DALAL & BROACHA
STOCK BROKING PVT. LTD.

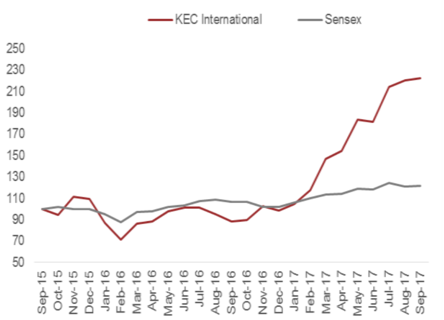
Analyst: Avinash Kumar (022) 67141449

Initiating Coverage@ Dalal & Broacha

BUY	
Current Price	315
Target Price	380
Upside/Downside	21%
52 Week Range	Rs.111/322

Key Share Data	
Market Cap (Rs.bn)	79.7
Market Cap (US$ mn)	1257
No of o/s shares (mn)	257
Face Value	2
Monthly Avg.vol(BSE+NSE) Nos	701,176
BSE Code	532714
NSE Code	KEC
Bloomberg	KECI IN

Price performance



% Shareholding	Mar-16	Dec-15
Promoters	50.9	50.9
FII	7.8	7.8
DII	23.6	23.6
Others	17.7	17.7
Total	**100.0**	**100.0**

Growth momentum to continue

KEC is on a strong growth trajectory with expected earnings CAGR of 17% over FY17-19E. An established transmission line EPC player, the company has forayed into newer high growth areas like railways and solar. Despite tepid topline in FY17 profits doubled due to cost efficiency and interest savings. A promising order and execution pipeline coupled with cost control makes it the pick among the transmission EPC companies. Initiate coverage with Buy; TP of Rs **380.**

Proven transmission line EPC player, diversifying into emerging areas

KEC is a proven transmission line EPC player with a consistent order win record with PGCIL. Its share of PGCIL is ~15-20%. It has also historically worked with SEBs and is a frontrunner for intra state transmission projects. It also has an international portfolio with international transmission projects as well as its subsidiary SAE in the USA. To reduce dependence on transmission, it has forayed into new areas like railways and solar.

Business visibility is strong across verticals for KEC

PGCIL has a budgeted spend of Rs 245bn in FY18 and KEC will be among the front runners. The bid pipeline for railway and solar projects and state orders look good with a pipeline of Rs 10bn in TN and Rs 9.5bn in Karnataka. Management indicated that Saudi and Far East markets have a strong outlook in its international business, while African markets are not as strong. It is also getting into civil construction. It has guided a 15% topline growth and a 9.5% EBIDTA margins in FY18. Railways and solar are key areas with expected revenues of Rs 7.5bn in (+80%) & Rs 5bn (up 3x) respectively.

Focus on debt reduction and working capital is helping profitability

The company is focusing on debt reduction and has brought down debt by Rs 11.5bn in FY17. Similarly, it has brought down receivables by Rs 5.5bn and is targeting to bring down receivables from 240days currently to 180days. This has a palpable impact on its interest costs and the company is working towards bringing interest costs to 2.5% of sales from the current 2.9%.

Initiate coverage with a Buy rating and TP of Rs 380

A promising order and execution pipeline coupled with cost control makes it the pick in the transmission EPC space. This coupled with balance sheet focus and working capital management should ensure continued robust 20% CAGR over FY17-19E. Initiate with Buy and a TP of Rs 380. Based on a target multiple of 20xFY19E.

Key Financials

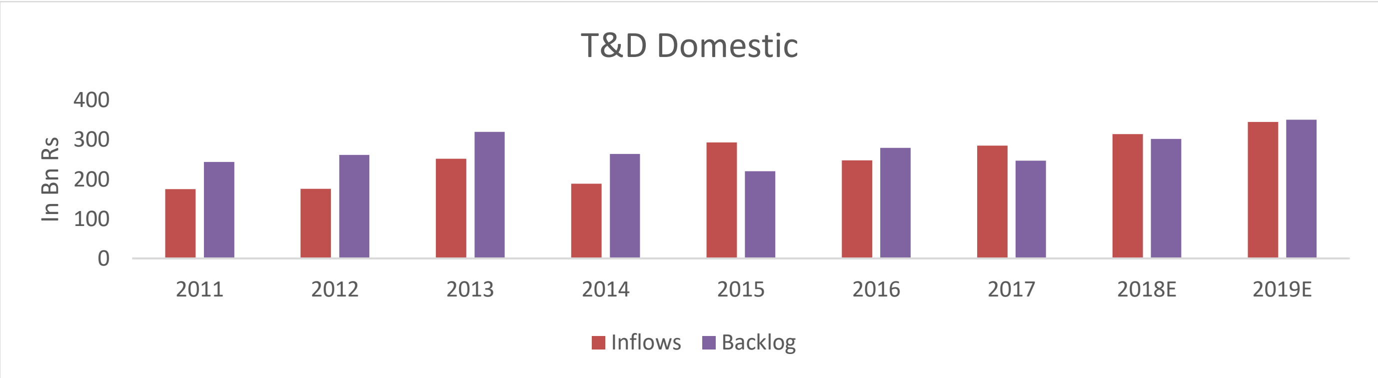
Rs mn	Net Sales	% Growth	EBITDA	OPM%	PAT	% Growth	EPS	P/E (x)	ROE %	RoCE%
FY16	85163	7.2%	6793	6.0%	1915	89.4%	7.4	42.3	12.7%	15.0%
FY17	87551	2.8%	8179	9.3%	3043	19.0%	11.8	26.6	19.2%	20.0%
FY18E	102734	17.3%	9842	9.6%	3755	23.4%	14.6	21.6	19.7%	21.6%
FY19E	125615	22.3%	11959	9.5%	4884	30.1%	19.0	16.6	21.1%	23.4%

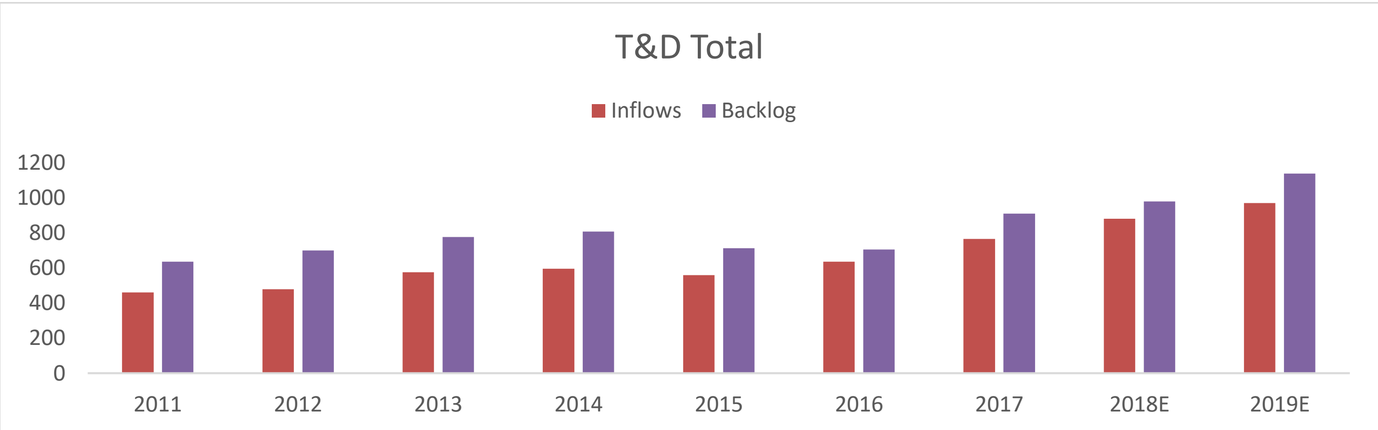
Proven transmission line EPC player, diversifying into emerging areas

KEC is a proven transmission line EPC player with a consistent order win record with PGCIL. Its share of PGCIL is ~15-20%. KEC is one of the few EPC companies that has successfully managed the cycle of ups and downs in the domestic T&D business in the last seven decades. Over time, the company has gained expertise to offer end-to-end solutions in power T&D – power transmission line projects, concept to commissioning of high voltage AIS (upto 1150kv) and GIS (upto 765kv). KEC being a leader in Power Transmission EPC space also growing rapidly in substation segment which now comprises a significant part of the order book, this segment generated Rs 6bn of total revenues in FY17.

With huge investments being planned in terms of "One Nation - One Grid" connectivity with focus on affordability & reliability. It includes substantial outlays by the state government for expanding intra-state transmission infrastructure in addition to PGCIL increased capital outlay. Initiatives like UDAY to improve DISCOMs liquidity position helps states in India gain traction, paving way for improved profitability for the company and sector as a whole in coming years.

The company prefers to work with few SEBs like Tamil Nadu, Karnataka, West Bengal, Gujarat, Rajasthan etc., which have the financial backing from multilateral or bilateral agencies. Going forward, KECI is expected to maintain its share in the domestic T&D orders as the competition from relatively smaller and insignificant players is likely to be limited with utilities / project developers now preferring to award larger turnkey projects (Rs8-9bn range) rather than splitting them into multiple smaller sized contracts.

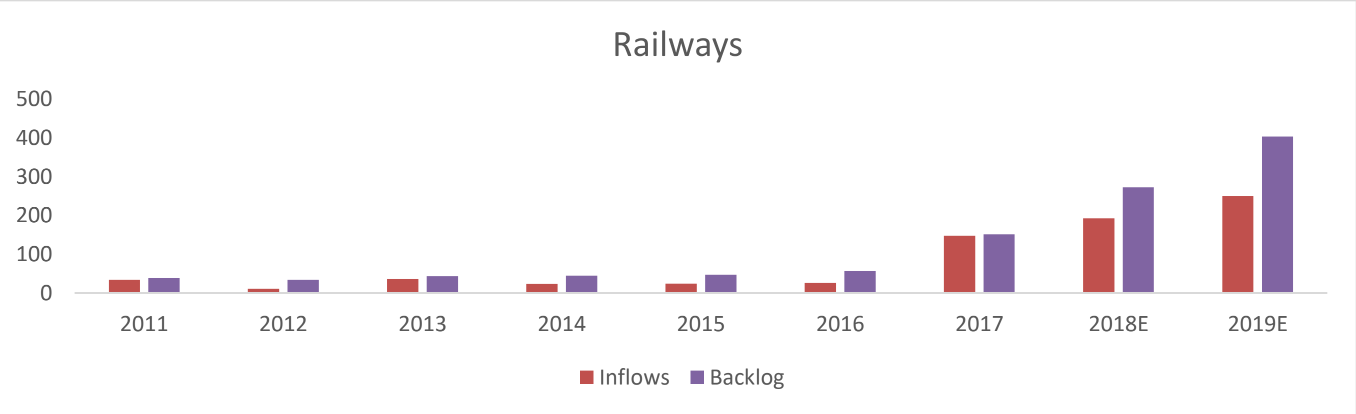




Business visibility is strong across verticals for KEC

KEC with its growing order book is focused across its different verticals. With increased budgetary allocations from govt in infra projects, railways and overhead electrification targets augurs well for the company.

Opportunity size in railways is huge and KEC is well placed to tap this. As per sources ~Rs200bn of railway electrification and gauge conversion projects are expected to be awarded in FY18. Going forward, railways is also expected to award bigger composite projects in the near term. The competition is expected to reduce as smaller players with weaker / poor balance sheets are precluded from bidding for larger composite orders. The increasing order accretions and revenue bookings is expected to help KEC completely absorb the fixed overheads and report higher profitability similar to the T&D margins in the next 3-4 quarters. As on date the gap in margins between railways and T&D is ~75bps.



Given that Government of India plans to add nearly 100GW of solar power in the next 5-6 years, we believe there exists huge potential (~Rs5tn) for EPC companies specialising in mounting structures and turnkey solutions. However, KEC believes that order inflow for solar EPC projects could get delayed in the near term as many SEBs and developers are yet to finalise the power rates and conclude the PPAs. The bid pipeline for railway and solar projects and state orders look good with a pipeline of Rs 10bn in TN and Rs 9.5bn in Karnataka. It is also getting into civil construction which is at a nascent stage but expects the company to grow leaps and bound. It has guided a 15% topline growth and a 9.5% EBIDTA margins in FY18. Railways and solar are key areas with expected revenues of Rs 7.5bn in (+80%) & Rs 5bn (up 3x) respectively.

Increasing Government spend on infrastructure to help KEC

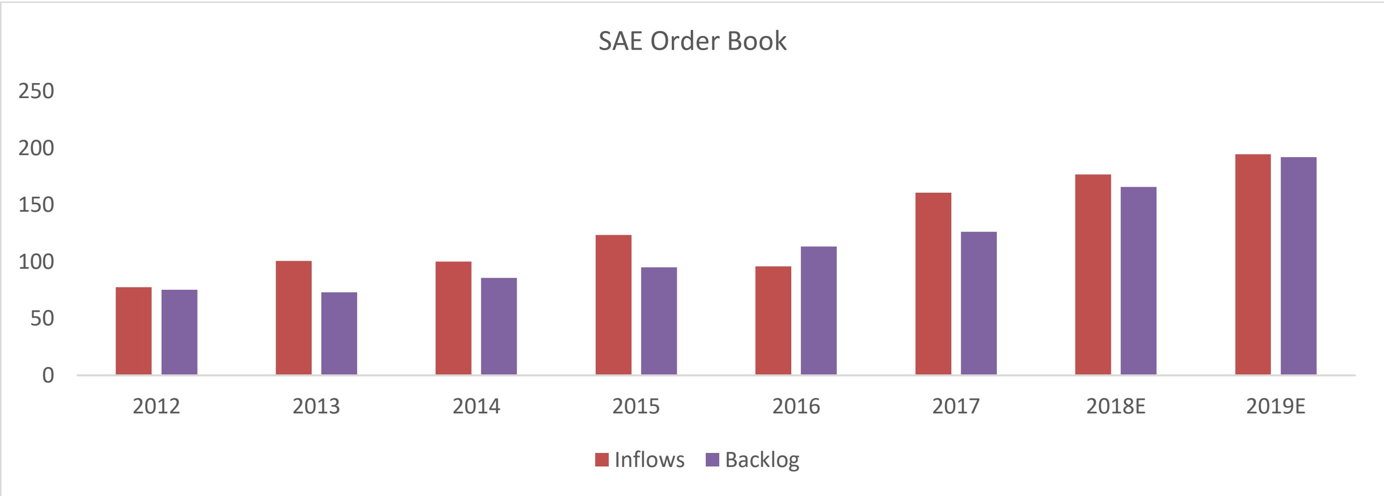
Increase in budgetary allocation for railways to Rs 1,310bn from Rs 1,210bn and overhead electrification targets of 6,000kms augers well for the company since it is responsible for 40% of the total railway's electrification as on FY17. The company had substantial order inflow and robust order book back log of around Rs 16bn. It is currently executing 14 projects of which 9 was secured in FY17.

The Indian government thrust on urban infrastructures such as metro and smart cities is expected to provide a significant boost to the domestic power cable business which is estimated to grow 15-20% in medium-term. Cables business margin maintained at a 6%, which is currently the industry average. The Company is expecting to reach 7-8% by the end of this year.

With central and state governments announcing financial support of Rs 81bn and planned capacity of solar parks doubled from 20GW to 40GW as per National Solar mission presents increasing interest for the company.

The Company's renewed focus on International Business

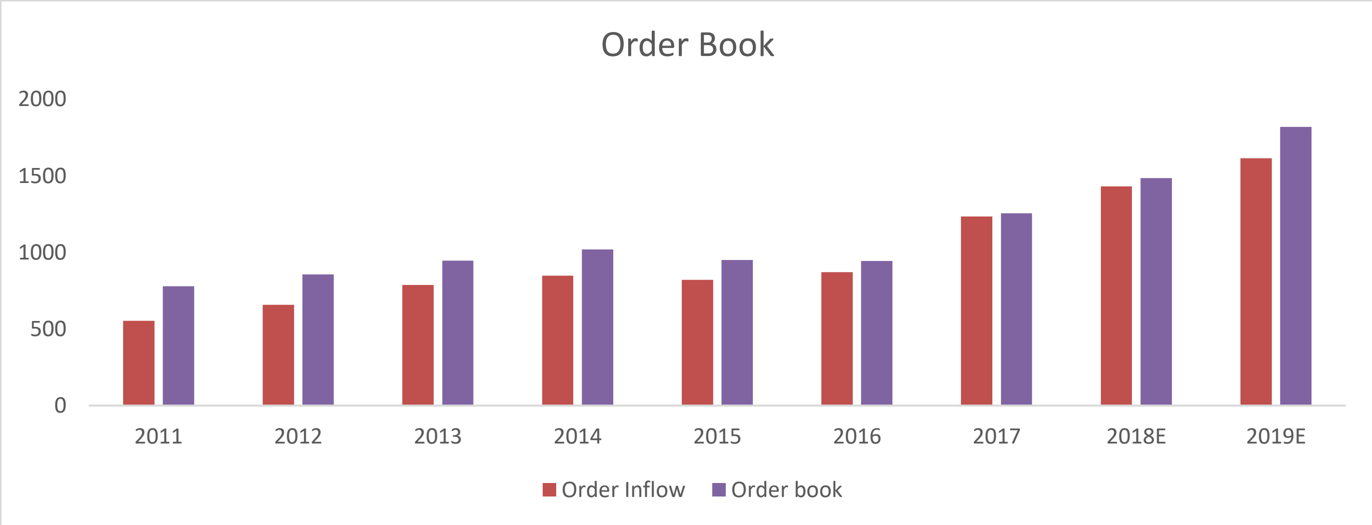
The company has secured some large orders in the international market and has successfully rebalanced its middle portfolio and entered/re-entered eight countries namely Senegal, Jordan, Egypt, Tanzania, Mozambique, Zambia, Malaysia and Thailand. The number of inquiries has increased, especially from North America as there is need to build new lines and refurbish old lines. It added new customers from Egypt and Jordan. Based on the geopolitical tension between countries in the Middle East, KEC is selective about any new project from this region and is keen to avoid this region due to the warlike situation so any project in Saudi will not generate any cash flow for now. Company's revenues from Brazil have shown some improvement and the management expects stronger profitability from this region going forward. As there are very less number of competitors in Brazil, the competition is less and the company has strong opportunities. Management indicated that Saudi and Far East markets have a strong outlook in its international business, while African markets are not as strong. It is planning to invest Rs 5bn in Mauritius for upcoming projects.



Focus on debt reduction and working capital is helping profitability

The company is focusing on debt reduction and has brought down debt by Rs 11.5bn in FY17. Similarly, it has brought down receivables by Rs 5.5bn and going forward, the endeavor would be to reduce the working capital to 180 days from the existing 220 days. This has a palpable impact on its interest costs and the company is working towards bringing interest costs further down to 2.5% of sales from the current 2.9%.

Overall the order intake of the Company grew by 42% YoY and the total order book grew by ~34% YoY for FY17 and International order book grew by 27% YoY. The Company is confident about all the project it has undertaken, as most of these projects are funded by multilateral sources so the credibility of these projects is high.



Key Risks

- **Currency risks and volatility in commodity prices to impact profitability**: Significant proportion of international billings are in currencies other than the USD or Euro, which exposes the company to cross currency fluctuations and translation losses. Since the international T&Đ EPC jobs are fixed price contracts, KEC would also be exposed to volatility in commodity prices. Commodities like aluminum, zinc and copper can be hedged on LME while the same mechanism is not available for steel.
- **Slowdown in Middle East & Africa (MENA) and other geographies**: KEC derives majority of its international business from the MENA regions. The sharp correction in crude oil prices had negatively impacted many infrastructure projects, either leading to their cancellation or deferral. Similarly, the global slowdown has resulted in lower energy demand and consequently lower demand for power. With crude oil now settling at over USD45 - 50/ barrel, we expect increasing budgetary allocation to the infrastructure projects especially those related to power generation and transmission.

Initiate coverage with a Buy rating and TP of Rs 380

A promising order and execution pipeline coupled with cost control makes it the pick in the transmission EPC space. This coupled with balance sheet focus and working capital management should ensure continued robust 20% CAGR over FY17-19E. Initiate with Buy and a TP of Rs 380. Based on a target multiple of 20xFY19E.

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Financials

Profit & Loss (Rs Mn)	FY15	FY16	FY17	FY18E	FY19E
Net Sales	84,678	85,163	87,551	102,734	125,615
Raw Materials	(64,527)	(62,198)	(59,489)	(69,468)	(86,272)
Employee Cost	(5,865)	(6,424)	(7,327)	(8,835)	(11,054)
Other Expenses	(9,168)	(9,749)	(12,556)	(14,588)	(16,330)
Cost of Sales	(79,560)	(78,370)	(79,372)	(92,892)	(113,657)
Operating Profit	**5,118**	**6,793**	**8,179**	**9,842**	**11,959**
Depreciation	(881)	(876)	(1,305)	(1,495)	(1,625)
PBIT	4,237	5,917	6,874	8,347	10,333
Other Income	1,462	103	289	280	219
Interest	(3,089)	(2,774)	(2,536)	(2,761)	(2,918)
Prior period items	0	0	0	0	0
Profit Before Tax	2,611	3,245	4,627	5,866	7,634
Provision for Tax	(1,001)	(1,331)	(1,584)	(2,111)	(2,750)
PAT	**1,610**	**1,915**	**3,043**	**3,755**	**4,884**
Extra ordinary Items	0	0	0	0	0
Share of JV/ Associate	0	0	0	0	0
Adj. PAT	**1,610**	**1,915**	**3,043**	**3,755**	**4,884**

Balance Sheet (Rs Mn)	FY15	FY16	FY17	FY18E	FY19E
Equity Capital	514	514	514	514	514
Reserves	12,784	14,605	15,349	18,513	22,634
Net Worth	**13,298**	**15,119**	**15,864**	**19,027**	**23,148**
Long term borrowings	21,894	25,144	19,981	20,981	21,981
Short term borrowings	0	0	0	0	0
Total Debt	21,894	25,144	19,981	20,981	21,981
Capital Employed	**35,192**	**40,263**	**35,845**	**40,009**	**45,129**
Gross Block	13,393	13,393	16,443	17,943	19,443
Accumulated Depreciatioı	(4,747)	(5,374)	(7,278)	(8,773)	(10,398)
Net Block	8,646	8,019	9,165	9,170	9,045
Capital WIP	164	117	51	51	51
Total Fixed Assets	**8,811**	**8,136**	**9,216**	**9,221**	**9,096**
Goodwill & Intagible	3,943	4,180	1,910	1,910	1,910
Investments	0	0	1,304	1,304	1,304
Inventories	7,671	6,847	3,947	5,577	6,739
Sundry debtors	40,120	46,858	42,268	47,745	56,009
Cash & bank	2,063	1,113	2,080	3,151	3,103
Loans & advances and Ot	14,664	13,540	26,424	30,720	38,751
Trade Paybles	(35,575)	(33,496)	(21,983)	(25,557)	(30,883)
Current Liabilities	(4,759)	(5,818)	(27,033)	(31,428)	(37,977)
Provisions	(1,219)	(1,136)	(1,047)	(1,394)	(1,685)
Working Capital	22,966	27,906	24,655	28,813	34,059
Deffered Tax Liabilities	(527)	(421)	(1,240)	(1,240)	(1,240)
Capital Deployed	**35,192**	**39,801**	**35,845**	**40,009**	**45,129**

Cash Flow Statement (Rs Mn)	FY15	FY16	FY17	FY18E	FY19E
Pre tax Profit	2611	3245	4627	5865	7638
Add: Dep. & Amortization	881	876	1305	1495	1625
Total tax paid	(1001)	(1331)	(1584)	(2111)	(2750)
Other Adjsutments	3089	2774	2536	2761	2918
Cash Profit	**5579**	**5565**	**6884**	**8009**	**9432**
(Inc) / Dec in					
Sundry Debtors	(432)	(6737)	4590	(5477)	(8264)
Inventories	99	824	2900	(1630)	(1162)
Loans & Advances	(3365)	1125	(12884)	(4296)	(8031)
Current liabilities & Trade payble	1358	(1103)	9613	8316	12165
Change in Working Capital	**(2340)**	**(5891)**	**4219**	**(3087)**	**(5293)**
CF from Operating Activities	**3239**	**(327)**	**11103**	**4921**	**4139**
CF from Investing Activities	**65**	**(899)**	**(957)**	**(1500)**	**(1500)**
CF from Financing Activities	**(2695)**	**382**	**(9997)**	**(2350)**	**(2686)**
Cash Generated (Utilised)	623	(951)	967	1071	(47)
Cash at the start of year	1440	2063	1113	2080	3151
Cash at the end of year	2063	1113	2080	3151	3103

Ratios	FY15	FY16	FY17	FY18E	FY19E
OPM	6.0	8.0	9.3	9.6	9.5
NPM	1.9	2.2	3.5	3.7	3.9
Tax Rate %	(38.3)	(41.0)	(34.2)	(36.0)	(36.0)
Growth Ratio (%)					
Net Sales	7.2	0.6	2.8	17.3	22.3
Operating Profit	3.7	32.7	20.4	20.3	21.5
PAT	89.4	19.0	58.9	23.4	30.1
Per Share					
Earning Per Share (EPS)	6.3	7.4	11.8	14.6	19.0
Cash Earnings (CPS)	9.7	10.9	16.9	20.4	25.3
Dividend	0.9	1.0	1.6	2.0	2.6
Book Value	51.7	58.8	61.7	74.0	90.0
Free Cash flow	3,305	(1,226)	10,145	3,421	2,639
Valuation Ratios					
P/E (x)	50.4	42.3	26.6	21.6	16.6
P/B (x)	6.1	5.4	5.1	4.3	3.5
EV / Sales	1.2	1.2	1.1	1.0	0.8
EV / EBIDTA	19.7	15.5	12.1	10.1	8.4
Div. Yield (%)	0.3	0.3	0.5	0.6	0.8
FCF Yield (%)	1,048	(389)	3,217	1,085	837
Return Ratios (%)					
ROE	12.1	12.7	19.2	19.7	21.1
ROCE*	16.2	15.0	20.0	21.6	23.4

* includes other income

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