

KEC INTERNATIONAL

Robust execution boosts revenue

India Equity Research | Engineering and Capital Goods



KEC International's (KEC) Q1FY13 revenue grew 33%, ahead of our and Street estimates, on back of strong execution in transmission. Adjusting for gain on account of INR depreciation, revenue grew 30%. Margin (adjusted for forex loss) continued to remain under pressure and stood at 8.7%, down 70bps YoY. Despite weak operating performance, PAT (Adj. for Forex) surged 49% on low base effect. Order book improved 17% on strong intake, up 53% to INR20bn. Maintain 'HOLD' with TP of INR60 (earlier INR57).

Strong execution and margin pressure continue

KEC reported robust revenue growth of 33% to INR13.6bn led by international transmission business, which surged 55% YoY. Adjusting for currency benefit, sales improved 30%. Adjusting for forex loss, EBITDA growth was lower at 24% due to weak operating performance. Margin dipped 70bps to 8.7% because of entry strategy into new business (at lower margin). Despite weak operating performance, the company's PAT (adj. for Forex) surged 49% to INR332mn on low base effect.

Order intake spirals; order backlog improves

The company's order intake surged 53% YoY to INR20bn. It secured orders from all business verticals with a good mix of private and government orders. The backlog grew 17% YoY to INR94.6bn. Transmission and power systems contribute 68% and 18% to total order book, respectively. In terms of geographic spread, KEC has a well diversified order book—while India made up 43% of the backlog, Central Asia and Africa made up 27%, with Americas contributing 14%.

Outlook and valuations: Profitability concerns; maintain 'HOLD'

The company's entry strategy into newer businesses like water and railways has suppressed margin over the past few quarters. However, management has indicated that now margin is likely to improve from the current level to a normal of 8-9% as it finds its feet in the new business. We marginally raise our earnings by 2% , as we build in execution pickup/ increased order intake. On our revised consol earnings, the stock is trading at 6.6x and 5.3x FY13E and FY14E, respectively. We maintain our cautious stance on the margin front and retain our 'HOLD/SP' with a TP of INR 60

EDELWEISS 4D RATINGS

Absolute Rating	HOLD
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Equalweight

MARKET DATA (R: KECL.BO, B: KECI.IN)

CMP	: INR 57
Target Price	: INR 60
52-week range (INR)	: 94 / 31
Share in issue (mn)	: 257.1
M cap (INR bn/USD mn)	: 15/ 263
Avg. Daily Vol.BSE/NSE('000)	: 296.1

SHARE HOLDING PATTERN (%)

	Current	Q4FY12	Q3FY12
Promoters %	43.9	43.1	42.0
MF's, FI's & BK's	37.4	39.0	39.6
FII's	2.3	2.3	2.4
others	16.5	15.7	16.0
* Promoters pledged share (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Capital Goods Index
1 month	2.9	(0.9)	5.0
3 months	0.6	(0.4)	(13.1)
12 months	(27.4)	(4.6)	(31.4)

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August 1, 2012

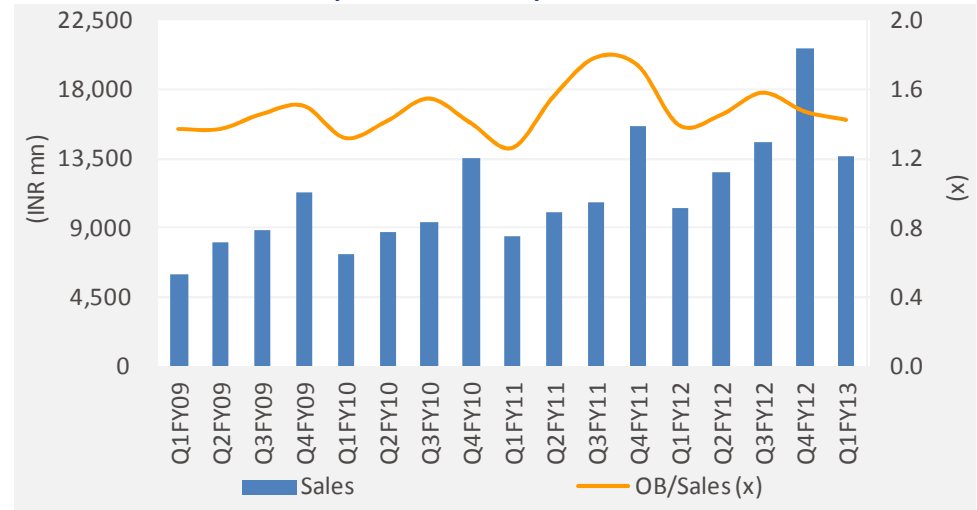
Financials (Consolidated)

Year to March	Q1FY13	Q1FY12	% change	Q4FY12	% change	FY12	FY13E	FY14E
Net revenues (INR mn)	13,642	10,229	33.4	20,690	(34.1)	58,147	66,132	77,213
EBITDA (INR mn)	1,033	960	7.6	1,695	(39.1)	4,713	5,393	6,422
Adj. Net profit (INR mn)	332	331	0.4	743	(55.3)	1,555	2,193	2,700
Diluted EPS (INR)	1.3	1.3	0.4	2.9	(55.3)	6.0	8.5	10.5
Diluted P/E (x)						9.3	6.6	5.3
EV/EBITDA (x)						5.0	4.2	3.5
ROAE (%)						15.1	18.3	19.2

Other key highlights

- Current order book stands at INR94.6bn, of which 68% comes from transmission, 18% from power systems and the balance from railways, cables and telecom and water.
- In terms of order book’s geographic spread, orders from India comprised 43% of backlog, Central Asia and Africa made up 27%, with Americas contributing 14% (US has become the second largest market after India for KEC).
- Phase I of the cable manufacturing facility at Vadodara is complete and the company will look at Phase II expansion when overall market conditions improve, which will be post pick up in capex cycle.
- Phase II expansion of the cable facility will, however, not require incremental capex given INR1.6bn was spent for both phases. The company’s capex is maintained at INR1.2bn for FY13, which could see downward revision.
- On SEA, the order backlog stood at INR6.7bn with intake at INR1.8bn during the quarter. Management indicated that the company is not looking to enter the EPC business in US in a hurry and will stick to tower supply for the next few quarters.
- Management indicated that margins should improve in the domestic business as sensible bidding is seen at PGCIL.
- KEC is not expecting any major orders from the dedicated freight corridor where it is technically qualified for two bids.

Chart 1: Revenue and visibility – Remains steady



Source: Company, Edelweiss research

Chart 2: EBITDA and EBITDA margin – Remains under pressure

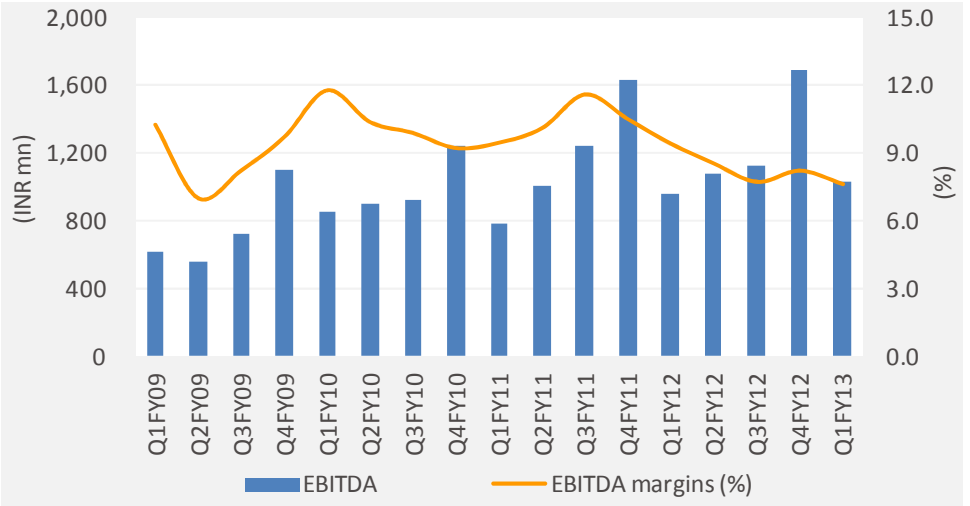
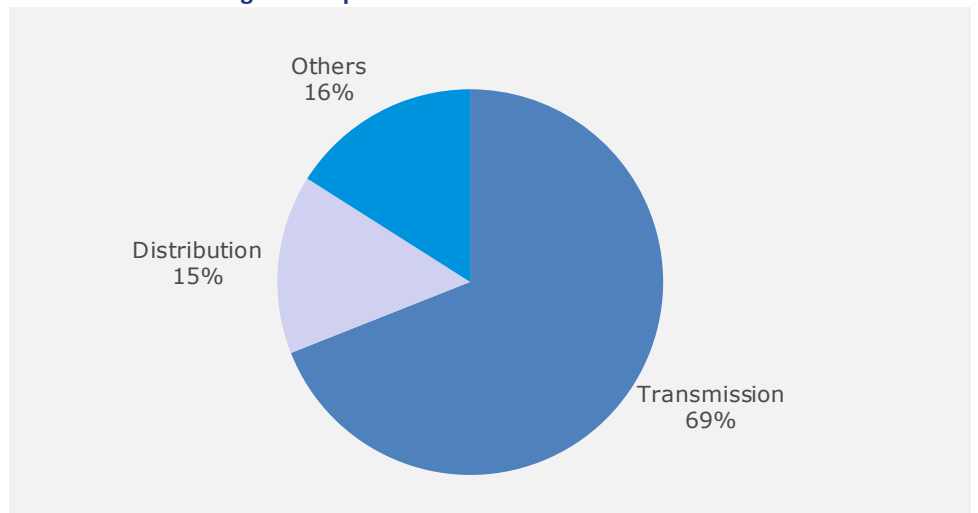


Chart 3: Order backlog break up



Source: Company, Edelweiss research

Financial snapshot(Consol)

(INR mn)

Year to March	Q1FY13	Q1FY12	% Change	Q4FY12	% Change	FY12	FY13E	FY14E
Net revenues	13,642	10,229	33.4	20,690	(34.1)	58,147	66,132	77,213
Staff costs	1,148	972	18.2	1,114	3.1	4,274	5,155	5,975
Direct costs	6,548	4,758	37.6	16,081	(59.3)	43,173	48,437	55,999
Other operating expenses	4,912	3,540	38.8	1,800	172.9	5,987	7,148	8,816
Total expenditure	12,609	9,269	36.0	18,995	(33.6)	53,434	60,740	70,791
EBITDA	1,033	960	7.6	1,695	(39.1)	4,713	5,393	6,422
Depreciation	123	117	5.3	115	6.6	479	488	548
EBIT	910	843	7.9	1,580	(42.4)	4,234	4,905	5,874
Other income	28	-	-	-	-	68	74	81
Interest	400	332	20.6	410	(2.4)	1,597	1,706	1,896
Profit before tax	537	511	5.0	1,170	(54.1)	2,705	3,273	4,059
Tax	205	181	13.5	427	(52.0)	1,150	1,080	1,360
Reported net profit	332	331	0.4	743	(55.3)	1,555	2,193	2,700
Equity capital (FV INR 10)	514	514	-	514	-	514	514	514
No. of shares (mn)	257	257	-	257	-	257	257	257
Adj. EPS (INR)	1.3	1.3	-	2.9	-	6.0	8.5	10.5

As % of net revenues

Direct costs	48.0	46.5	-	77.7	-	74.2	73.2	72.5
Employee cost	8.4	9.5	-	5.4	-	7.3	7.8	7.7
Other operating expenses	36.0	34.6	-	8.7	-	10.3	10.8	11.4
EBITDA	7.6	9.4	-	8.2	-	8.1	8.2	8.3
Reported net profit	2.4	2.4	-	5.4	-	11.4	16.1	19.8
Tax rate	38.1	35.3	-	36.5	-	42.5	33.0	33.5

Company Description

KEC was incorporated in 1945 as Kamani Engineering Corporation by the RPG Group. It is in the business of designing and manufacturing power transmission towers and telecom infrastructure. Nearly 70% of KEC's revenues came from the international market in FY11. The company's order backlog at the end of FY11 was ~INR 78 bn, with ~79% contributed by transmission projects, and the balance by distribution, railway and telecom projects.

Investment Theme

We believe KEC has a robust order backlog and with higher order flows from Power Grid Corporation (PGCIL) expected, it has balanced order mix between international and domestic orders. We believe KEC is likely to significantly benefit from increased order flows from PGCIL. Further, KEC being present in over 20 countries in the international geographies, is expected to keep international orders flowing in. However currently, margins are under attack due to increase in competitive intensity and entry into new business vertical.

Key Risks

Forex fluctuation could potentially impact margins for the company. Further the PAT margins are sensitive to interest rates and any increase the same is likely to negatively impact the company.

Financial Statements (Consolidated)

Key Assumptions

Year to March		FY10	FY11	FY12	FY13E	FY14E
Macro -	GDP(Y-o-Y %)	8.4	8.4	6.5	6.4	7.0
	Inflation (Avg)	3.6	9.9	8.8	7.0	6.0
	Repo rate (exit rate)	5.0	6.8	8.5	7.3	6.8
	USD/INR (Avg)	47.4	45.6	47.9	53.5	50.0
Company -	Order intake (SA) - INR Mn	40,744	56,842	62,526	71,905	82,691
	Order intake (Sub) - INR Mn	-	6,660	7,326	8,425	9,689
	Order backlog - INR Mn	55,000	77,902	96,324	117,966	143,015

Income statement

(INR mn)

Year to March	FY10	FY11	FY12	FY13E	FY14E
Income from operations	39,082	44,742	58,147	66,132	77,213
Materials costs	29,709	32,357	43,173	48,437	55,999
Employee costs	1,689	2,833	4,274	5,155	5,975
Other manufacturing expenses	3,616	4,926	5,987	7,148	8,816
Total operating expenses	35,014	40,116	53,434	60,740	70,791
EBITDA	4,069	4,625	4,713	5,393	6,422
Depreciation & Amortization	270	408	479	488	548
EBIT	3,798	4,217	4,234	4,905	5,874
Other income	-	26	68	74	81
Interest expenses	865	1,075	1,597	1,706	1,896
Profit before tax	2,934	3,168	2,705	3,273	4,059
Provision for tax	1,037	1,111	1,150	1,080	1,360
Net profit	1,897	2,057	1,555	2,193	2,700
Extraordinary income/ (loss)	-	-	538	-	-
Profit After Tax	1,897	2,057	2,093	2,193	2,700
Shares outstanding (mn)	247	257	257	257	257
Diluted EPS (INR)	7.7	8.0	6.0	8.5	10.5
Dividend payout (%)	16.4	14.8	19.6	13.9	11.3

Common size metrics - as % of net revenues

Year to March	FY10	FY11	FY12	FY13E	FY14E
Operating expenses	89.6	89.7	91.9	91.8	91.7
EBITDA margins	10.4	10.3	8.1	8.2	8.3
Net profit margins	4.9	4.6	2.7	3.3	3.5

Growth ratios (%)

Year to March	FY10	FY11	FY12	FY13E	FY14E
Rev. growth (%)	14.0	14.5	30.0	13.7	16.8
EBITDA	35.5	13.7	1.9	14.4	19.1
Net profit	63.1	8.5	(24.4)	41.1	23.1

Balance sheet						(INR mn)
As on 31st March	FY10	FY11	FY12	FY13E	FY14E	
Equity capital	514	514	514	514	514	
Reserves & surplus	7,162	8,952	10,564	12,402	14,746	
Shareholders funds	7,676	9,466	11,078	12,916	15,260	
Secured loans	7,755	14,322	11,139	12,639	13,839	
Unsecured loans	112	-	-	-	-	
Borrowings	7,867	14,322	11,139	12,639	13,839	
Deferred tax (net)	461	497	513	513	513	
Sources of funds	16,004	24,284	22,730	26,068	29,612	
Gross block	8,291	10,382	10,949	12,199	13,049	
Depreciation	1,541	2,366	2,852	3,333	3,881	
Net block	6,750	8,016	8,097	8,866	9,168	
Capital work in progress	383	392	1,122	1,137	1,152	
Goodwill	-	2,813	3,209	3,209	3,209	
Investments	19	-	-	1,750	3,000	
Inventories	2,498	3,359	4,401	5,240	5,867	
Sundry debtors	19,450	21,716	25,062	31,833	37,656	
Cash and equivalents	678	1,540	2,029	2,466	2,706	
Loans and advances	3,973	4,714	5,101	6,376	7,970	
Other current assets	-	6,433	6,487	-	-	
Total current assets	26,598	37,760	43,081	45,915	54,199	
Sundry creditors and others	17,190	23,937	31,807	34,503	40,810	
Provisions	556	760	972	305	305	
Total current liabilities & provisions	17,746	24,696	32,779	34,808	41,116	
Net current assets	8,852	13,064	10,302	11,106	13,084	
Uses of funds	16,004	24,284	22,730	26,068	29,612	
Book value per share (INR)	31.1	36.8	43.1	50.2	59.4	

Free cash flow						(INR mn)
Year to March	FY10	FY11	FY12	FY13E	FY14E	
Net profit	2,155	2,489	2,320	2,193	2,699	
Depreciation	270	408	479	488	548	
Deferred tax	-	166	16	-	-	
Others	440	932	1,106	-	-	
Gross cash flow	2,866	3,995	3,922	2,681	3,247	
Less: Changes in WC	2,519	2,297	(1,568)	368	1,737	
Operating cash flow	347	1,697	5,490	2,313	1,510	
Less: Capex	588	785	493	1,265	865	
Free cash flow	(242)	912	4,997	1,048	645	

Cash flow metrics					
Year to March	FY10	FY11	FY12	FY13E	FY14E
Operating cash flow	347	1,697	5,490	2,313	1,510
Investing cash flow	(510)	(5,125)	(406)	(3,015)	(2,115)
Financing cash flow	(678)	3,960	(4,596)	1,145	845
Net cash flow	(841)	532	488	443	240
Capex	(588)	(785)	(493)	(1,265)	(865)
Dividends paid	(285)	(354)	(355)	(355)	(355)

Engineering and Capital Goods

Profitability & efficiency ratios

Year to March	FY10	FY11	FY12	FY13E	FY14E
ROAE (%)	28.6	24.0	15.1	18.3	19.2
ROACE (%)	27.1	20.9	18.0	20.9	23.1
Inventory day	29	33	33	36	36
Debtors days	177	168	147	157	164
Payable days	219	232	236	250	245
Cash conversion cycle (days)	(12)	(31)	(56)	(57)	(45)
Current ratio	1.5	1.5	1.3	1.3	1.3
Debt/EBITDA	1.9	3.1	2.4	2.3	2.2
Debt/Equity	1.0	1.5	1.0	1.0	0.9
Adjusted debt/equity	1.0	1.5	1.0	1.0	0.9
Interest coverage	4.4	3.9	2.7	2.9	3.1

Operating ratios

Year to March	FY10	FY11	FY12	FY13E	FY14E
Total asset turnover	2.8	2.2	2.5	2.7	2.8
Fixed asset turnover	6.6	6.1	7.2	7.8	8.6
Equity turnover	5.9	5.2	5.7	5.5	5.5

Valuation parameters

Year to March	FY10	FY11	FY12	FY13E	FY14E
Diluted EPS (INR)	7.7	8.0	6.0	8.5	10.5
Y-o-Y growth (%)	63.1	4.0	(24.4)	41.1	23.1
CEPS (INR)	8.8	10.2	8.0	10.4	12.6
Diluted PE (x)	7.4	7.1	9.4	6.6	5.3
Price/BV (x)	1.8	1.5	1.3	1.1	1.0
EV/Sales (x)	0.5	0.6	0.4	0.3	0.3
EV/EBITDA (x)	5.2	5.9	5.0	4.3	3.5

Peer comparison valuation

Name of the companies	CMP	Market cap (USD mn)	PE (x)		P/BV (x)		ROE (%)	
			2013E	2014E	2013E	2014E	2013E	2014E
KEC	56	259	6.6	5.3	1.1	0.9	18.3	19.2
Kalpataru Power (SA)	69	191	6.1	5.5	0.6	0.5	9.5	9.8
Jyoti structures	38.0	56.2	3.1	2.8	0.4	0.4	14.1	14.1

Source: Bloomberg, Edelweiss research

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
ABB India	REDUCE	SU	L	Bajaj Electricals	BUY	SO	M
BGR Energy Systems	HOLD	SP	M	Bharat Electronics	BUY	SO	H
Bharat Heavy Electricals	HOLD	SP	L	Crompton Greaves	BUY	SO	M
Cummins India	HOLD	SP	L	Havells India	BUY	SO	M
Jyoti Structures	HOLD	SP	M	Kalpataru Power Transmission	HOLD	SP	M
KEC International	HOLD	SP	M	Larsen & Toubro	BUY	SO	M
Siemens	BUY	SO	L	Sterlite Technologies	HOLD	SP	H
Techno Electric & Engineering	BUY	SO	M	Thermax	HOLD	SP	L
Voltamp Transformers	REDUCE	SU	M	Voltas	HOLD	SP	L

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

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Coverage group(s) of stocks by primary analyst(s): Engineering and Capital Goods

ABB India, BGR Energy Systems, Bharat Electronics, Bharat Heavy Electricals, Bajaj Electricals, Crompton Greaves, Havells India, Jyoti Structures, KEC International, Cummins India, Kalpataru Power Transmission, Larsen & Toubro, Siemens, Sterlite Technologies, Techno Electric & Engineering, Thermax, Voltamp Transformers, Voltas

Recent Research

Date	Company	Title	Price (INR)	Recos
01-Aug-12	Bharat Electronics	Slow start, but robust momentum anticipated; <i>Result Update</i>	1,222	Buy
01-Aug-12	Cummins INC	Beats estimates; positive on India growth; <i>Global Pulse</i>		Not Rated
30-Jul-12	Havells India	Mixed bag; <i>Result Update</i>	555	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	104	60	18	183
* 1 stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	114	58	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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