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Kalpataru Power Transmission Ltd.

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Date: 24th November 2020

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Kalpataru Power Transmission Ltd.

Five factors that make it a compelling Tactical BUY

Kalpataru Power Transmission (KPTL), the global leader offering integrated solutions in T &D space, has over the years diversified into segments like Railways and Oil & Gas pipeline to capture bigger opportunity and grow faster. It has an exposure to the construction space with a 67% stake in JMC Projects, which reported strong order inflow in H1FY21, leading the management to revise upwards its FY21E guidance. On the standalone side, KPTL's strong order book and healthy bid pipeline offers high revenue visibility with higher profitability potential. We believe, Transmission Asset sales, deleveraging, merger of KPTL & JMC, and strategic stake divestment in Logistic business will result in a significant re-rating for KPTL over the medium term. Most importantly, management has guided for 40% pledge reduction over next one year which was a major hangover on the stock price over the recent past. We recommend 'Tactical Buy' with a target price of INR 500.

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CMP INR: 295

Rating: Tactical BUY

Target Price INR: 500

Upside: 70%

Bloomberg:	KPP:IN
52-week range (INR):	170 / 477
Share in issue (cr):	15
M cap (INR cr):	4,760
Promoter Holding (%)	55.29

Healthy revenue visibility, deleveraging a key trigger

KPTL has an order book of INR 12,292 crore and is L1 in tenders worth INR 2,400 crore which offers healthy revenue visibility of ~1.7 years. The management indicated a healthy bid pipeline across businesses and guided for 5% Revenue growth in FY21E. KTPL has decided to shift from the asset ownership model and started selling its T&D assets. It expects to close divesture of all 4 T&D assets in FY21E and post that, the standalone operation is expected to be debt free. KPTL is expected to maintain ROCE in the healthy 18-19% range over FY20-23E.

JMC sitting on a record high order book

In H1FY21, JMC's order inflow crossed INR 6,000 crore and the management revised its FY21 order inflow guidance to INR 7,000 crore. It is confident of achieving 0-5% revenue growth and 11% EBITDA margin in FY21E. Disciplined approach in managing the EPC business is visible in the way leverage remained under check even after significant growth over the last 5 years and continuous investment in BOT road assets. Standalone ROCE increased to 17% from 8% over FY15-20. After a flat FY21E, we see 23% revenue growth to INR 4,580 crore in FY22E followed by 14% revenue growth in FY23E. EBITDA margin is expected to reach to 11.3% in FY23E as compared 11.1% Reported in FY20.

Expect deleveraging, Asset sale & Pledge reduction to drive re-rating

At CMP of INR 295, KPTL's standalone operation is trading at 8x/7x FY22/23E EPS of INR 38/44, a huge discount to its peers, providing a margin of safety. *We believe, multiple triggers like T&D asset sales, deleveraging, merger of JMC & KPTL, strategic stake sale in logistic business and promoter pledge reduction will result in a significant re-rating in stock price over the medium term. We recommend 'Tactical Buy' with a target price of INR 500.*

Year to March	FY20	FY21E	FY22E	FY23E
Revenue (INR cr)	7,904	8,422	9,572	10,691
Revenue growth (%)	11.1	6.6	13.7	11.7
EBITDA (INR cr)	860	908	1035	1160
Adjusted PAT (INR cr)	439	503	585	667
P/E (x)	10.3	9.0	7.7	6.7
Price-to-book value (x)	1.2	1.1	1.0	0.8
EV-to-EBITDA (x)	6.2	5.8	5.0	4.3
RoACE (%)	19.0	17.7	18.8	19.1
RoAE (%)	13.8	13.4	13.7	13.7

Date: November 24, 2020

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I. KPTL Standalone operation: Healthy revenue visibility, deleveraging a key trigger

Healthy bid pipeline gives us confidence

KPTL, under its standalone umbrella, has 3 business divisions: transmission line, railways and O&G EPC. It has an order book of INR 12,292 crore and is L1 in tenders worth INR 2,400 crore, which offers healthy revenue visibility for ~1.7 years. After a muted FY20, order inflow started picking up and stood at INR 2,557 crore in H1FY21 as against INR 1,750 crore YOY.

The management indicated healthy bid pipeline across businesses. Domestic transmission orders earlier got deferred, but have started to return in August. Domestic T&D segments bid for INR 10,000-15,000 crore of orders and Railways segment bid for INR 1,500-2,000 crore worth of orders recently. Railway electrification orders worth INR 3,000-5,000 crore may accrue to the company over the next 3-5 months. O&G division is expected to win INR 8,000-10,000 crore worth of orders in the next 6-8 months.

Exhibit 1: Order book at INR 12,292 crore, strong additions even in H1FY21

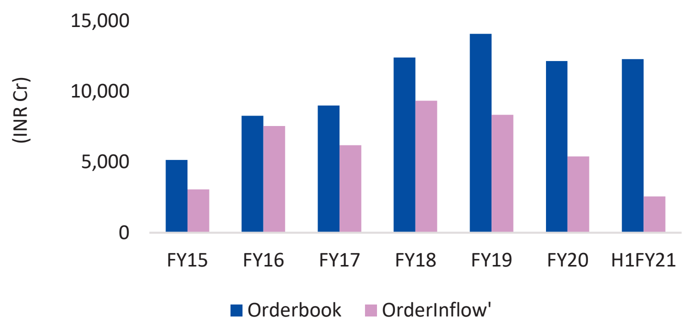
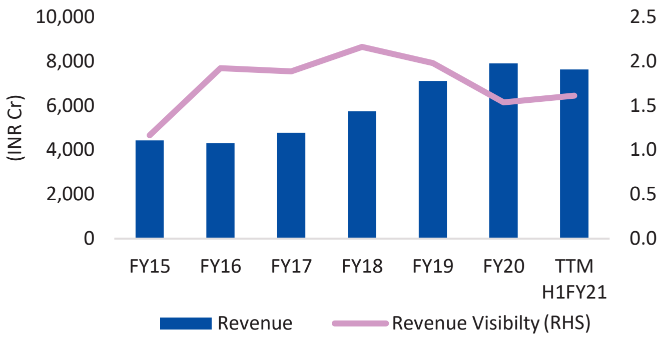


Exhibit 2: KPTL has a revenue visibility of ~1.7 years



Source: Company, Edelweiss Professional Investor Research

Diversification will help KPTL garner higher market share in the non-T&D space

Over the last few years, KPTL has diversified its presence by venturing into newer segments. For long, the company has been seen as a proxy play on Power Grid Corporation of India's (PGCIL) capex, which is now slowing down, leading to concerns around its growth outlook. However, the management has been able to successfully reduce dependency on its traditional single-largest client. Non-T&D business share has increased to 40% of order book in H1FY21 from 16% in FY15.

Exhibit 3: 50% of order book is from railways and O&G

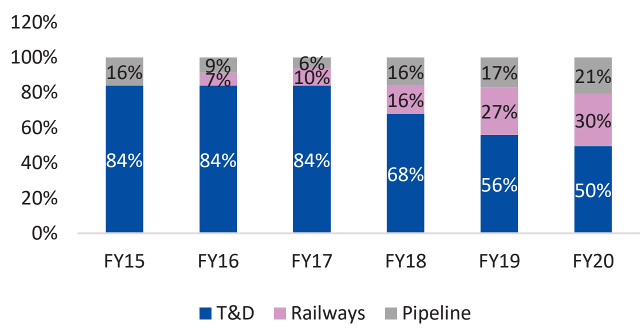
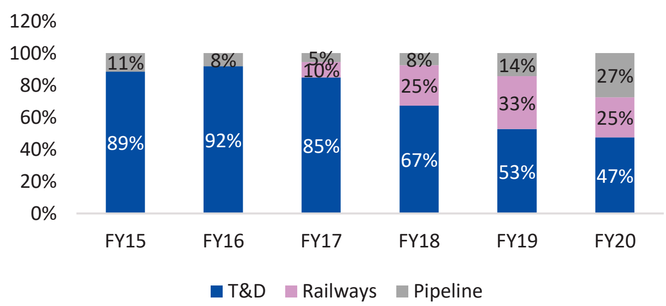


Exhibit 4: Order inflow has significantly diversified over the last 2 years



Source: Company, Edelweiss Professional Investor Research

Railways and O&G verticals reported exponential growth over the last few years

The railways and O&G verticals have seen exponential growth over last few years. Railway's order book and revenue grew 6x and 10x, respectively, between FY16 and FY20. The same for O&G grew 3x and 5x, respectively. With a strong order book and healthy bid pipeline, these 2 businesses will be the key growth drivers for the company going forward.

Exhibit 5: Order book from railways grew 6x over FY16-20

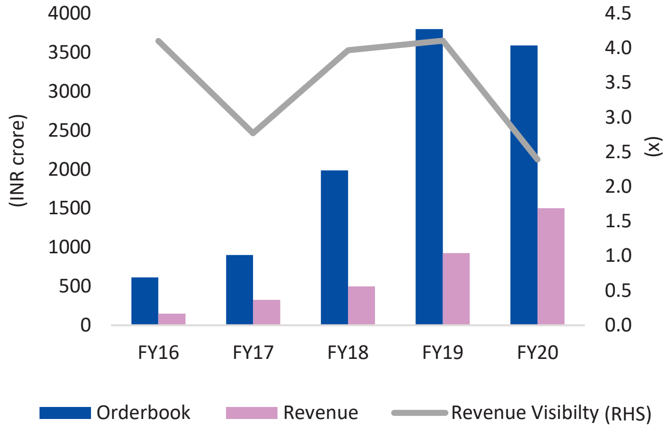
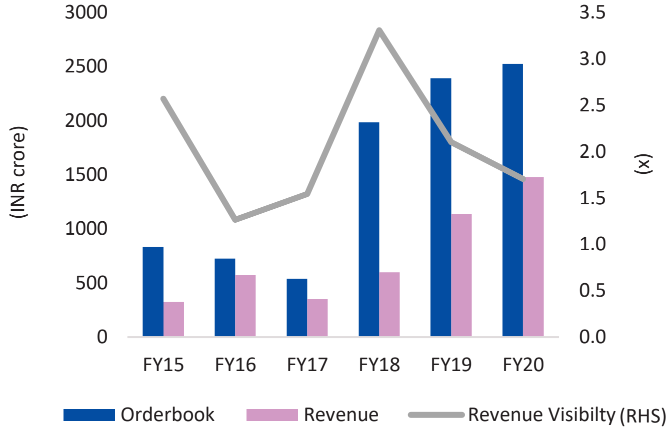


Exhibit 6: O&G order book grew 5x over FY15-20



Source: Company, Edelweiss Professional Investor Research

Operating efficiencies, cost control measures boosted margin performance

Operating profit margin has consistently improved to 11% in FY20 from a low of 10% in FY15. Despite flattish revenue growth over FY19 and FY20, this surge was led by operating efficiencies and cost control measures. Due to financial leverage, net profit over the last 5 years received a significant fillip and net profit margin improved to 6% from 4% between FY15 and FY20.

Exhibit 7: EBIDTA improved from 10% to 11% over FY15-20

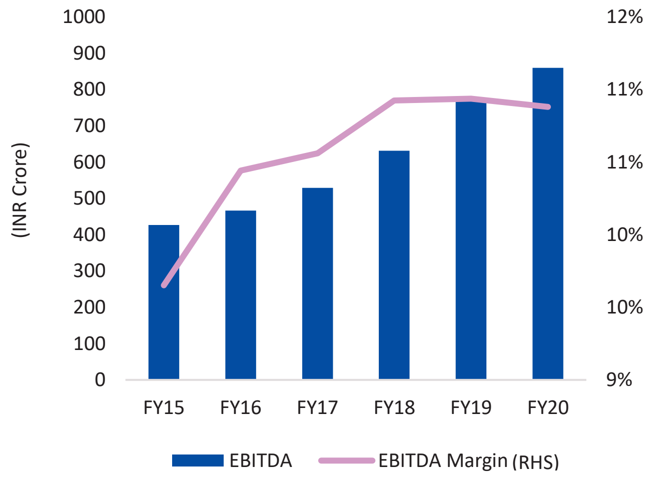
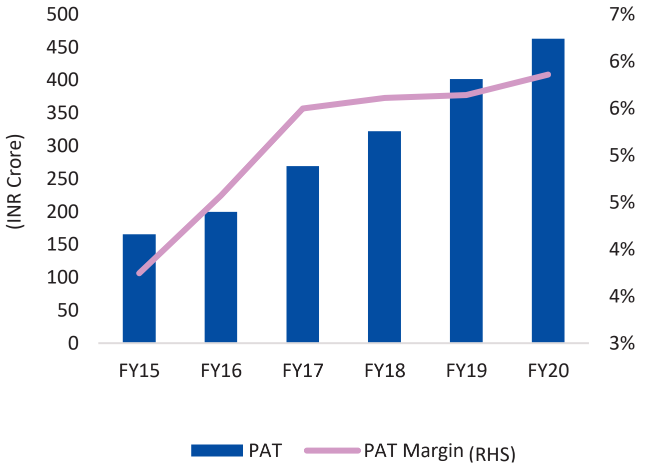


Exhibit 8: Net Profit Margin improved from 4% to 6% over FY15-20



Source: Company, Edelweiss Professional Investor Research

Leverage remains under control, return ratios improve despite macro uncertainties

KPTL will face some working capital challenges due to the current economic situation. However, the management's focus continues to remain on reducing its leverage and on better allocation of capital, which gives us confidence that it will continue with its low leverage over FY20-23E.

Higher profitability, better capital allocation and lowering of debt have aided improvement in ROCE by 500bps over the last 5 years. Return ratios have remained healthy despite high macro uncertainties.

Exhibit 9: Leverage remains under control

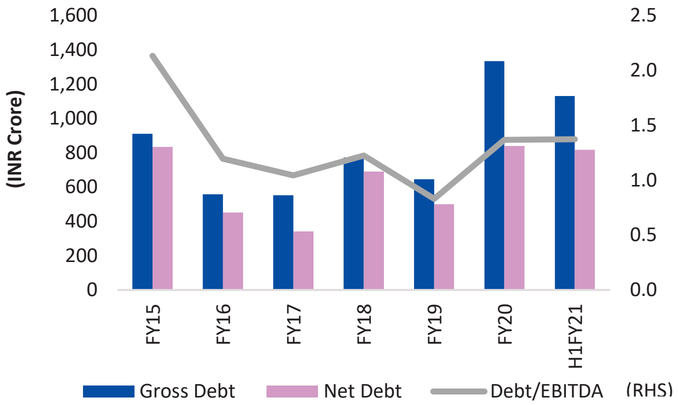
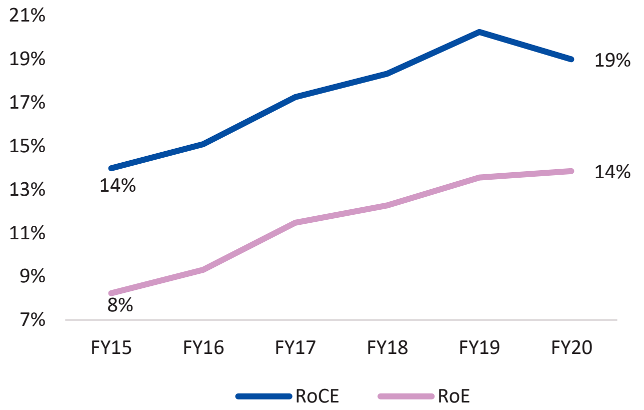


Exhibit 10: ROCE improved by 500bps over the last 5 years



Source: Company, Edelweiss Professional Investor Research

Higher order book to drive revenue growth; margin to remain healthy

With an order book of INR 12,292 crore, L1 position of INR 2,400 crore, and incremental order inflows especially in the railways and O&G space, we expect 10% revenue CAGR over FY20-23E and EBITDA margin of 10.8-11%. With conscious steps to reduce leverage, KPTL is expected to maintain ROCE in the 18-19% range over FY20-23E.

(INR cr)	FY18	FY19	FY20	FY21E	FY22E	FY23E	CAGR FY20-23E
Revenue	5,741	7,115	7,904	8,422	9,572	10,691	10%
- YOY growth		*24%*	*11%*	*7%*	*14%*	*12%*	
EBITDA	631	778	860	907	1,035	1,160	10%
- EBITDA margin	*11%*	*10.9%*	*10.9%*	*10.8%*	*10.8%*	*10.9%*	
PAT	322	401	463	502	585	667	12%
- PAT margin	*5.6%*	*5.6%*	*5.9%*	*6.0%*	*6.1%*	*6.2%*	
ROCE	*18%*	*20%*	*19%*	*18%*	*19%*	*19%*	

Source: Company, Edelweiss Professional Investor Research

Sale of T&D BOOT assets is expected to make standalone Balance Sheet debt free by FY21E

The management has decided to shift from the asset ownership model and started selling its T&D BOOT assets over the last 1 year. It expects to close sale of all 4 assets in FY21E, subject to approval.

- Kalpataru Satpura Transco already transferred to CLP India. Cash proceeds received in FY20.
- Alipurduar Transmission: A definitive agreement has been signed with Adani Transmission for a total enterprise value (EV) of INR 1,130 crore. All approvals for sale received and management expects to receive cash proceeds in November, 2020.
- Jhajjar KT Transco: Completed sale of Jhajjar KT Transco (JKTPL) for enterprise value of INR 310 crore and entire proceeds already received.
- Kohima Mariani Transmission: Deal inked with CLP. It has already commissioned element 1 and 3; element 2 construction work completed and commissioning is expected in Q3FY21. Post which, the deal is expected to be finalised.

After all 4 T&D assets are sold, the ~INR 1,600 crore of SPV debt will go away. Equity inflow of ~INR 1,100 crore will be used to repay standalone debt, making it debt free by FY21-end. Group level debt is expected to fall by ~INR 2,000 crore over the next 1 – 1.5 years. However, to remain conservative, we did not consider complete benefit of deleveraging in our assumptions.

Exhibit 11: KPTL's T&D BOOT assets, going asset light in the next 6-8 months

Projects (INR cr)	Total project cost	KPTL's share	Invested equity	Debt	Sold at EV	Net inflow	P/B	Buyer
Satpura Transco	280	100%	60	110	200	90	1.5	CLP India
Jhajjar KT Transco	350	51%	42	0	118	60	1.43	IndiGrid
Alipurduar Transmission	1,080	100%	250	630	1,130	520	2.08	Adani
Kohima Mariani Transmission	1,283	74%	220	900	1,120	440	2	CLP India
Total	**2,993**		**572**	**1,640**	**2,568**	**1,110**	**1.9**	

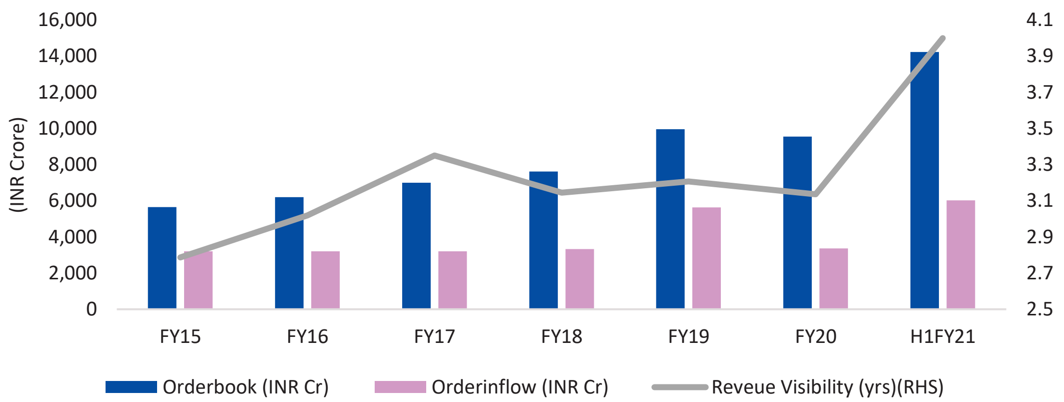
Source: Company, Edelweiss Professional Investor Research

II. JMC Projects sitting on a record high order book

Reports healthy order addition in H1FY21, revenue visibility at fresh high

JMC continued to report strong order inflow even during the lockdown period. In H1FY21, order inflow crossed INR 6,000 crore and the management revised its FY21 order inflow guidance to INR 7,000 crore. At INR 14,227 crore at the end of H1FY21, the company has the highest order book and record revenue visibility. After the lockdown, manpower availability and site execution has improved and the revenue de growth in H1FY21 is only 10% compared to that of H1FY20.The management is confident of achieving 0-5% revenue growth and 11% EBITDA margin in FY21E.

Exhibit 12: JMC's order book and revenue visibility is at record highs



Source: Company, Edelweiss Professional Investor Research

Internal efficiency and cost savings resulted in higher profitability

Besides reporting industry leading revenue growth over the last 5 years, JMC's EBITDA margin improved to 11% from 7% over FY15-20. Due to higher operating profit and financial leverage, PAT jumped 5x over the same period.

Exhibit 13: EBIDTA improved from 7% to 11% over FY15-FY20

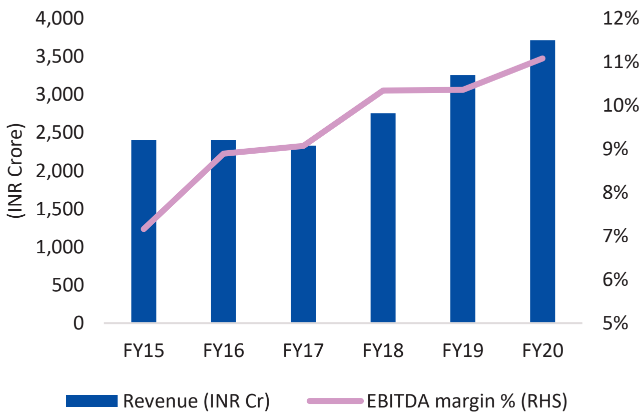
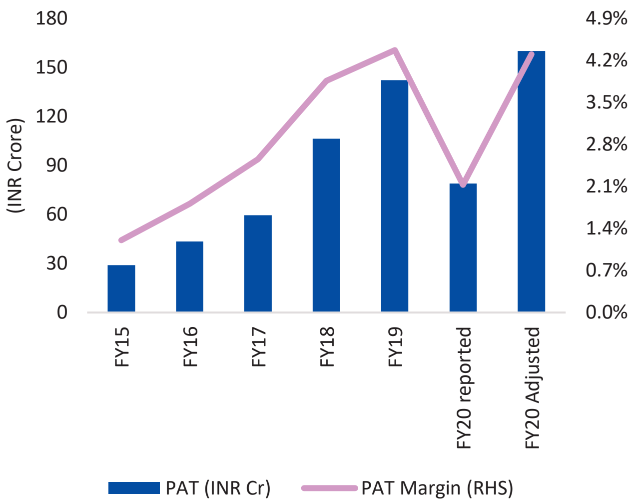


Exhibit 14: PAT margin increased to 4.5% from 1% over FY15-20



Source: Company, Edelweiss Professional Investor Research

*FY20 PAT is adjusted for write-off of INR 79 crore taken for investment in a BOT asset

BOT road assets: Debt restructuring will temporarily offer some breathing space

Although JMC's standalone EPC operation is doing significantly well, BOT road assets remained a point of concern. Investments in BOT assets increased o touch INR 821 crore in September, 2020. The company has also made a provision of INR 79 crore due to impairment of loans and advances provided to road assets, which impacted profitability of the EPC business in FY20.

Exhibit 15: BOT road assets are a significant drag on JMC's operations

(INR Cr)	Total Project Cost	JMC's share	Total Equity	Total Investment	Debt
Rohtak Bawal (Kurukshetra Expressway)	1,100	51%	200	275	400
Rewa MP/UP Border (Vindhyachal Expressway)	685	100%	150	300	335
Nagpur Waiganga (Waiganga Expressway)	440	100%	100	145	340
Agra Aligarh (Brij Bhumi Expressway)	250	100%	40	100	160
Total				**820**	**1,235**

Source: Company, Edelweiss Professional Investor Research

The management has initiated the restructuring process for Kurukshetra Expressway and Wainganga Expressway Pvt (WEPL), which is expected to get completed in the next 3-6 months. With this restructuring, JMC's yearly investment commitment on all 4 assets will reduce significantly in the medium term and cash generation in standalone operations will improve. It has also appointed advisors/consultant to look for strategic investors/buyers for its road assets. However, considering the current market condition, especially for toll roads, we see a rare possibility of road asset sales happening in the medium term.

Leverage under check despite constant outlays on road assets; return ratios significantly improve

JMC's disciplined approach in managing its EPC business is clearly visible in the way leverage remained under check even after significant growth over the last 5 five years and continuous investments in BOT road asset. Standalone ROCE also increased to 17% from 8% over FY15-20.

Exhibit 16: Debt-to-EBITDA ratio improved to 1.7x from 4.4x over FY15-20

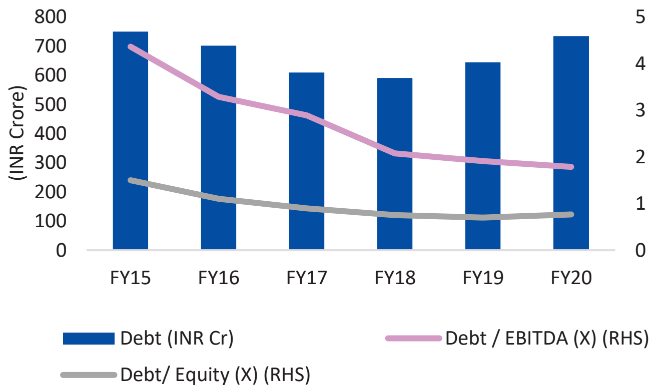
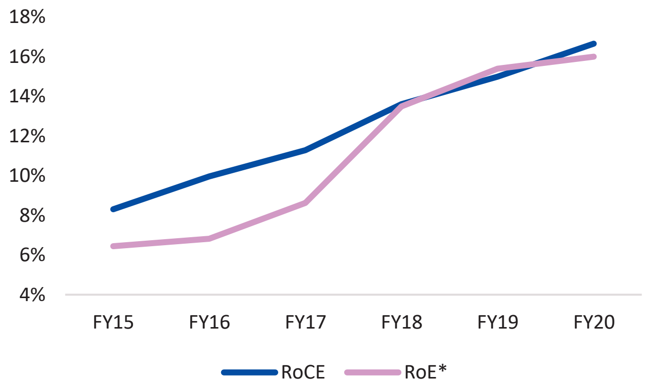


Exhibit 17: ROCE improved to 17% from 8% over FY15-20



Source: Company, Edelweiss Professional Investor Research

*FY20 RoE is adjusted for impairment in road assets

Strong order book to bolster revenue growth in FY21E; EBITDA margin to remain above 11%

JMC's order book currently stands at INR 14,227 crore, with more than 3 years of revenue visibility. Despite overall slowdown in ordering activity, it managed order inflows of INR 6,000 crore in H1 and revised upward its guidance to INR 7,000 crore in FY21.

After a flat FY21E, we see 23% revenue growth to INR 4,580 crore in FY22E followed by 14% Revenue growth in FY23E. EBITDA margin is expected to reach to 11.3% in FY23E as compared 11.1% Reported in FY20.

(INR cr)	FY18	FY19	FY20	FY21E	FY22E	FY23E	CAGR FY20-23E
Revenue	2,756	3,253	3,713	3,727	4,579	5,239	12%
- YoY growth		*18%*	*14%*	*0%*	*23%*	*14%*	
EBITDA	285	337	411	382	504	589	13%
- EBITDA margin	*10.3%*	*10.4%*	*11.1%*	*10.3%*	*11.0%*	*11.3%*	
PAT (adjusted for extraordinary items)	106	142	158	138	215	264	19%
- PAT margin	*3.9%*	*4.4%*	*4.3%*	*4.2%*	*3.0%*	*4.1%*	
RoCE	*14%*	*15%*	*17%*	*13%*	*17%*	*17%*	

Source: Company, Edelweiss Professional Investor Research

III. KPTL-JMC merger will create a larger entity with additional growth avenues

KPTL has initiated the process of merging JMC with itself and process is expected to complete over next one year. The merged entity will be much bigger, with INR 25,000 crore of order book and INR 13,000 crore of revenue (based on FY20 numbers). Moreover, the merged entity will have a bigger and stronger balance sheet, diversified order book, higher revenue visibility and better growth opportunities. Due to the large scale of its operations and diversified presence, the merged entity will be able to claim a higher valuation.

Exhibit 18: Merged entity will have a higher order book…

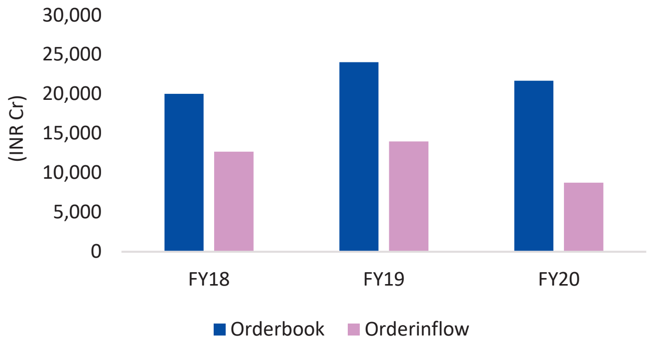


Exhibit 19: ….with greater revenue visibility

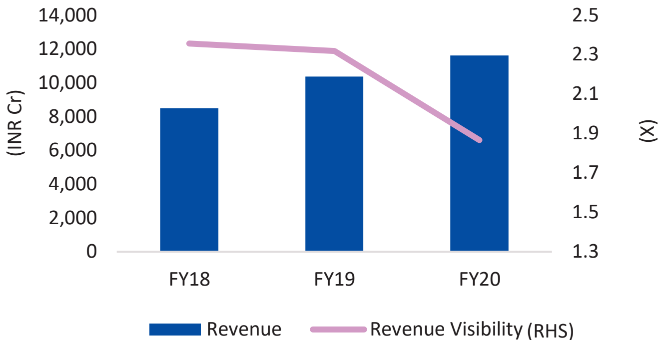


Exhibit 20: Merged entity will have a healthy EBITDA margin

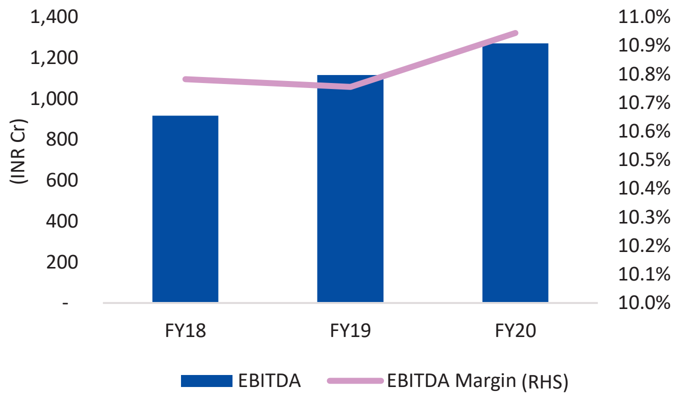
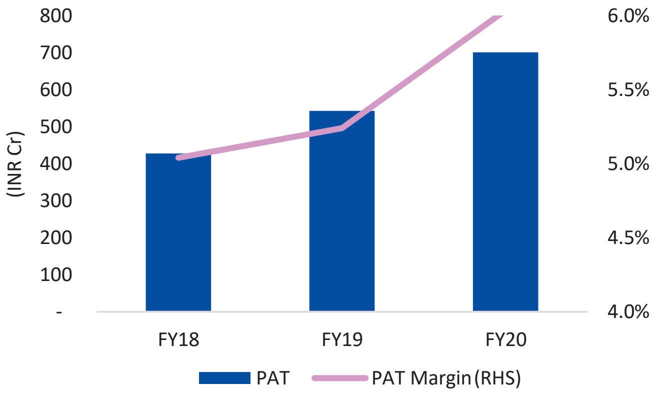


Exhibit 21: PAT margin is close to industry leaders



Source: Company, Edelweiss Professional Investor Research

IV. Shree Subham Logistics (SSL): Business turnaround and divestment will trigger benefits

SSL started reporting an improvement in performance over the last 1 year, especially on the margin front. EBITDA margin improved to 33% in FY20 from 30% in FY19. Net loss fell to INR 8 crore from INR 15 crore over the same period. Improvement in performance continued in H1FY21, with revenue up 11% YoY and EBITDA margin of 26%. As expected by the management, the PAT has become positive in H1FY21.

KPTL appointed advisors to find a strategic or financial partner in SSL. Total equity investment from the parent is INR 400 crore and we believe it will be able to divest its partial stake at a better price.

(INR cr)	FY18	FY19	FY20	FY21E	FY22E	FY23E	CAGR FY20-23E
Revenue	69	124	132	139	153	168	8%
- YoY growth		*80%*	*7%*	*5%*	*10%*	*10%*	
EBITDA	12	36	44	46	50	55	8%
- EBITDA margin	*17.3%*	*29.5%*	*33.1%*	*33%*	*33%*	*33.0%*	
PAT	(41)	(15)	(8)	3	4	8	NA
- PAT margin	*(60.5%)*	*(12.5%)*	*(6%)*	*2.3%*	*2.9%*	*4.9%*	

Source: Company, Edelweiss Professional Investor Research

V. Expect deleveraging, asset sale to drive re-rating

We believe, multiple triggers like T&D asset sales, deleveraging, merger of JMC & KPTL, strategic stake sale in logistic business and promoter pledge reduction will result in a significant re-rating in KPTL stock price over the medium term. KPTL's promoters intend to pare current pledge (INR 720 crore) by INR 150 crore by March 2021 and further by INR 150 crore before December 2021 and hence pledge could be down from 57% to 30% over the next one year.

At CMP of INR 295, KPTL's standalone operation is trading at 8x/7x FY22/23E EPS of INR 38/44, a huge discount to its peers, providing a margin of safety. ***We recommend 'Tactical Buy' with a target price of INR 500.***

Sum of The Parts (SoTP)-based target price

KPTL: Standalone	
Valuation methodology	**P/E**
PAT FY22E (INR crore)	585
Multiple (x)	12
Implied value (INR crore)	7,020
Number of shares	15
Value per share (INR)	**467**
JMC: Standalone (67% stake)	
Valuation methodology	**P/E**
PAT FY22E (INR crore)	215
Multiple (x)	10
Implied value (INR crore)	1,443
Number of shares of KPTL	15
Value per share (INR) for KPTL	96
Value per share after holding company discount at 30% (INR)	**30**
Shree Shubham Logistics	
Valuation Methodology	**P/E**
PAT - March-22E (INR Cr)	4
Multiple (x)	8
Implied value (INR Cr)	36
No of shares	15
Value per share (INR)	**2**
Total value (INR per share)	**500**

Source: Company, Edelweiss Professional Investor Research

Income Statement (INR Cr)

Year to March	FY20A	FY21E	FY22E	FY23E
Total operating income	7904	8421.8	9572.3	10690.7
Gross profit	2001	2162.3	2375.2	2656.8
Employee costs	526	547.4	574.3	641.4
Other expenses	615	707.4	765.8	855.3
EBITDA	860	907.5	1035.1	1160.1
Depreciation	110	112.7	119	128.7
Less: Interest expense	166	155.1	170.8	175.9
Add: Other income	58	65.7	69.9	73.3
Profit before tax	642	705.4	815.2	928.8
Prov for tax	203	202.9	229.9	261.9
Less: Other adj	-24	-14	0	0
Reported profit	463	516.5	585.3	666.9
Less: Excp.item (net)	24	14	0	0
Adjusted profit	439	502.5	585.3	666.9
Diluted shares o/s	15.3	15.3	15.3	15.3
Adjusted diluted EPS	28.6	32.8	38.2	44
DPS (INR)	0.35	0.3	0.3	0.3
Tax rate (%)	3.16	2.88	2.82	2.82

Important Ratios (%)

Year to March	FY20A	FY21E	FY22E	FY23E
COGS (% of rev)	74.7	74.3	75.2	75.1
Employee cost (% of rev)	6.7	6.5	6.0	6.0
Other exp (% of rev)	7.8	8.4	8.0	8.0
EBITDA margin (%)	10.9	10.8	10.8	10.9
Net profit margin (%)	5.6	6.0	6.1	6.2
Revenue growth (% YoY)	11.1	6.6	13.7	11.7
EBITDA growth (% YoY)	10.5	5.5	14.1	12.1
Adj. profit growth (%)	4.1	14.5	16.5	13.9

Valuation Metrics

Year to March	FY20A	FY21E	FY22E	FY23E
Diluted P/E (x)	10.3	9.0	7.7	6.7
Price/BV (x)	1.2	1.1	1.0	0.8
EV/EBITDA (x)	6.2	5.8	5.0	4.3
Dividend yield (%)	1.4	1.2	1.2	1.2

Balance Sheet (INR Cr)

Year to March	FY20A	FY21E	FY22E	FY23E
Share capital	31	31	31	31
Reserves	3505	3976	4515	5136
Shareholders funds	3536	4006	4546	5166
Minority interest	0	0	0	0
Borrowings	1177	1001	951	901
Trade payables	3393	3516	4042	4512
Other liabs & prov	1303	1191	1175	954
Total liabilities	9655	9985	11011	11861
Net block	625	635	620	595
Intangible assets	9	7	5	2
Capital WIP	40	41	42	43
Total fixed assets	674	683	666	640
Non current inv	864	864	864	864
Cash/cash equivalent	337	231	302	358
Sundry debtors	3617	3923	4616	5155
Loans & advances	630	662	695	729
Other assets	3533	3622	3869	4115
Total assets	9655	9985	11011	11861

Free Cash Flow (INR Cr)

Year to March	FY20A	FY21E	FY22E	FY23E
Reported profit	463	517	585	667
Add: Depreciation	110	113	119	129
Interest (net of tax)	102	106	118	122
Others	-99	-106	-118	-122
Less: Changes in WC	-333	-391	-436	-541
Operating cash flow	243	238	268	255
Less: Capex	-170	-122	-102	-102
Free cash flow	73	116	166	153

Key Ratios

Year to March	FY20A	FY21E	FY22E	FY23E
RoE (%)	13.8	13.4	13.7	13.7
RoCE (%)	19.0	17.7	18.8	19.1
Inventory days	42.0	42.0	37.0	38.0
Receivable days	161.0	163.0	163.0	167.0
Payable days	196.0	201.0	192.0	194.0
Working cap (% sales)	39.1	41.6	41.4	42.4
Gross debt/equity (x)	0.3	0.2	0.2	0.2
Net debt/equity (x)	0.2	0.2	0.1	0.1
Interest coverage (x)	4.5	5.1	5.4	5.9

Valuation Drivers

Year to March	FY20A	FY21E	FY22E	FY23E
EPS growth (%)	4.1	14.5	16.5	13.9
RoE (%)	13.8	13.4	13.7	13.7
EBITDA growth (%)	10.5	5.5	14.1	12.1
Payout ratio (%)	11.6	8.9	7.9	6.9

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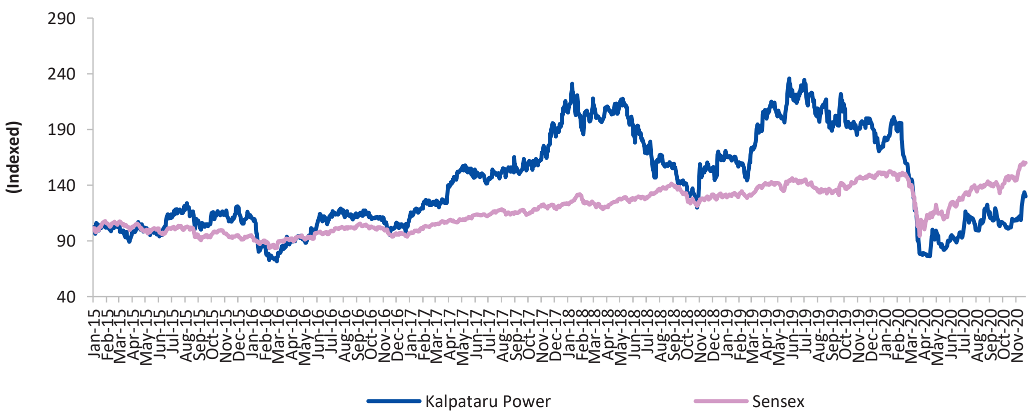
Rating	Expected to
BUY	appreciate more than 15% over a 12-month period
HOLD	appreciate between 5% and 15% over a 12-month period
REDUCE	return below 5% over a 12-month period



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