

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%

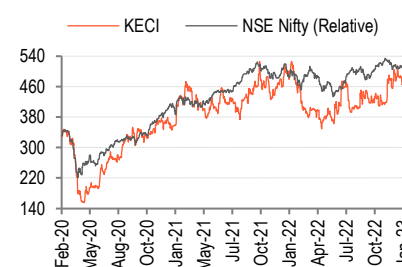
Source: NSE | Price as of 1 Feb 2023

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



Fig 1 – Quarterly performance

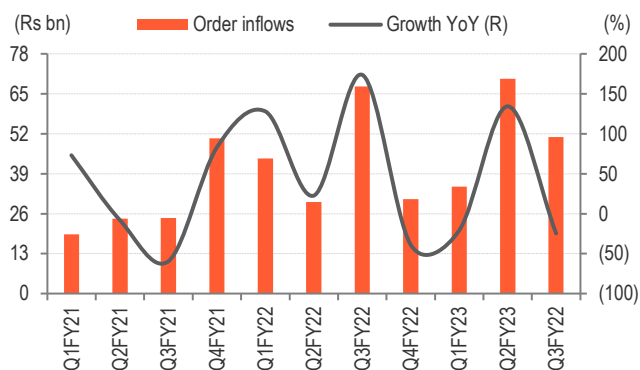
Particulars (Rs mn)	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Revenue	43,746	33,400	31.0	40,640	7.6
EBITDA	1,999	2,390	(16.4)	1,780	12.3
EBITDA Margin (%)	4.6	7.2	(260bps)	4.4	20bps
Depreciation	408	393	-	399	-
Interest	1,493	824	-	1,277	-
Other Income	17	50	-	161	-
PBT	114	1,223	(90.7)	266	(57.0)
Tax	(62)	287	-	(287)	-
Adjusted PAT	176	936	(81.2)	552	(68.1)
Exceptional item	0	0	-	0	-
Reported PAT	176	936	-	552	-
Adj. PAT Margin (%)	0.4	2.8	(240bps)	1.4	(100bps)
EPS (Rs)	0.7	3.6	-	2.1	-

Source: Company, BOBCAPS Research

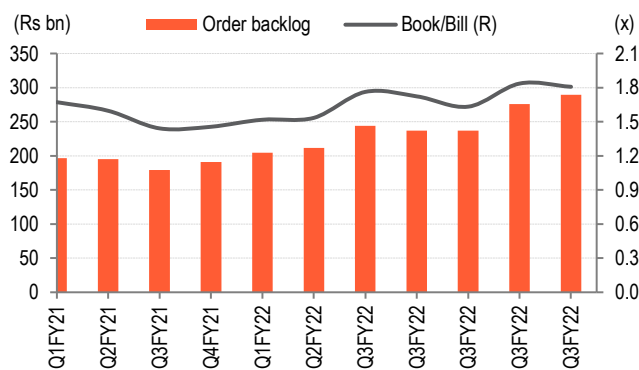
Fig 2 – Actual vs. Estimates

Particulars	Actual	Estimate	Variance (%)
Revenue	43,746	40,464	8.1
EBITDA	1,999	2,104	(5.0)
EBITDA Margin (%)	4.6	5.2	(60bps)
Adj. PAT	176	364	(51.6)

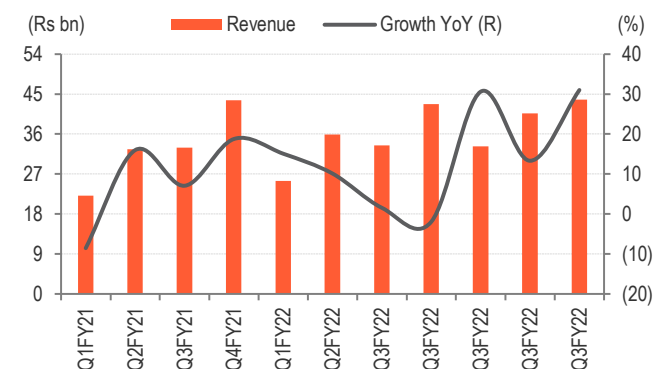
Source: Company, BOBCAPS Research

Fig 3 – Order inflows

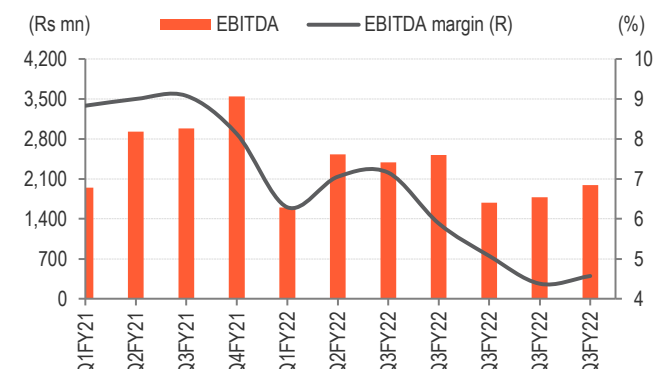
Source: Company, BOBCAPS Research

Fig 4 – Order backlog

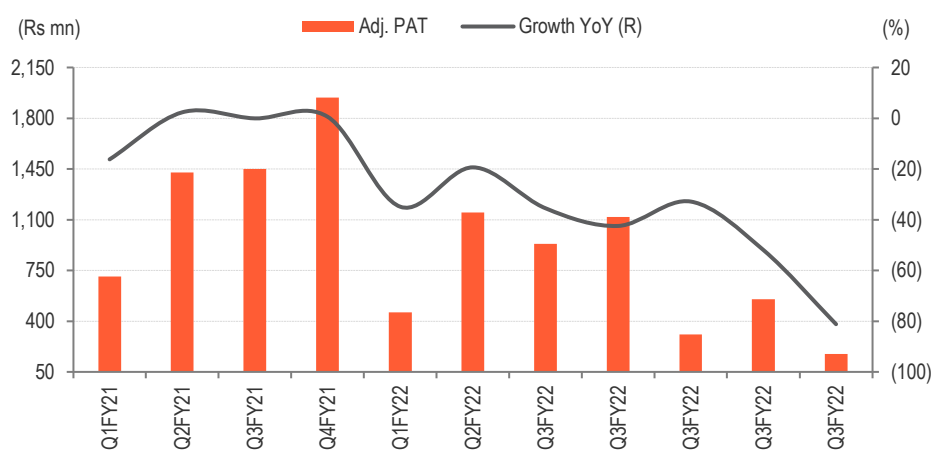
Source: Company, BOBCAPS Research

Fig 5 – Revenue trend

Source: Company, BOBCAPS Research

Fig 6 – EBITDA trend

Source: Company, BOBCAPS Research

Fig 7 – PAT trend

Source: Company, BOBCAPS Research

Earnings call highlights

- Outlook:** The transmission & distribution (T&D), civil, and oil & gas industries are driving KECI's orders, taking the pipeline to Rs 1.1tn in Q3FY23. Management is confident that margins will improve as orders placed at current commodity prices and with logistics costs factored in will be executed in subsequent quarters. Meanwhile, a gradual recovery is expected at SAE Brazil in the coming quarters.
- Guidance:** Management is confident of achieving over 20% revenue growth for FY23, with total order inflows of Rs 180bn-200bn. Q4FY23 EBITDA margin is guided to rise by 75-100bps, with interest at Rs 1.3bn-1.35bn and debt of Rs 52bn-53bn (a reduction of Rs 3bn). The consolidated tax rate for FY23 is projected at 15.5%, with a rate of 25% expected in FY24.
- Margins:** Standalone EBITDA margin remained a drag at 4.7% in Q3FY23 due to the execution of TBCB and legacy projects (3-4% of the order backlog) and higher logistic costs. Meanwhile, SAE Brazil's EBITDA loss of Rs 0.5bn pulled the consolidated margin down to 4.6%.
- SAE Brazil:** Management indicated that SAE Mexico and SAE Brazil would be operationally positive in Q4FY23, though pre-tax losses would continue due to

higher interest cost, before turning PBT-positive in Q1FY24. Debt for SAE Brazil stood at US\$ 50mn, with an interest rate of 18-20%. Management has guided that this would be refinanced by 4-5%. SAE's order book at Rs 1bn mainly includes supplies of towers, hardware and poles.

- **Working capital:** Working capital is guided at 125-130 days in Q4FY23. The key to this would be (i) collections from railways, as payments were held back due to a shift to milestone-based payment, (ii) potential collections from Afghanistan to the tune of Rs 2bn by Mar'24, and (iii) inversion of the GST duty structure (wherein the overall input GST was at 18% whereas the output GST was at 12%), which has led to accumulation of Rs 5bn in the GST account. Management expects this to be released over the next two years, including Rs 1bn in Q4FY23.
- **Solar business:** KEC is refocusing on the solar business and has secured a large order for a 500MW photo voltaic project. Management indicated that it will focus on pure engineering, procurement, and construction (EPC) projects without the modules or consider partnering with a module provider when bidding for projects.
- **Others**
 - Forex loss stood at Rs 300mn for 9MFY23 (part of other expenditure).
 - Spur Infrastructure's revenue climbed 81% YoY to Rs 1.6bn and the subsidiary was the lowest bidder (L1) for projects worth Rs 9bn.
 - KECI's capex is envisaged at Rs 2bn for FY23 and Rs 2.5bn in FY24.

Valuation methodology

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 has also 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.

Fig 8 – Revised estimates

(Rs mn)	New			Old			Change (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY24E
Sales	1,65,926	1,97,516	2,33,275	1,62,403	1,86,662	2,10,824	2.2	5.8	10.6
EBITDA	8,229	13,302	18,554	11,272	15,888	19,282	(27.0)	(16.3)	(3.8)
PAT	1,503	5,450	9,409	3,858	7,580	10,290	(61.1)	(28.1)	(8.6)
EPS	5.8	21.2	36.6	15.0	29.5	40.0	(61.1)	(28.1)	(8.6)
EBITDA Margin (%)	5.0	6.7	8.0	6.9	8.5	9.1	(198bps)	(178bps)	(119bps)

Source: BOBCAPS Research

Key risks

Key upside risks to our estimates are:

- Significant uptick in margin
- Better profitability in SAE Brazil

Key downside risks to our estimates are:

- Slowdown in T&D capex

Sector recommendation snapshot

Company	Ticker	Market Cap (US\$ bn)	Price (Rs)	Target (Rs)	Rating
ABB India	ABB IN	7.2	2,789	3,100	HOLD
AIA Engineering	AIAE IN	3.3	2,852	3,300	BUY
Cummins India	KKC IN	4.8	1,427	1,300	HOLD
Hitachi Energy	POWERIND IN	1.6	3,147	3,600	BUY
KEC International	KECI IN	1.4	457	500	HOLD
Larsen & Toubro	LT IN	36.8	2,146	2,440	BUY
Siemens India	SIEM IN	12.8	2,945	3,500	BUY
Thermax	TMX IN	2.8	1,956	2,100	HOLD

Source: BOBCAPS Research, NSE | Price as of 1 Feb 2023

Financials

Income Statement

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Total revenue	131,142	137,423	165,926	197,516	233,275
EBITDA	11,412	9,035	8,229	13,302	18,554
Depreciation	1,525	1,579	1,642	1,707	1,776
EBIT	9,887	7,456	6,587	11,595	16,778
Net interest inc./(exp.)	2,627	3,160	4,978	4,740	4,666
Other inc./(exp.)	299	134	400	432	467
Exceptional items	0	0	0	0	0
EBT	7,559	4,431	2,009	7,286	12,580
Income taxes	2,032	674	506	1,836	3,170
Extraordinary items	0	436	0	0	0
Min. int./Inc. from assoc.	0	0	0	0	0
Reported net profit	5,527	3,321	1,503	5,450	9,409
Adjustments	0	436	0	0	0
Adjusted net profit	5,527	3,757	1,503	5,450	9,409

Balance Sheet

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Accounts payables	62,777	68,473	77,281	86,583	102,258
Other current liabilities	23,850	27,490	29,548	37,880	44,738
Provisions	0	0	0	0	0
Debt funds	19,565	30,646	32,646	25,500	17,500
Other liabilities	691	580	700	834	985
Equity capital	514	514	514	514	514
Reserves & surplus	33,083	35,685	36,160	40,453	48,705
Shareholders' fund	33,597	36,199	36,674	40,967	49,219
Total liab. and equities	140,479	163,389	176,849	191,763	214,700
Cash and cash eq.	2,492	2,619	(6,871)	(16,111)	(20,457)
Accounts receivables	53,858	51,061	62,279	76,842	89,475
Inventories	8,422	10,665	13,638	16,234	19,173
Other current assets	54,064	72,524	78,619	82,765	91,357
Investments	0	0	0	0	0
Net fixed assets	13,975	15,377	15,735	16,027	16,252
CWIP	179	25	25	25	25
Intangible assets	0	0	0	0	0
Deferred tax assets, net	0	0	0	0	0
Other assets	7,491	11,119	13,425	15,981	18,874
Total assets	140,480	163,389	176,849	191,763	214,700

Cash Flows

Y/E 31 Mar (Rs mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Cash flow from operations	8,445	(2,837)	(6,276)	3,486	9,553
Capital expenditures	(1,801)	(1,986)	(2,000)	(2,000)	(2,000)
Change in investments	878	(116)	0	0	0
Other investing cash flows	(351)	55	(2,186)	(2,423)	(2,742)
Cash flow from investing	(1,274)	(2,047)	(4,186)	(4,423)	(4,742)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	(564)	8,709	2,000	(7,146)	(8,000)
Interest expenses	0	0	0	0	0
Dividends paid	0	0	0	0	0
Other financing cash flows	(6,075)	(3,750)	(1,028)	(1,157)	(1,157)
Cash flow from financing	(6,639)	4,959	972	(8,303)	(9,157)
Chg in cash & cash eq.	533	75	(9,491)	(9,240)	(4,346)
Closing cash & cash eq.	2,492	2,619	(6,871)	(16,111)	(20,457)

Per Share

Y/E 31 Mar (Rs)	FY21A	FY22A	FY23E	FY24E	FY25E
Reported EPS	21.5	12.9	5.8	21.2	36.6
Adjusted EPS	21.5	14.6	5.8	21.2	36.6
Dividend per share	4.0	4.0	4.0	4.5	4.5
Book value per share	130.7	140.8	142.6	159.3	191.4

Valuations Ratios

Y/E 31 Mar (x)	FY21A	FY22A	FY23E	FY24E	FY25E
EV/Sales	0.7	0.7	0.5	0.4	0.3
EV/EBITDA	8.5	11.1	10.9	5.9	4.1
Adjusted P/E	21.2	31.2	78.1	21.5	12.5
P/BV	3.5	3.2	3.2	2.9	2.4

DuPont Analysis

Y/E 31 Mar (%)	FY21A	FY22A	FY23E	FY24E	FY25E
Tax burden (Net profit/PBT)	73.1	84.8	74.8	74.8	74.8
Interest burden (PBT/EBIT)	76.5	59.4	30.5	62.8	75.0
EBIT margin (EBIT/Revenue)	7.5	5.4	4.0	5.9	7.2
Asset turnover (Rev./Avg TA)	93.4	84.1	93.8	103.0	108.7
Leverage (Avg TA/Avg Equity)	4.6	4.7	4.9	4.9	4.8
Adjusted ROAE	18.0	10.8	4.1	14.0	20.9

Ratio Analysis

Y/E 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
YoY growth (%)					
Revenue	9.6	4.8	20.7	19.0	18.1
EBITDA	(7.5)	(20.8)	(8.9)	61.7	39.5
Adjusted EPS	(2.3)	(32.0)	(60.0)	262.7	72.6
Profitability & Return ratios (%)					
EBITDA margin	8.7	6.6	5.0	6.7	8.0
EBIT margin	7.5	5.4	4.0	5.9	7.2
Adjusted profit margin	4.2	2.7	0.9	2.8	4.0
Adjusted ROAE	18.0	10.8	4.1	14.0	20.9
ROCE	26.3	17.6	15.3	25.6	31.8
Working capital days (days)					
Receivables	150	136	137	142	140
Inventory	23	28	30	30	30
Payables	175	182	170	160	160
Ratios (x)					
Gross asset turnover	5.3	5.0	5.6	6.2	6.9
Current ratio	1.2	1.1	1.1	1.1	1.1
Net interest coverage ratio	3.8	2.4	1.3	2.4	3.6
Adjusted debt/equity	0.1	0.2	0.2	0.2	0.2

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

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BUY – Expected return >+15%

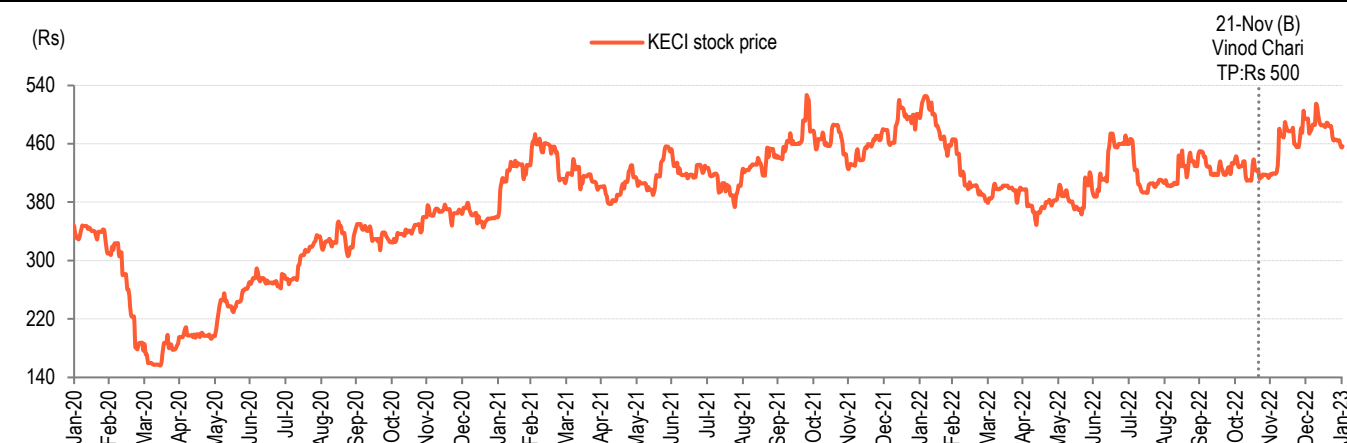
HOLD – Expected return from -6% to +15%

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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