi Research

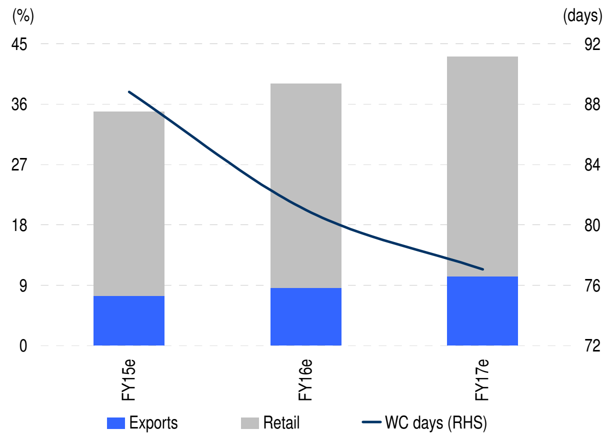
Healthy balance sheet

Over FY16-17, the company is likely to generate operating cash-flows of about ₹1.14bn, in our view; of this, ~₹600m would be used for routine capex plus minor capex in cables; hence, the debt-equity ratio is expected to fall to 1.1x by FY17. We expect debt of ~₹5bn in FY17. We expect the interest cost (as percent of sales) to fall in FY17 to 4.8%, from 6% in FY15e, a 127-bp improvement. This, coupled with the improved margin due to greater revenue would help toward the steeply improved profitability. The PAT margin would more than double, to 3.7% in FY17, from 1.6% in FY15e.

We expect the FY17 RoCE to be 31.3% (from 20.7% in FY15e).

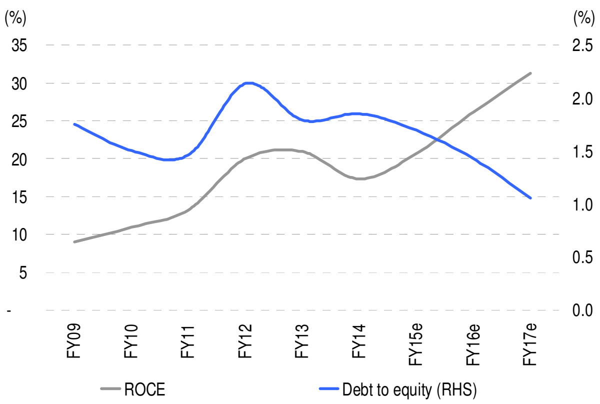
Both the export and retail businesses, which are expected to grow faster than the overall business, are less working-capital intensive. Because of this, we expect working-capital days to come at 77 in FY17, from 89 in FY15.

Fig 20 – Greater share of exports and retail to reduce working capital



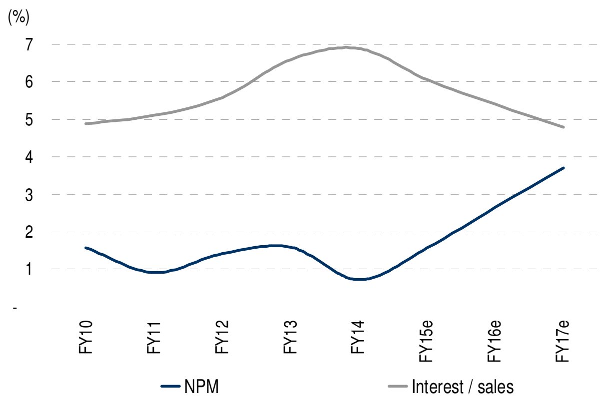
Source: Anand Rathi Research

Fig 21 – Better return ratios to reduce debt



Source: Company, Anand Rathi Research

Fig 22 – Lower interest cost as % of sales to expand NPM



Source: Company, Anand Rathi Research NPM = PAT margin

Financials

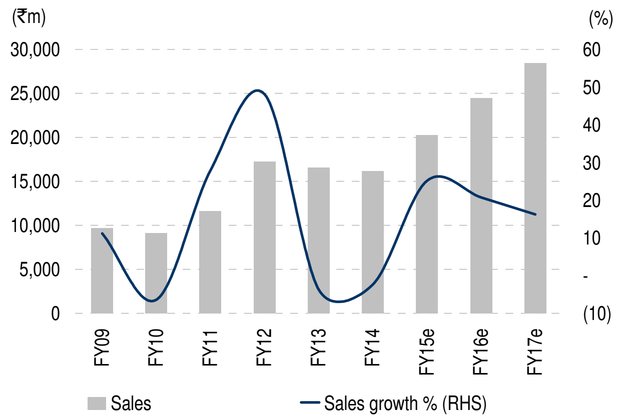
We expect the EPC business to report a 45% CAGR over FY15-17. With an order book of ~₹17bn, we expect it to boost growth

- We expect KEI's revenue to record an 18% CAGR over FY15-17, fuelled by strong growth in EHV cables, EPC, retail and export businesses, which bring in ~44% of revenue.
- We expect profit to register a strong 82% CAGR, powered by strong revenue, a 179-bp margin expansion and declining interest costs (as percent of sales) over FY15-17.
- We expect the balance sheet to be strengthened as minimal capex and an improving working-capital cycle would help generate sufficient free-cash flows and improve theRoE and RoCE substantially over FY15-17. This would also help in reducing the debt-equity ratio through repayment of debt.

Strong, 18%, revenue CAGR over FY15-17

On account of the government's greater emphasis on infrastructure, demand for cables in India could shoot up. We expect an 18% revenue CAGR over FY15-17 to ₹28.45bn, driven by strong growth in the EHV cables and EPC businesses. The cable division, comprising LT power cables, HT power cables and EHV cables, registered a 9% CAGR over FY09-15e and is likely to report a 17% CAGR over FY15-17, in our view.

Fig 23 – Revenue growth trend



Source: Company, Anand Rathi Research

We expect winding and house wires/stainless-steel wires to record 11%/6% CAGRs over the same period

Fig 24 – Revenue break-up

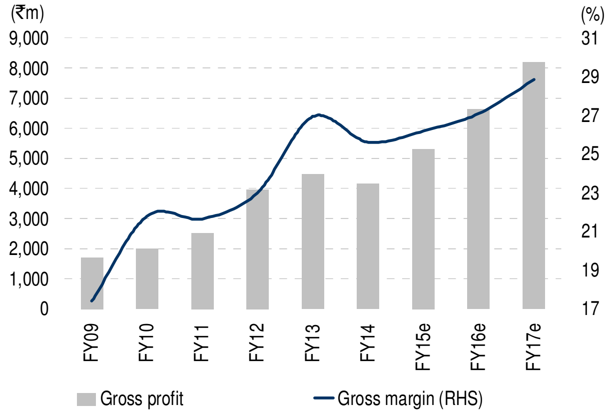
(₹ m)	FY 13	FY14	FY15e	FY16e	FY17e
Cables	**12,948**	**12,718**	**14,873**	**17,164**	**20,203**
% growth		*(1.8)*	*16.9*	*15.4*	*17.7*
% of sales	71.4	72.5	68.1	65.4	66.2
Winding, flexi & house wires	**2,665**	**2,941**	**3,751**	**4,243**	**4,642**
% growth		*10.4*	*27.5*	*13.1*	*9.4*
% of sales	14.7	16.8	17.2	16.2	15.2
Turnkey projects	**1,524**	**857**	**2,110**	**3,673**	**4,421**
% growth		*(43.8)*	*146.1*	*74.1*	*20.4*
% of sales	8.4	4.9	9.7	14.0	14.5
Stainless steel wires	**831**	**1,003**	**1,083**	**1,162**	**1,221**
% growth		*20.8*	*7.9*	*7.3*	*5.1*
% of sales	4.6	5.7	5.0	4.4	4.0
Traded goods (SS wires)	**155**	**15**	**19**	**23**	**28**

Source: Company, Anand Rathi Research

EBITDA margin to step up

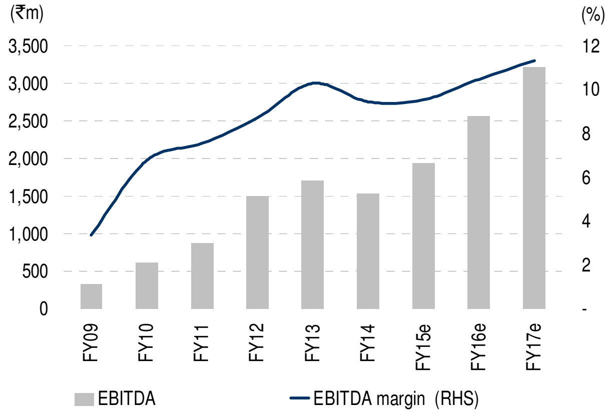
In the past, the company had been generating healthy EBITDA margins of around 10-14% (FY05-08). In FY09, however, the margin slipped to ~3% because of volatile raw-material prices (copper and aluminum). But, with raw-material prices stabilising, margins have begun to steady. At present, the gross margin is about 26% and we expect this to improve to 28% by FY17. The EBITDA margin has improved by 617bps over FY09-15e. With the company's strong focus on EHV, EPC and retail, we expect the margin to come at around 11.3% by FY17, up 179bps over FY15.

Fig 25 – Gross margin improvement . . .



Source: Company, Anand Rathi Research

Fig 26 – . . . to drive EBITDA margin up

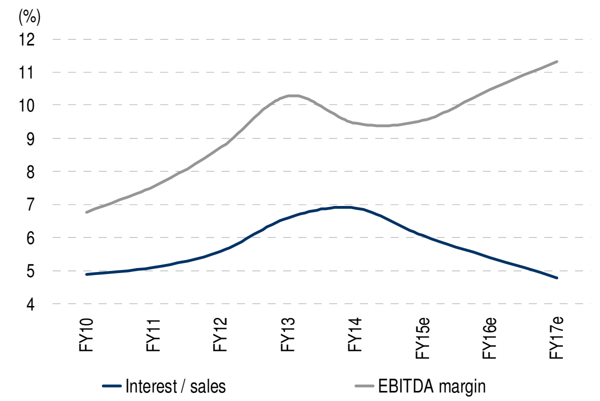


Source: Company, Anand Rathi Research

Net profit to register an 82% CAGR over FY15-17

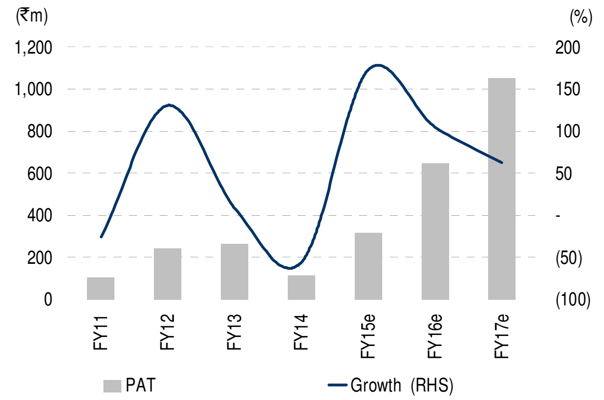
We expect the company to register an 82% CAGR over FY15-17 in net profit to ₹1.05bn, aided by strong revenue growth, healthy operating profit margins and a better leverage position. At present, the retail segment constitutes about 27% of the business; with the retail-business expansion, profitability could improve since this is a slightly higher-margin business. Exports, ~7% of sales in FY15, are expected to rise to 10% in FY17. The increasing focus on EPC, retail, EHV cables and exports would help improve profit margins to ~3.7%, from 1.6% in FY15.

Fig 27 – Higher margin and lower interest cost . . .



Source: Company, Anand Rathi Research

Fig 28 – . . . to drive strong growth in PAT



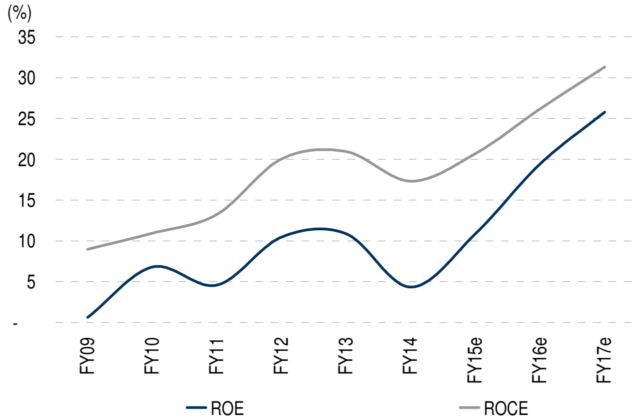
Source: Company, Anand Rathi Research

Improving return ratios

Better return ratios in the next three years

With strong PAT growth and better margins in the next three years, we expect substantially improved return ratios. We estimate the RoE and RoCE would improve from 11% and 20.7% in FY15, respectively, to 25.8% and 31.3% in FY17. The subdued sales growth in FY14 had cut into the return ratios; but, with the robust revenue and margin growth over FY15-17, the return ratios are trending upward.

Fig 29 – Climbing return ratios



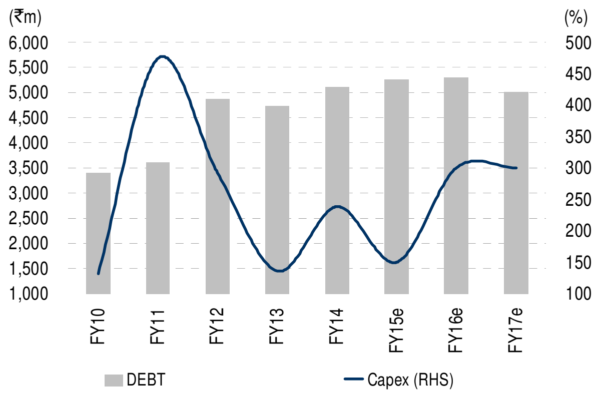
Source: Company, Anand Rathi Research

Minimal capex and lower debt lead to a strong balance sheet

Minimal capex plans would lead to FCF generation and lower the debt-equity ratio over the next two years

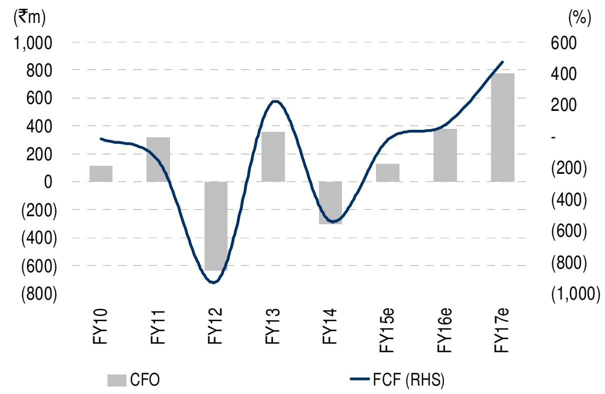
The company has minimal capex plans (just ~₹0.6bn) for the next two years, to be funded through internal accruals. It has already started to pay off its term debt, and we expect the debt-equity ratio to fall to 1.1x in FY17, from 1.7x in FY15e. With minimal capex, we expect KEI to generate free-cash flows over the next two years. The fixed-asset turnover is likely to come at 9.4x in FY17, from 6.7x in FY15e, in our view. As we expect the institutional business to contribute less over FY15-17, working capital days required would drop to 77 in FY17 from 89 in FY15e.

Fig 30 – Lower capex to keep debt in check



Source: Company, Anand Rathi Research

Fig 31 – FCF to increase from FY15



Source: Company, Anand Rathi Research

Fig 32 – Income statement (₹ m)

Y/E March	FY13	FY14	FY15e	FY16e	FY17e
Revenues	**16,584**	**16,189**	**20,260**	**24,461**	**28,432**
Growth in revenues (%)	(3.7)	(2.4)	25.1	20.7	16.2
Raw materials	12,119	12,043	14,954	17,838	20,236
% of Sales	73.1	74.4	73.8	72.9	71.2
Personnel expenses	461	516	729	954	1,166
% of Sales	2.8	3.2	3.6	3.9	4.1
Selling and other expenses	2,298	2,100	2,644	3,106	3,810
% of Sales	13.9	13.0	13.1	12.7	13.4
EBITDA	**1,705**	**1,530**	**1,932**	**2,562**	**3,220**
EBITDA Margin (%)	10.3	9.5	9.5	10.5	11.3
Depreciation	204	210	251	297	313
PBIT	**1,501**	**1,321**	**1,681**	**2,265**	**2,907**
Interest expenses	1,094	1,115	1,227	1,320	1,361
PBIT from operations	**407**	**205**	**454**	**945**	**1,546**
Other non operating income	24	13	18	22	26
PBT before extra-ordinary items	431	218	472	967	1,572
Extra-ordinary income/ (expenses)	-	-	-	-	-
PBT	431	218	472	967	1,572
Provision for tax	167	102	156	319	519
Effective tax rate	38.9	46.8	33.0	33.0	33.0
PAT	263	116	316	648	1,053
Minority Interest	-	-	-	-	-
PAT after minority interest	**263**	**116**	**316**	**648**	**1,053**
Adjusted PAT	**263**	**116**	**316**	**648**	**1,053**
Growth in PAT (%)	8.2	(56.0)	172.7	104.8	62.6
PAT margin (%)	1.6	0.7	1.6	2.6	3.7

Source: Company, Anand Rathi Research

Fig 33 – Balance sheet (₹ m)

Y/E March	FY13	FY14	FY15e	FY16e	FY17e
Equity Share Capital	140	147	154	154	154
Share Warrants	-	44	-	-	-
Reserves	2,415	2,539	2,861	3,428	4,363
Shareholders' fund	2,556	2,731	3,016	3,582	4,518
Minority Interest	-	-	-	-	-
Debt	4,736	5,106	5,256	5,306	5,006
Deferred Tax Liability	106	160	160	160	160
Total Capital Employed	**7,397**	**7,998**	**8,433**	**9,049**	**9,685**
Gross Block	4,124	4,357	4,507	4,807	5,107
Accumulated depreciation	1,036	1,216	1,467	1,764	2,077
Net Block	3,089	3,141	3,040	3,043	3,030
Capital WIP	26	2	2	2	2
Total Fixed Assets	3,115	3,143	3,042	3,045	3,032
Investments	31	31	31	31	31
Inventories	3,582	4,031	4,531	5,292	6,023
Debtors	4,212	4,286	5,458	6,420	7,374
Cash and bank balances	156	46	142	185	240
Loans and Advances	413	391	391	391	391
Other current / non current assets	338	549	549	549	549
Total current assets	8,701	9,304	11,072	12,837	14,578
Current liabilities and provisions	4,449	4,480	5,713	6,864	7,956
Net current assets	4,252	4,824	5,359	5,973	6,622
Misc. Expenditure	-	-	-	-	-
Total Assets	**7,397**	**7,998**	**8,433**	**9,049**	**9,685**

Source: Company, Anand Rathi research

Fig 34 – Cash flow statement (₹ m)

Y/E March	FY13	FY14	FY15e	FY16e	FY17e
Cash flow from operating activities					
Profit before tax	431	218	472	967	1,572
Depreciation	204	210	251	297	313
Interest expenses	1,094	1,115	1,227	1,320	1,361
Operating profit before working capital change	**1,729**	**1,543**	**1,950**	**2,584**	**3,246**
Working capital adjustment	194	682	439	571	593
Gross cash generated from operations	**1,535**	**861**	**1,511**	**2,013**	**2,652**
Direct taxes paid	167	102	156	319	519
Cash generated from operations	**1,368**	**759**	**1,355**	**1,694**	**2,134**
Cash flow from investing activities					
Capex	136	238	150	300	300
Investment	-	0	-	-	-
Cash generated from investment activities	**(136)**	**(238)**	**(150)**	**(300)**	**(300)**
Cash flow from financing activities					
Proceeds from share capital and premium	59	49	49	-	-
Borrowings/ (Repayments)	(140)	370	150	50	(300)
Interest paid	(1,094)	(1,115)	(1,227)	(1,320)	(1,361)
Dividend paid	(16)	(18)	(36)	(81)	(118)
Cash generated from financing activities	**(1,190)**	**(714)**	**(1,064)**	**(1,352)**	**(1,778)**
Others	(71)	(83)	44	0	0
Net cash increase/ (decrease)	**112**	**(110)**	**96**	**43**	**55**

Source: Company, Anand Rathi Research

Fig 35 – Ratios

Y/E March	FY13	FY14	FY15e	FY16e	FY17e
Margins (%)					
EBITDA margin	10.3	9.5	9.5	10.5	11.3
PBIT margin	2.5	1.3	2.2	3.9	5.4
PBT margin	2.6	1.3	2.3	4.0	5.5
PAT margin	1.6	0.7	1.6	2.6	3.7
Growth (%)					
Revenue growth	(3.7)	(2.4)	25.1	20.7	16.2
EBITDA growth	13.6	(10.2)	0.3	0.3	0.3
Net Profit growth	8.2	(56.0)	172.7	104.8	62.6
Return Ratios (%)					
RoCE	20.9	17.3	20.7	26.2	31.3
RoIC	12.9	8.9	13.7	17.3	20.8
RoE	10.9	4.3	10.9	19.4	25.8
Turnover					
Asset-turnover ratio (x)	5.4	5.2	6.7	8.0	9.4
Working-capital cycle (days)	86.8	98.7	88.8	81.0	77.0
Average collection period (days)	98.1	94.5	90.0	88.0	87.0
Average payment period (days)	109.2	106.5	110.0	111.0	112.0
Inventory holding (days)	82.6	93.5	89.0	87.0	86.0
Per share (₹)					
EPS	3.4	1.5	4.1	8.4	13.6
CEPS	6.7	4.4	7.3	12.2	17.7
Book Value	33.1	35.4	39.0	46.4	58.5
Solvency ratios					
Debt/ Equity	1.9	1.9	1.7	1.5	1.1
Interest coverage	1.4	1.2	1.4	1.7	2.2
Net Debt/ EBITDA	2.7	3.3	2.6	2.0	1.5
Valuation parameters (x)					
P/E	24.3	55.3	20.3	9.9	6.1
P/BV	2.5	2.3	2.1	1.8	1.4
EV/ EBITDA	6.4	7.5	6.0	4.5	3.5
EV/ Sales	0.7	0.7	0.6	0.5	0.4
M-Cap/ Sales	0.4	0.4	0.3	0.3	0.2

Source: Company, Anand Rathi Research

Valuation

We have attempted to arrive at a fair valuation by comparing it with its peer set. In these, brand equity offers advantages regarding realisations, margins, asset turnover, capital ratios, etc.

The peer set reports a high RoE and stable EBITDA margins. Aligning with the average of its peer set on parameters such as fixed-asset turnover, earnings and book value, we arrive at a fair price of ₹128. It is noteworthy that the company is set to report a 25.8% RoE and a 31% RoCE for FY17. Based on this, the justifiable EV/EBITDA parameter would be 5x. These become relevant as the company would be deleveraging quite sharply in coming years.

Considering that KEI could report an EBITDA margin of over 11%, we have ascribed an EV/EBITDA multiple of 5, a P/E of 10 and a P/B of 1.75 (considering its cash-flow-generating ability and high RoCE).

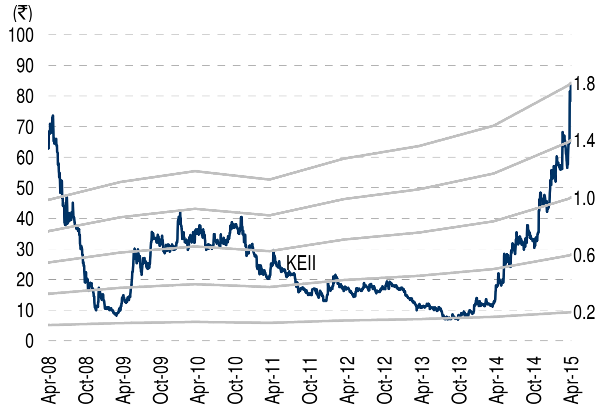
Fig 36 – Valuation

	FY17e (₹ m)	Parameter	Ascribed Multiple (x)	Justifiable Price (₹)
Revenue	28,432			
EBITDA	3,220	EV/EBITDA	5	147
PAT	1,053	PE	10	136
Net worth	4,518	PB	1.8	102
Net debt	4,766			
RoE (%)	25.8			
Average target price				**128**

Source: Anand Rathi Research

Accordingly, we arrive at targets of ₹147 and ₹102. Averaging these, we get a target price of ₹128.

Fig 37 – PB band



Source: Bloomberg, Anand Rathi Research

Fig 38 – Peer comparison

Company	V-Guard	Havells	Finolex Cables	KEI
PE (X)				
FY15e	43.2	42.4	19.6	20.3
FY16e	28.6	33.2	16.1	9.9
FY17e	22.4	26.2	12.6	6.1
PB (X)				
FY15e	8.2	9.6	3.3	2.1
FY16e	6.7	8.2	2.8	1.8
FY17e	5.3	6.8	2.3	1.4
EV/EBITDA				
FY15e	22.5	20.4	11.8	6.0
FY16e	16.5	17.2	9.4	4.5
FY17e	13.1	13.7	7.0	3.5
EBIDTA (%)				
FY15e	7.8	9.3	11.5	9.5
FY16e	8.8	9.9	12.8	10.5
FY17e	9.1	10.8	14.6	11.3
RoE (%)				
FY15e	20.6	24.0	18.4	10.9
FY16e	25.7	26.7	19.0	19.4
FY17e	26.3	28.3	20.3	25.8
RoCE (%)				
FY15e	27.7	27.9	21.1	20.7
FY16e	33.5	30.1	22.2	26.2
FY17e	35.4	33.7	24.0	31.3
Debt Equity (x)				
FY15e	0.2	0.4	0.1	1.7
FY16e	0.2	0.3	0.1	1.4
FY17e	0.1	0.2	0.0	1.1
Share of C&W (%)				
FY14	31	26	85	89

Source: Anand Rathi Research

At the current price of ₹83, the stock trades at 6x FY17e P/E and 3.5x EV/EBITDA. We believe that the strong return-ratios, improving free-cash flows and constant payouts would drive growth. We reckon that the improving debt-equity ratio to 1.1x by FY17 would call for a re-rating. On the above analysis, we recommend a Buy on KEI, with a target price of ₹128, which gives us a 54% potential return.

Risks

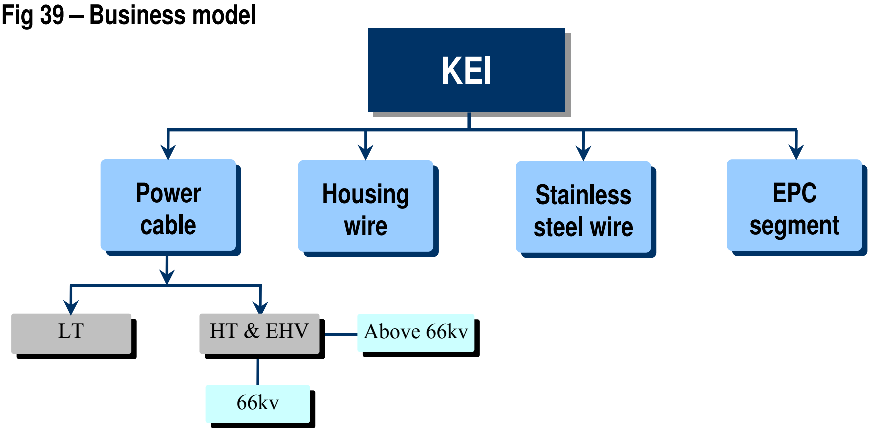
- **Volatile raw material prices.** Raw material (copper and aluminium) constitute around 74% of its expenditure. The inability to pass on the increase in raw material prices could cut into margins.
- **Higher interest rate.** KEI is highly leveraged, with debt to equity of over 1x. Any upward movement in interest rates would hit it hard.

Company Background & Management

New Delhi-based KEI Industries was established in 1968 as a partnership firm, Krishna Electrical Industries. It primarily manufactures house-wiring rubber cables. With 400 products it is now established in EHV, MV and LV cables, addressing demand of more than 800 customers in different sectors: power, oil refineries, railways, automobiles, cement, steel, fertilisers, textiles, real estate, etc. It has also made a foray into engineering, procurement and construction (EPC) and was ranked one of the top-three cable-manufacturing companies in India

Its plants are located in Bhiwadi and Chopanki (Rajasthan) and Silvassa (D & NH). It has over 800 employees, 310 workers and 2,000 contract labourers across the country, with installed capacity of 600km of EHV cables, 5,000km of HT cables, 67,000km of LT cables, 280,000km of winding and house wires and 4,800 tonnes of stainless steel wire.

Fig 39 – Business model



Source: Company

Its product basket comprises extra-high voltage cables up to and including 220kV, high and medium voltage cables, low tension cables, control and instrumentation cables, specialty and rubber cables, winding, flexibles and house wires, OVC/poly-wrapped winding wire, and stainless steel wire. It is also involved in engineering, procurement and construction, etc.

The company has a strong sales and distribution network in all metros, tier-I and tier-II cities with a strong order book of ~₹17bn. Besides its dominance in its home market, it exports to about 45 countries. Its entry into the EHV segment was aided by technological collaboration with Switzerland-based Brugg Kabel AG, which has over 100 years' experience manufacturing cables up to 550kV. This has enabled it faster entry into the EHV-cable market with designs which are sought by end-users.

Fig 40 – Management and Board of Directors

Name	Position	Profile
Mr Anil Gupta	Chairman & MD	M.Com from Delhi University and expert in Indian electrical cable. Rich experience of 25 years at the helm of the KEI Group. Responsible for managing and implementing key policies relating to marketing, production, quality control and product development
Mr K.G. Somani	Non- executive and independent director	Practicing chartered accountant and Fellow of The Institute of Chartered Accountants of India. Former president of The Institute of Chartered Accountants of India
Mr Rajeev Gupta	ED (Finance) & CFO	B.Com (Hons.) and chartered accountant. About 20 years' experience in finance. Heads the Finance and Accounts Department and designated as Executive Director (Finance) and CFO

Source: Company

Appendix

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Ratings Guide			
	Buy	**Hold**	**Sell**
Large Caps (>US$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US$1bn)	>25%	5-25%	<5%

Anand Rathi Research Ratings Distribution (as of 17 April 2015)			
	Buy	**Hold**	**Sell**
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