

KEI INDUSTRIES

INR 86



Maintaining momentum

BUY

KEI Industries' (KEI) Q3FY08 results were in line with expectations on revenue and profitability fronts. For the quarter, revenue grew by ~46% Y-o-Y to ~INR 2 bn, EBITDA grew by ~23% Y-o-Y to INR 301 mn, and net profit grew by ~22% Y-o-Y to INR 135 mn. EBITDA margins declined significantly (~240bps) in the quarter to ~12.9% driven by higher raw material expense and staff cost, both of which increased by ~53% Y-o-Y. Net margins were down by ~110bps to ~5.8%, primarily due to impact of reduced EBITDA and higher interest expense.

EBITDA margins dipped due to lower margins in the stainless steel wires segment, which dropped due to volatility in nickel prices, the key input for manufacturing stainless steel. Margins in the power cables business were also impacted on account of KEI's effort to gain faster entry in the HT cables segment and expenses incurred by the company to expand its dealer network and develop markets in new geographies.

We have revised our FY09 estimates upwards as we expect faster ramp up in the Chaupanki facility, which commenced partial production in January 2008. Our FY09 revenue and PAT estimates stand revised upwards by ~12% to INR 13 bn and by 7% to ~INR 870 mn, respectively. We are also introducing our FY10E numbers. We expect revenues of ~INR 16.5 bn and PAT of ~INR 1 bn in FY10E. KEI is the second-largest power cable manufacturer and the largest listed player in the power cable space in India. On our fully diluted EPS of INR 11 and INR 14, the stock is trading at a P/E of 8x and 6x for FY09E and FY10E, respectively. KEI remains a significant play on the Indian power cable industry. We continue to maintain our 'BUY' recommendation on the stock.

* **Partial completion of Chaupanki expansion project**

KEI's new manufacturing facility at Chaupanki commenced commercial production in the first week of January 2008. However, the HT cable unit of the Chaupanki facility is in the final phase of construction and is expected to be commissioned by May 2008. The Chaupanki facility is likely to contribute ~INR 3.5 bn to revenues annually. Further, the company's HT cables upgradation and LT cables expansion at Bhiwadi is in the final phase of construction and is expected to be operational by April 2008.

* **Loss in stainless steel wire segment**

Fall in nickel prices in Q2FY08 resulted in lower selling prices of house wires, which impacted the company's margins for the second time in a row. KEI posted meagre operating margins of ~1.6% in the quarter in the stainless steel wires segment, down by ~6% Y-o-Y.

Financials

Year to September	Q3FY08	Q3FY07	% change	Q2FY08	% change	FY07	FY08E
Revenues (INR mn)	2,335	1,605	45.5	1,984	17.7	6,043	8,851
EBITDA (INR mn)	301	245	22.9	279	7.9	872	1,210
Net profit (INR mn)	135	110	22.4	116	16.2	401	580
EPS (INR)	2.3	2.2	4.5	2.0	16.2	6.8	7.4
P/E (x)						12.6	11.6
EV/EBITDA (x)						7.8	5.6
ROAE (%)						32.0	31.5

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Market Data

52-week range (INR) : 168 / 64
Share in issue (mn) : 59.1
M cap (INR bn/USD mn) : 5.1 / 129.0
Avg. Daily Vol. BSE / NSE ('000) : 619.7

Share Holding Pattern (%)

Promoters : 35.8
MFs, Fls & Banks : 8.6
Fls : 16.5
Others : 39.1

* **Plans to enter power generation projects**

KEI plans to enter the power generation space, for which it will form a subsidiary company through which investments will be made in power projects. The company plans to enter into joint ventures for generation of power through biomass-based power plants.

* **Key revision in estimates**

We have revised our revenue estimates upwards for FY09 on the back of increased capacity for the LT cable segment. We expect lower margins in FY09E and FY10E due to higher competition in the LT power cables segment and lower margins in the HT cables segment as the company gains entry in the market. Consequently, our EBITDA and PAT estimates for FY09 stand revised. Key revisions are given in the table below:

Table 1: Revised estimates post Q3FY08 results

	Previous estimates		Revised estimates		Remarks
	FY08E	FY09E	FY08E	FY09E	
Revenues (INR mn)	8,851	11,790	8,851	13,193	Higher revenue due to increased capacity for the LT cable segment
EBITDA (INR mn)	1,210	1,612	1,210	1,712	Higher EBITDA in FY09E due to increase in revenue estimates, margin compression in LT cable segment due to higher competition and lower margins in the HT cables segment as the company gains entry in the market.
EBITDA margin (%)	13.7	13.7	13.7	13.0	
PAT (INR mn)	580	812	580	870	Higher PAT in FY09E due to increase in revenue estimates
Net margin (%)	6.5	6.9	6.5	6.6	
Fully diluted EPS (INR)	7.4	10.4	7.4	11.1	Adjusted for increase in PAT estimates

Source: Edelweiss estimates

* **Outlook and valuations: Strong revenue visibility; maintain 'BUY'**

In our view, the improvement in revenue visibility story holds true for KEI, as it does for other electrical equipment manufacturers. KEI is the second-largest power cable manufacturer and the largest listed player in the power cable space in India. For investors looking to play the power cable space in India, KEI is the best option available. On our fully diluted EPS of INR 11 and INR 14, the stock is trading at a P/E of 8x and 6x for FY08E and FY09E, respectively. We continue to maintain our **'BUY'** recommendation on the stock.

Financials snapshot						(INR mn)		
Year to March	Q3FY08	Q3FY07	% change	Q2FY08	% change	FY07	FY08E	FY09E
Revenues (net)	2,335	1,605	45.5	1,984	17.7	6,043	8,851	13,193
Raw material	1,760	1,151	53.0	1,476	19.3	4,385	6,505	9,794
Staff cost	38	25	52.5	35	8.6	115	150	220
Other operating expenses	236	184	28.2	195	21.3	672	985	1,468
Total expenditure	2,034	1,360	49.6	1,705	19.3	5,171	7,640	11,481
EBITDA	301	245	22.9	279	7.9	872	1,210	1,712
Depreciation	19	16	20.5	18	4.2	57	131	177
EBIT	282	229	23.0	260	8.2	815	1,079	1,535
Interest	104	70	48.6	97	6.9	237	300	386
Other income	(2)	0	(731.6)	(1)	276.5	2	9	5
Extraordinary items	0	0	NM	0	0.0	0	0	0
PBT	176	159	10.3	163	8.2	580	788	1,155
Tax	41	49	(16.7)	47	(12.0)	178	209	284
Adjusted net profit	135	110	22.4	116	16.2	401	580	870
Reported net profit	135	110	22.4	116	16.2	401	580	870
Equity capital(FV:INR 2)	118	101	17.1	118	-	118	120	120
Fully diluted no. of shares (mn)	59	50	17.1	59	-	59	78	78
EPS (INR)	2.3	2.2	4.5	2.0	16.2	6.8	7.4	11.1
Market cap. (INR mn)						5,074	5,074	5,074
P/E (x)						12.6	11.6	7.7
EV/EBITDA (x)						7.8	5.6	4.0
Market cap / Revenues (x)						0.8	0.6	0.4
as % of net revenues								
Raw material	75.4	71.7	5.1	74.4	1.4	72.6	73.5	74.2
Other operating expenses	10.1	11.5	(11.9)	9.8	3.0	11.1	11.1	11.1
EBITDA	12.9	15.3	(15.6)	14.1	(8.3)	14.4	13.7	13.0
Adjusted net profit	5.8	6.9	(15.9)	5.9	(1.2)	6.6	6.5	6.6
Tax rate	23.3	30.8	(24.5)	28.6	(18.7)	30.8	26.5	24.6

Company Description

KEI is one of the leading manufacturers of low-tension and high-tension power cables in India. It has an annual capacity of 3,000 kms for high-tension cables and 37,000 kms capacity for low-tension cables. It is undertaking massive capacity expansion projects in high-tension power cables to become one of the leading players in the segment.

Investment Theme

Power cables constitute ~3% of the total power generation project cost, while it accounts for ~2% of the project cost in power transmission projects. Considering the demand for power cables is high on the back of industrial expansion and infrastructure growth, KEI as a leading player in this space is well-placed to leverage this growth opportunity.

Key Risks

Since copper is the main raw material for power cables, any unexpected increase in its prices is likely to impact KEI's margins negatively.

As pre qualifications are awarded to various players from different state utilities and corporates, entry barriers are likely to fall, resulting in higher competition.

Financial Statements

Income statement					(INR mn)
Year to March	FY06	FY07	FY08E	FY09E	FY10E
Income from operations	3,013	6,043	8,851	13,193	16,521
Direct costs	2,031	4,385	6,505	9,794	12,265
Employee costs	81	115	150	220	275
Other expenses	453	672	985	1,468	1,838
Total operating expenses	2,564	5,171	7,640	11,481	14,378
EBITDA	449	872	1,210	1,712	2,143
Depreciation and amortisation	27	57	131	177	195
EBIT	422	815	1,079	1,535	1,949
Interest expenses	95	237	300	386	485
Other income	9	2	9	5	6
Profit before tax	336	580	788	1,155	1,470
Provision for tax	76	178	209	284	362
Reported profit	260	401	580	870	1,108
Adjusted net profit	260	401	580	870	1,108
Basic shares outstanding	10.1	59.0	60.2	60.2	60.2
Diluted share outstanding	10.1	59.0	78.3	78.3	78.3
Dividend per share	2.0	0.5	0.5	0.5	0.5
Dividend payout (%)	7.8	7.3	5.2	3.5	2.7

Common size metrics- as % of net revenues

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Operating expenses	85.1	85.6	86.3	87.0	87.0
Depreciation	0.9	0.9	1.5	1.3	1.2
Interest expenditure	3.1	3.9	3.4	2.9	2.9
EBITDA margins	14.9	14.4	13.7	13.0	13.0
Net profit margins	8.6	6.6	6.5	6.6	6.7

Growth metrics (%)

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Revenues	46.8	100.6	46.5	49.1	25.2
EBITDA	112.4	94.3	38.9	41.4	25.2
PBT	171.5	72.3	35.9	46.5	27.3
Net profit	210.0	54.4	44.4	50.2	27.3
Basic EPS (adjusted for split)	210.0	54.4	44.4	50.2	27.3

Cash flow statement

Cash flow statement					(INR mn)
Year to March	FY06	FY07	FY08E	FY09E	FY10E
Net profit	260	401	580	870	1,108
Add: Depreciation	27	57	131	177	195
Add: Deferred tax	25	32	0	0	0
Gross cash flow	312	490	710	1,047	1,302
Less: Dividends	20	29	30	30	30
Less: Changes in W. C.	442	1,029	883	1,366	1,048
Operating cash flow	(150)	(569)	(203)	(349)	224
Less: Change in investments	2	1	0	0	0
Less: Capex	489	516	900	400	100
Free cash flow	(641)	(1,086)	(1,103)	(749)	124

Balance sheet					(INR mn)
As on 31st March	FY06	FY07	FY08E	FY09E	FY10E
Equity capital	101	118	120	120	120
Amount against warrants	39	0	0	0	0
Reserves & surplus	852	1,401	2,044	2,881	3,955
Shareholders funds	992	1,519	2,165	3,001	4,075
Secured loans	532	2,730	2,632	2,832	2,832
Unsecured loans	235	366	613	1,114	1,270
Borrowings	767	3,096	3,245	3,945	4,102
Sources of funds	1,759	4,614	5,410	6,947	8,177
Gross block	886	1,402	2,302	2,702	2,802
Depreciation	142	191	271	378	495
Net block	744	1,211	2,031	2,324	2,307
Capital work in progress	61	199	0	0	0
Total fixed assets	805	1,410	2,031	2,324	2,307
Investments	2	4	4	4	4
Inventories	984	1,761	2,579	3,844	4,814
Sundry debtors	757	1,741	2,550	3,801	4,760
Cash and equivalents	141	1,375	665	543	744
Loans and advances	121	393	576	859	1,075
Total current assets	2,004	5,270	6,370	9,047	11,394
Sundry creditors and others	968	1,949	2,855	4,256	5,329
Provisions	23	45	66	98	123
Total CL & provisions	991	1,994	2,921	4,354	5,452
Net current assets	1,012	3,276	3,449	4,693	5,942
Net deferred tax	(60)	(75)	(75)	(75)	(75)
Uses of funds	1,759	4,614	5,410	6,946	8,177
Book value per share (BV)	17	26	37	51	69

Ratios

Year to March	FY06	FY07	FY08E	FY09E	FY10E
ROAE (%)	40.9	32.0	31.5	33.7	31.3
ROACE (%)	33.9	25.6	21.5	24.8	25.8
Current ratio	2.0	2.6	2.2	2.1	2.1
Debtors (days)	92	105	105	105	105
Fixed assets t/o (x)	3.7	4.3	4.4	5.7	7.2
Non cash working capital t/o (x)	4.6	4.4	3.8	3.8	3.5
Average capital t/o (x)	2.4	1.9	1.8	2.1	2.2
Net debt/Equity	0.6	1.1	1.2	1.1	0.8
Debt/Equity	0.8	2.0	1.5	1.3	1.0

Valuations parameters

Year to March	FY06	FY07	FY08E	FY09E	FY10E
EPS (INR) (adjusted for split)	4.4	6.8	9.6	14.5	18.4
<i>Y-o-Y growth (%)</i>	<i>210.0</i>	<i>54.4</i>	<i>41.4</i>	<i>50.2</i>	<i>27.3</i>
Diluted EPS	3.3	6.8	7.4	11.1	14.1
<i>Y-o-Y growth (%)</i>	<i>210.0</i>	<i>104.9</i>	<i>8.7</i>	<i>50.2</i>	<i>27.3</i>
CEPS (INR)	4.9	7.8	12.0	17.8	22.1
P/E (x)	25.9	12.6	11.6	7.7	6.1
Price/BV(x)	5.1	3.3	2.3	1.7	1.2
EV/Sales (x)	2.3	1.1	0.8	0.5	0.4
EV/EBITDA (x)	15.1	7.8	5.6	4.0	3.2

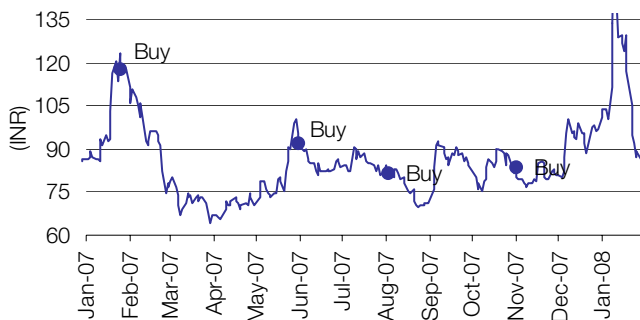
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Coverage group(s) of stocks by primary analyst(s): Power:

KEI Industries, Apar Industries, Emco, Kalpataru Power Transmission, KEC International, RPG Transmission, Jyoti Structures, ABB, BHEL, Voltas, L & T, Siemens, Suzlon Energy and Crompton Greaves

KEI Industries



Date	Company	Title	Price (INR)	Recos
25-Jan-08	Kirloskar Oil. Engr.	Out of stream; Result Update	137	Accum.
25-Jan-08	TIL	Margins continue to impress;610 Result Update		Buy
26-Nov-07	Siemens India	High margins, a one off; Result Update	1,952	Reduce
02-Nov-07	TIL	On fire; Result update	482	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	108	44	16	3	188

* 12 stocks under review / 5 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	103	66	19

Rating Interpretation

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

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