

Sector: Capital Goods
Company Update

	Change
Reco: Buy	↔
CMP: Rs. 250	
Price Target: Rs. 325	↓

↑ Upgrade ↔ No change ↓ Downgrade

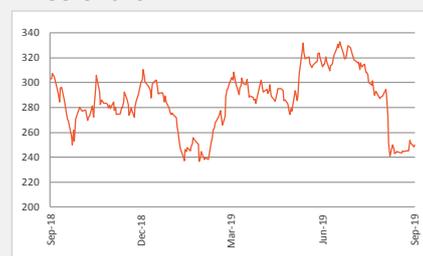
Company details

Market cap:	Rs. 6,427 cr
52-week high/low:	Rs. 341/230
NSE volume: (No of shares)	3.6 lakh
BSE code:	532714
NSE code:	KEC
Sharekhan code:	KEC
Free float: (No of shares)	12.5 cr

Shareholding (%)

Promoters	51.4
FII	7.3
DII	26.3
Others	15.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-14.2	-22.1	-16.7	-14.9
Relative to Sensex	-13.7	-17.7	-15.4	-13.7

Sharekhan Research, Bloomberg

We met KEC International's management to update ourselves with current industry environment and the company's future outlook. The management highlighted that order inflows continue to remain tepid during Q2FY2020 till date although would not affect execution for FY2020 due to its strong order backlog. KEC during FY2020 till date announced order inflows of over Rs. 1900 crore and had guided for Rs. 16000-17000 crore inflow target for FY2020 which may fall short by Rs. 3000-4000 crore. However, with current order backlog of Rs. 19000 crore+ (~1.7x its TTM revenue) and lower than expected order inflows during FY2020 is unlikely to materially affect revenue for FY2020-FY2021. On a positive note, tendering for Green Energy Corridor, Regional Rapid Transit System (RRTS) orders, Railways (OHE and track doubling & tripling), Civil (government projects) and International (SAARC, Brazil) are expected to come up during FY2020. On the flip side, tendering from PGCIL, Railway signaling orders, Civil Industrial orders and Saudi Arabia are expected to remain weak. We have lowered our FY2021E factoring lower order intake for FY2020. We also lowered our valuation multiple owing to near term weakness in project tendering. Consequently, our PT stands revised to Rs. 325. We maintain Buy on the stock due to comfort on valuation.

Order inflows may fall short of guidance; Execution for FY2020 to be unaffected: KEC's announced order inflows till date for FY2020 stood at Rs. 1900 crore+ which may fall short of its yearly guidance of Rs. 16000-17000 crore due to delays in tendering for green energy corridor projects, railway signaling & RRTS and continued weak private industrial capex. On the positive note, tendering for Green Energy Corridor (Rs. 15000-20,000 crore bidding pipeline), Regional Rapid Transit System (RRTS) orders for balance packages of Delhi-Meerut corridor (~Rs. 3000-4000 crore EPC opportunity), Railways (Rs. 3000-4000 crore), Civil (Rs. 600 crore target majorly from government projects) and International (Rs. 10,500 crore orders target) are expected to come up during FY2020. On the flip side, tendering from PGCIL, Railway signaling orders, Civil Industrial orders and Saudi Arabia are expected to remain weak in the near term. However, due to strong current order backlog, the management retained revenue growth guidance of 15-20% for FY2020.

Our Call

Maintain Buy with a revised PT of Rs. 325: We have revised our estimates downwards for FY2021E factoring lowering order inflow for FY2020. We have also lowered our valuation multiple considering near term sluggishness in order tendering. KEC has corrected by ~25% over trailing two and half months on account of continued slowdown in order tendering. We expect KEC's stock price has already built in sluggish macro environment and offers favourable risk reward to investors at current juncture. Hence, we have maintained our Buy rating on the stock with revised PT of Rs. 325 (lowering FY2021E earnings and valuation multiple).

Key Risks

Slowdown in tendering activities, especially in T&D and railways.

Valuation (Standalone)

Particulars	Rs cr			
	FY18	FY19	FY20E	FY21E
Revenue	10,058	11,001	12,656	14,633
OPM (%)	10.0	10.5	10.4	10.4
Adjusted PAT	460	486	564.0	667.9
% YoY growth	51.1	5.7	16.0	18.4
Adjusted EPS (Rs.)	17.9	18.9	21.9	26.0
P/E (x)	14.0	13.2	11.4	9.6
P/B (x)	3.2	2.6	2.3	1.9
EV/EBITDA (x)	7.8	6.8	6.4	5.7
RoNW (%)	25.7	21.9	21.6	21.8
RoCE (%)	25.1	26.4	24.5	23.8

Source: Company; Sharekhan estimates

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Green Energy Corridor projects to commence tendering in short term: KEC eyes Rs. 10000-11000 crore bidding pipeline from phase I green energy projects plus TBCB (Southern states like TamilNadu, Karnataka and Andhra Pradesh) to come up for bidding in next one to one and half month. KEC expects order inflows of ~Rs. 2000-3000cr (at 1:5 strike rate) during FY20. The phase II of Green energy corridor has the potential of Rs. 40000-45000 crore which in the long run provides growth avenue for KEC.

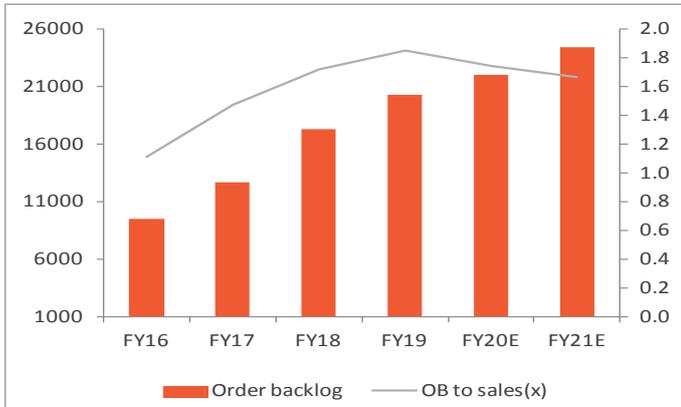
Railways – RRTS provides significant opportunities: KEC recently won orders worth Rs. 580 crore in the RRTS and civil works of Rs 265 crore in Metro sectors, which is in line with the company's strategy to expand its presence in the Railways segment and its civil segment. Of the 8 RRTS corridors, 3 of them (Delhi- Meerut, Delhi- Panipat and Delhi- Alwar) have been classified as priority corridors totaling ~Rs. 80,000 crore which provides ~Rs. 24000 crore EPC opportunity. While Delhi-Meerut has seen award of two packages, another Rs. 3000-4000 crore EPC work for balance packages is yet to be awarded. Delhi-Panipat and Delhi-Alwar may take two years time to come up for bidding. On the conventional side of railways, the company is witnessing tendering opportunity in overhead electrification (~Rs. 5000 crore) projects and doubling and tripling of lines (~Rs. 10000 to Rs. 15000 crore).

Civil – To focus on government tenders due to muted private capex: The company has been witnessing slowdown in private industrial capex which is likely to continue in the near term. Consequently, it has shifted its focus to government projects (Rs. 600 crore target majorly from government project). Owing to long gestation period of government projects, the revenue may accrue at a slower pace. KEC expects to book Rs. 700-750 crore revenue from civil work for FY2020 with year end order book target of Rs. 750-800 crore.

International orders – Other regions to compensate for slowing Saudi Arabia: In the international front, KEC is witnessing traction in Bangladesh and the SAARC nations. Order inflows in these geographies are likely to gain momentum in H2FY20. Traction in the MENA region continues, but Saudi Arabia has been witnessing fierce competition and hence management believes order inflows from this region might slow down. Hence, KEC is trying to diversify into new countries in the MENA region. In the SAE region all 3 major EPC projects on SAE's book are now under execution. There is one more auction up-coming in Brazil in December and KEC will be bidding for the project.

Financials in charts

Order book and order book to sales



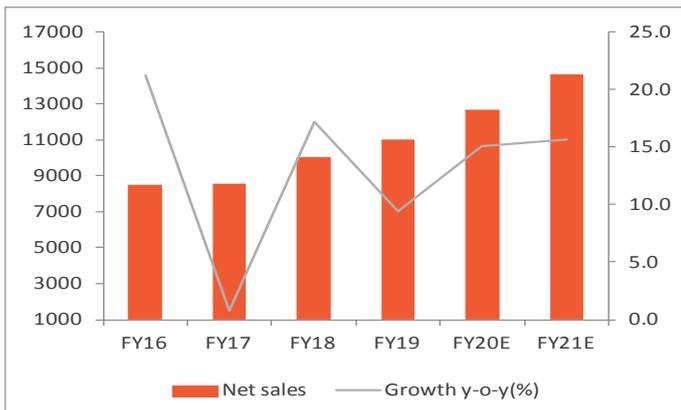
Source: Company, Sharekhan Research

Order inflow trend



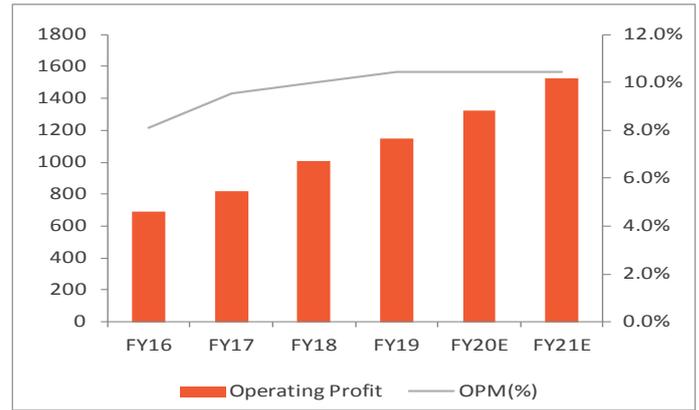
Source: Company, Sharekhan Research

Revenue Trend



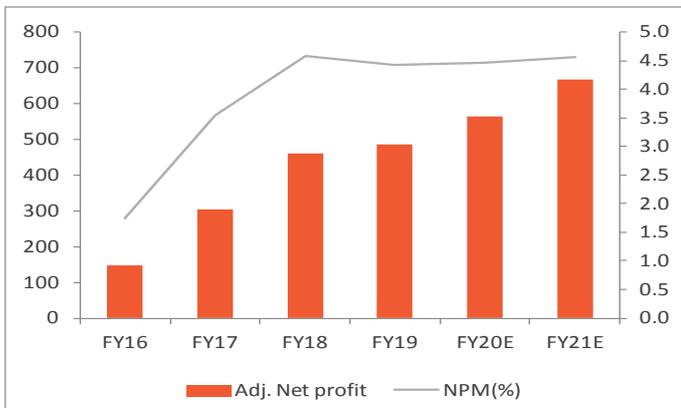
Source: Company, Sharekhan Research

Operating Profit and OPM(%) trend



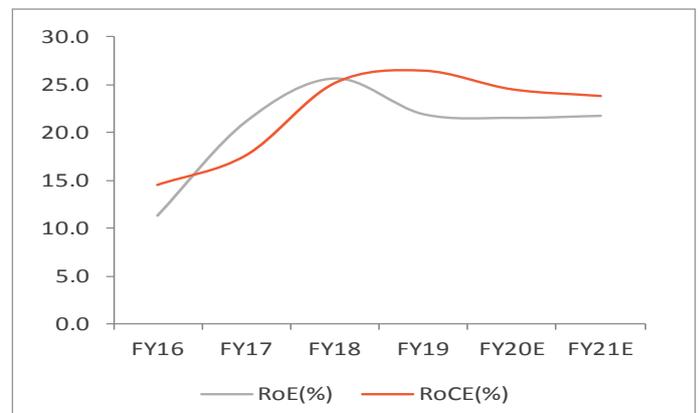
Source: Company, Sharekhan Research

Net profit & PAT margin trend



Source: Company, Sharekhan Research

Return ratios trend



Source: Company, Sharekhan Research

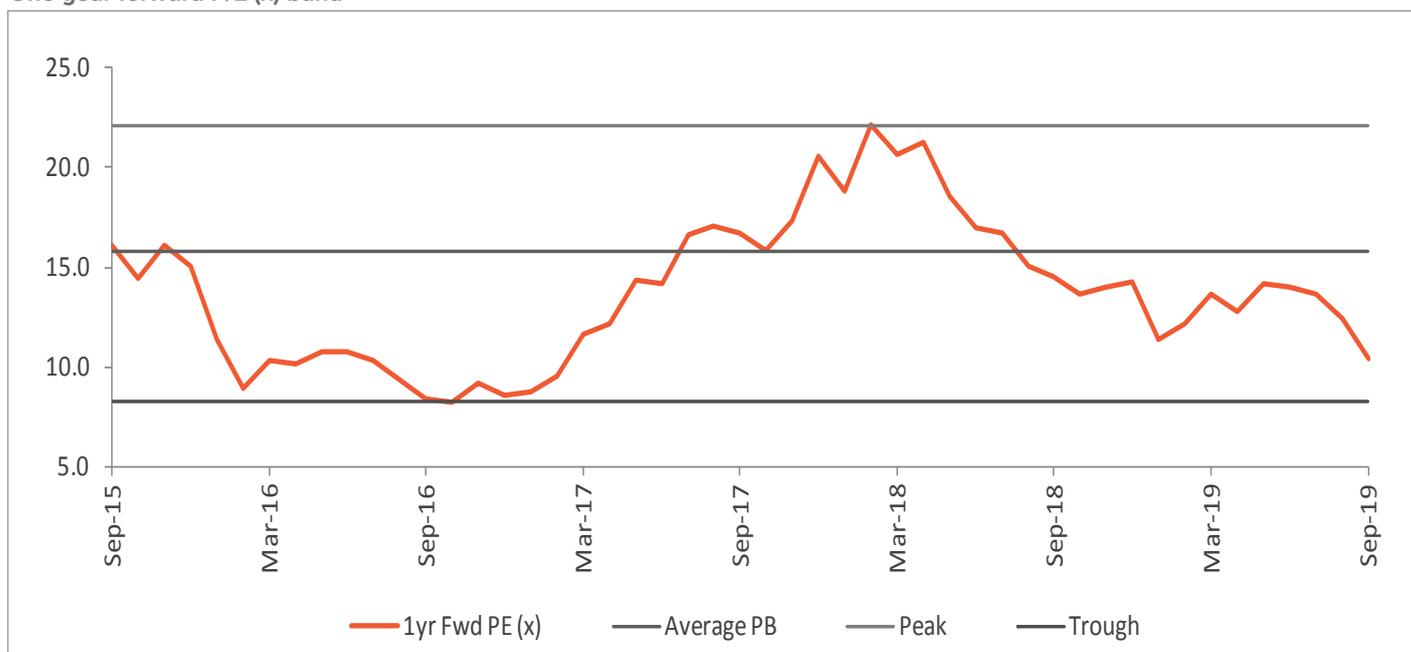
Outlook

Weakness in order inflow in near term likely to persist: The delays in project tendering especially in green energy corridor projects, RRTS order, PGCIL tendering, Railway signaling, private industrial capex and Saudi Arabia orders has resulted in lower order intake during H1FY2020 till date. Consequently, order inflow for FY2020 may fall short of its full year guidance resulting into lower revenue booking for FY2021 (FY2020 revenue may not be materially affected due to current strong order backlog). Over the medium to long term, the management foresees traction building up in tendering across segments barring private industrial capex which should replenish its order intake.

Valuation

Maintain Buy with a revised PT of Rs. 325: We have revised our estimates downwards for FY2021E factoring lowering order inflow for FY2020. We have also lowered our valuation multiple considering near term sluggishness in order tendering. KEC has corrected by ~25% over trailing two and half months on account of continued slowdown in order tendering. We expect KEC's stock price has already built in sluggish macro environment and offers favorable risk reward to investors at current juncture. Hence, we have maintained our Buy rating on the stock with revised PT of Rs. 325 (lowering FY2021E earnings and valuation multiple).

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
KEC	11.4	9.6	6.4	5.7	2.3	1.9	21.6	21.8
L&T	18.3	15.9	13.6	12.1	2.7	2.4	15.2	15.7
KPTL	13.5	16.2	7.8	6.6	2.0	1.8	13.8	14.5

Source: Sharekhan Research

About company

KEC International is a Global Power Transmission Infrastructure EPC major. The company is present in the verticals of power T&D, cables, railways, renewable (solar energy), smart Infra and civil. Globally, the company has powered infrastructure development in more than 61 countries. KEC is a leader in power transmission EPC projects and has more than seven decades of experience. Over the years, it has grown through the organic as well as inorganic route.

Investment theme

T&D spending in India is expected to be around Rs. 2,300 billion over FY2018-FY2023E, up 28% over FY2012-FY2017. A large part of this spend is likely to come from State Electricity Boards. Additionally, ordering for Green Energy Corridor is likely to provide ample opportunities in the domestic market. Moreover, expansion in regional transmission network in Africa, SAARC and CIS countries is likely to supplement domestic demand and present a large business opportunity. KEC has significantly scaled up the non-T&D segments (railways and civil segments) and margins in these segments have improved significantly. Opportunity size remains high in the non-T&D segment to provide enough opportunity to ramp up its total order outstanding for the business. Order book remains strong, providing strong revenue visibility; and order inflow visibility remains healthy in international T&D and railways.

Key Risks

- ◆ Slower-than-expected execution of projects in domestic and international markets due to various reasons is expected to impact KEC performance.
- ◆ Slowdown in tendering activities, especially in T&D, railways and overseas orders.

Additional Data

Key management personnel

Mr. Harsh Vardhan Goenka	Non-Executive - Non Independent Director-Chairperson
Mr. Vimal Kejriwal	Executive Director
Rajeev Aggarwal	Chief Financial Officer
Mr. Ajit Tekchand Vaswani	Non-Executive - Independent Director

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Swallow Associates Ltd	26.36
2	Summit Securities Ltd	10.86
3	HDFC Asset Management Co Ltd	8.97
4	Instant Holdings Ltd	8.49
5	Aditya Birla Sun Life Asset Manage	3.46
6	Reliance Capital Trustee Co Ltd	2.98
7	Aditya Birla Sun Life Trustee Co P	2.93
8	Kotak Mahindra Asset Management Co	2.84
9	IDFC Mutual Fund/India	2.22
10	STEL Holdings Ltd	1.95

Source: Bloomberg

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