

August 31, 2023

COMPANY UPDATE | Sector: Capital Goods

KEC International Ltd

Take-off ready after repairs; Upgrade to Buy

We recently interacted with KEC International. The company is on the cusp of a major turnaround driven by stellar growth in its TAM, sequential margin recovery, and reduction of working capital to normalized levels. KEC is the market leader in the domestic T&D EPC industry and is expected to be a major beneficiary of a stellar growth in TAM. With execution of legacy projects largely behind, turnaround in SAE Brazil profitability and a stable commodity environment, the company has significant leverage in terms of margin improvement in the next 2 years. Additionally, the working capital cycle is expected to improve led by improved collection efficiency and higher mix of Civil business.

Dream domestic T&D capex driven by renewable power evacuation projects

- There is a strong momentum in the T&D ordering pipeline which is driven by the massive investments taking place in renewable energy installations which will require setting up of transmission infrastructure in order to evacuate the generated power
- The TAM (excluding state projects) for FY24 stands at ~Rs200-250bn consisting of TBCB projects, orders from private developers and PGCIL. We foresee this TAM to grow at a ~25-30% CAGR for the coming 3 years
- The FY25 and FY26 capex outlay of PGCIL, which is a key customer for KEC is expected to be more than 2x of FY23 levels which provides robust visibility for the next 2-3 years
- In an industry which is oligopolistic in nature, KEC has a ~20-25% market share in PGCIL tenders and is expected to be a major beneficiary of the tenders in the short to medium term

Strong order inflow in Civil to drive non-T&D business

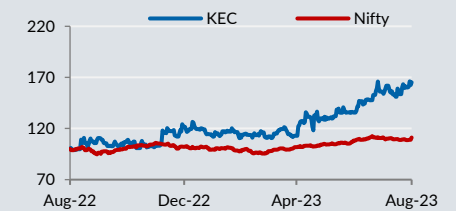
- In the recent years, Civil has been the fastest growing segment with FY23 witnessing 75% revenue growth while order inflows grew by 15% on a high base
- Within Civil, the Water business is the single-largest contributor with a ~40% share in the order book of ~Rs105.4bn primarily driven by the government's thrust on expanding the network of piped water connections under the Jal se Jal scheme. Out of the overall outlay on this scheme, only ~40-50% has been exhausted so the balance portion translates into a very healthy runway for the next 2-3 years
- Another key growth avenue within Civil is residential real estate which has an order book of ~Rs20-25bn currently. The company has a strong inquiry inflow from marquee developers. A major advantage in the residential real estate projects is the absence of Right of Way issues which the company typically encounters in the T&D and Water businesses so execution can take place at a faster pace

Reco	: BUY
CMP	: Rs 671
Target Price	: Rs 816
Potential Return	: +21%

Stock data (as on August 31, 2023)

Nifty	19,254
52 Week h/l (Rs)	699 / 400
Market cap (Rs/USD mn)	169845 / 2061
Outstanding Shares (mn)	257
6m Avg t/o (Rs mn):	362
Div yield (%):	0.5
Bloomberg code:	KECI IN
NSE code:	KEC

Stock performance



	1M	3M	1Y
Absolute return	5.9%	28.5%	65.1%

Shareholding pattern (As of Jun'23 end)

Promoter	51.9%
FII+DII	38.2%
Others	9.9%

Δ in stance

(1-Yr)	New	Old
Rating	BUY	REDUCE
Target Price	816	596

Δ in earnings estimates

	FY24E	FY25E
EPS (New)	21.9	45.3
EPS (Old)	21.8	42.6
% change	0.6	6.4

Financial Summary

(Rs mn)	FY23	FY24E	FY25E
Revenues	172,817	199,986	233,293
Yoy growth (%)	25.8	15.7	16.7
OPM (%)	4.8	7.1	9.5
EPS (Rs)	6.8	21.9	45.3
EPS growth	-53.1	220.0	106.8
P/E (x)	98.1	30.6	14.8
EV/EBITDA (x)	24.5	14.3	9.2
Debt/Equity (x)	0.9	0.8	0.6
RoE (%)	19.4	22.3	29.5
RoCE (%)	10.7	13.0	18.6

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Margin improvement to be driven by SAE Brazil turnaround and benign commodity costs

- T&D segment is expected to see sequential improvement in margin driven by 1) complete execution of legacy projects by 2QFY24 (standalone business), 2) turnaround in SAE Brazil profitability, 3) stable commodity environment
- The company targets an EBITDA margin of 7% in FY24 which is expected to further improve in FY25. The margin recovery is expected to be broad based with both T&D and non-T&D segments contributing to the same
- The company has stopped booking EPC projects in SAE Brazil since 3QFY23 and SAE turned PBT positive in 1QFY24. The company expects SAE margin to further improve to mid-single digits by FY24 end driven by improvement in the Brazil business profitability

Working capital cycle expected to improve led by improved collection efficiency and higher mix of Civil business

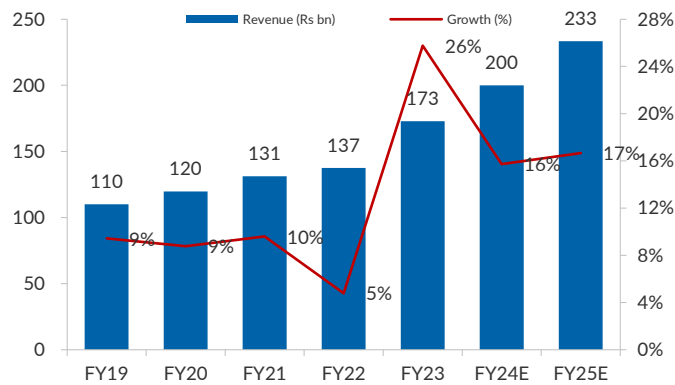
- WCC is expected to come down to 110 days in FY24 from 126 days in FY23 on the back of improved receivable position and an expected collection of ~Rs4bn pertaining to Afghanistan projects
- The revenue share of Civil business is expected to improve to 24% in FY25 from 19% in FY23. This is expected to lower the WCC given better payment cycles in Water and other segments
- Therefore, debt (including acceptances) is expected to remain stable at FY23 levels of ~Rs57bn

VALUATION AND VIEW

- KEC is the market leader in the domestic T&D EPC industry with a market share of ~20-25% in the PGCIL and private sector ordering
- The company is well-placed to capitalize on the government's thrust on capex across segments such as, power, water supply, metros, and healthy growth in residential real estate, which would translate into a healthy order pipeline
- Given its strong order book, margin expansion levers (SAE Brazil turnaround, stable commodity environment, improving NWC days) and robust revenue visibility, we believe KEC is poised to post revenue/PAT CAGR of 16%/157% over FY23- FY25E. At CMP, the stock trades at 30.6x/14.8x FY24E/FY25E EPS. We upgrade the stock to BUY with a revised TP of Rs816, valuing the company at 18x FY25E earnings

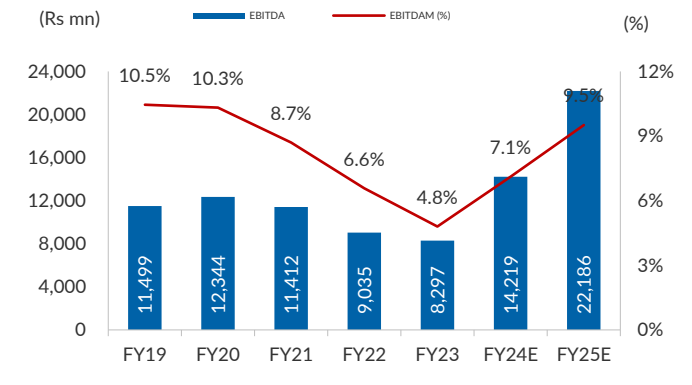
STORY IN CHARTS

Exhibit 1: Revenue to see healthy growth in FY24 & 25



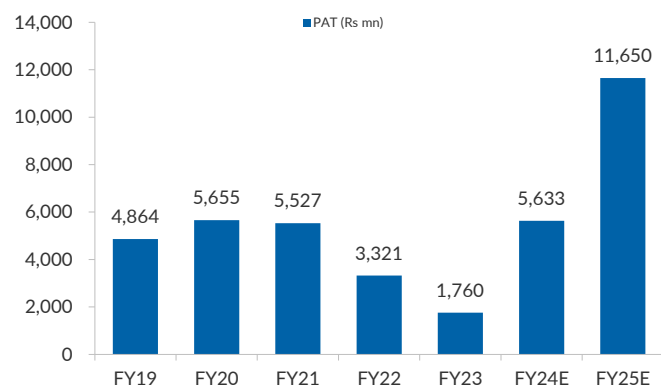
Source: Company, YES Sec

Exhibit 2: EBITDA margin to improve gradually



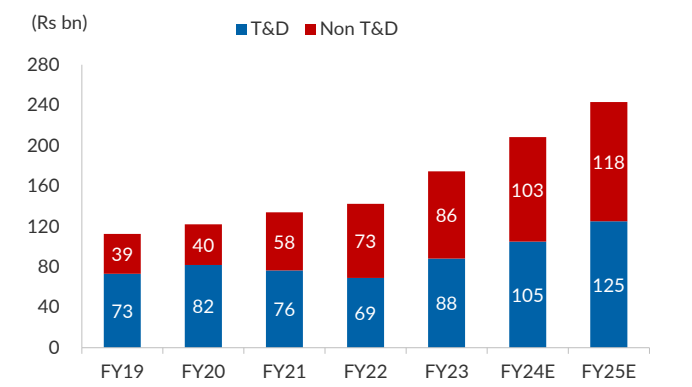
Source: Company, YES Sec

Exhibit 3: PAT to recover from FY23 lows



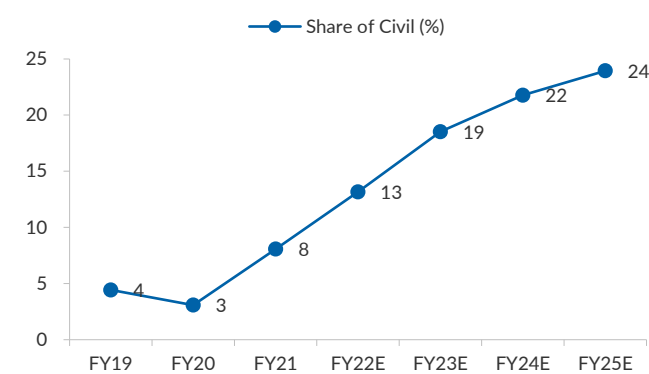
Source: Company, YES Sec

Exhibit 4: Share of T&D revenue to remain constant



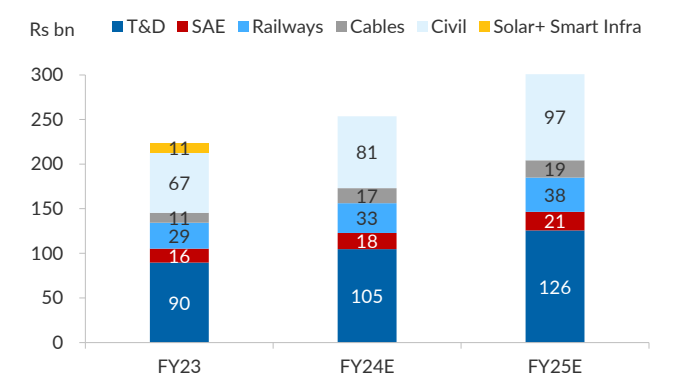
Source: Company, YES Sec

Exhibit 5: Civil to be a larger share of revenue



Source: Company, YES Sec

Exhibit 6: Order inflow composition



Source: Company, YES Sec

FINANCIALS

Exhibit 7: Balance Sheet (Consolidated)

Y/e 31 Mar (Rs mn)	FY21	FY22	FY23	FY24E	FY25E
Sources of Funds					
Equity capital	514	514	514	514	514
Reserves	33,083	35,685	37,200	41,988	51,891
Non Controlling Int.	0	0	0	0	0
Net worth	33,597	36,199	37,714	42,503	52,405
Debt	20,657	30,646	33,834	33,834	33,834
Deferred tax liab (net)	(68)	(1,703)	(3,201)	(3,201)	(3,201)
Total liabilities	54,186	65,142	68,347	73,135	83,038
Application of Funds					
Gross Block	18,954	21,594	23,046	25,046	26,546
Depreciation	7,796	9,161	10,228	11,981	13,840
Fixed Asset	13,975	15,377	15,828	16,075	15,717
CWIP	179	25	115	115	115
Investments	11	126	0	0	0
Net Working Capital	40,021	49,615	52,404	56,946	67,206
Inventories	8,422	10,665	11,372	12,602	15,340
Sundry debtors	55,668	55,738	72,554	68,488	79,895
Cash & equivalents	2,492	2,619	3,442	3,263	2,987
Loans & Advances	47,137	62,440	64,820	80,595	94,017
Other Current Asset	11,965	14,258	15,283	19,999	23,329
Sundry creditors	61,703	68,473	83,883	95,884	111,853
Provisions	825	1,015	1,186	1,400	1,633
Other current liabilities	23,135	26,617	29,997	30,717	34,876
Total Assets	54,186	65,142	68,347	73,135	83,038

Source: Company, YES Sec

Exhibit 8: Income statement (Consolidated)

Y/e 31 Mar (Rs mn)	FY21	FY22	FY23	FY24E	FY25E
Revenue	131,142	137,423	172,817	199,986	233,293
% Change YoY	9.6	4.8	25.8	15.7	16.7
Operating profit	11,412	9,035	8,297	14,219	22,186
EBITDA margins	8.7	6.6	4.8	7.1	9.5
% Change YoY	(7.5)	(20.8)	(8.2)	71.4	56.0
Depreciation	1,525	1,579	1,615	1,753	1,858
EBIT	9,887	7,456	6,683	12,466	20,328
EBIT margins	7.5	5.4	3.9	6.2	8.7
Interest expense	2,627	3,160	5,386	5,413	5,583
Other income	299	134	313	360	583
Profit before tax	7,559	4,431	1,610	7,412	15,329
Taxes	2,032	674	(151)	1,779	3,679
Effective tax rate (%)	26.9	15.2	(9.3)	24.0	24.0
Net profit	5,527	3,757	1,760	5,633	11,650
Minorities and other					
Net profit after minorities	5,527	3,757	1,760	5,633	11,650
Exceptional items	0	(436)	0	0	0
Net profit	5,527	3,321	1,760	5,633	11,650
% Change YoY	(2.3)	(39.9)	(53.1)	220.0	106.8
EPS (Rs)	21.5	14.6	6.8	21.9	45.3

Source: Company, YES Sec

Exhibit 9: Cash Flow Statement (Consolidated)

Y/e 31 Mar (Rs mn)	FY21	FY22	FY23	FY24E	FY25E
Profit before Tax	7,559	3,994	1,610	7,412	15,329
Interest	2,627	3,160	5,386	5,413	5,583
Depreciation	1,525	1,579	1,615	1,753	1,858
Other Items	1,071	546	(73)	-	-
(Inc)/Dec in WC	(2,298)	(9,253)	(255)	(4,720)	(10,536)
Direct Taxes Paid	2,088	2,863	2,215	1,779	3,679
CF from Oper. Activity	8,396	(2,837)	6,067	8,080	8,554
(Inc)/Dec in FA	1,801	1,431	1,783	2,000	1,500
Free Cash Flow	6,595	(4,269)	4,284	6,080	7,054
(Pur)/Sale of Invest.	(3,075)	(3,478)	(3,135)	(4,000)	(3,000)
CF from Inv. Activity	(1,274)	(2,047)	(1,352)	(2,000)	(1,500)
Change in Networkth	-	-	-	-	-
Inc/(Dec) in Debt	(3,083)	8,709	2,365	-	-
Interest Paid	(3,501)	(2,725)	(5,344)	(5,413)	(5,583)
Dividends Paid	(5)	(1,025)	(1,029)	(845)	(1,747)
Others	-	-	-	(0)	(0)
CF from Fin. Activity	(6,589)	4,959	(4,008)	(6,258)	(7,330)
Inc/(Dec) in Cash	533	75	707	(179)	(276)
Opening cash Balance	1,527	1,998	2,076	2,812	2,633
Others	(62)	4	28	-	-
Closing cash Balance	1,998	2,076	2,812	2,633	2,357

Source: Company, YES Sec

Exhibit 10: Du-pont Analysis

Y/e 31 Mar (Rs mn)	FY21	FY22	FY23	FY24E	FY25E
Tax burden (x)	3.6	9.4	(48.6)	5.3	4.2
Interest burden (x)	0.2	0.1	(0.0)	0.1	0.2
EBIT margin (x)	0.1	0.1	0.0	0.1	0.1
Asset turnover (x)	2.4	2.1	2.5	2.7	2.8
Financial leverage (x)	1.6	1.8	1.8	1.7	1.6
RoE (%)	21.5%	17.5%	19.4%	22.3%	29.5%

Source: Company, YES Sec

Exhibit 11: Ratio Analysis

Y/e 31 Mar	FY21	FY22	FY23	FY24E	FY25E
Basic (Rs)					
EPS	21.5	14.6	6.8	21.9	45.3
Dividend per share	4.0	4.0	3.0	3.3	6.8
Cash EPS	27.4	20.8	13.1	28.7	52.5
Book value per share	130.7	140.8	146.7	165.3	203.8
Div. payout (%)	18.6	31.0	43.8	15.0	15.0
Valuation ratios (x)					
P/E	31.2	45.9	98.1	30.6	14.8
P/CEPS	24.5	32.4	51.1	23.4	12.8
P/B	5.1	4.8	4.6	4.1	3.3
EV/EBIDTA	16.7	22.2	24.5	14.3	9.2
Dividend yield (%)	0.6	0.6	0.4	0.5	1.0
Profitability Ratios (%)					
RoC	18.5	13.4	11.3	12.2	14.1
RoE	21.2	17.7	10.6	4.7	13.9
RoCE	16.7	14.1	10.6	11.4	13.7
Liquidity ratios					
Debtor (days)	155	148	153	125	125
Inventory (days)	23	28	24	23	24
Creditor (days)	172	182	177	175	175
Net working Capital (days)	104	125	103	98	100
Asset Turnover (x)	2.4	2.1	2.5	2.7	2.8

Source: Company, YES Sec

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