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FIRST LIGHT

02 February 2023

RESEARCH

INDIA STRATEGY | UNION BUDGET REVIEW

Quality over Quantity

BOB ECONOMICS RESEARCH | UNION BUDGET ANALYSIS 2023-24

KEC INTERNATIONAL | TARGET: Rs 500 | +10% | HOLD

Disappointing quarter – cut to HOLD

Daily macro indicators

Indicator	30-Jan	31-Jan	Chg (%)
US 10Y yield (%)	3.54	3.51	(3bps)
India 10Y yield (%)	7.40	7.34	(5bps)
USD/INR	81.50	81.92	(0.5)
Brent Crude (US$/bbl)	84.9	84.5	(0.5)
Dow	33,717	34,086	1.1
Hang Seng	22,070	21,842	(1.0)
Sensex	59,500	59,550	0.1
India FII (US$ mn)	**27-Jan**	**30-Jan**	**Chg ($ mn)**
FII-D	(71.1)	52.1	123.3
FII-E	(752.5)	(697.2)	55.3

Source: Bank of Baroda Economics Research

SUMMARY

INDIA STRATEGY: UNION BUDGET REVIEW

- Budget attempts to balance employment generation, social support, and infrastructure creation while keeping the fiscal glide path intact
- Consistency visible in government policies despite being the last full budget prior to general elections in 2024
- Expect a multiplier effect from the near-term consumption boost due to tax breaks and targeted expenditure

Click here **for the full report.**

INDIA ECONOMICS: UNION BUDGET ANALYSIS 2023-24

- Budget for FY24 balances between fiscal consolidation, nudging private investment through crowding in, and protecting consumer income from inflationary pressures through tax relief.
- Capex target for FY24 (BE) has been increased by ~37% to Rs 10 lakh crore, pushing the capex-GDP ratio to 3.3% from 2.7% in FY23RE. Revenue expenditure growth will be moderate next year.
- This will be achieved with the help of 12% increase in net revenue receipts (+8.2% in FY23RE), and gross borrowing of Rs 15.4 lakh crore (Rs 14.2 lakh crore in FY23RE).

Click here **for the full report.**

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KEC INTERNATIONAL

- EBITDA margin muted for the second consecutive quarter at 4.6% in Q3, dragged down by muted profitability in standalone business
- Order pipeline stands at Rs 1.1tn with strong momentum in the T&D, civil, and oil & gas verticals
- FY24/FY25 margin estimates pared to bake in the Q3 miss, leading to 28%/9% EPS cut; downgrade to HOLD post rally

Click here for the full report.

UNION BUDGET REVIEW

01 February 2023

FY24 Union Budget: Quality over Quantity

- **Budget attempts to balance employment generation, social support, and infrastructure creation while keeping the fiscal glide path intact**
- **Consistency visible in government policies despite being the last full budget prior to general elections in 2024**
- **Expect a multiplier effect from the near-term consumption boost due to tax breaks and targeted expenditure**

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Setting the stage for growth: The FY24 Budget carries the longstanding themes of the current government forward – these include ease of living, digitalisation, ease of doing business, formalisation of the economy, reduction in the scope for abuse and arbitrage, boosting Make in India, and last but not least, providing an ecosystem to bolster India's per capita income. Note, the capex allocation is 33% higher YoY. Moreover, the level of monitoring and, therefore, execution has improved significantly, implying that the actual economic impact of the capex is far more than in the past.

Fiscal prudence: The government has reiterated a credible glide path towards a 4.5% fiscal deficit by FY26 without affecting expenditure, with the FY24BE deficit at 5.9%.

Building blocks: A key feature of government policies has been the efforts to uplift the poorer sections of society while remaining focused on ease of doing business and boosting infrastructure spend. This means that subsidy expenditure remains elevated, though it is lower as a percentage of GDP. Separately, the hike in TCS (tax collection at source) for overseas tour packages to 20% will serve the twin purpose of prioritising local tourism over overseas tourism and capturing flows that may not have been subject to income tax. Lastly, funds have been allocated to catalyse the startup ecosystem in agriculture, a sector that is yet to see the full benefits of digitisation.

Tax rationalisation: Another important aspect of the Budget was rationalisation of direct and indirect taxes to remove anomalies and improve compliance. Measures include a hike in TCS on certain types of overseas expenses, removal of tax exemption on life insurance policies exceeding annual premium of Rs 500,000, plugging the tax loophole in Infrastructure Investment Trust (InvIT) payment to unitholders, and capping capital gains tax exemption on reinvestment of house sale proceeds. The Budget also proposes to hike the limit for the presumptive tax scheme.

Winners & losers: We believe the capital goods, auto and power sectors are among the biggest beneficiaries of this capex-centric budget, with the next rung of gainers being consumer staples and discretionary. Some of the tax provisions are negative for life insurance companies. We have outlined the sectoral impact in this report.

UNION BUDGET ANALYSIS 2023-24

01 February 2023

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Chief Economist

Aditi Gupta | Dipanwita Mazumdar
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Economists

- Budget for FY24 balances between fiscal consolidation, nudging private investment through crowding in, and protecting consumer income from inflationary pressures through tax relief.
- Capex target for FY24 (BE) has been increased by ~37% to Rs 10 lakh crore, pushing the capex-GDP ratio to 3.3% from 2.7% in FY23RE. Revenue expenditure growth will be moderate next year.
- This will be achieved with the help of 12% increase in net revenue receipts (+8.2% in FY23RE), and gross borrowing of Rs 15.4 lakh crore (Rs 14.2 lakh crore in FY23RE).
- Fiscal deficit (as % of GDP) remains on target (6.4%) for FY23(RE) and will be brought down to 5.9% in FY24(BE).
- We believe that in the next two budgets the government will lower the fiscal deficit ratio by 75 bps annually to reach the 4.5% mark.

Rs lakh crore	FY22	FY23RE	FY24BE	FY23 (% chg)	FY24 (% chg)
Total tax revenue	27.1	30.4	33.6	12.3	10.4
Total non-tax revenue	3.7	2.6	3.0	(28.3)	15.2
Centre's revenue (net)	21.7	23.5	26.3	8.2	12.1
Total capital receipts	16.2	18.4	18.8	13.6	2.2
Total receipts	37.9	41.9	45.1	10.5	7.7
Total expenditure	37.9	41.9	45.0	10.4	7.5
Revenue expenditure	32.0	34.6	35.0	8.1	1.2
Capital expenditure	5.9	7.3	10.0	22.8	37.4
Revenue deficit (% of GDP)	4.4%	7.3%	4.1%	2.9%	-
Fiscal deficit (% of GDP)	6.7%	6.4%	6.4%	5.9%	-

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HOLD
TP: Rs 500 | ⮝ 10%

KEC INTERNATIONAL | Capital Goods | 01 February 2023

Disappointing quarter – cut to HOLD

- **EBITDA margin muted for the second consecutive quarter at 4.6% in Q3, dragged down by muted profitability in standalone business**
- **Order pipeline stands at Rs 1.1tn with strong momentum in the T&D, civil, and oil & gas verticals**
- **FY24/FY25 margin estimates pared to bake in the Q3 miss, leading to 28%/9% EPS cut; downgrade to HOLD post rally**

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Disappointing quarter: KECI's Q3FY23 EBITDA margin remained muted for the second consecutive quarter at 4.6%, down 260bps YoY. In a negative surprise, the standalone margin fell to a multi-year low of 4.7%, largely due to the execution of tariff-based competitive bidding (TBCB) projects and legacy projects. Interest cost soared 88% YoY, further weighing on net profit which contracted 81%.

Outlook optimistic: KECI's order pipeline stands at Rs 1.1tn, with strong momentum seen in T&D, civil, and oil & gas projects. Management is confident in achieving over 20% revenue growth for FY23, with order inflows guided to reach Rs 180bn-200bn for the year. We expect the company's operating margin to recover to 6.7% in FY24 (from 5.0% in FY23E), as the orders placed at current commodity prices will be executed in subsequent quarters. Also, challenges at SAE Brazil are slowly easing with closure of the last EPC project, which should aid gradual recovery in the coming quarters.

Working capital intensity to reduce: Working capital has been a sore spot for KECI and remains elevated. We expect normalisation by Q1FY24 led by (i) stabilising collections from the railways, (ii) release of capital related to an inverted GST duty structure (Rs 5bn to be released over next 2Y), and (iii) potential collections from Afghanistan to the tune of Rs 2bn.

Downgrade to HOLD post rally: We remain positive on KECI's growth story given the healthy order backlog of Rs 290bn backed by a robust order pipeline. However, based on the disappointing margin performance over the last two quarters, we scale back our margin estimates for FY24/FY25, resulting in EPS cuts of 28%/9%. The stock also had run up over the past month which leaves limited upside potential. We, therefore, downgrade our rating from BUY to HOLD. Our TP stays at Rs 500 as we roll valuations forward to Dec'24E while retaining our 14x target P/E multiple 20% discount to 5Y average.

Key changes

Target	Rating
◄►	▼

Ticker/Price	KECI IN/Rs 457
Market cap	US$ 1.4bn
Free float	47%
3M ADV	US$ 3.3mn
52wk high/low	Rs 550/Rs 346
Promoter/FPI/DII	52%/12%/27%

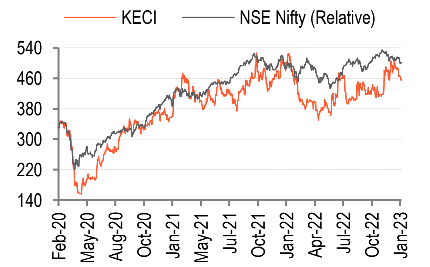
Source: NSE | Price as of 1 Feb 2023

Key financials

Y/E 31 Mar	FY22A	FY23E	FY24E
Total revenue (Rs mn)	137,423	165,926	197,516
EBITDA (Rs mn)	9,035	8,229	13,302
Adj. net profit (Rs mn)	3,757	1,503	5,450
Adj. EPS (Rs)	14.6	5.8	21.2
Consensus EPS (Rs)	14.6	17.3	31.1
Adj. ROAE (%)	10.8	4.1	14.0
Adj. P/E (x)	31.2	78.1	21.5
EV/EBITDA (x)	11.1	10.9	5.9
Adj. EPS growth (%)	(32.0)	(60.0)	262.7

Source: Company, Bloomberg, BOBCAPS Research

Stock performance



Source: NSE

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Recommendation scale: Recommendations and Absolute returns (%) over 12 months

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.

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