

KEC International

Expanding its geographical presence



analysis adds up

India Equity Research | Engineering and Capital

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Company Update

KEC International has announced it is signing an agreement to acquire a 100% stake of SAE Towers Holdings LLC (SAE Towers), a US-based company for an EV of US\$95 mn. KEC is expected to gain foothold in North America and Latin America markets through SAE Towers and the acquisition is also expected to help the company gain expertise in the pole tower and hardware segment of power T&D value chain. SAE Towers enjoys better operating margins than KEC and has healthy return ratios (RoE and RoCE of more than 30% each). Since the acquisition is EPS-accretive, we believe it will be positive for the company. Hence, we raise our PT to Rs718 (from Rs677) and also upgrade our FY11 and FY12 EPS by 4.0% and 10.0%, respectively. We reiterate our BUY rating.

SAE towers enjoys market leadership

SAE Towers is engaged in the manufacturing and supply of power transmission towers. It has manufacturing facilities in Brazil (65,000 tonnes) and Mexico (35,000 tonnes) and operates the largest tower testing station in Brazil. SAE Towers enjoys market leadership in Brazil and Mexico, with a market share of 46% and 43%, respectively. In addition to from providing multiple configurations of lattice towers, the company also provides pole towers, substation structures and transmission hardware. With a tower manufacturing capacity of 100,000 tonnes, SAE Towers is expected to help KEC make a leap into the global league for manufacturing transmission towers.

Improving fundamentals for North and Latin American transmission market

Through this acquisition, KEC aims to expand its presence in North and Latin American markets. Fundamentals of the transmission tower in these geographies is also expected to improve with substantial investment planned in the US, Mexico and Brazil. Cumulatively, an investment of US\$20-25 bn is planned over the next 3-4 years. Despite tough global economic conditions, SAE Towers has maintained its growth momentum and management has guided for steady growth in revenue and stable margins for the company.

Acquisition EPS accretive in nature – increasing PT to Rs718 per share

KEC acquired SAE Towers at an EV of US\$95 mn (with current debt of US\$16 mn and cash on hand of US\$3 mn). Although funding details are not available, we expect it to be entirely debt-funded. SAE Towers registered revenue of US\$120 mn in CY09 and has guided for US\$135 mn in CY10E. It has also guided for US\$19 mn in operating profit (with an operating margin of 14%). It currently has an orderbook of US\$120 mn and the deal is likely to be concluded by the end of September 2010. We have factored in benefits accrued to KEC on behalf of this acquisition and have increased our revenue and net profit for FY12E by 12% and 10%, respectively. Based on our revised EPS estimate of Rs57.5 for FY12, we arrive at a PT of Rs718.

Risks – Significantly higher equity dilution for the funding of the acquisition and a meaningful slowdown in domestic power T&D ordering pose risks to our valuation.

Exhibit 1: Financials and valuation summary

Y/E March	Sales (Rs mn)	Change (%)	EBITDA (%)	PAT Rep. (Rs mn)	PAT Adj. (Rs mn)	EPS Adj. (Rs)	Change (%)	PE (x)	RoE (%)	RoCE (%)	EV/EBITDA (x)	EV/Sales (x)
FY08	28,145	37.9	12.6	1,722	1,722	34.9	25.7	14.5	44.9	37.1	8.5	1.1
FY09	34,274	21.8	8.8	1,163	1,163	23.6	(32.5)	21.4	22.1	24.0	9.9	0.9
FY10	38,772	13.1	9.9	1,710	1,710	33.3	41.1	15.2	25.8	25.6	8.6	0.9
FY11E	49,796	28.4	10.3	2,180	2,180	42.4	27.5	11.9	25.4	24.5	7.1	0.7
FY12E	63,673	27.9	10.6	2,954	2,954	57.5	35.5	8.8	27.4	26.3	5.5	0.6

Note: Pricing as on 7 September 2010. Source: Company data, Quant Global Research estimates

BUY

Rs 498

Reuters: KECL.BO; Bloomberg: KECI

12-month price target: Rs718

Krishnakant Thakur

krishnakant.thakur@quantcapital.co.in

91 22 3954 1467

Pawan Parakh

pawan.parakh@quantcapital.co.in

91 22 3954 1471

Market cap	Rs25.2 bn(US\$0.5 bn)
52 week high/low:	Rs684/441
Share o/s:	51 mn
Share o/s (fully diluted):	51 mn
Avg daily trading vol (3m):	50 ('000)
Avg daily trading val (3m):	Rs24.7 mn (US\$0.5 mn)

Quant vs. Consensus

	PT	EPS (FY12E)
Mean	586	49.7
High	718	57.5
Low	433	33.3
Quant	718	57.5

	Buy(s)	Hold(s)	Sell(s)
Nos	16	5	1

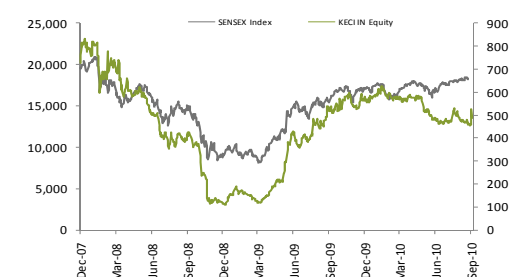
Source: Bloomberg

Shareholding pattern

	Jun 10	Mar 10	Dec 09
Promoters	41.7	42.0	41.9
FIs	5.8	5.4	5.6
MF/s/FIs/Banks	38.0	39.3	39.5
Others	14.5	13.3	13.0

Source: BSE

Price movement



Source: Bloomberg

Exhibit 1: Upward revision in estimates

	Previous estimate		Revised estimate	
	FY11E	FY12E	FY11E	FY12E
Revenues (Rs mn)	47,726	56,842	49,796	63,673
EBITDA (Rs mn)	4,902	6,007	5,151	6,770
PAT (Rs mn)	2,096	2,694	2,180	2,954
EPS (Rs)	40.8	52.4	42.4	57.5
Price target (Rs)		677		718

Source: Quant Global Research estimates

Financials

Exhibit 2: Income statement

Income statement (Rs mn)	FY08	FY09	FY10	FY11E	FY12E
Income from operations	28,145	34,274	38,772	49,796	63,673
Direct costs	20,319	25,505	29,613	37,833	48,149
Employee costs	1,233	1,416	1,681	2,192	2,703
Other expenses	3,050	4,350	3,620	4,621	6,050
Total operating expenses	24,602	31,271	34,915	44,646	56,903
EBITDA	3,543	3,003	3,857	5,151	6,770
Depreciation and amortisation	251	227	262	479	620
EBIT	3,293	2,775	3,595	4,671	6,149
Interest expense	677	1,000	865	1,318	1,605
Other income	3	3	10	0	0
Profit before tax	2,619	1,778	2,739	3,353	4,545
Provision for tax	897	615	1,030	1,174	1,591
Extraordinary income/ (loss)	0	0	0	0	0
Minority interest	0	0	0	0	0
Profit after tax	1,722	1,163	1,710	2,180	2,954
Basic EPS (Rs)	34.9	23.6	33.3	42.4	57.5
Fully diluted EPS (Rs)	34.9	23.6	33.3	42.4	57.5
Dividend per share (Rs)	5.0	5.0	6.0	6.0	6.0
Equity shares outstanding (mn)	49	49	51	51	51
Diluted number of shares (mn)	49	49	51	51	51

Source: Company data, Quant Global Research estimates

Exhibit 3: Balance sheet statement

Balance sheet (Rs mn)	FY08	FY09	FY10	FY11E	FY12E
Equity capital	493	493	514	514	514
Reserves & surplus	4,458	5,092	7,162	8,980	11,573
Shareholders funds	4,952	5,586	7,676	9,494	12,088
Minority Interest	0	0	0	0	0
Secured loans	5,906	6,106	7,755	12,027	12,027
Unsecured loans	11	112	112	112	112
Borrowings	5,918	6,218	7,867	12,139	12,139
Deferred Tax Liabilities (Net)	200	298	461	461	461
Total sources of funds	11,070	12,102	16,004	22,095	24,688
Gross block	5,213	6,255	8,291	11,271	12,271
Depreciation	899	1,222	1,541	2,021	2,641
Net block	4,314	5,032	6,750	9,251	9,631
Capital work in progress	189	514	383	354	354
Total fixed assets	4,503	5,546	7,133	9,605	9,985
Investments	5	18	19	19	19
Inventories	2,053	2,258	2,498	3,669	4,677
Sundry debtors	14,300	18,510	19,449	24,557	31,400
Cash and equivalents	680	1,365	678	1,486	563
Loans and advances	2,701	3,266	3,973	4,775	6,106
Other current assets	0	0	0	0	0
Total current assets	19,735	25,398	26,597	34,488	42,746
Sundry creditors and others	12,633	18,416	17,189	21,405	27,282
Provisions	540	444	556	612	779
Total CL & provisions	13,173	18,860	17,745	22,017	28,062
Net current assets	6,562	6,538	8,852	12,471	14,684
Miscellaneous Expenses not w/off	0	0	0	0	0
Uses of funds	11,070	12,102	16,004	22,095	24,688

Source: Company data, Quant Global Research estimates

Exhibit 4: Cash flow statement

Cash flow statement (Rs mn)	FY08	FY09	FY10	FY11E	FY12E
Operating Profit before tax	2,619	1,778	2,739	3,353	4,545
Add: Depreciation	251	227	262	479	620
Add: Non cash expenses					
Less: Taxes paid	-897	-615	-1,030	-1,174	-1,591
Less: Exceptional items paid					
Add: Others	757	-46	961		
Gross Cash Flow	2,729	1,344	2,933	2,659	3,574
Less: Changes In Working Capital	-3,526	709	-3,001	-2,810	-3,136
Cash Flow from operating activities	-797	2,053	-68	-151	438
Capex	-703	-1,366	-1,906	-2,951	-1,000
Investments	201	-13	-1	0	0
Cash Flow from investing activities	-501	-1,379	-1,907	-2,951	-1,000
Share Issuance/(Buyback)	-	-	-	-	-
Increase in debt	2,053	301	1,649	4,272	0
Dividend Paid	-289	-289	-361	-361	-361
Financing cash flow	1,765	12	1,288	3,911	-361
NET CASH FLOW	466	685	-687	808	-923
Opening cash and cash equivalents	214	680	1,365	678	1,486
Closing cash and cash equivalents	680	1,365	678	1,486	563

Source: Company data, Quant Global Research estimates

Exhibit 5: Key ratios

Key ratio	FY08	FY09	FY10	FY11E	FY12E
Profitability (%)					
EBITDA margins	12.6	8.8	9.9	10.3	10.6
EBIT margins	11.7	8.1	9.3	9.4	9.7
Net profit margins	6.1	3.4	4.4	4.4	4.6
Growth metrics (%)					
Revenues	38	22	13	28	28
EBITDA	41	-15	28	34	31
Net profit	65	-32	47	27	36
EPS	26	-32	41	27	36
Operating ratios (x)					
Total Asset Turnover(x)	3.1	3.0	2.8	2.6	2.7
Fixed Assets turnover (x)	6.7	7.3	6.6	6.2	6.7
Net debt/Equity (x)	1.1	0.9	0.9	1.1	1.0
Current Ratio (x)	1.5	1.3	1.5	1.6	1.5
Valuation					
ROAE (%)	44.9	22.1	25.8	25.4	27.4
ROACE (%)	37.1	24.0	25.6	24.5	26.3
Diluted PE (x)	14.5	21.4	15.2	11.9	8.8
Price/BV(x)	5.0	4.5	3.4	2.7	2.1
EV/EBITDA (x)	8.5	9.9	8.6	7.1	5.5

Source: Company data, Quant Global Research estimates

Ratings and other definitions

Stock rating system

BUY. We expect the stock to deliver >15% absolute returns.

ACCUMULATE. We expect the stock to deliver 6-15% absolute returns.

REDUCE. We expect the stock to deliver +5% to -5% absolute returns.

SELL. We expect the stock to deliver negative absolute returns of >5%.

Not Rated (NR). We have no investment opinion on the stock.

Sector rating system

Overweight. We expect the sector to relatively outperform the Sensex.

Underweight. We expect the sector to relatively underperform the Sensex.

Neutral. We expect the sector to relatively perform in line with the Sensex.

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612, maker chambers IV, nariman point, mumbai 400 021, india
phone 91 22 4088 0100, 3025 0100 fax 91 22 4088 0198, 3025 0198