



CMP: 362.4

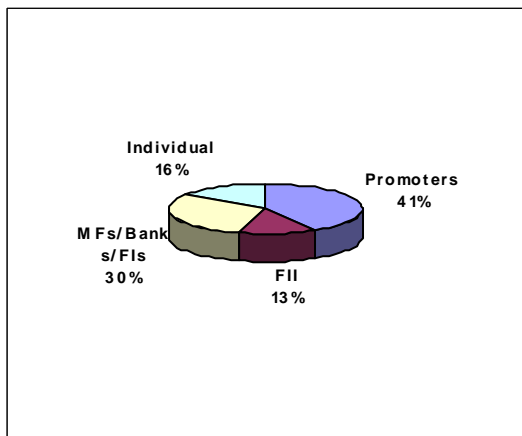
BUY
Target: 418

Key Data

| | |
|-----------------------|----------|
| Bloomberg Code | KECI IN |
| BSE Code | 532714 |
| NSE Code | KEC |
| Face Value (INR) | 10 |
| Market Cap. (INR mn.) | 19,811.9 |
| 52 Week High (INR) | 950.0 |
| 52 Week low (INR) | 311.6 |
| 52 Week Avg. Volume | 35,787 |

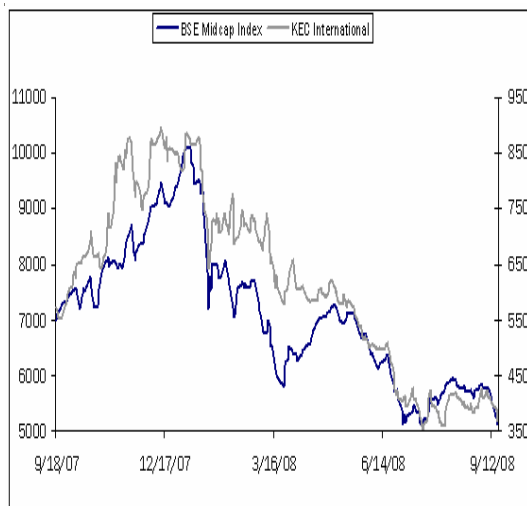
| | Revenue (Rs. mn) | EPS | P/E |
|-------|------------------|------|-----|
| FY08 | 28,144.8 | 39.6 | 9.2 |
| FY09E | 36,000.0 | 38.0 | 9.5 |
| FY10E | 44,866.7 | 46.5 | 7.8 |

Shareholding Pattern



Source: Company

Historical Stock Performance



Source : Bloomberg

Analyst
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A Towering Corporate, the World over...

KEC International (KEC) is among the largest power transmission & distribution companies in the world. RPG Transmissions and NITEL, both owned by the same promoter group, were merged into KEC in Oct. 07. This merger is beneficial as it gives KEC a presence in the growing domestic power T&D and telecom infrastructure markets. Power T&D has good growth prospects on account of the government's thrust via the Five Year Plans. The telecom infrastructure sector is poised for growth on the back of governmental initiatives via the USO fund. KEC has an order book of Rs. 46 bn, 75% of which is from international orders. KEC's strong presence in the international market would enable it to exploit the growth opportunities in the US, Middle East and South Asian markets. KEC is also planning to enter the railways sector on an increased scale due to the huge investments that are planned into this sector. At the CMP of Rs. 362.4, KEC is quoting at 9.5 times FY09E earnings and 7.8 times FY10E earnings. Relative valuation yields a target price of Rs. 418. This represents an upside potential of 15.3% from CMP. Therefore, we initiate coverage with a **Buy** rating on KEC International.

Key Highlights

- KEC is entering the railways sector in a big way. This sector has good growth potential on the back of the investments planned by Indian Railways (Rs. 780 bn).
- KEC would be incurring a capex of Rs. 1000 mn in this year in its subsidiary NITEL. Order inflow growth for this company is expected to be around 50% on the back of government initiatives in this sector.
- The stock has witnessed a correction post the announcement of Q1FY09 results. However, with the various initiatives being taken by the company mgmt, we feel that this is the right time to buy into the stock.



About KEC International

KEC International (KEC) is one of the largest power transmission EPC companies in the world. The company is into turnkey projects for power transmission lines, execution of railway electrification projects, setting up substations, optical fiber installations and turnkey telecom infrastructure services. RPG Transmissions and NITEL were merged into KEC Intl. from Oct. 07. This merger is beneficial to KEC as it results in geographical diversification of KEC's order book, provides entry into telecom towers and results in a bigger balance sheet. In the year ended Mar. 08, the company registered a 37.9% and 64.5% increase in net sales & net profit to Rs. 28.1 bn and Rs. 1.7 bn respectively, including the impact of the mergers.

Investment Rationale

Order book provides revenue visibility

KEC's order book as on Apr. 30, 2008 stands at Rs. 46 bn which translates into an order book / FY08 sales of 1.64x. In addition to this, KEC's L1 position is around Rs. 8 bn. The orders are executable in a period of 18-24 months on an average. 75% of its order book consists of international orders. Orders in transmission sector account for 80% of its order book.

| | South Asia | International | Total |
|--------------|---------------|---------------|---------------|
| Transmission | 8,950 | 28,150 | 37,100 |
| Distribution | 1,000 | 5,620 | 6,620 |
| Substations | 700 | 800 | 1,500 |
| Telecom | 240 | | 240 |
| Railways | 540 | | 540 |
| TOTAL | 11,430 | 34,570 | 46,000 |

Source: Company, DDAV Research

Governmental thrust on power T&D and telecom sectors

In India, the ratio of investments in generation to T&D stands at 1:0.5 as compared with the global norm of 1:1 which presents a strong growth opportunity. Almost Rs. 500 bn was spent on T&D in the X Five Year Plan. The XI Five Year Plan (2007-12) envisages investment of Rs. 1,400 bn in T&D. Rural electrification via RGGVY is another huge growth opportunity, with a planned outlay of Rs. 400 bn by FY10. Further, the govt. has projected doubling of power generation capacity every 10 years after 2012, which would provide further growth impetus.

The Govt. has set a teledensity target of 32.74% by 2010 (currently 15.6%), which would necessitate construction of 150,000 more towers in next 2-3 yrs. Currently, there are only 120,000 towers, which presents a huge growth opportunity for KEC. The 2nd phase of USO funded projects is coming up, which provides an opportunity of 10,000 towers. KEC is already working on the 1st phase of USO funded projects. The company has earmarked 50% of its capital expenditure, or Rs. 1000 mn, for the telecom division.



Merger of RPG Transmissions and NITEL beneficial to KEC

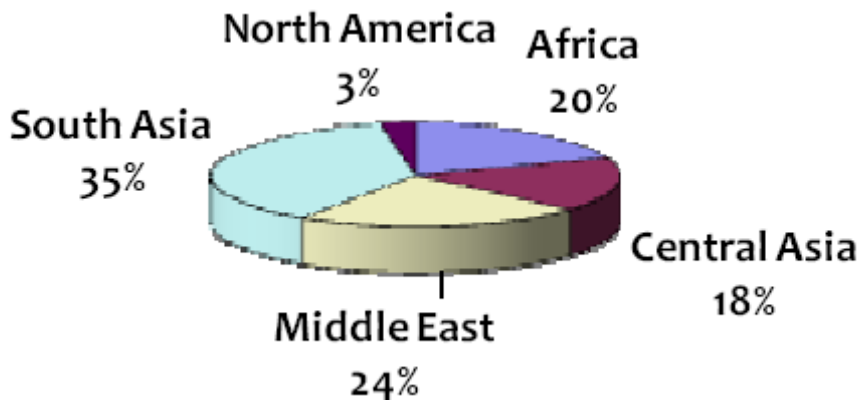
The merger of RPG Transmissions and NITEL with the company has made KEC one of the largest transmission companies across the globe. The merger has increased the total tower manufacturing capacity of the company to 161,000 tons per annum. The merger would enable KEC to utilize the surplus capacity of RPG Transmissions effectively and to reduce costs substantially. The company would extend its operational areas to telecom, railways power transmission and rural electrification.

Opportunities in railways

The XI Five Year Plan has made an outlay of Rs. 430 bn (excluding dedicated freight corridors) for the rail sector. Out of this, projects worth Rs. 250 bn are expected to be executed. The total outlay for dedicated freight corridors (DFC) is Rs. 350 bn. The project tenders are expected to be floated by end of 2009. KEC plans to bid for signaling, laying of tracks, earth work etc. besides railway electrification which it is already into.

Opportunities in the international market

In US, there has been no major investment in power infrastructure in the last 10 yrs. Investments worth \$66 bn are expected in the North American market over the next 5 yrs. Infrastructure spending in Middle East has increased considerably due to the record crude prices. European funds are funding projects in Central Asia due to the gas finds in that region. A grid is being proposed to be built amongst the SAARC countries. KEC has a strong presence in these markets with 75% of its outstanding orders from these markets. The graph below shows the order book breakup by region.



Source: Company, DDAV Research

Business Outlook

Being a power deficit nation, India is investing substantially for developing its power generation capacity. This will be accompanied by investments in T&D. Also, development of a National Grid will result in more opportunities for players like KEC. The telecom sector is also poised to grow rapidly on account of favorable government policies and the low tele-density. Huge investments have been targeted in the railways sector in India. With spiraling crude prices, infrastructure spending in the Middle East and Central Asia has increased, which provides another growth opportunity. We believe KEC is the best placed to capitalize on these opportunities as it is one of the biggest players in the world in this space.

Investment Risk

Since most of the infrastructure spending is done by government authorities, order flow is subject to policy changes. KEC is subject to currency risk as it has a large proportion of dollar denominated orders. The company also faces the risk of commodity prices, especially that of steel. However, KEC submits its quote based on its outlook on the steel prices and the exchange rates. The company's currency risk is mitigated by its foreign currency expenditures.



| (In Rs. mn) | FY 07 | FY08 | FY09E | FY10E |
|--------------------|----------|----------|----------|----------|
| Revenue | 20,406.3 | 28,144.8 | 36,000.0 | 44,866.7 |
| Total Expenditure | 17,887.9 | 24,601.5 | 32,076.0 | 40,200.5 |
| Operating profit | 2,518.5 | 3,543.3 | 3,924.0 | 4,666.1 |
| Depreciation | 334.4 | 250.7 | 310.7 | 360.7 |
| EBIT | 2,191.0 | 3,295.1 | 3,615.9 | 4,308.0 |
| Interest | 592.5 | 676.5 | 776.3 | 833.8 |
| Tax | 552.2 | 896.9 | 965.5 | 1,181.2 |
| PAT | 1,046.3 | 1,721.7 | 1,874.1 | 2,293.0 |
| Diluted EPS | 27.8 | 39.6 | 38.0 | 46.5 |
| Sales Growth % | 18.1% | 37.9% | 27.9% | 24.6% |
| Operating Margin % | 12.3% | 12.6% | 10.9% | 10.4% |
| Net Margin % | 5.1% | 6.1% | 5.2% | 5.1% |

Source: Company, DDAV Research

We expect topline and PAT to grow at CAGR of 26.3% and 15.4% from FY08 to FY10. An important price trigger would be the winning of EPC contracts in the US, as it would open up a huge market for KEC. We haven't incorporated this into the valuation exercise.

Valuation

| | FY 07 | FY08 | FY09E | FY10E |
|-----------|-------|-------|-------|-------|
| EPS (Rs.) | 27.8 | 39.6 | 38.0 | 46.5 |
| P/E (x) | 13.0 | 9.2 | 9.5 | 7.8 |
| ROE | 40.4% | 35.9% | 29.1% | 27.2% |
| ROCE | 33.9% | 30.8% | 27.4% | 27.5% |

Source: Company, DDAV Research

We recommend **Buy** on this stock with a FY09 target price of Rs. 418. At the target price, the stock quotes at FY09E P/E of 11x.

Peer Valuation

| FY08 parameters | KEC International | Areva T&D | Kalpataru | Jyoti Structures |
|------------------|-------------------|-----------|-----------|------------------|
| Revenue (Rs. mn) | 28,144.8 | 20,063.0 | 26,748.5 | 13,704.0 |
| EBIDTA Margin | 12.6% | 18.7% | 12.5% | 12.6% |
| Net Margin | 6.1% | 10.8% | 6.2% | 5.3% |
| EPS | 39.6 | 51.5 | 62.2 | 8.9 |
| CMP | 362.4 | 1488.2 | 773.0 | 103.7 |
| P/E (x) | 9.2 | 28.9 | 12.4 | 11.7 |

Source: Company, DDAV Research



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