

HOLD

TP: Rs 550 | ▼ 0%

KEC INTERNATIONAL

Capital Goods

15 June 2023

Management meet takeaways: Guidance maintained

- Management reiterated its FY24 order inflow (+15% YoY), revenue and EBITDA margin (~7%) guidance
- T&D and civil projects carry strong prospects; SAE Brazil now EBITDA-positive and guided to be PBT-positive in FY24
- Management’s confidence on margins leads us to raise our target P/E to 15x (vs. 14x); retain HOLD with a new TP of Rs 550 (vs. Rs 500)

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FY24 guidance maintained: Management continues to guide for revenue growth in excess of 15% for FY24 anchored by expected strong order inflows of Rs 250bn. KECI’s current addressable order pipeline totals Rs 1tn, and the company pegs the share of the transmission and distribution (T&D) and civil segments at 30-40% each. EBITDA margin is guided to recover from the trough of H2FY23 as legacy orders get executed in H1FY24. Management reiterated its earlier guidance of a ~100bps YoY increase in margin by H1 and expects to exit FY24 with near double-digit margins. Net working capital days are guided to improve to ~110 days, closer to KECI’s long-term target of <100 days.

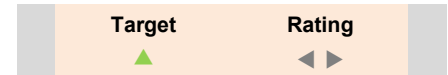
T&D and civil projects to be key drivers for FY24: KECI’s timely diversification into railway and civil projects over the last five years has helped it offset the muted growth in T&D. Notably, working capital requirements are relatively lower for the civil segment. Management expects growth in the civil business (mainly data centres, water, residential, commercial projects) and power T&D business to fuel orders in FY24. However, it pointed out that growth in rail ordering has slowed.

SAE Brazil troubles subsiding: Subsidiary SAE Brazil’s troubles stem from delays and subsequent cost overruns in its legacy EPC projects. Higher interest rates have also exacerbated losses. While the entity has turned EBITDA-positive in Q4FY23, management expects it to be PBT-positive in FY24. SAE Brazil has completely stopped EPC projects and only has tower supply orders.

FY24 interest cost to trend lower: In FY23, interest cost as a percentage of sales rose to 3.1% mainly due to higher interest rates, with the full impact seen in Q4. However, KECI has managed significant collections in the meantime, leading to some reduction in borrowings. For FY24, we estimate interest cost-to-sales at 2.5-2.6%.

Maintain HOLD: Management has reiterated confidence in margin improvement which leads us to raise our target FY25E P/E a notch to 15x from 14x, a 15% discount to the 5Y average, translating to a revised TP of Rs 550 (vs. Rs 500). Considering the runup in stock price (~25% in the last two months), we retain HOLD.

Key changes



Ticker/Price	KECI IN/Rs 552
Market cap	US\$ 1.7bn
Free float	47%
3M ADV	US\$ 5.2mn
52wk high/low	Rs 586/Rs 352
Promoter/FPI/DII	52%/13%/26%

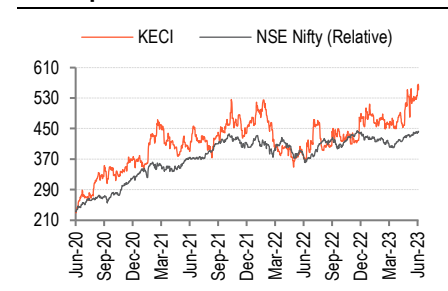
Source: NSE | Price as of 15 Jun 2023

Key financials

Y/E 31 Mar	FY23A	FY24E	FY25E
Total revenue (Rs mn)	1,72,817	2,02,357	2,36,340
EBITDA (Rs mn)	8,297	13,747	18,742
Adj. net profit (Rs mn)	1,760	5,647	9,450
Adj. EPS (Rs)	6.8	22.0	36.8
Consensus EPS (Rs)	6.8	25.5	37.7
Adj. ROAE (%)	4.8	14.1	20.4
Adj. P/E (x)	80.6	25.1	15.0
EV/EBITDA (x)	13.7	8.1	6.3
Adj. EPS growth (%)	(53.2)	220.8	67.4

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE



Analyst meet takeaways

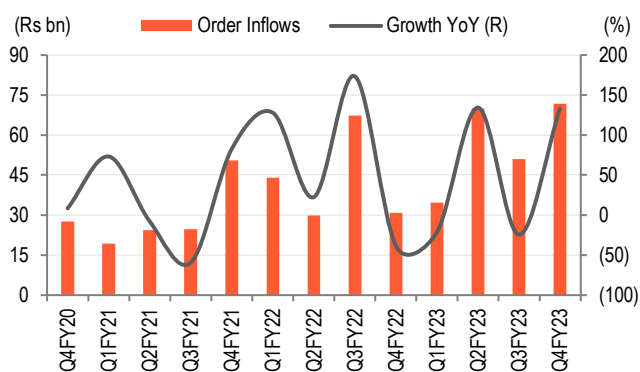
- **Margins:** All SAE projects with negative margins have been completed and other legacy projects are to be executed by H1FY24. Thus, management expects KECI to post an EBITDA margin of 6% in H1 and 8% in H2, averaging out to 7% for the year. Management further expects to exit FY24 with near-double-digit margins.
- **Revenue:** KECI posted revenue of Rs 172.8bn in FY23 and is confident of reaching Rs 200bn in the current year, supported by the T&D and civil segments. The company is seeing strong traction in both domestic and international markets (Middle East, Africa, and Asia).
- **Order intake:** Management is confident of clocking order inflow worth Rs 250bn in FY24. KECI has also been picky in accepting projects and looks at three major determining factors: (i) margin profile, (ii) cash flows (front ended or back ended), and (iii) geopolitical factors. Smaller projects generally entail intense competition as compared to larger ones, thus earning slimmer margins. Also, management does not prefer entering projects that have back-ended cash flows or potential for frequent payment delays, leading it to steer clear of working with state utilities.
- **Working capital cycle:** KECI had a cash conversion cycle of 118 days in FY23, and expects to bring this down to 110 days in the current financial year.
- **Cables segment:** The cables business is a negative working capital business, where sales are made on cash and purchases on credit. It is one of the highest cash generating businesses but has a lower margin profile. Management expects the segment to grow in single digits in the long term.
- **T&D:** The T&D business is one of the most important segments for KECI, contributing 50% of revenue. The segment performed well last year and is expected to grow rapidly in FY24 as well. In a positive change for the sector, the government has altered its stance on when to build transmission lines. Earlier, lines would be built after the plant was bid out – a protracted process that would elongate the working capital cycle of companies such as KECI. In the last couple of years, the government has opted to have the lines built even if plant bidding is delayed, which is proving beneficial for the company.
- **Civil:** The civil segment is the second most important segment for KECI in recent times, with order flow of Rs 66bn. The company is seeing significant demand, especially in water projects, which form the largest vertical within the civil business with an order book of Rs 40 bn. The civil segment grew 50% in FY23, posting a topline of Rs 33bn. Management aims to increase this number to Rs 50bn and expects growth in the segment to settle at 25-30% thereafter.
- **Solar projects:** KECI has reentered solar projects as stabilisation of policy measures and the government's thrust on green energy have lowered uncertainty in the sector.
- **International:** The company has returned to the Kuwait market while halting work on EPC projects in the US.

Fig 1 – Quarterly performance

Particulars (Rs mn)	Q4FY23	Q4FY22	YoY (%)	Q3FY23	QoQ (%)	FY23	FY22	YoY (%)
Revenue	55,250	42,748	29.2	43,746	26.3	172,817	137,423	25.8
EBITDA	2,835	2,517	12.6	1,999	41.8	8,297	9,035	(8.2)
EBITDA Margin (%)	5.1	5.9	(80bps)	4.6	60bps	4.8	6.6	(180bps)
Depreciation	415	419	-	408	-	1,615	1,579	-
Interest	1,616	954	-	1,493	-	5,386	3,160	-
Other Income	55	34	-	17	-	313	134	-
PBT	859	1,178	(27.1)	114	651.4	1,610	4,431	(63.7)
Tax	137	58	-	(62)	-	(151)	762	-
Adjusted PAT	722	1,120	(35.6)	176	310.2	1,761	3,669	(52.0)
Exceptional item	0	0	-	0	-	0	348	-
Reported PAT	722	1,120	(35.6)	176	310.2	1,761	3,321	(47.0)
Adj. PAT Margin (%)	1.3	2.6	(130bps)	0.4	90bps	1.0	2.7	(170bps)
EPS (Rs)	2.8	4.4	-	0.7	-	6.8	14.3	-

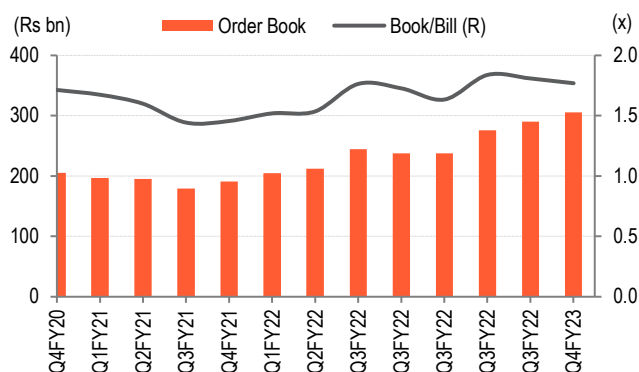
Source: BOBCAPS Research, Company

Fig 2 – Order inflows



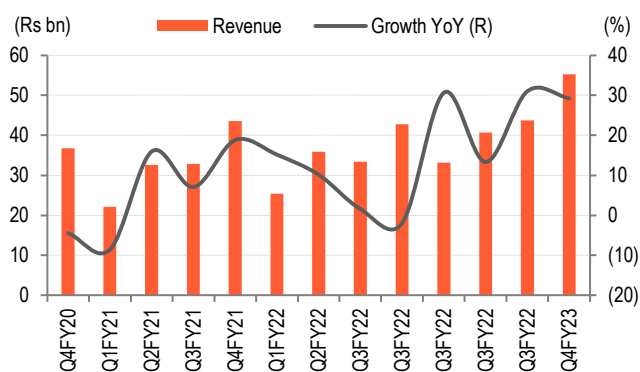
Source: Company, BOBCAPS Research

Fig 3 – Order backlog



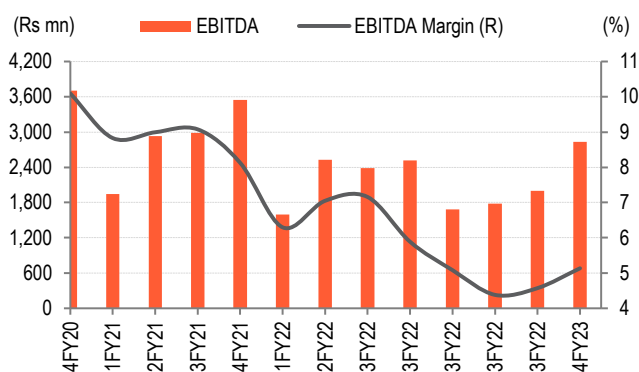
Source: Company, BOBCAPS Research

Fig 4 – Revenue trend



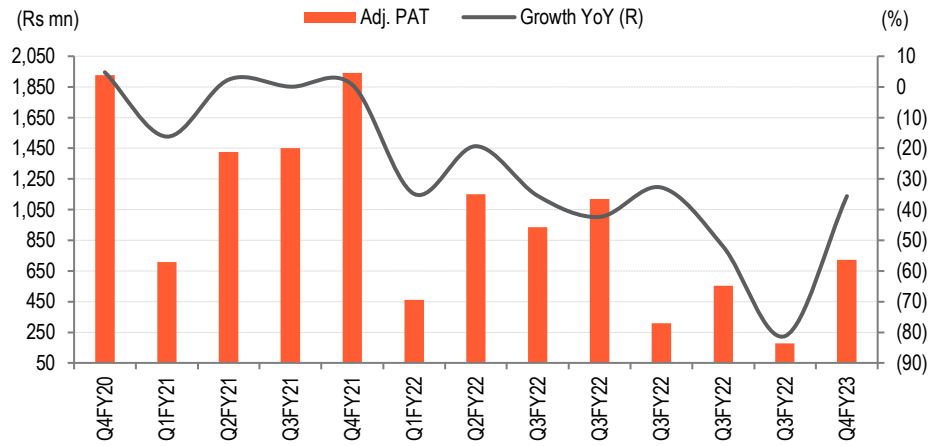
Source: Company, BOBCAPS Research

Fig 5 – EBITDA trend



Source: Company, BOBCAPS Research

Fig 6 – Profit trend



Source: Company, BOBCAPS Research

Valuation methodology

A burgeoning order book of Rs 300bn+ and structural industry tailwinds bode well for KECI. Management has reiterated confidence in margin improvement, working capital and debt levels, which leads us to raise our target FY25E P/E multiple a notch to 15x from 14x, a 15% discount to the stock's five-year average, translating to a revised TP of Rs 550 (vs. Rs 500). In light of the 25% runup in stock price over the last two months, we maintain HOLD.

Fig 7 – Key assumptions

Particulars (Rs mn)	FY22	FY23	FY24E	FY25E
Revenue	1,37,423	1,72,817	2,02,357	2,36,340
EBITDA	9,035	8,297	13,747	18,742
EBITDA Margin (%)	6.6	4.8	6.8	7.9
EPS (Rs)	14.6	6.8	22.0	36.8

Source: Company, BOBCAPS Research

Key risks

- Above-anticipated margin recovery is a key upside risk to our estimates.
- Weakness in standalone margins, a debt-heavy balance sheet and elevated working capital are key downside risks.

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
ABB India	ABB IN	11.1	4,314	3,700	HOLD
AIA Engineering	AIAE IN	3.8	3,328	3,500	BUY
Cummins India	KKC IN	6.2	1,830	2,000	BUY
Hitachi Energy	POWERIND IN	2.1	4,003	4,400	BUY
KEC International	KECI IN	1.7	552	550	HOLD
Larsen & Toubro	LT IN	40.4	2,361	2,630	BUY
Siemens India	SIEM IN	16.3	3,752	3,700	HOLD
Thermax	TMX IN	3.4	2,351	2,400	HOLD

Source: BOBCAPS Research, NSE | Price as of 15 Jun 2023

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
Total revenue	1,31,142	1,37,423	1,72,817	2,02,357	2,36,340
EBITDA	11,412	9,035	8,297	13,747	18,742
Depreciation	1,525	1,579	1,615	1,679	1,747
EBIT	9,887	7,456	6,682	12,068	16,996
Net interest inc./(exp.)	2,627	3,160	5,386	4,857	4,727
Other inc./(exp.)	299	134	313	338	365
Exceptional items	0	0	0	0	0
EBT	7,559	4,431	1,610	7,549	12,634
Income taxes	2,032	674	(151)	1,902	3,184
Extraordinary items	0	436	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	5,527	3,321	1,760	5,647	9,450
Adjustments	0	436	0	0	0
Adjusted net profit	5,527	3,757	1,760	5,647	9,450

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
Accounts payables	62,777	68,473	83,883	94,248	1,10,076
Other current liabilities	23,850	27,490	30,937	38,808	45,326
Provisions	0	0	0	0	0
Debt funds	19,565	30,646	33,834	25,500	17,500
Other liabilities	691	580	318	372	435
Equity capital	514	514	514	514	514
Reserves & surplus	33,083	35,685	37,200	41,690	49,983
Shareholders' fund	33,597	36,199	37,714	42,204	50,498
Total liab. and equities	1,40,479	1,63,389	1,86,686	2,01,133	2,23,834
Cash and cash eq.	2,492	2,619	3,442	2,000	2,802
Accounts receivables	53,858	51,061	68,961	74,290	82,881
Inventories	8,422	10,665	11,372	14,414	16,835
Other current assets	54,064	72,524	74,482	79,544	87,722
Investments	0	0	0	0	0
Net fixed assets	13,975	15,377	15,828	16,149	16,402
CWIP	179	25	115	115	115
Intangible assets	0	0	0	0	0
Deferred tax assets, net	0	0	0	0	0
Other assets	7,491	11,119	12,487	14,622	17,077
Total assets	1,40,480	1,63,389	1,86,686	2,01,133	2,23,834

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23A	FY24E	FY25E
Cash flow from operations	8,445	(2,837)	6,067	12,129	14,352
Capital expenditures	(1,801)	(1,986)	(1,626)	(2,000)	(2,000)
Change in investments	878	(116)	126	0	0
Other investing cash flows	(351)	55	147	(2,080)	(2,393)
Cash flow from investing	(1,274)	(2,047)	(1,352)	(4,080)	(4,393)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(564)	8,709	2,365	(8,334)	(8,000)
Interest expenses	0	0	0	0	0
Dividends paid	0	0	0	0	0
Other financing cash flows	(6,075)	(3,750)	(6,373)	(1,157)	(1,157)
Cash flow from financing	(6,639)	4,959	(4,008)	(9,491)	(9,157)
Chg in cash & cash eq.	533	75	707	(1,442)	802
Closing cash & cash eq.	2,492	2,619	3,442	2,000	2,802

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23A	FY24E	FY25E
Reported EPS	21.5	12.9	6.8	22.0	36.8
Adjusted EPS	21.5	14.6	6.8	22.0	36.8
Dividend per share	4.0	4.0	3.0	4.5	4.5
Book value per share	130.7	140.8	146.7	164.2	196.4

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23A	FY24E	FY25E
EV/Sales	0.9	0.9	0.7	0.6	0.5
EV/EBITDA	10.7	13.8	13.7	8.1	6.3
Adjusted P/E	25.7	37.8	80.6	25.1	15.0
P/BV	4.2	3.9	3.8	3.4	2.8

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23A	FY24E	FY25E
Tax burden (Net profit/PBT)	73.1	84.8	109.3	74.8	74.8
Interest burden (PBT/EBIT)	76.5	59.4	24.1	62.6	74.3
EBIT margin (EBIT/Revenue)	7.5	5.4	3.9	6.0	7.2
Asset turnover (Rev./Avg TA)	93.4	84.1	92.6	100.6	105.6
Leverage (Avg TA/Avg Equity)	4.6	4.7	5.1	5.0	4.8
Adjusted ROAE	18.0	10.8	4.8	14.1	20.4

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23A	FY24E	FY25E
YoY growth (%)					
Revenue	9.6	4.8	25.8	17.1	16.8
EBITDA	(7.5)	(20.8)	(8.2)	65.7	36.3
Adjusted EPS	(2.3)	(32.0)	(53.2)	220.8	67.4
Profitability & Return ratios (%)					
EBITDA margin	8.7	6.6	4.8	6.8	7.9
EBIT margin	7.5	5.4	3.9	6.0	7.2
Adjusted profit margin	4.2	2.7	1.0	2.8	4.0
Adjusted ROAE	18.0	10.8	4.8	14.1	20.4
ROCE	26.3	17.6	15.0	26.2	31.8
Working capital days (days)					
Receivables	150	136	146	134	128
Inventory	23	28	24	26	26
Payables	175	182	170	170	170
Ratios (x)					
Gross asset turnover	5.3	5.0	5.8	6.4	7.0
Current ratio	1.2	1.1	1.1	1.1	1.1
Net interest coverage ratio	3.8	2.4	1.2	2.5	3.6
Adjusted debt/equity	0.1	0.2	0.2	0.1	0.1

Source: Company, BOBCAPS Research | Note: TA = Total Assets

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BUY – Expected return >+15%

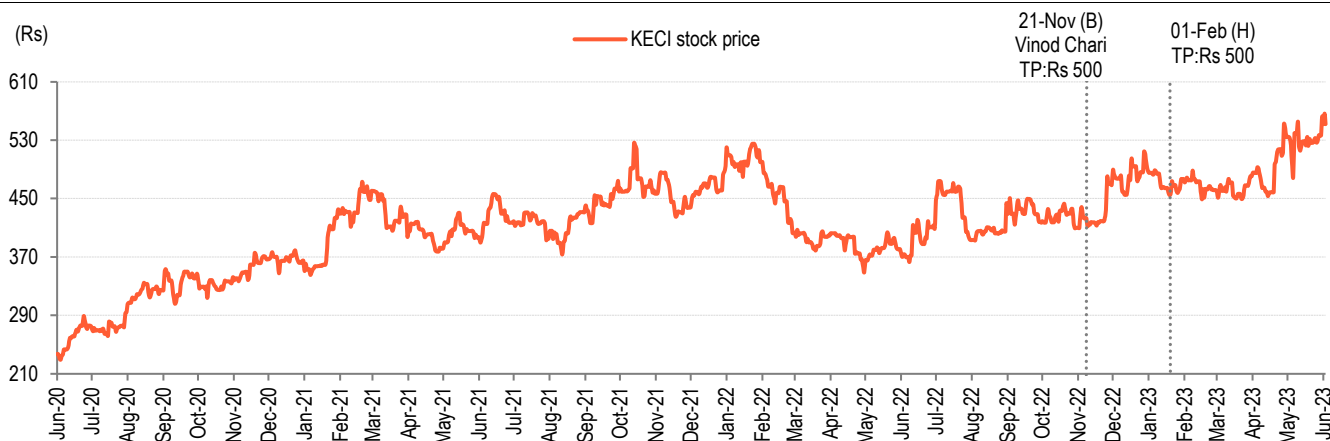
HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Ratings and Target Price (3-year history): KEC INTERNATIONAL (KECI IN)



B – Buy, H – Hold, S – Sell, A – Add, R – Reduce

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