KEC International

BUY	CMP Rs329	Target Rs377	Upside 14.6%

Sustaining the momentum in tough times; Retain BUY

Our View: We revise our FY21E/FY22E earnings estimates marginally by 4%/6% respectively to factor in the Q2FY21 performance (execution beat/margin miss), minor impact from Covid related disruptions & strong bidding pipeline. KECI is trading attractively at ~12x FY22 EPS, vs long term avg. 1-yr forward P/E of 14x. Retain 'BUY' with revised TP of Rs377 at 14x FY22 EPS. We remain positive on KECI given its diversified & healthy order backlog, ability to bag orders in tough times & proven execution track record.

Uncertain on near term margins; Aiming for 10%+ in long run: EBITDA Margin compression was mainly due to i) Depreciation of Brazilian currency, and Cost escalations in Brazil, ii) Increasing share of Non-TD (ramp up of Railway & Civil, and iii) Extra cost incurred due to Covid. For the next half, it would mainly depend on the mix of business. If international T&D ramps up, suppose it goes back to 50% of share then we may see margins going to 10% in second-half. The management has re-iterated of maintaining EBITDA Margin of 10%+ in the long run.

Strong order pipeline: KECI has current order book of Rs230bn, further mgmt. expects Rs250bn of project to be tendered in next 2 months. Similarly, a significant number of tenders in Africa, SAARC are expected to be quoted in next few months.

Domestic T&D activities expected to be better in H2FY21: Core T&D has been Substantially strong due to International orders. KECI has L1 of Rs35bn form International T&D business. Management is cautiously positive on SAE with normalization in operations. Of the 3 EPC projects, the company is expecting to complete one project this quarter. One of the orders was sold to French part, the company is executing from them. The other order is L1 with Sterlite. In addition, four L1 orders are under negotiation with execution in Q1FY22. The company has been cautious in new negotiating new orders due to volatility in metal prices in Brazil. Especially after Valle dam burst, sever volatility in commodity prices & transport prices are seen.

Exhibit 1: Result Table (Standalone)

(Rs mn)	Q2 FY21	Q2 FY20	% yoy	Q1 FY21	% qoq	Q2FY21 Yes Sec	vs. our est
Order inflow	24,350	26,510	(8.1)	19,310	26.1	30,221	(19.4)
Order backlog	195,150	180,850	7.9	196,820	(0.8)	196,949	(0.9)
Total sales	32,577	28,088	16.0	22,068	47.6	29,492	10.5
EBITDA	2,931	2,938	(0.2)	1,949	50.4	3,097	(5.4)
EBITDAM (%)	9.0	10.5	(146.3)	8.8	16.6	10.5	(150.3)
Depreciation	(374)	(347)	7.7	(391)	(4.3)	(377)	(0.9)
Interest	(674)	(822)	(17.9)	(663)	1.8	(650)	3.8
Other income	68	36	88.6	69	(2.0)	38	78.6
PBT	1,950	1,805	8.0	965	102.2	2,107	(7.5)
Tax	(525)	(414)	26.8	(257)	104.6	(590)	(11.1)
Adjusted PAT	1,426	1,391	2.5	708	101.3	1,517	(6.0)
Exceptional item	0	0		0		0	
Reported PAT	1,426	1,391	2.5	708	101.3	1,517	(6.0)

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Focus on expansion of railways business: Significant ramp up of project is seen. Company got its first order for Metro electrification. The company is focusing on new technologies - third rail, power supply, ballast less tracks, signalling & telecommunication. Delay in awarding of projects has been seen in H1FY21. The company expect revenue of Rs35bn in FY21. Of Rs50bn order book, 2/3 is non OHE. The railways segment has evolved from OHE – Civil (conventional railway) – new offerings: Metro - third rail, power supply, ballast less tracks, signaling & telecommunication. To expand its addressable market, company would look to cater to international markets.

Civil: Company is currently working on 4 DMRC and Kochi project. Second Kochi project has commenced. In-line with execution strategy, the company has received order with FGD, warehouses & water pipeline. Currently has an L1 of more than RS30bn. Civil business is behind railways by 6-8 quarters. Management expects this segment to clock a revenue of Rs14-15bn by year end. The company has classified civil business into i) Metro Civil which forms the major portion, ii) Water pipelines, iii) Warehouse, data centre, residential, industrials, hospitals, airports, cement, auto, hydrocarbon, gas grids. The company has received its first order from Chemical industry during this quarter.

Non-T&D share: For FY21, the share of Non-T&D would be 45-46%. In the longer run, the company does not expect significant growth in T&D mainly due to larger bases. However, increasing share of Railways & Civil will help. Working Capital for non T&D business is more or less similar to T&D, for railways it is much better.

Net Debt: Debt levels are within the targeted range of Rs25bn. The company does not see significant reduction in debt level over the next two-years as its focussing to grow at a healthy rate of 15%. Instead focus would be reducing Net Working Capital to 110 days from current 130 days, and reduction in interest cost (management expects interest cost as a % Sales to be below 2% in the second half). Notably, on receivable side, collection is good, especially in case of railways, company has received Rs4-5bn of bank guarantee.

Interest cost: Blended debt cost is ~5% for KECI (due to excessive liquidity in the system, banks are offering short term loan at 30-40bps over AAA rated, rather below MCLR).

Forex: Due to increasing share of international order, the company has increased its foreign debt level (currently at 60%). The management stated it has tried to match liabilities of loan worth receivables. However, now rupee cost has come down, the company has shifted to Indian rupee. Hence, we would see Forex gains in Q3FY21.

Impact of RM price: Except SAE, no significant impact of RM on results were seen. In case of Cable business, EPC players are waiting reduction in copper prices, rather when the prices will fall; hence Cable business was flat.

Mechanization & Digitalization: The company has been able to increase its efficiency by 2x in case of railways due to mechanization. It is moving towards digitalization through automation drive at its project sites, which could aid in margin uptick in medium term.

Export incentives: The impact of MEIS provision is around Rs100-150mn for Q2FY21. The same impact would be seen in Q3FY21 to the tune of Rs100-150mn. However, with commissioning of Dubai plant, majority of Indian offtake would be consumed in India and for export orders Dubai centre would be looked after. Dubai centre has commenced its operation and started receiving orders, the company has started dispatching.

Management indicated that all 220+ sites are operational with labour availability and manufacturing activities at pre-COVID-19 levels.

Key highlights from Q2FY21 results:

- Order book stood at Rs195bn (+8% yoy). Domestic/International mix stands at 61%/39%. L1 order position is at ~Rs35bn.
- Order inflow was Rs43.7bn during YTDFY21, up 16% yoy. Domestic/International mix stands at 41%/59%.
- KECI's sales came in at Rs32.6bn, 16% up yoy (+10.5% vs our est.)
- Railways/Solar & smart infra sales increased by 45%/253%/307% yoy respectively while T&D (incl SAE)/Cables business execution remained flat yoy.
- EBITDA margin stood at 9% (-150bps vs our est.), 146bps down yoy. EBITDA remained flat yoy to Rs2.93bn (in line with our est.)
- Interest cost declined by 18% yoy to Rs674mn (2.1% of sales.)
- PAT came in at Rs1.43bn, up 2.5% yoy (-6% vs our est.)
- Net Working Capital (NWC) stands at 132 days as on 30th September 2020.
- Net debt stood at Rs24.2bn as on Q2FY21. Overall net debt and interest bearing acceptances has been maintained flat despite a growth in revenue yoy led by, i) Judicious monitoring of cash flows, ii) Continuous focus on collection of retention, iii) Concerted efforts for expediting commercial closure of projects

Exhibit 2: Cost Analysis (Standalone)

As a % of net sales	Q2 FY21	Q2 FY20	bps yoy	Q1 FY21	bps qoq	Q2FY21 Yes Sec	vs. our est
COGS	46.7	49.5	(282.4)	46.5	21.3	49.0	(232.6)
Erection expenses	25.6	19.7	590.9	22.7	297.0	22.5	312.7
Employee cost	8.3	9.8	(147.7)	11.4	(314.2)	9.0	(69.9)
Other expenses	10.4	10.5	(14.5)	10.6	(20.7)	9.0	140.0
Total costs	91.0	89.5	146.3	91.2	(16.6)	89.5	150.3

Exhibit 3: Financial Summary

Y/e 31 Mar (Rs mn)	FY18	FY19	FY20	FY21E	FY22E
Revenues	100,526	110,005	119,654	127,319	141,776
yoy growth (%)	17.1	9.4	8.8	6.4	11.4
EBITDA	10,057	11,499	12,344	11,716	14,000
EBITDAM (%)	10.0	10.5	10.3	9.2	9.9
Adjusted PAT	4,604	4,958	5,655	5,490	6,920
yoy growth (%)	50.4	6.1	16.3	(2.9)	26.0
EPS (Rs)	17.8	18.9	22.0	21.4	26.9
P/E (x)	18.5	17.4	15.0	15.4	12.2
P/BV (x)	4.2	3.5	3.0	2.6	2.2
EV/EBITDA (x)	9.8	8.6	8.5	9.1	7.7
Net Debt/Equity (x)	0.7	0.6	0.7	0.7	0.6
ROE (%)	25.6	21.9	21.6	18.1	19.5
ROCE (%)	16.2	16.8	16.7	13.7	14.7

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