

KEI INDUSTRIES**INR 49****Margin squeeze****BUY**

June 19, 2008

Disappointing numbers, driven by margin contraction

KEI Industries' (KEII) Q4FY08 results were in line with our estimates in terms of revenue growth, but below our expectation in terms of profitability. EBITDA margins were down, as other operating expenditure increased on account of higher overhead expenses arising from various capacity expansion projects. Further, employee expenditure increased during the quarter, as the company made provision of ~INR 21 mn towards ESOP and leave encashment, in compliance with the revised accounting standard.

Headline numbers - PAT below expectations

For Q4FY08, revenues grew ~25% Y-o-Y, to ~INR 2.6 bn. Cables contributed ~90% to total sales, while the balance 10% was contributed by stainless steel wires. EBITDA grew ~8% Y-o-Y, to ~INR 270 mn. EBITDA margin for the quarter declined ~150bps Y-o-Y, to ~10.5%, on account of higher employee and other operating expenditure. Adjusted PAT declined ~11% Y-o-Y, to ~INR 102 mn, driven by decrease in operating margin, higher interest expense, and tax provision. During this quarter, KEII had an extraordinary loss of ~INR 37 mn towards loss on forex derivative contracts.

For FY08, revenues grew ~45% Y-o-Y, to INR 8.7 bn. EBITDA grew ~28% Y-o-Y, to ~INR 1092 mn. EBITDA margin declined ~190bps Y-o-Y, to ~12.5%, on account of higher raw material and employee costs. Adjusted PAT grew ~18% Y-o-Y, to INR 472 mn. Other income, of ~INR 43 mn for the year, was higher on account of duty drawback on exports.

Outlook and valuations: Attractive; maintain 'BUY'

While we continue to believe that KEII is likely to have strong revenue visibility over the long term, delay in capacity expansion and margin pressures are likely to negatively impact its revenues and earnings growth, respectively. We have downgraded our revenues estimates by ~7% and ~8% (to ~INR 12 bn and ~INR 15 bn) for FY09E and FY10E, respectively, due to delay in capacity expansion of low tension (LT) and high tension (HT) facilities in Bhiwadi. While volatility in prices of commodities like copper and aluminium can be controlled by hedging, increase in steel and polymer prices are likely to negatively impact margins for orders on hand. We have, therefore, downgraded our PAT estimates by ~26% and ~21% (to ~INR 647 mn and ~INR 874 mn) for FY09E and FY10E respectively. The stock is trading at P/E of ~6x and ~4x our revised FY09E and FY10E, respectively. We believe that with RoE of over 25% and ~30%-plus revenue and PAT CAGR over the next two years, KEII is attractively valued. We continue to maintain our '**BUY**' recommendation on the stock.

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Reuters : KEIN.BO
Bloomberg : KEII IN

Market Data

52-week range (INR) : 168 / 46
Share in issue (mn) : 60.8
M cap (INR bn/USD mn) : 2.9 / 69.2
Avg. Daily Vol. BSE/NSE ('000) : 555.6

Share Holding Pattern (%)

Promoters : 34.8
MFs, FIs & Banks : 7.6
FIIs : 17.5
Others : 40.0

Relative Performance (%)

	Sensex	Stock	Stock over Sensex
1 month	(10.5)	(0.2)	(9.5)
3 months	4.0	(0.1)	(14.0)
12 months	7.9	(0.4)	(47.9)

Financials

Year to March	Q408	Q407	% change	Q308	% change	FY08	FY09E
Net revenues (INR mn)	2,585	2,074	24.6	2,335	10.7	8,747	12,303
EBITDA (INR mn)	270	251	7.9	301	(10.2)	1,092	1,476
Net profit (INR mn)	65	114	(42.9)	145	(55.4)	435	647
Diluted EPS (INR)	1.1	2.2	(51.1)	2.5	(55.4)	5.6	8.3
Diluted P/E (x)						8.9	6.0
EV/EBITDA (x)						5.3	4.2
ROAE (%)						25.6	26.1

Delays in capacity addition plans

At the beginning of FY08, KEII undertook capacity expansion for LT and HT cables at Chaupanki, and upgrading its LT and HT cables facilities at its existing site in Bhiwadi. Further, the company was planning to add HT cables capacity at a site adjacent to its Bhiwadi facility. As we understand, the LT cable capacity in Chaupanki started contributing to revenues in January 2008, while the HT cables facility is likely to commence production from September 2008. Further, the up-gradation of the LT and HT cables facility at the existing site is likely to be complete by June 2008. We, however, believe the additional HT cables capacity at the new site in Bhiwadi is likely to be delayed beyond Q1FY09.

Key revision in estimates

We have downgraded our FY09E and FY10E revenue estimates by ~7% and ~8%, to ~INR 12 bn and ~INR 15 bn, respectively, on account of likely delay in capacity addition for HT and LT cables. Further, with increase commodity prices, our EBITDA stands downgraded by ~14% and ~15%, to INR 1.5 bn and INR 1.8 bn, for FY09E and FY10E, respectively. Our PAT estimates stand downgraded by ~26% and ~21%, to ~INR 647 mn and ~INR 874 mn, for FY09E and FY10E, respectively, on account of the possibility of higher-than-expected interest cost in future.

Revised estimates post FY08 results

	Previous estimates		Revised estimates		Remarks
	FY09E	FY10E	FY09E	FY10E	
Revenues (INR mn)	13,193	16,521	12,303	15,237	Revenues downgraded on account of delay in capacity scale up
EBITDA (INR mn)	1,712	2,143	1,476	1,828	Lower EBITDA margins as raw material cost pressure intensify
EBITDA margin (%)	13.0	13.0	12.0	12.0	
PAT (INR mn)	871	1,109	647	874	Decrease in PAT on account of higher expected interest expenditure
Net margin (%)	6.6	6.7	5.3	5.7	
Diluted EPS (INR)	11.1	14.2	8.3	11.2	

Source: Edelweiss research

Financial snapshot: Standalone

(INR mn)

Year to March	Q408	Q407	% change	Q308	% change	FY08	FY09E	FY10E
Revenues	2,585	2,074	24.6	2,335	10.7	8,747	12,303	15,237
Raw material	1,935	1,589	21.8	1,760	9.9	6,572	9,227	11,428
Staff costs	85	39	119.7	38	125.0	189	246	305
Other operating expenses	294	196	50.1	236	24.7	894	1,353	1,676
Total expenditure	2,314	1,823	26.9	2,034	13.8	7,654	10,826	13,409
EBITDA	270	251	7.9	301	(10.2)	1,092	1,476	1,828
Interest	82	75	9.2	72	14.1	369	515	554
Depreciation	24	12	107.1	32	(24.2)	81	119	132
Other income	11	4	160.3	10	4.4	43	37	46
PBT	175	168	4.1	207	(15.8)	685	879	1,188
Tax	73	54	34.8	62	18.0	213	232	314
Core profit	102	114	(10.5)	145	(30.1)	472	647	874
Extraordinary income/(loss)	(37)	0	NM	0	NM	(37)	0	0
Adjusted net profit	65	114	(42.9)	145	(55.4)	435	647	874
Net profit	65	114		145		435	647	874
Equity capital (FV INR 2)	118	101		118		120	120	120
Diluted shares (mn)	59	50		59		78	78	78
Diluted EPS (INR)	1.1	2.2	(51.1)	2.5	(55.4)	5.6	8.3	11.2
P/E (x)						8.9	6.0	4.4
EV/EBITDA (x)						5.3	4.2	3.4
Market cap / Revenues (x)						0.3	0.2	0.2

as % of net revenues

Raw material	74.9	76.6		75.4		75.1	75.0	75.0
Staff expenses	3.3	1.9		1.6		2.2	2.0	2.0
Other operating expenses	11.4	9.5		10.1		10.2	11.0	11.0
EBITDA	10.5	12.1		12.9		12.5	12.0	12.0
Net profit	2.5	5.5		6.2		5.0	5.3	5.7

NM: Not meaningful

Company Description

KEII is one of the leading manufacturers of low-tension (LT) and high-tension (HT) power cables in India. It has an annual capacity of 37,000 kms capacity for LT cables and 3,000 kms for HT cables. It is undertaking massive capacity expansion projects in HT 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 fact that the demand for power cables is high (on the back of industrial expansion and infrastructure growth), KEII (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 KEII'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	FY08	FY09E	FY10E	
Income from operations	3,013	6,043	8,747	12,303	15,237	
Materials costs	2,031	4,385	6,572	9,227	11,428	
Employee cost	81	115	189	246	305	
Other manufacturing expenses	453	672	894	1,353	1,676	
Total operating expenses	2,564	5,171	7,654	10,826	13,409	
EBITDA	449	872	1,092	1,476	1,828	
Depreciation and amortisation	27	57	81	119	132	
EBIT	422	815	1,011	1,357	1,697	
Interest expense	95	237	369	515	554	
Other income	9	2	43	37	46	
Profit before tax	336	580	685	879	1,188	
Provision for tax	76	178	213	232	314	
Core profit	260	401	472	647	874	
Extraordinary income/(loss)	0	0	(37)	0	0	
Profit after tax	260	401	435	647	874	
Profit after minority interest	260	401	435	647	874	
Equity shares outstanding (mn)	50	59	60	60	60	
EPS (INR) basic	5.2	6.8	7.8	10.7	14.5	
Diluted shares (mn)	50	59	78	78	78	
EPS (INR) fully diluted	5.2	6.8	6.0	8.3	11.2	
CEPS (INR)	6.1	8.0	9.2	12.7	16.7	
DPS	0.4	0.5	0.5	0.5	0.5	
Dividend payout (%)	8.9	8.6	8.1	5.4	4.0	

Common size metrics- as % of net revenues

Year to March	FY06	FY07	FY08	FY09E	FY10E
Operating expenses	85.1	85.6	87.5	88.0	88.0
Material cost	67.4	72.6	75.1	75.0	75.0
Employee cost	2.7	1.9	2.2	2.0	2.0
Other manufacturing expenses	15.0	11.1	10.2	11.0	11.0
Depreciation and amortisation	0.9	0.9	0.9	1.0	0.9
Interest expenditure	3.1	3.9	4.2	4.2	3.6
EBITDA margins	14.9	14.4	12.5	12.0	12.0
Net profit margins	8.6	6.6	5.4	5.3	5.7

Growth metrics (%)

Year to March	FY06	FY07	FY08	FY09E	FY10E
Revenues	46.8	100.6	44.7	40.7	23.9
EBITDA	112.4	94.3	25.4	35.1	23.9
Net profit	210.0	54.4	17.6	37.1	35.1
EPS	143.2	32.1	(11.5)	37.1	35.1

Balance sheet**(INR mn)**

As on 31st March	FY06	FY07	FY08E	FY09E	FY10E
Equity capital	101	118	120	120	120
Share warrants	39	0	0	0	0
Reserves & surplus	852	1,401	2,054	2,665	3,504
Shareholders funds	992	1,519	2,174	2,786	3,624
Secured loans	532	2,730	2,632	2,832	2,832
Unsecured loans	235	366	613	1,039	1,171
Borrowings	767	3,096	3,245	3,870	4,003
Deferred tax (Net)	60	75	75	75	75
Sources of funds	1,819	4,689	5,494	6,730	7,702
Gross block	886	1,402	2,180	2,580	2,680
Depreciation	142	191	273	392	523
Net block	744	1,211	1,907	2,188	2,157
Capital work in progress	61	199	400	0	0
Investments	2	4	4	4	4
Inventories	984	1,761	2,601	3,686	4,565
Sundry debtors	757	1,741	2,550	3,545	4,390
Cash and bank balances	141	1,375	401	682	765
Loans and advances	121	393	576	801	992
Total current assets	2,004	5,270	6,129	8,713	10,712
Sundry creditors and others	968	1,949	2,880	4,081	5,054
Provisions	23	45	67	94	117
Total current liabilities & provisions	991	1,994	2,946	4,175	5,171
Net current assets	1,012	3,276	3,182	4,538	5,541
Uses of funds	1,819	4,689	5,494	6,730	7,702
Book value per share (BV) (INR)	20	26	36	46	60

Free cash flow

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Net profit	260	401	435	647	874
Add: Depreciation	27	57	81	119	132
Add: Deferred tax	22	15	0	0	0
Add: Others	(5)	(43)	0	0	0
Gross cash flow	304	430	516	766	1,005
Less: Changes in working capital	442	1,029	880	1,075	920
Operating cash flow	(138)	(600)	(364)	(310)	86
Less: Capex	542	654	979	0	100
Free cash flow	(680)	(1,254)	(1,343)	(310)	(14)

Cash flow metrics

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Operating cash flow	(138)	(600)	(364)	(310)	86
Financing cash flow	773	2,489	215	590	97
Investing cash flow	544	655	979	0	100
Net cash flow	91	1,234	(1,128)	280	83
Capex	542	654	979	0	100
Dividend paid	(23)	(34)	(35)	(35)	(35)
Share issuance/(Buyback)	478	195	100	0	0

Profitability & liquidity ratios

Year to March	FY06	FY07	FY08E	FY09E	FY10E
ROAE (%)	40.9	32.0	25.6	26.1	27.3
ROACE (%)	32.6	25.1	19.9	22.2	23.5
Inventory (days)	134	114	121	124	132
Debtors (days)	76	75	90	90	95
Payable (days)	142	121	134	138	146
Cash conversion cycle	68	68	77	77	81
Current ratio	2.0	2.6	2.1	2.1	2.1
Debt/EBITDA	1.7	3.6	3.0	2.6	2.2
Interest cover (x)	4.5	3.4	2.7	2.6	3.1
Debt/Equity (x)	0.8	2.0	1.5	1.4	1.1
Adjusted debt/Equity	0.8	2.0	1.5	1.4	1.1

Operating ratios

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Fixed assets turnover (x)	5.9	6.2	5.6	6.0	7.0
Total asset turnover(x)	2.3	1.9	1.7	2.0	2.1
Equity turnover(x)	4.7	4.8	4.7	5.0	4.8

Du pont analysis

Year to March	FY06	FY07	FY08E	FY09E	FY10E
NP margin %	8.6	6.6	5.4	5.3	5.7
Total assets turnover	2.3	1.9	1.7	2.0	2.1
Leverage multiplier	2.0	2.6	2.8	2.5	2.3
ROAE %	40.9	32.0	25.6	26.1	27.3

Valuation parameters

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Diluted EPS (INR)	5.2	6.8	6.0	8.3	11.2
Y-o-Y growth (%)	143.2	32.1	(11.5)	37.1	35.1
CEPS (INR)	6.1	8.0	9.2	12.7	16.7
Diluted P/E (x)	9.6	7.2	8.2	6.0	4.4
Price/BV(x)	2.5	1.9	1.4	1.1	0.8
EV/Sales (x)	1.0	0.8	0.7	0.5	0.4
EV/EBITDA (x)	6.9	5.3	5.3	4.2	3.4
Dividend yield %	0.8	1.0	1.0	1.0	1.0

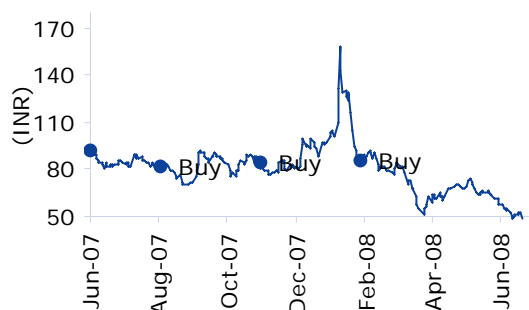
Note: Ratios are adjusted for share split

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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



Recent Research

Date	Company	Title	Price (INR)	Recos
11-Jun-08	Suzlon Energy	Repowered; Event Update	270	Buy
02-Jun-08	NTPC	Burning bright; Result Update	161	Accum
20-May-08	Suzlon Energy	Risk-reward unfavourable; 318	318	Reduce
02-May-08	Reliance Infrastructure	Huge potential, but slight delay in EPC; Result Update	1,523	Accum.

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	104	60	15	2	193

* 11 stocks under review / 1 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	85	73	35

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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