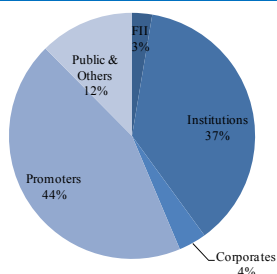
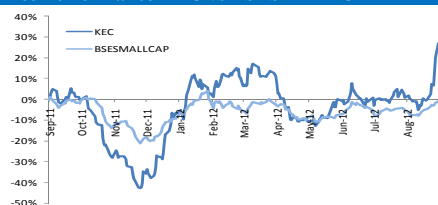



**SKP Securities Ltd**
**CMP ₹ 73**
**KEC International Ltd.**
*...growth by spreading wings*
**Initiating Coverage - Buy**
**Target ₹ 88**
**Key Share Data**

Face Value (₹)	2.0
Equity Capital (₹ mn)	514.2
M.Cap (₹ mn)	18254.0
52-wk High/Low (₹)	2.4
Avg. Daily Vol	66246
BSE Code	532714
NSE Code	KEC
Reuters Code	KECL.BO
Bloomberg Code	KECI IN

**Shareholding Pattern (as on June 30, 2012)**

*Source: Capitaline*

Financials (₹ mn)				
Particulars	FY11	FY12	FY13E	FY14E
Net Sales	44765.4	58147.4	66511.4	73827.7
Sales Gr.	14.6%	29.9%	14.4%	11.0%
EBIDTA	4767.8	4713.2	5320.9	5980.0
PAT	2056.5	2093.0	2076.7	2504.8
PAT Gr.	8.4%	1.8%	-0.8%	20.6%
EPS (₹)	8.0	8.1	8.1	9.7
CEPS (₹)	9.6	10.0	10.7	12.2
Particulars	FY11	FY12	FY13E	FY14E
Int Cover (x)	3.7	2.7	2.9	3.3
P/E (x)	9.1	9.0	9.0	7.5
P/BV (x)	2.0	1.7	1.5	1.3
P/Cash EPS (x)	7.6	7.3	6.8	6.0
M.Cap/Sales (x)	0.4	0.3	0.3	0.3
EV/EBIDTA (x)	6.5	5.9	6.2	5.6
ROCE (%)	18.9%	19.0%	15.8%	16.6%
ROE (%)	21.7%	18.9%	16.2%	16.8%
EBIDTM (%)	10.7%	8.1%	8.0%	8.1%
NPM (%)	4.6%	3.6%	3.1%	3.4%
Debt-Equity (x)	1.4	1.0	1.3	1.2

**Price Performance KEC vs BSESMALLCAP**

**Analyst: Vineet P. Agrawal**

 Tel No: +91 22 2281 9012; Mobile: 98195 10575  
 e-mail: vineet.agrawal@skpmoneywise.com

**Company Profile**

Incorporated in 1945, KEC international Ltd (KEC) is a diversified EPC services provider offering infrastructure turnkey solutions in the space of T&D, telecom infrastructure, power and telecom cables, railways and water infrastructure. The Company has presence in 46 countries across the globe from Americas, Central Asia, MENA, rest of Africa and South Asia.

**Investment Rationale**

**Strong and diversified order backlog of ₹ 94.6 bn - topline expected to grow with the CAGR of 18%:**

- KEC's order book is growing at a CAGR of 24.3% for the last five years. Currently, it has order backlog of ₹ 94.6 bn (as on Aug 2012).
- KEC has received orders worth ₹ 62 bn during FY12 of which 70%, 6%, 10%, 4% and 14% are contributed by power transmission, power system, cables, telecom, railways and water respectively. Further it received orders about ₹ 30 bn in FY13 till date.
- With the robust order book and healthy order intake we expect KEC's topline to grow with a healthy CAGR of 18% between FY11-FY14.

**Venturing in to 220 -400 kv cable segment:**

- KEC is setting up a Greenfield facility, to manufacture HV and EHV cables, in Vadodara Gujarat. The estimated cost of the project is about ₹ 1.8 bn. Phase I of the project is already complete.
- KEC will be able to manufacture cables up to 400 kv with the completion of phase II. The Company presently manufactures power cables from 33 kv to 132 kv.
- The plant will have the initial capacity of 4,000 cable kms.
- Expected revenue from the plant at full capacity is about ₹ 3.5-4.0 bn.

**Spreading wings in new geographies and new business verticals – de-risking of revenue model:**

- KEC started its activities in T&D segment from domestic market in 1959.
- Today, the company has spread its wings in regions such as Middle East, Americas, and Africa, South Asia and Central Asia. The current order book of the company includes orders from these regions.
- The company has acquired SAE Towers Holdings LLC, USA in 2010. Today Americas has become second largest market for KEC after India. America's has the share of 14% in the current order book (as on Aug 2012).
- This ensures well diversified revenue streams driven from high growth sectors.

**Outlook & Recommendation**

- At the current market price of ₹ 73, the stock is trading at a P/E of 9.0x and 7.5x on FY13E and FY14E earnings of ₹ 8.1 and ₹ 9.7 respectively.
- We recommend BUY rating on the stock with a target price of ₹ 88/- (20% upside) in 12 months at the P/E of 9x on FY14E earnings.**

## Industry Overview

### Introduction:

- Globally, 25.9% of world's population is still without access to power. India and Sub Saharan Africa face the largest power deficit. The per capita power consumption of India and Sub-Saharan Africa is far below the world average and a large percentage of the population in those regions is without access to power. Per capita power consumption across the region at a glance:

Country	Per Capita Power Consumption (kwh)	Population without access to Power
India	571	33.7%
Sub-Saharan Africa	511	67.5%
MENA	2,445	6.2%
Latin America	1,901	6.6%
Europe & Central Asia	5,307	--
North America	13,167	--
China	2,631	0.6%
World Average	2,803	25.9%

Source: Company

- Power shortage and its increasing demand is driving substantial investments in power generation worldwide. The world's net electricity generation capacity is expected to increase from 19.1 trillion kwh in 2008 to 35.2 trillion kwh by 2035. Region wise net electricity generation at a glance:

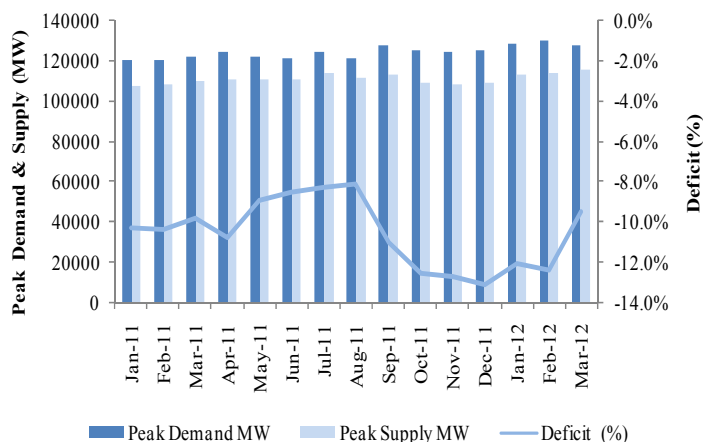
Year	India	ME	Africa	Americas	China	Others	Total
2008	1.8	0.7	0.6	6.0	3.2	6.8	19.1
2015	2.4	0.9	0.7	6.3	5.0	7.3	22.6
2020	2.9	1.0	0.9	6.8	6.0	7.8	25.4
2025	3.5	1.1	1.0	7.3	7.3	8.4	28.6
2030	4.1	1.3	1.1	8.0	8.0	8.9	31.4
2035	4.7	1.4	1.3	8.6	8.6	9.5	34.1
% Increase	161.1%	100.0%	116.7%	43.3%	168.8%	39.7%	78.5%
CAGR (%)	3.6%	2.6%	2.9%	1.3%	3.7%	1.2%	2.2%

Source: Company and SKP Research Desk; All figures in trillion kwh; CAGR has been calculated as follows:  $(4.7/1.8)^{(1/27)}-1$  and so on

- There is a strong growth opportunity in the conventional EPC markets of India, Middle East and Africa where overall increase in net electricity generation during this period is expected to be 139% as compared to overall 79% worldwide.

### India:

- Today, India is the 5<sup>th</sup> largest economy in the world, though the power generation is always lagging behind demand. Average, peak time power deficit is about 11% (between Jan 11 to Mar 12).
- Government of India has planned to increase the power generation capacity by 75,785 MW in 12<sup>th</sup> five year plan as compared to actual capacity addition of 52,063 MW during 11<sup>th</sup> five year plan (target achievement of 66%).



Source: CEA

- The transmission and distribution network will have to be significantly expanded and strengthened in order to support the expansion in power generation. Growth in transmission lines and substations from 6<sup>th</sup> five year plan to 11<sup>th</sup> five year plan at a glance:

Five Year Plan	Transmission Lines (ckm)				Substations (MVA)			
	765 kv	400 kv	220 kv	Total	765 kv	400 kv	220 kv	Total
6th Plan	-	6,029	46,005	52,034	-	9,320	37,291	46,611
7th Plan	-	19,824	59,631	79,455	-	21,580	53,742	75,322
8th Plan	-	36,142	79,600	115,742	-	40,865	84,177	125,042
9th Plan	-	49,378	96,993	146,371	-	60,380	116,363	176,743
10th Plan	-	75,722	114,629	190,351	-	92,942	156,497	249,439
11th Plan	5,730	113,367	140,164	259,261	25,000	151,027	223,774	399,801

Source: CEA

- Government has planned to add 109,440 ckm of transmission lines and 270,000 MVA of substations (transformation capacity) as compared to actual addition of 68,910 ckm of transmission lines and 150,362 MVA of substations during 11<sup>th</sup> five year plan.
- The total fund requirement for development of transmission system is estimated to be of the order of ₹ 1.8 tn of which ₹ 1.0 tn, ₹ 0.5 tn and ₹ 0.3 tn will be shared among Central Sector (PGCIL), State sector and Private Sector respectively.

### Middle East and North America (MENA):

- Soaring demand and rapid industrial developments enabled the countries in the Middle-east region to continue in their sphere as the most dynamic power sectors in the world.
- The consumption of electricity in the Middle-East region has been growing continuously and is further poised to grow at even faster pace in the next decade.

#### Saudi Arabia:

- Saudi Arabia is the biggest market for power sector in the Middle East. The Kingdom’s expanding population, which stands at 27.1 mn, is the largest in the Gulf region. In order to support its increasing population and industrial base, the Saudi Government has strategically mapped out an investment program to diversify the country’s economy.
- The power generation sector is a key component of the government’s plan, as the demand for electricity expands by nearly 8 percent each year and is set to reach 60,000 MW by 2025.
- In response to the long-term increase in electricity demand, the Saudi Electricity Company (SEC), the largest utility company in the Arab world, has planned an USD 80 bn industry upgrade for power generation facilities, substations, and transportation and distribution lines. The SEC has planned at least 34 power projects over the next eight years, ranging from 20-30 MW extensions to projects in excess of 1,600 MW.
- In total, the projects are designed to add more than 21,000 MW of capacity. Central to the expansion program are five independent power projects valued at USD 20 bn which will run through 2017.

#### United Arab Emirates:

- UAE is the second largest power market in The Middle East. UAE is a rapidly growing economy whose power needs are anticipated to increase upto 50% in order to meet its growing demand for power, by the year 2020.
- UAE also has one of the highest levels of per capita power consumption across the globe. The electricity consumption in the UAE region is slated to cross 100 TWh by 2012, putting pressure on the supply side. In fact, the power demand is expected to increase at one of the highest rate in the

Middle East region by 2020 due to increasing consumers, high growth in construction sector, and industrial development especially in Dubai, Sharjah and Abu Dhabi.

- Government's projections for investment into the UAE power sector are promising. The nation plans to invest more than USD 50 bn of funds in the sector by 2015. In fact, by the year 2020, private sector is projected to be presented with an opportunity to invest upto USD 100 Billion into the power generation sector.

#### **North Africa**

- Moving ahead of the recent political unrest, countries in this region are again on the growth trajectory. Egypt has already announced fresh investment in transmission. The Ministry of Electricity determined the new sites where it will implement its third contingency plan to meet the summer's demand. The plan includes establishing new power generation units in a number of already installed stations. These units will be established in Elseiyuf station in Alexandria, Elmahmodeya, Damanhour in Beheira, West Cairo and 6th of October stations.
- The plan also includes 1,500 MW for the national grid, with \$1.5 billion in investments, in preparation for its operation during May 2013.
- The Ministry is also preparing plans to upgrade power transmission networks. The networks will operate on 500 kv and 200 kv voltages to match the new electric capacities which will soon be loaded on the national grid.

#### **Rest of Africa:**

- The region has one of the lowest per capital power consumption in the World (511 kwh v/s World average of 2,803 kwh in 2009). Further, about two-third of the population is without access to power. This indicates that this region has huge growth potential. Total estimated investment in the Africa region as per IEA is USD 68 bn in transmission between 2008-2030.

#### **Central Asia:**

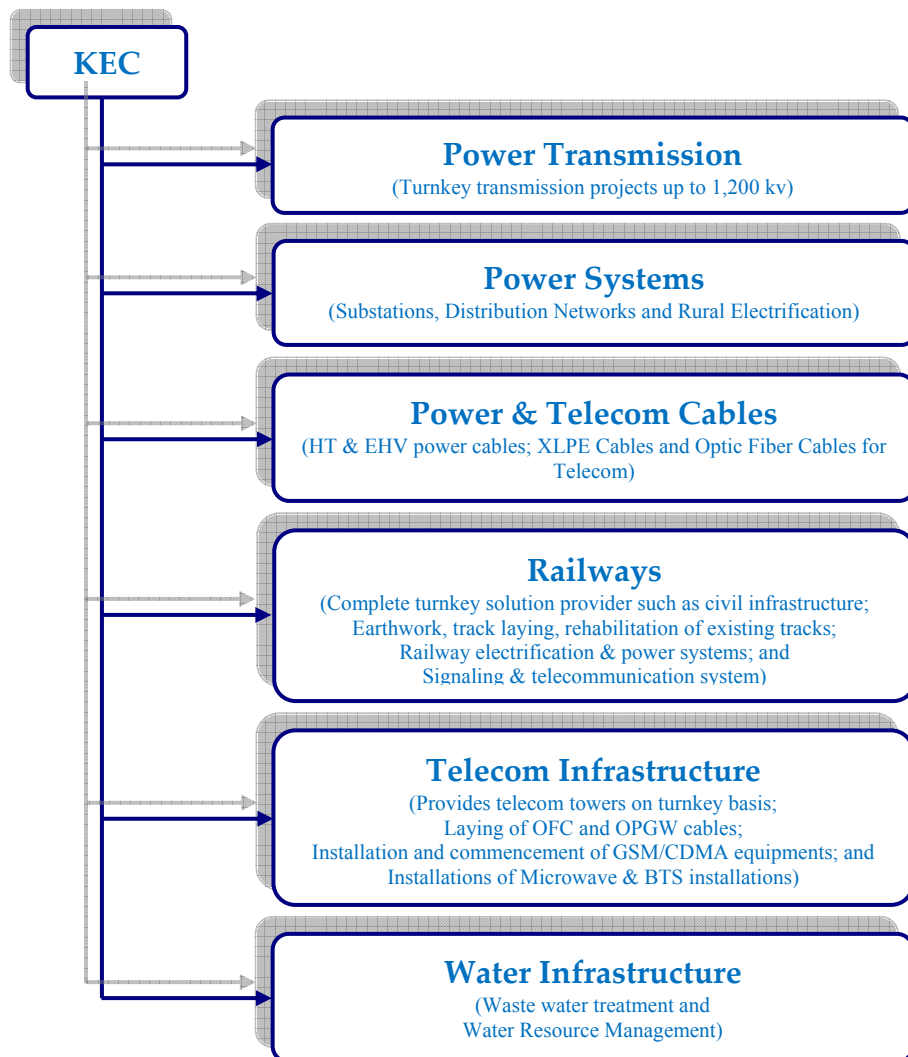
- The region continues to be a high potential market. Several initiatives, supported and funded by multilateral funding institutions, are being undertaken by central Asian countries to expand and upgrade their power infrastructure.
- Kazakhstan, Ukraine and Georgia are the major markets in this region. Kazakhstan is the first one to bring in power sector reforms after the disintegration of the former Soviet Union. Presently, the country is implementing Phase 2 of the Kazakhstan Electricity Rehabilitation Project.

#### **Americas:**

- **USA:** According to the Department of Energy, 70% of transmission lines are more than 25 years old, therefore, in order to avoid power outages, it is estimated that USD 3 bn annual investment is required.
- **Canada:** The transmission infrastructure within Canada is experiencing an unprecedented growth. New power generation sources in Alberta, Manitoba and new found land-Labrador have increased transmission demand. In addition to this, a large part of the network needs to be refurbished in order to meet the growing power demand.
- **Brazil:** Brazil is an emerging economy and the largest market in Latin America. Over the next ten years, the Brazilian government plans to increase power generation capacity by 61 GW and transmission lines capacity by 42,553 kms.
- The vast majority of new generation plants are coming in remote northern region of Brazil but the requirement of power is more in southern regions of the country, which is necessitating investment in long distance transmission lines.

## The Company: A Snap Shot

- KEC International Ltd (KEC), an RPG group company, is a diversified engineering, procurement and construction (EPC) services provider offering holistic infrastructure turnkey solutions in the areas of transmission & distribution (T&D), power & telecom cables, telecom infrastructure, railway infrastructure and water infrastructure.
- KEC was incorporated in 1945, primarily as manufacturing, enameling and trading company for Hollowware. It was taken over by RPG group in 1982.
- KEC has presence in over 46 countries across the globe from Americas, Central Asia, Middle East and North Africa (MENA), rest of Africa and the South Asia.
- Business mix of the company at a glance:



*Source: Company and SKP Research Desk*

### **Power Transmission:**

- Transmission Lines is the largest business vertical of KEC with the experience of more than 50 years.
- The Company has the capabilities to design, manufacture, test, supply and erection of transmission lines on turnkey basis up to 1,200 kv.
- KEC has successfully executed turnkey projects and supply of transmission line towers in 46 countries across the globe. It has strong presence in South Asia (India, Bangladesh and Srilanka), Middle East & North America (MENA), rest of Africa, Central Asia, and Americas.
- KEC is the first company in India who has executed 765 kv transmission line in India and abroad. Globally, KEC is also the first company for successfully testing 1,200 kv tower.
- The Company has its state-of-the-art manufacturing facilities in India and South America. The company has three manufacturing facilities in India at Jaipur (36,000 MTPA), Nagpur (55,000 MTPA), Jabalpur (60,000 MTPA).
- KEC is spreading its wing globally by getting business from new geographies y-o-y. The company entered in DC Congo, Africa in FY12 and North America and Latin America in FY11 by acquiring SAE, USA.

### **SAE Acquisition:**

- KEC acquired 100% stake in SAE Towers Holdings LLC (SAE), USA in September 2010 at an enterprise value of USD 95 mn.
- SAE is the leading manufacturer of lattice transmission line towers in the Americas. It also manufactures steel poles for electrical transmission and related hardware.
- Annual production capacity of SAE is 100,000 MTPA spread across two locations viz Monterrey, Mexico (35,000 MTPA) and Belo Horizonte, Brazil (65,000 MTPA). Mexico facility is serving North American markets whereas Brazil facility is catering to Latin American Markets.
- This acquisition has strengthened the leadership of KEC in the segment by building strong presence in the large, advanced and growing markets of North America and South America (including USA, Canada, Mexico, Brazil and other neighboring countries). Spend on transmission and distribution lines in these areas are rapidly increasing.
- Americas has contributed 32% of the total revenue in Q1FY13, thus becoming the second largest market for KEC after India. SAE has contributed 20% of the total revenues. Rest was shipped from India. Transmission line towers contributed about 90% of the total revenues from Americas.

### **Testing Towers:**

- KEC is the only company having four tower testing facilities, three in India (Nagpur, Jabalpur and Jaipur) and one in Brazil.
- Jaipur and Jabalpur testing stations have the capability of tower testing up to 400 kv and 800 kv respectively. Nagpur test station is among one of the few tower testing stations across the globe which can test towers up to 1,200 kv.
- Belo Horizonte is the largest testing station in Americas with the capability of tower testing up to 765 kv.
- All the testing towers are strategically located near the manufacturing facilities.



### Power Systems:

- Power System is the second largest business vertical of KEC. It offers complete range of turnkey solutions from concept to commissioning of substations, distribution networks, rural & industrial electrification, cabling work and balance of plant related projects.
- **Substations:** KEC offers turnkey solutions for all kind of substations viz air insulated substations, gas insulated substations and hybrid substations. Presently, the Company is executing projects up to 1,150 kv at Kazakhstan and up to 400 kv in India.
- **Distribution Networks:** The Company has also forayed in to Distribution augmentation works during FY12. KEC is presently executing projects in Indore, Madhya Pradesh.
- **Rural Electrification:** KEC has electrified more than 11,000 villages and has provided electricity to more than 500,000 below poverty line families.
- Government of India launched Rajiv Gandhi Grameen Vidyutikaran Yojana (RGGVY) in April 2005, a comprehensive scheme for providing access of electricity to all rural household. During 10<sup>th</sup> and 11<sup>th</sup> five year plans 48,387 and 60,087 villages respectively, have been electrified.
- As on July 31, 2011, only 11,388 villeges were left un-electrified out of the total coverage under RGGVY. RGGVY will be continued for uncovered villages and 32 uncovered districts under previous (10<sup>th</sup> and 11<sup>th</sup>) five year plans. Government has envisaged ₹ 660 bn under RGGVY for 12<sup>th</sup> five year plan (2013-17).
- **R-APDRP:** Government of India has proposed to continue with R-APDRP in 12<sup>th</sup> plan. Objective of R-APDRP is to reduce AT&C loss to (15%) through establishment of baseline data and integrated IT applications for energy audit/accounting and investing in improvement of distribution structure. The GOI has estimated the total fund requirement of ₹ 158.7 bn during the 12<sup>th</sup> plan.

### Power & Telecom Cables:

- KEC is one of the leading manufacturers of power and telecom cables in India. The Company is present in the industry for over 52 years.
- The Company is well equipped with manufacturing and testing facilities for the entire range of power and telecom cables. The manufacturing facilities of the company are situated at Mysore, Karnataka; Thane, Maharashtra; and Silvassa.
- KEC manufactures wide range of control and power cables, essential for power distribution by utilities and process industries. Currently, the company manufactures power cables ranging from 33 kv to 132 kv. KEC is pioneer in manufacturing cross linked polyethylene (XLPE) cables in India and currently is among the only three companies in India to manufacture and supply 132 kv cables.
- The company is setting up a green-field facility at Vadodara, Gujarat to manufacture high tension (HT) cables and extra high voltage (EHV) cables. KEC will enhance its capability to produce cable of 220 kv and 400 kv with the commissioning of the plant. The installed capacity of the plant will be 4,000 cable km.
- The Company also manufactures jelly filled communication cables and optic fiber cables for the telecom network of basic telecom companies.

**Railways:**

- KEC entered in this segment in 1961 with railway electrification. Today, the division has transformed into complete turnkey solution provider in EPC space. The services include-
  - civil infrastructure including bridges, tunnels, platform, workshop modernization, building of station and facilities;
  - earth work, new track laying and rehabilitation of existing tracks;
  - railway electrification and power systems; and
  - signaling and telecommunication work.
- KEC has electrified more than 6,000 kms of Indian Railways which is about 15% of total Indian Railways electrified network.
- The Company also undertakes railways infrastructure jobs for private customers.
- **Acquisition of Jay Signaling Pvt Ltd in September 2010:** KEC has acquired Jay Signaling Pvt Ltd, a railway signaling automation systems and Technology company. The company undertakes turnkey signaling contracts for the Indian Railways. Signaling works, being a highly specialized segment of the railways, require technical skills and experience. *KEC is poised to undertake the entire gamut of activities under the railway infrastructure segment with this acquisition.*
- **Entry in Turkmenistan:** The Company has received an order for establishment of power supply, signaling and telecommunication systems on turnkey basis, from Ministry of Railway Transport of Turkmenistan, in July 2012. The project is the part of North South Railway Project in Turkmenistan. The value of the project is ₹ 5.9 bn of which KEC’s share is ₹ 1.9 bn.
- *This is the largest ever order for the company in the segment. KEC has expanded its footprint in CIS region with this order. KEC already has presence in Kazakhstan, Tajikistan and Georgia in this region.*
- **Recent Orders:** Some of the recent orders KEC received for the segment:

Period	Business Vertical	Country	Client	Amount ₹ mn
Nov-11	Supply of railway track materials and signalling equip	Kenya	Kenya Railway Corporation	490
Jun-11	First Railway Siding	Nagpur, India	--	130
Jul-12	Power Supply, Signalling and Telecommunication	Turkmenistan	Ministry of Railway Transport	1,920
Sep-12	Electrification, signalling telecommunication works	India	Rail Vikas Nigam Ltd.	1,620

*Source: Company & SKP Research Desk*

**Segment Highlights:**

- **Dedicated Freight Corridors (DFC):** The Government of India has planned to construct two DFC’s namely Western DFC and Eastern DFC comprising 1,534 kms and 1,839 kms respectively. Total investment is estimated at over ₹ 400 bn. The completion of the project is expected by 2006-17.
- Further, in February, 2012, a panel headed by Sam Pitroda, advisor to the prime minister, in a report to the government suggested investment of ₹ 8.2 tn for modernization of Indian Railways over the next five years. This includes ₹ 200 bn for up-gradation of the signaling system in existing routes and an additional ₹ 200 bn for installing state-of-the art signaling system for bullet trains.
- **Metro Projects:** Increasing urbanization and strain on the existing transport infrastructure is necessitating investment in modern metro rails. Almost ₹ 2 tn investments are expected to be made in various metro projects across the country in the coming 10 years.
- Besides Delhi, Bengaluru, Hyderabad, Mumbai and Chennai, projects will be launched in Pune, Lucknow, Kanpur, Ahmedabad, Ludhiana, Kochi, Indore and Chandigarh.



## Water Management:

- KEC entered in water segment in 2011. The business is divided in two sub verticals-
  - Water resource management; and
  - Water and waste water management.
- KEC undertakes projects related to construction of canals, dams, tunnels, embankments and lift irrigation schemes under water resource management whereas it undertakes complete integrated water management projects which would comprise of intake system, transmission, storage, treatment and storage of water supply, under waste water management.
- In addition to this the company also boasts to be present in water reuse and sea water desalination projects.
- The company intends to mark its presence in complete value chain of Water Treatment and Water Resource Management which includes Irrigation, Embankment, Flood Control and Construction of dams, barrages, canals, tunnels etc.
- **Recent Orders:** Some of the recent orders KEC received for the segment during last one year:

Period	Business Vertical	State	Client	Amount ₹ mn
Apr-12	Construction of Canal	Madhya Pradesh	Madhya Pradesh Water Resource Department	440
Jan-12	Construction of Canal	Madhya Pradesh	Madhya Pradesh Water Resource Department	1,230
Jan-12	Flood Protection Works	West Bengal	Irrigation and Waterways Department	
Nov-11	Construction of Canal - 3 orders	Madhya Pradesh & Gujarat	--	980
Jun-11	Construction of Canal	Madhya Pradesh	Madhya Pradesh Water Resource Department	480
Apr-11	Water Business	Madhya Pradesh (5 Orders)	Madhya Pradesh Water Resource Department	310

Source: Company & SKP Research Desk

## Raw Material

- Steel and Zinc are the two major raw materials used in the manufacturing the tower structures. Steel plates, angles channels etc are used for fabricating the structure where as zinc is used for galvanization of fabricated structure.
- KEC procures its raw material both from domestic as well as foreign vendors.
- Since, both steel and zinc are highly price volatile, KEC undergoes hedging to mitigate price risk.

## Peers

Player	EBIDTM (%)	D/E (x)	EV/EBIDTA (x)	P/E (x)
JSL	10.2%	1.1	1.7	4.6
Kalpatru	9.3%	0.7	4.0	8.0
KEC	10.3%	1.0	5.1	8.7

Source: Capitaline & SKP Research Desk; All figures pertaining to FY12

## Investment Arguments

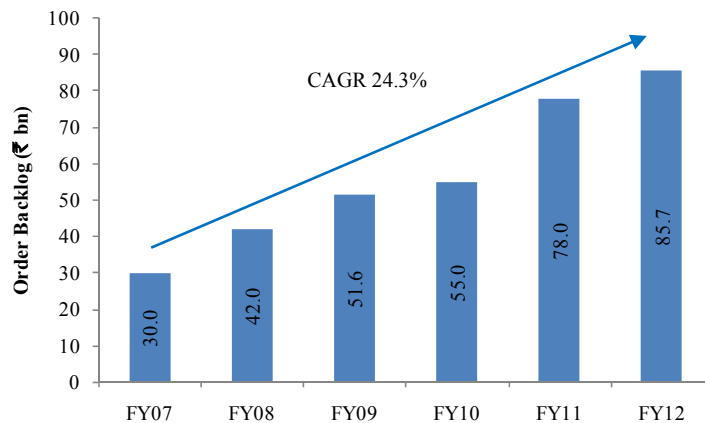
**Strong and diversified order backlog of ₹ 94.6 bn – revenues expected to grow with the CAGR of 18% in next couple of years:**

- KEC has a strong order backlog of ₹ 94.6 bn (as on Aug, 2012) from its various business segment. Breakup of the order book is as follows:

Business Segment	₹ bn	Contribution %	Geography	₹ bn	Contribution %
Transmission	64.4	68%	India	40.4	43%
Power Systems	17.0	18%	SAARC (Excl India)	5.3	6%
Cables	2.4	3%	MENA	8.4	9%
Telecom	2.0	2%	Africa and Central Asia	25.6	27%
Railways	4.8	5%	Americas	13.3	14%
Water	4.0	4%	Asia Pasific	1.6	2%
<b>Total ₹ mn)</b>	<b>94.6</b>	<b>100%</b>		<b>94.6</b>	<b>100%</b>

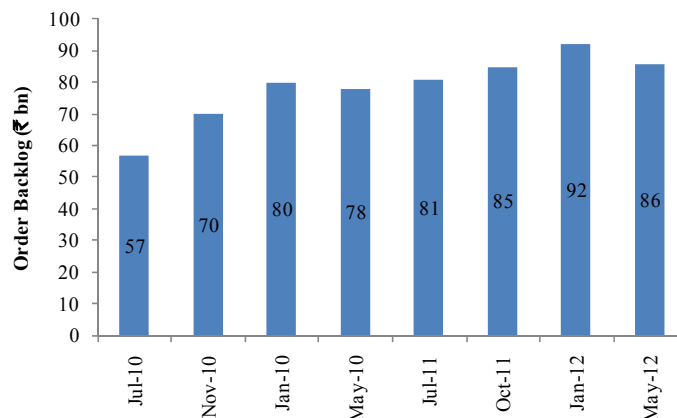
Source: Company – Investor Presentation - Aug 2012; SKP Research Desk

- **Robust Growth in order book y-o-y:** Order book of the company is growing at the CAGR of 24% for past five years. The following graph indicates the order backlog by KEC, in past five years:



Source: Company and SKP Research Desk

- **Steady q-o-q order backlog:** KEC has maintained a steady order backlog at q-o-q basis. Order backlog for the last eight quarters are as follows:



Source: Company and SKP Research Desk

- Further, KEC has received about ₹ 30 bn worth order in FY13 so far from its various clients, details of which are as follows:

Period	Business Segment	Region	Client	₹ mn
May-12	Transmission Line	Kazakhstan	Kazakhstan Electricity Grid Operating Company JSC	4,040
Jun-12	Transmission Line	Tamilnadu, India	Tamilnadu Transmission Corporation Ltd	3,610
	Supply and establishment of OPGW cables	India	PGCIL	300
Jul-12	Transmission Line	Orissa, India	PGCIL	2,990
	Transmission Line	AP, India	PGCIL	2,470
	Transmission Line	Srilanka	Ceylon Electricity Board	540
	Power Systems (Substations)	--	--	1,950
	Transmission Line	Bangladesh	Power Grid Company of Bangladesh	530
	SAE Towers (supply of lattice towers)	US, Canada, Mexico, Brazil	--	1,800
	Power Systems (Substations)	Malaysia	Sarawak Energy Berhad	750
	Power Systems (Substations)	Nairobi, Kenya	Kenya Power & Lighting Company Ltd	280
	Power Supply, Signalling and Telecommunication	Turkmenistan	Ministry of Railway Transport	1,920
	Supply of power and telecom cables	--	--	2,120
Sep-12	Transmission Line	UP, India	PGCIL	1,140
	Transmission Line	Philippines	National Grid Corporation of Phillipines	380
	Tower Supply (SAE Towers)	US, Mexico and Brazil	--	1,740
	Electrification, signalling and telecommunication Works	India	Rail Vikas Nigam Ltd.	1,620
	Supply of power and telecom cables	--	--	1,140

Source: Company and SKP Research Desk

- KEC maintains cordial relationship with its clients by providing in time quality construction which helps them to garner repeat orders.
- **The Company is enjoying strong growth in its top line continuously. The revenues of the company have grown with the CAGR of 19% during last three years. *With the strong order backlog and healthy reputation with its clients in place, KEC is well positioned to cater the burgeoning demand of the industry – domestic as well as international. We expect the revenues of the company to grow at a CAGR of around 18% between FY11 – FY14.***

#### Venturing in to 220 -400 kv cable segment:

- KEC is setting up a green-field facility at Vadodara, Gujarat to manufacture high tension and EHV cables, with the total estimated cost of ₹ 1.8 bn.
- The plan is divided in two phases of which Phase – I is already complete and Phase-II will be completed within next two months.
- KEC will be able to manufacture EHV cables up to 400 kv, with the completion of Phase-II. KEC presently manufactures power cables ranging from 33 kv to 132 kv.
- The above mentioned state-of-the-art facility will have the initial capacity of 4,000 cable kms (after completion of phase-II) which can be expanded further in the future.
- The plant is expected to generate revenue to the tune of ₹ 3.5 bn once it becomes operational at full capacity.
- *Since, the Vadodara facility has state-of-the-art machineries matching global standards; it is expected to play an important role in expanding KEC's presence in the growing HT and EHV cable segment.*

**Spreading wings in new geographies and new business verticals – de-risking of revenue model:**

- **Entering in new geographies:** The Company started its transmission line business in 1959 by supplying and erecting 220 kv transmission lines in domestic market. It supplied its first international order in 1961 to New Zealand.
- Since then, KEC has supplied and received turnkey projects in the sector in various geographies. Today, the company has spread its wings in continents such as such as Middle East, Americas, and Africa and so on.
- The Company has also increased its geographical presence through the acquisition of SAE Towers Holdings LLC, USA, in September 2010. This acquisition marked entry into large markets of North and South America. In a very short time span, Americas has become one of the largest markets for the Company outside India.
- Americas has contributed 32% of the total revenue in Q1FY13, thus becoming the second largest market for KEC after India. Transmission line towers contributed about 90% of the total revenues from Americas. SAE has contributed 20% of the total revenues. Rest was shipped from India.
- The current order book of the company includes orders from the countries like Middle East, Americas, Africa, CIS, SAARC, India etc. America's has the share of 14% in the current order book (as on Aug 2012).
- The Company has also spread it wings in DR Congo in supply and installation of OPGW wires, by securing order worth ₹ 2.1 bn in FY12.
- **Focusing on private customers:** Traditionally, KEC has secured most of its business from Government organizations across the globe. Now, the Company is focusing on adding private sector customers in its customer base. KEC secured five transmission line orders worth ₹ 5.9 bn from private sector players. Private sector contribution to the order book has increased from 1% in FY11 to 23% in FY12.
- **Expanding businesses:** Furthermore, HEC has also diversified its business by entering into various segments such as Cables, Railways and water. Today, the company has the orders more than ₹ 2.4 bn, ₹ 4.8 bn and ₹ 4 bn in cables, railways and water segment respectively (as on Aug 2012).
- Currently, the company is bidding for railways and water contracts in consortium for want of pre-qualification norms. We expect that KEC to fulfill all the qualification norms by next ten months time for railway contracts.
- Recently, KEC has received an order for establishment of power supply, signaling and telecommunication systems on turnkey basis, from Ministry of Railway Transport of Turkmenistan, in July 2012. The project is the part of North South Railway Project in Turkmenistan. The value of the project is ₹ 5.9 bn of which KEC's share is ₹ 1.9 bn.
- *KEC has expanded its footprint in CIS region with this order. KEC already has presence in Kazakhstan, Tajikistan and Georgia in this region.*
- *This ensures well diversified revenue streams driven from high growth sectors. This also ensures that any slowdown in particular sector and geography will not adversely affect the revenues of the company.*

## Key Concerns

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### **Slow down in infrastructure spending by the Government may impact the results:**

- As it is well known that KEC derives majority of its revenues from power sector. The investment in power transmission sector very much depends upon power generation capacity additions. Any slowdown in infrastructure spending by the Government would adversely affect the performance of the company.
- 11th five year plan witnessed the actual power generation capacity addition of 52,063 MW which was around 66% of the targeted capacity (78,700 MW).

### **Raw material price movements:**

- As mentioned earlier, steel and zinc is the major raw materials of the company, prices of which are highly volatile. Any such adverse price movement in the future may affect the profitability of the company.

### **Political Unrests:**

- KEC businesses are spread across various countries and regions. Political unrests in the Company's existing markets can impact the progress of the company.

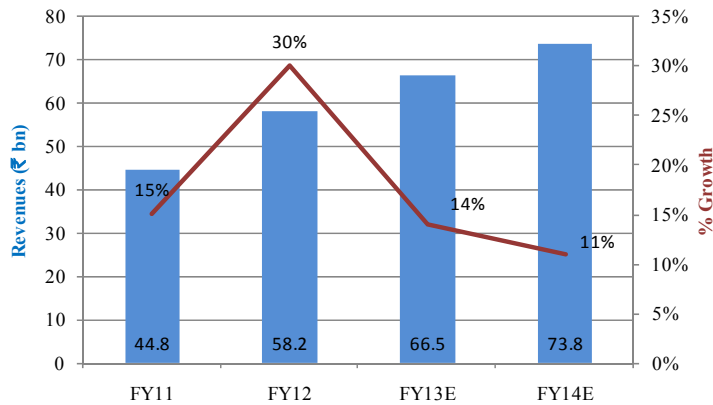
### **Currency Fluctuation:**

- As mentioned earlier KEC's businesses are spread across the globe, thus the company is exposed to the risk of currency fluctuations.
- Any unfavorable price movement in respective currency may further dent the margins of the company.

### **Delay in execution of projects due to bottlenecks:**

- EPC projects could face delays due to bottlenecks such as right of way, forest clearance, shortage of manpower etc. This could lead to delay in payments and thereby prolonging of working capital cycle and increasing the overall cost of the project.

## Financial Outlook



Source: Company & SKP Research

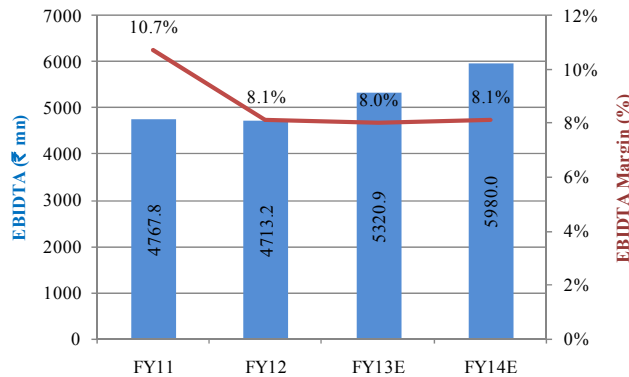
**Top-line to grow at a CAGR of around 18%**

For FY12, net sales increased to ₹ 58.2 bn by registering growth of 30% y-o-y basis due to strong execution of international transmission orders. International transmission segment grew by 56% followed by power systems which grew by 47%.

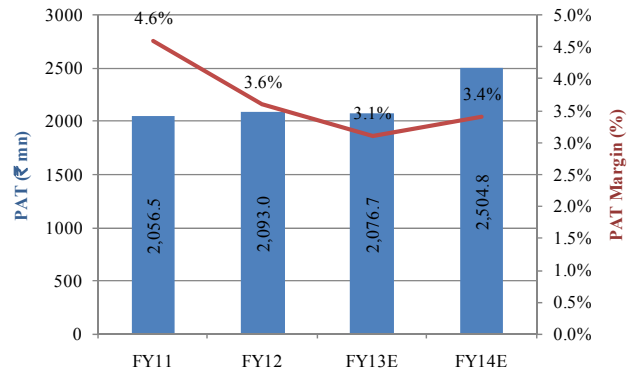
*We expect the company to grow at a CAGR of 18% between FY12-14 with the revival of economy on the back of economic reforms to be announced by the Government of India.*

### EBITDA margin to remain under pressure

KEC has witnessed an EBITDA margin of 8.1%, a fall by 260 bps, in FY12 due to execution of low margin contracts, high cost of raw material and high employee cost. We expect the margins of the company to remain under pressure and expected to be maintained at the same levels by FY14.



Source: Company & SKP Research



### PAT margin to stabilize around 3.4%

PAT margin has declined to 3.6% in FY12. *We expect PAT margin to stabilize around 3.4% by FY14E.* EPS of the company is expected to grow from ₹ 8.1 in FY12 to ₹ 9.7 in FY14E.

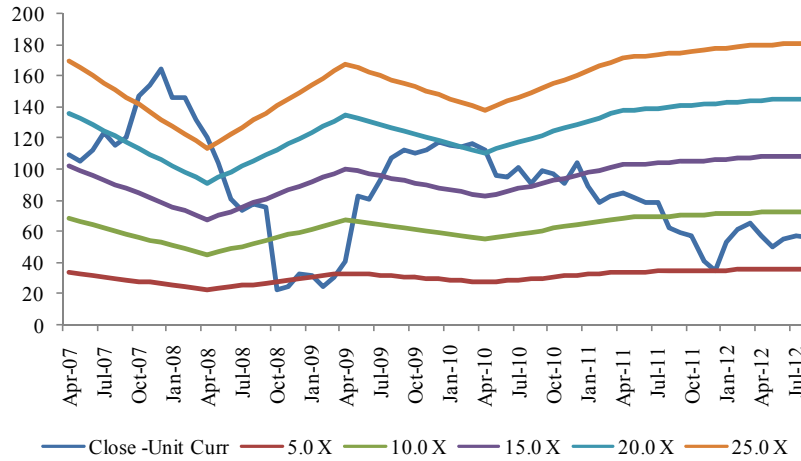


## Valuation

At current market price of ₹ 73, the stock is trading at a P/E of 9.0x and 7.5x of FY13E and FY14E earnings of ₹ 8.1 and ₹ 9.7 respectively.

We recommend BUY rating on the stock with a target price of ₹ 88/- (20% upside) in 12 months at the P/E of 9x on FY14E earnings.

### One Year forward P/E band:



Source: Capitaline

## Consolidated Financials

### FINANCIALS

(All data are in ₹ mn unless specified, Y/e March)

Income Statement	FY11	FY12	FY13E	FY14E	Balance Sheet	FY11	FY12	FY13E	FY14E
Net Operating Income	44765.4	58147.4	66511.4	73827.7	Equity Capital	514.2	514.2	514.2	514.2
Operating Expenditure	39997.6	53434.2	61190.5	67847.6	Reserves	8951.7	10563.8	12279.6	14423.4
EBIDTA	4767.8	4713.2	5320.9	5980.0	Net Worth	9465.9	11078.0	12793.8	14937.6
Depreciation	408.1	479.2	683.3	635.9	Loan Funds	13589.7	11239.2	16586.6	17245.1
EBIT	4359.6	4234.0	4637.6	5344.2	Deferred Tax Liab.	496.9	513.2	513.2	513.2
Interest	1176.4	1597.4	1575.7	1638.3	<b>Total Liabilities</b>	<b>23552.4</b>	<b>22830.4</b>	<b>29893.5</b>	<b>32695.9</b>
Other Income	68.9	616.3	133.0	147.7	Net Fixed Assets	8016.0	8097.4	9165.8	8530.0
EBT	3252.1	3252.9	3194.9	3853.5	Capital WIP	277.8	1121.7	0.0	0.0
Exceptional Item	84.9	9.8	0.0	0.0	Goodwill on Cons.	2812.5	3209.3	3209.3	3209.3
Tax	1110.8	1150.1	1118.2	1348.7	Net Current Assets	12446.2	10402.0	17518.4	20956.7
PAT	2056.5	2093.0	2076.7	2504.8	Deferred Tax Assets	0.0	0.0	0.0	0.0
EPS (₹)	8.0	8.1	8.1	9.7	<b>Total Assets</b>	<b>23552.5</b>	<b>22830.4</b>	<b>29893.5</b>	<b>32695.9</b>

Cash Flow Statement	FY11	FY12	FY13E	FY14E	Ratios	FY11	FY12	FY13E	FY14E
PBT	3167.2	3243.1	3194.9	3853.5	<b>Valuation ratios (x)</b>				
Add: Depreciation, Interest & Other Expenditure	1537.3	1603.7	2259.0	2274.2	P/E	9.1	9.0	9.0	7.5
Net change in WC, Tax, Int	-3006.8	643.1	-8051.9	-4685.3	P/Cash EPS	7.6	7.3	6.8	6.0
<b>Cash Flow from Operating Activities</b>	<b>1697.7</b>	<b>5489.9</b>	<b>-2598.0</b>	<b>1442.4</b>	P/BV	2.0	1.7	1.5	1.3
Capital Expenditure	-815.7	-1228.6	-630.0	0.0	EV/EBIDTA	6.5	5.9	6.2	5.6
Investments, Sales of FA, Dividend received and others	-4309.8	896.0	0.0	0.0	EV/Sales	0.7	0.5	0.5	0.5
<b>Cash flow investing Activities</b>	<b>-5125.5</b>	<b>-332.6</b>	<b>-630.0</b>	<b>0.0</b>	<b>Earning Ratios (%)</b>				
<b>Cash flow from Financing Activities</b>	<b>-678.3</b>	<b>3957.0</b>	<b>-4596.0</b>	<b>3410.7</b>	EBIDTAM	10.7%	8.1%	8.0%	8.1%
Net Increase/Decrease in Cash & Cash equivalents	-840.2	529.2	561.4	182.7	OPM	9.7%	7.3%	7.0%	7.2%
Opening Cash Balance	1409.9	560.5	1460.4	2029.1	NPM	4.6%	3.6%	3.1%	3.4%
Cash balance of acquired subsidiaries	370.7	7.3	0.0	0.0	ROE	21.7%	18.9%	16.2%	16.8%
<b>Closing Cash Balance</b>	<b>1460.4</b>	<b>2029.1</b>	<b>2211.8</b>	<b>2313.5</b>	ROCE	18.9%	19.0%	15.8%	16.6%
					<b>B/S Ratios</b>				
					Current ratio (x)	1.5	1.3	1.5	1.6
					D/E (x)	1.4	1.0	1.3	1.2
					Debtor Days	171.3	151.3	156.5	163.0
					Creditor Days	167.8	174.6	176.4	170.0
					Inventory Days	47.4	45.0	47.7	48.4
					FA/Turnover (x)	5.6	7.2	7.3	8.7

## Notes:

**The above analysis and data are based on last available prices and not official closing rates. SKP Research is also available on Bloomberg, Thomson First Call & Investext Myiris, Moneycontrol, Tickerplant and ISI Securities.**

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