

KEC INTERNATIONAL

INR 312



Power puff

BUY

KEC International's (KEC) Q2FY07 results were in line with our expectations in terms of revenue growth and profitability. Net revenue grew by 13% Y-o-Y to INR 4.6 bn. EBITDA margin expanded by 260bps Y-o-Y and 170bps Q-o-Q to 12.2% as revenue from more projects entered the profit-recognition phase in Q2FY07. However, net margin expansion by only 80bps to 4.6%, depressed by higher tax incidence. Consequently, EBIDTA grew by 44% Y-o-Y to INR 571 mn and net profit grew by 40% Y-o-Y to INR 217 mn.

Order backlog as on Q2FY07-end was INR 30 bn compared to INR 28 bn as on Q1FY07-end. Order backlog scenario has been stagnant for the industry as contracts from Power Grid Corporation (PGCIL) slowed down in Q2FY07. We expect robust investment scenario in the T&D space in KEC's key addressed geographies of Middle East, Africa, and India is likely to translate into high order backlog. On our EPS estimates of INR 25.2 and INR 34.3 for FY07 and FY08, respectively, the stock trades at 12.4x and 9.1x FY07E and FY08E earnings, respectively. We continue to remain positive on KEC's performance outlook and maintain our 'BUY' recommendation.

* **Robust investment scenario in T&D space continues**

International orders constituted ~75% of the order backlog, while the balance portion was contributed by domestic orders. Rural electrification project orders were at 16% of the total order backlog. We expect robust growth in KEC's order backlog going forward, given a favorable investment environment in Middle Eastern and African markets. In India, we anticipate increase in contracts from PGCIL in H2FY07 vis-à-vis H1FY07. PGCIL is likely to float tenders worth INR 15 bn in Q3FY07, which is likely to aid growth in KEC's visibility horizon.

* **Outlook and valuations**

We expect KEC to grow revenues by a CAGR of 22% for FY06-08E, in the backdrop of a robust demand scenario across its operating geographies, customer and types of contract. We expect net sales of INR 20.8 bn and INR 25.6 bn in FY07E and FY08E, respectively. EBITDA margin is likely to continue showing modest improvement. In the backdrop of strong H1FY07 performance in EBITDA-level profitability, we would like to believe that a case of margin improvement does exist but given the volatility of such project-led businesses, we do not see would like to stick to our margin assumptions. Improvement in return ratios post restructuring provides us comfort on valuations at current levels. At current EPS estimates of INR 25.2 and INR 34.3 for FY07 and FY08, respectively, the stock is trading at 12.4x and 9.1x FY07E and FY08E earnings, respectively. We reiterate our 'BUY' recommendation.

Financials

Year to March	Q2FY07	Q2FY06*	% change	Q1FY07	% change	FY06	FY07E
Revenues (INR mn)	4676.6	4127.2	13.3	4123.6	13.4	17272.3	20798.5
EBITDA (INR mn)	571.2	395.8	44.3	430.3	32.7	1622.1	1996.5
Net profit (INR mn)	216.8	154.9	40.0	145.6	48.9	493.0	951.6
EPS (INR)	5.8	4.1	39.8	3.9	48.9	13.1	25.2
PE (x)						23.8	12.4
EV/EBITDA (x)						8.8	7.1
ROAE (%)						19.3	41.5

* Proforma numbers

October 31, 2006

Priyanko Panja
+91-22-2286 4300
priyanko.panja@edelcap.com

Misal Singh
+91-22-2286 4316
misal.singh@edelcap.com

Reuters : KECI.BO
Bloomberg : KEC IN

Market Data

52-week range (INR) : 510 / 210
Share in issue (mn) : 37.7
M cap (INR bn/USD mn) : 11.8 / 261.5
Avg. Daily Vol. BSE/NSE ('000) : 332.1

Share Holding Pattern (%)

Promoters : 34.3
MFs, FIs & Banks : 35.0
FII's : 12.3
Others : 18.5

* Favorable macro scenario in India

The current power transmission capacity in India is 11,000 MW. PGCIL has a target of achieving 18,000 MW by the end of the tenth plan. We believe this sets the stage for acceleration in the order inflow for the industry as a whole. The most important entry barriers in this industry are the prequalification norms. KEC being the oldest, is one of the best players in terms of prequalification norms. We believe KEC is in a sweet spot and is likely to grow firmly over the long term.

Financials snapshot								(INR mn)
Year to March	Q2FY07	Q2FY06*	% change	Q1FY07	% change	FY06	FY07E	FY08E
Revenues (net)	4,677	4,127	13.3	4,124	13.4	17,272	20,799	25,610
Raw material**	1,951	2,321	(15.9)	1,306	49.4	13,123	15,581	19,034
Staff cost	218	207	5.4	219	(0.5)	838	1,085	1,323
Other operating expenses***	1,937	1,204	60.9	2,169	(10.7)	1,689	2,136	2,761
Total expenditure	4,105	3,731	10.0	3,693	11.2	15,650	18,802	23,118
EBITDA	571	396	44.3	430	32.7	1,622	1,997	2,492
Depreciation	84	29	187.3	88	(4.8)	269	217	226
EBIT	488	367	33.0	343	42.4	1,353	1,780	2,266
Interest	157	163	(3.4)	118	32.5	593	457	471
Other income	2	5	NM	0	500.0	4	64	75
Extraordinary items	-	-	NM	-	NM	-	-	-
PBT	333	209	59.0	224	48.2	765	1,387	1,870
Tax	116	54	113.5	79	46.8	272	435	578
Adjusted net profit	217	155	40.0	146	48.9	493	952	1,292
Reported net profit	217	155	40.0	146	48.9	493	952	1,292
Equity capital(FV:INR10)	377	376	0.1	377	-	377	377	377
# of shares (mn)	38	38	0.1	38	-	38	38	38
EPS (INR)	5.8	4.1	39.8	3.9	48.9	13.1	25.2	34.3
Market cap. (INR mn)						11,758	11,758	11,758
PE (x)						23.8	12.4	9.1
EV/EBITDA (x)						8.8	7.1	5.7
Market cap / Revenues (x)						0.7	0.6	0.5
as % of net revenues								
Raw material**	41.7	56.2	(25.8)	31.7	31.7	76.0	74.9	74.3
Other operating expenses***	41.4	29.2	42.0	52.6	(21.3)	9.8	10.3	10.8
EBITDA	12.2	9.6	27.4	10.4	17.0	9.4	9.6	9.7
Adjusted net profit	4.6	3.8	23.5	3.5	31.3	2.9	4.6	5.0
Tax rate	34.8	25.9	34.2	35.1	(0.9)	35.5	31.4	30.9

* Proforma numbers

**does not include erection and construction charges for Q1FY07

***includes erection and construction charges for Q1FY07

Financial Statements

Income statement					(INR mn)
Year to March	FY04	FY05	FY06	FY07E	FY08E
Income from operations	8,168	12,303	17,272	20,799	25,610
Direct costs	4,723	8,844	13,123	15,581	19,034
Employee costs	555	760	838	1,085	1,323
Other expenses	1,909	1,503	1,689	2,136	2,761
Total operating expenses	7,187	11,107	15,650	18,802	23,118
EBITDA	981	1,196	1,622	1,997	2,492
Depreciation and amortisation	101	101	269	217	226
EBIT	880	1,096	1,353	1,780	2,266
Interest expenses	605	487	593	457	471
Other income	55	68	4	64	75
Profit before tax	330	676	765	1,387	1,870
Provision for tax	(137)	254	272	435	578
Extraordinary items	214	-	-	-	-
Reported profit	253	423	493	952	1,292
Adjusted net profit	466	423	493	952	1,292
Shares outstanding	33	38	38	38	38
Dividend per share	-	-	1.2	2.7	4.2
Dividend payout %	-	-	9.2	10.7	12.3

Common size metrics- as % of net revenues

Year to March	FY04	FY05	FY06	FY07E	FY08E
Operating expenses	88.0	90.3	90.6	90.4	90.3
Depreciation	1.2	0.8	1.6	1.0	0.9
Interest expenditure	7.4	4.0	3.4	2.2	1.8
EBITDA margins	12.0	9.7	9.4	9.6	9.7
Net profit margins (adjusted)	5.7	3.4	2.9	4.6	5.0

Growth metrics (%)

Year to March	FY04	FY05	FY06	FY07E	FY08E
Revenues	11.9	50.6	40.4	20.4	23.1
EBITDA	86.0	21.9	35.6	23.1	24.8
PBT	334.6	105.3	13.0	81.4	34.8
Net profit (adjusted)	N.A	(9.4)	16.6	93.0	35.8
EPS	589.0	(19.9)	16.5	93.0	35.8

Cash flow statement

Cash flow statement					(INR mn)
Year to March	FY04	FY05	FY06	FY07E	FY08E
Net profit	466	423	493	952	1,292
Add: Depreciation	101	101	269	217	226
Add: Misc expenses written off	1	(3)	3	-	-
Add: Deferred tax	(137)	219	201	288	350
Gross cash flow	431	739	966	1,456	1,867
Less: Dividends	-	31	52	114	178
Less: Changes in W. C.	(444)	(1,237)	(466)	(507)	1,186
Operating cash flow	876	1,945	1,381	1,849	503
Less: Change in investments	(156)	8	205	-	-
Less: Capex	(403)	(145)	(508)	110	372
Free cash flow	1,435	2,082	1,684	1,739	130

Balance sheet					(INR mn)
As on 31st March	FY04	FY05	FY06	FY07E	FY08E
Equity capital	333	376	377	377	377
Preference capital	220	130	130	130	130
Reserves & surplus	1,823	2,742	1,365	2,202	3,316
Shareholders funds	2,375	3,249	1,872	2,709	3,823
Secured loans	5,494	4,749	3,325	3,616	3,543
Unsecured loans	286	35	1	1	1
Borrowings	5,779	4,784	3,326	3,617	3,544
Sources of funds	8,155	8,033	5,198	6,327	7,367
Intangible assets	0	0	2,339	2,202	2,066
Gross block	2,698	2,440	2,024	2,194	2,566
Depreciation	1,241	1,030	133	213	303
Net block	1,457	1,410	1,892	1,981	2,263
Capital work in progress	40	152	60	0	0
Total fixed assets	1,497	1,562	1,951	1,981	2,263
Investments	866	874	205	205	205
Inventories	508	1,064	1,249	1,297	1,577
Sundry debtors	5,889	8,440	7,260	9,100	11,765
Cash and equivalents	403	1,661	636	2,667	2,724
Loans and advances	4,362	4,961	1,619	1,894	2,285
Total current assets	11,162	16,126	10,764	14,957	18,350
Sundry creditors and others	5,630	10,518	9,723	12,297	14,367
Provisions	87	142	136	231	312
Total CL & provisions	5,717	10,661	9,860	12,529	14,679
Net current assets	5,445	5,465	905	2,428	3,671
Net deferred tax	347	128	(201)	(489)	(839)
Others	0	3	0	0	0
Uses of funds	8,155	8,033	5,198	6,327	7,367
Book value per share (BV)	71	86	50	72	101

Ratios

Year to March	FY04	FY05	FY06	FY07E	FY08E
ROAE (%)	19.1	15.0	19.3	41.5	39.6
ROACE (%)	10.2	13.5	23.7	30.9	33.1
Current ratio	2.0	1.5	1.1	1.2	1.3
Debtors (days)	263	250	153	160	168
Fixed assets t/o (x)	5.5	7.9	8.9	10.5	11.3
Average working capital t/o (x)	1.4	2.3	10.5	12.5	8.4
Gross debt/equity	2.4	1.5	1.8	1.3	0.9

Valuations parameters

Year to March	FY04	FY05	FY06	FY07E	FY08E
EPS (INR)	14.0	11.2	13.1	25.3	34.3
Y-o-Y growth (%)	589.0	(19.9)	16.5	93.0	35.8
CEPS (INR)	17.1	13.9	20.2	31.0	40.3
PE (x)	22.2	27.8	23.8	12.4	9.1
Price/BV(x)	4.4	3.6	6.3	4.3	3.1
EV/Sales (x)	1.8	1.2	0.8	0.7	0.6
EV/EBITDA (x)	15.2	11.9	8.8	7.1	5.7

Edelweiss Securities

14th Floor, Express Towers,
Nariman Point, Mumbai – 400 021
Board: (91-22) 2286 4400
Email: research@edelcap.com



Naresh Kothari – 2286 4246

Head, Institutional Equities

Vikas Khemani – 2286 4206

Co-Head, Institutional Equities

INDIA RESEARCH		SECTOR	INSTITUTIONAL SALES	
Shriram Iyer	- 2286 4256	Head – Research	Nischal Maheshwari	- 2286 4205
Gautam Roy	- 2286 4305	Airlines, Textile	Rajesh Makharia	- 2286 4202
Ashutosh Goel	- 2286 4287	Automobiles, Auto Components	Shabnam Kapur	- 2286 4394
Vishal Goyal, CFA	- 2286 4370	Banking & Finance	Ashish Maheshwari	- 2286 4418
Revathi Myneni	- 2286 4413	Cement	Amish Choksi	- 2286 4201
Sumeet Budhraj	- 2286 4430	FMCG	Deepak Rao	- 2286 4204
Harish Sharma	- 2286 4307	Infrastructure, Auto Components, Mid Caps	Balakumar V	- (044) 4263 8283
Priyanko Panja	- 2286 4300	Infrastructure, Engineering, Telecom	Monil Bhala	- 2286 4363
Hitesh Zaveri	- 2286 4424	Information Technology	Ashish Agrawal	- 2286 4301
Pritesh Vinay	- 2286 4429	Metals, Mining	Nikhil Garg	- 2286 4282
Priyank Singhal	- 2286 4302	Media, Retail	Neha Shahra	- 2286 4276
Prakash Kapadia	- 2286 4432	Mid Caps	Priya Ramchandran	- 2286 4389
Niraj Mansingka	- 2286 4304	Oil & Gas, Petrochemicals	Anubhav Kanodia	- 2286 4361
Nimish Mehta	- 2286 4295	Pharmaceuticals, Agrochemicals	Tushar Mahajan	- 2286 4439
Swati Khemani	- 2286 4266	Textile	Harsh Biyani	- 2286 4419
Manika Preamsingh	- 4019 4847	Economist	Nirmal Ajmera	- 2286 4258
Sachin Arora	- 2286 4512	Alternative & Quantitative	Ankit Doshi	- 2286 4671
Sunil Jain	- 2286 4308	Alternative & Quantitative	Ravi Pilani	- 4009 4533
Yogesh Radke	- 2286 4328	Alternative & Quantitative	Dipesh Shah	- 2286 4434

Email addresses: firstname.lastname@edelcap.com

e.g. naresh.kothari@edelcap.com

unless otherwise specified

RATING INTERPRETATION

Buy	Expected to appreciate more than 20% over a 12-month period	Reduce	Expected to depreciate up to 10% over a 12-month period
Accumulate	Expected to appreciate up to 20% over a 12-month period	Sell	Expected to depreciate more than 10% over a 12-month period
Trading Buy	Expected to appreciate more than 10% over a 45-day period	Trading Sell	Expected to depreciate more than 10% over a 45-day period

This document has been prepared by Edelweiss Securities Private Limited (Edelweiss). Edelweiss and its holding company and associate companies are a full service, integrated investment banking, portfolio management and brokerage group. Our research analysts and sales persons provide important input into our investment banking activities. This document does not constitute an offer or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. The information contained herein is from publicly available data or other sources believed to be reliable, but we do not represent that it is accurate or complete and it should not be relied on as such. Edelweiss or any of its affiliates shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. This document is provided for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigation as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult his own advisors to determine the merits and risks of such investment. The investment discussed or views expressed may not be suitable for all investors. We and our affiliates, officers, directors, and employees may: (a) from time to time, have long or short positions in, and buy or sell the securities thereof, of company (ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as advisor or lender / borrower to such company (ies) or have other potential conflict of interest with respect to any recommendation and related information and opinions. This information is strictly confidential and is being furnished to you solely for your information. This information should not be reproduced or redistributed or passed on directly or indirectly in any form to any other person or published, copied, in whole or in part, for any purpose. This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject Edelweiss and affiliates to any registration or licensing requirements within such jurisdiction. The distribution of this document in certain jurisdictions may be restricted by law, and persons in whose possession this document comes, should inform themselves about and observe, any such restrictions. The information given in this document is as of the date of this report and there can be no assurance that future results or events will be consistent with this information. This information is subject to change without any prior notice. Edelweiss reserves the right to make modifications and alterations to this statement as may be required from time to time. However, Edelweiss is under no obligation to update or keep the information current. Nevertheless, Edelweiss is committed to providing independent and transparent recommendation to its client and would be happy to provide any information in response to specific client queries. Neither Edelweiss nor any of its affiliates, directors, employees, agents or representatives shall be liable for any damages whether direct, indirect, special or consequential including lost revenue or lost profits that may arise from or in connection with the use of the information. The analyst for this report certifies that all of the views expressed in this report accurately reflect his or her personal views about the subject company or companies and its or their securities, and no part of his or her compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this report. Analyst holding in stock: no.