

## Weak margins drag show...

**About the stock:** KEC International (KEC) is one of the EPC majors in key infrastructure sectors such as power T&D, railways, civil, urban infrastructure, solar, smart infrastructure, oil & gas pipelines and cables.

- A strategic shift in portfolio from T&D to non-T&D (13% contribution in FY16 increased to 50% in FY22)
- T&D diversified across countries with entry in ~20 countries in last five years

**Q1FY23 Results:** KEC reported a weak set of Q1FY23 numbers.

- Revenue grew 30.6% YoY to ₹ 3318.1 crore owing to healthy growth in both T&D & non T&D
- EBITDA was at ₹ 168.5 crore, up 5.4% YoY with margins at 5.1%, impacted primarily by elevated commodity prices & logistics costs and SAE Brazil performance
- Consequently, adjusted PAT came in at ₹ 31.1 crore, de-grew 32.6% YoY
- Q1FY23 order inflows came strong at ₹ 3472 crore

**What should investors do?** KEC's share price has grown by ~4x over the past five years (from ~₹ 125 in March 2016 to ~₹ 500 levels in January 2022).

- We remain long term positive and retain our **HOLD** rating on the stock

**Target Price and Valuation:** We value KEC at ₹ 475 i.e. 15x P/E on FY24E EPS

**Key triggers for future price performance:**

- We expect revenue to grow at ~16% CAGR in FY22-24E owing to strong order book worth ~₹ 23720 crore and L1 orders worth ~₹ 8000 crore
- Strong order pipeline for FY23E to ensure decent order inflow growth
- SAE business' legacy EPC projects will get executed by Q2FY23, which will arrest losses and help to improve margin. Also, execution of new orders with good margins will also come into play in H1FY23

**Alternate Stock Idea:** We also like Thermax in our coverage.

- Strong balance sheet, prudent working capital management, recent technological tie-ups, are expected to support growth
- BUY with a target price of ₹ 2405



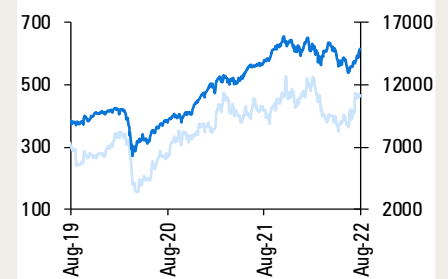
### Particulars

Particular	Amount
Market Capitalization	11,414.7
Total Debt (FY22)	2,862.7
Cash and Inv. (FY22)	295.0
EV	13,982.4
52 week H/L	₹550/ 346
Equity capital	₹ 51.4 Crore
Face value	₹ 2

### Shareholding pattern

(in %)	Sep-21	Dec-21	Mar-22	Jun-22
Promoter	51.8	51.8	51.8	51.9
FII	11.1	12.3	12.2	12.2
DII	27.0	26.4	26.4	26.5
Others	10.1	9.6	9.6	9.5

### Price Chart



### Recent Event & Key risk

- (i) Rising commodity prices (ii) Execution delays, order deferrals in T&D space (iii) Better execution and improving margins

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### Key Financial Summary

Particulars (₹ crore)	FY20	FY21	FY22	5 Year CAGR (FY17-FY22)	FY23E	FY24E	2 Year CAGR (FY22-FY24E)
Net Sales	11,965.4	13,114.2	13,742.3	10.1%	16,313.2	18,489.9	16.0%
EBITDA	1,234.7	1,141.2	903.5	2.0%	1,108.4	1,577.9	32.2%
EBITDA Margin (%)	10.3	8.7	6.6		6.8	8.5	
Net Profit	565.9	552.7	332.1	3.9%	398.5	762.0	51.5%
EPS (₹)	22.0	21.5	12.9		15.5	29.6	
P/E (x)	20.2	20.7	34.4		28.6	15.0	
RoNW (%)	20.2	17.0	10.6		10.8	17.6	
RoCE (%)	22.3	19.8	11.9		13.5	19.3	

Source: Company, ICICI Direct Research

## Key takeaways of recent quarter & conference call highlights

### Q1FY23 Results: Weak margins drag the show

- Consolidated revenue came in at ₹ 3318.1 crore, up 30.6% on a YoY basis, (above our estimate of ₹ 2815.2 crore)
- During Q1FY23, the overall T&D business (including SAE tower) revenue grew 17% on a YoY basis to ₹ 1645 crore. Non-T&D business (railways, civil, cables, other) registered robust growth of 46% to ₹ 1819 crore, on a YoY basis led by better execution. The railways business revenue came in at ₹ 705 crore, up 19% while civil business segment revenue registered significant growth of 99% YoY to ₹ 598 crore. Cables business grew 26% to ₹ 419 crore, YoY and oil & gas pipeline revenue came at ₹ 92 crore. Overall, T&D contributed 49.5% followed by railways (21.2%), civil (18.02%) and cable (12.6%) to revenues
- KEC's Q1FY23 order inflows came in strong at ₹ 3472 crore. The unexecuted order book as on Q1FY23 was at ₹ 23720 crore while the company is L1 in orders worth more than ₹ 8000 crore. T&D business contributed 46% to order book while non- T&D contributed 54% to order book. On order inflow front, T&D contributed 36% followed by civil (36%), cables (13%), railways (12%), and oil & gas (3%). Geographically, International order inflows contributes 15% and domestic contributed 85%
- EBITDA margins came in at 5.1% (below our estimate of 6.7%), down 122 bps on a YoY basis while it declined 81 bps on a QoQ basis, impacted primarily by elevated commodity prices & logistics costs and SAE Brazil performance. Absolute EBITDA came in at ₹ 168.5 crore, which increased 5.4% on a YoY basis. Generally, in a rising input environment, fixed price contracts in the international markets puts the company in a weak spot given input price inflation cannot be passed on. The same has a negative bearing on the respective project level margins
- Interest cost increased 54% YoY to ₹ 100 crore. In Q1FY23 KEC's net debt (excluding acceptances) has increased by ₹ 885 crore, YoY to ₹ 3418 crore, owing to few EPC orders in railways, where the billing is linked to erection i.e. milestone payments and loss in the SAE Brazil subsidiary. Net working capital day is at 148 days (vs. 137 days in Q4FY22). This is expected to normalise further owing to judicious monitoring of cash flows, focus on collections, especially retention receivables, and focus on expediting commercial closure of projects
- Adjusted PAT came in at ₹ 31.1 crore (below our estimate of ₹ 60.2 crore) which declined 32.6% YoY, impacted by continued headwinds on account of elevated raw material costs

### Q1FY23 Earnings Conference Call highlights

- In Q1FY23, overall T&D business (including SAE tower) revenue grew 17% YoY to ₹ 1645 crore owing to robust execution across India and Overseas. Company secured new orders of ₹ 1,200 crore+ for T&D and cabling projects across India, Middle East and Americas including a prestigious order to build India's first 765kV digital GIS substation from PGCIL. During the quarter SAE losses were on PBT was ₹ 100 crore, interest cost has significantly gone up to 18%. As per the management commentary the company will be out losses in SAE by end of Q2FY23 while some spill over may be there in Q3FY23
- The civil business segment revenue registered significant growth of 99% YoY to ₹ 598 crore. Civil segment will end year with double digit margin. Secured orders of ₹ 1,200 crore+ across industrial, residential, hydrocarbon, defence and data centre segments. KEC recorded all-time high order book + L1 of over ₹ 10,000 crore in the civil segment

- The railway business revenue came in at ₹ 705 crore, up 19% YoY. Delivered double-digit EBITDA margins, despite a challenging environment. KEC witnessing a gradual pick up in tendering activities and was confident of securing a larger share of orders in coming months. Lately few EPC orders in Railways, where the billing is linked to erection i.e. milestone payments and hampering cash flows. These projects will get completed by Q3FY23
- KEC is targeting order inflow growth for the next few years will be at ~15-20%. Civil, T&D and oil & gas segments will be the main drivers for growth. From Q3FY23 onwards, KEC is expecting gradual margin improvement and reduction in debt and improving working capital. The management is targeting 130-135 days of NWC by FY23E
- On the margins front, Q2FY23E will see same level of EBITDA margin compared to Q1FY23. The recovery is expected from Q3FY23E onwards as losses in SAE towers will be over by then, low margin T&D orders will be in completion and high margin news orders execution will come into play. For Q1FY23, railway segment margins were in double digits and civil segment will reach those believe by FY23 end. For FY24E, the management expects double digit margins at the company level
- Debt during Q1FY23 increased on account of loss funding at SAE level (debt at ₹ 400 crore), higher execution and input prices also lead to increase in working capital loans, also increased receivables from railways segment and release of PVC at end of execution of projects
- Tenders worth ~ ₹ 1,10,000 crore including quoted and unquoted. Out of this, the quoted tenders were at ₹ 27000 crore while from a segmental perspective, T&D international and domestic were at ₹ 55000 crore

Exhibit 1: Variance Analysis

	Q1FY23	Q1FY23E	Q1FY22	YoY (Chg %)	Q4FY22	QoQ (Chg %)	Comments
Revenue	3,318.1	2,815.2	2,540.0	30.6	4,274.8	-22.4	Owing to healthy growth in both T&D & Non T&D
Other Income	8.0	4.5	1.7	364.9	3.4	134.5	
Employee Expenses	340.6	334.6	301.9	12.8	318.0	7.1	
Raw Material Expenses	1,313.8	1,171.1	1,054.0	24.7	1,859.7	-29.4	
Other Operating Expenses	346.0	242.6	216.3	59.9	317.0	9.1	
Erecting and Contracting Expenses	1,149.2	878.3	808.0	42.2	1,528.4	-24.8	
EBITDA	168.5	188.7	159.9	5.4	251.7	-33.0	
EBITDA Margin (%)	5.1	6.7	6.3	-122 bps	5.9	-81 bps	Impacted primarily due to the elevated commodity prices & logistics costs and SAE Brazil performance.
Depreciation	39.3	25.7	38.1	3.0	41.9	-6.2	
Interest	100.0	86.2	64.9	54.1	95.4	4.8	
PBT	37.2	81.3	58.5	-36.5	117.8	-68.4	
Total Tax	6.1	21.1	12.4	-50.9	5.8	5.9	
Adjusted PAT	31.1	60.2	46.1	-32.6	112.0	-72.3	

Key Metrics

Order inflows	3,472	4,401	-21.1	3,082.0	12.7	
Order backlog	23720	19529	21.5	23716	0.0	Backlog and execution cycle ensures reasonable visibility in FY23E-24E

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	FY22		FY23E		FY24E		Comments
	Actual	Old	New	% Change	Old	New	
Revenue	13,742.3	15,850.8	16,313.2	2.9	17,927.4	18,489.9	3.1
EBITDA	903.5	1,107.9	1,108.4	0.0	1,482.6	1,577.9	6.4
EBITDA Margin (%)	6.6	7.0	6.8	-21 bps	8.3	8.5	23 bps
PAT	332.1	406.2	398.5	-1.9	649.2	762.0	17.4
EPS (₹)	12.9	15.8	15.5	-1.9	25.3	29.6	17.2

Source: Company, ICICI Direct Research

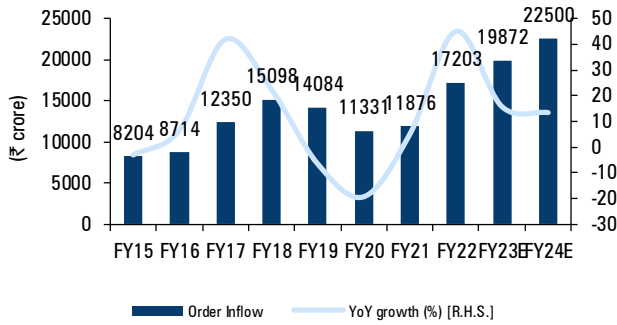
Exhibit 3: Assumptions

	Current			Earlier		Comments
	FY22	FY23E	FY24E	FY23E	FY24E	
Order Inflow growth	44.9	15.5	13.2	12.8	5.7	Order inflow estimates revised considering bunching up of tendering activities
Order Backlog growth	34.2	14.4	14.8	15.0	9.4	
Revenue growth	4.8	18.7	13.3	15.3	13.1	Strong revenue growth in railways, civil likely to continue amid good traction in international T&D
EBITDA Margins	6.6	6.8	8.5	7.0	8.3	

Source: Company, ICICI Direct Research

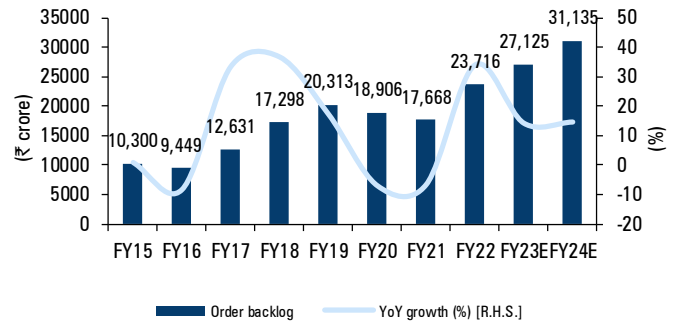
## Financial story in charts

Exhibit 4: KEC exhibits strong order inflow trend...



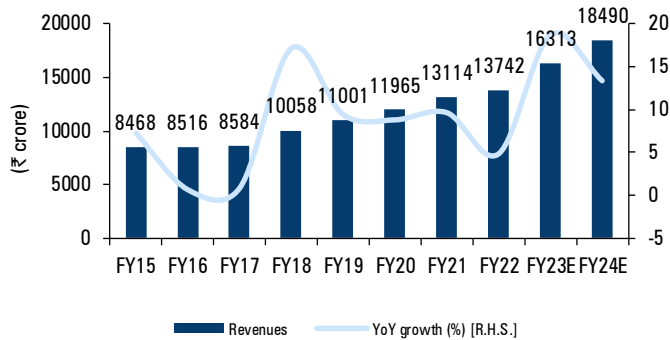
Source: Company, ICICI Direct Research

Exhibit 5: Order backlog trend and visibility



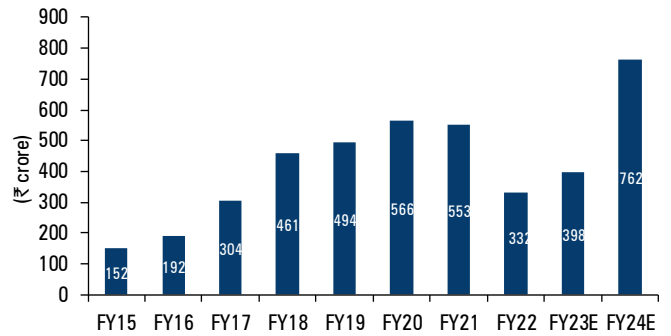
Source: Company, ICICI Direct Research

Exhibit 6: Revenue trend in FY15-24E



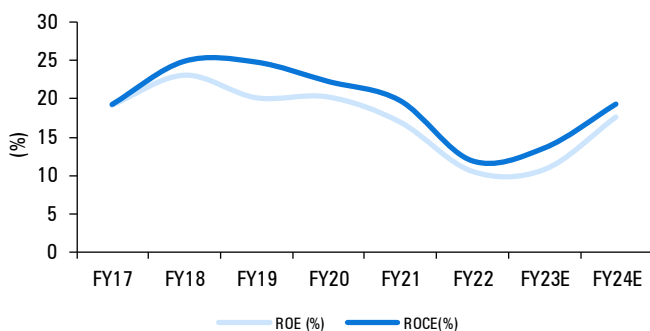
Source: ICICI Direct Research, Company

Exhibit 7: PAT to rise sharply on strong margin recovery



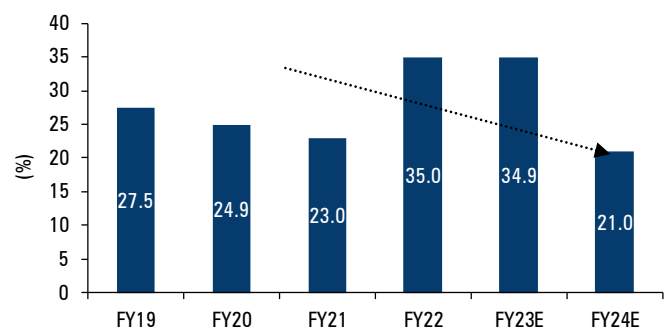
Source: ICICI Direct Research, Company

Exhibit 8: Return ratios



Source: Company, ICICI Direct Research

Exhibit 9: Interest/EBITDA ratio to improve, going ahead



Source: Company, ICICI Direct Research

## Financial summary

Exhibit 10: Profit and loss statement				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
<b>Total operating Income</b>	<b>13,114.2</b>	<b>13,742.3</b>	<b>16,313.2</b>	<b>18,489.9</b>
Growth (%)	9.6	4.8	18.7	13.3
Raw Material Expenses	5,700.6	5,949.0	6,929.9	7,867.8
Employee Expenses	1,115.1	1,258.7	1,414.1	1,552.3
Erecting & Contracting Exp.	3,907.0	4,509.2	5,434.3	5,931.9
Administrative Expenses	1,250.3	1,121.9	1,466.5	1,627.0
Total Operating Expenditure	11,973.0	12,838.8	15,244.8	16,979.0
<b>EBITDA</b>	<b>1,141.2</b>	<b>903.5</b>	<b>1,108.4</b>	<b>1,577.9</b>
Growth (%)	-7.6	-20.8	22.7	42.4
Depreciation	152.5	157.9	213.7	229.4
Interest	262.7	316.0	386.3	331.5
Other Income	29.9	13.4	33.0	29.5
Exceptional Item	0.0	43.6	0.0	0.0
PBT	755.9	399.4	541.3	1,046.4
Total Tax	203.2	67.4	142.9	284.4
<b>PAT</b>	<b>552.7</b>	<b>332.1</b>	<b>398.5</b>	<b>762.0</b>
Adjusted PAT	552.7	332.1	398.5	762.0
Growth (%)	-2.3	-39.9	20.0	91.2
EPS (₹)	21.5	12.9	15.5	29.6

Source: Company, ICICI Direct Research

Exhibit 11: Cash flow statement				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
Profit after Tax	552.7	332.1	398.5	762.0
Add: Depreciation	152.5	157.9	213.7	229.4
(Inc)/dec in Current Assets	-798.3	-1,779.1	-645.7	-1,638.0
Inc/(dec) in CL and Provisions	848.2	929.4	534.3	1,103.3
Others	3.3	3.0	5.0	5.0
<b>CF from operating activities</b>	<b>755.1</b>	<b>-359.7</b>	<b>500.7</b>	<b>456.8</b>
(Inc)/dec in Investments	-17.0	-16.5	-40.0	-40.0
(Inc)/dec in Fixed Assets	-132.2	-24.2	-180.0	-180.0
Others	0.0	0.0	0.0	0.0
<b>CF from investing activities</b>	<b>-499.0</b>	<b>-360.7</b>	<b>-359.0</b>	<b>-309.0</b>
Issue/(Buy back) of Equity	0.0	0.0	0.0	0.0
Inc/(dec) in loan funds	-218.4	1,019.3	250.0	-350.0
Dividend paid & dividend tax	-102.8	-103.8	-129.7	-138.9
Inc/(dec) in Sec. premium	0.0	0.0	0.0	0.0
Others	0.0	7.6	0.0	0.0
<b>CF from financing activities</b>	<b>-311.8</b>	<b>918.5</b>	<b>67.3</b>	<b>-488.9</b>
Net Cash flow	-55.7	198.0	209.0	-341.2
Opening Cash	152.7	97.0	295.0	504.0
<b>Closing Cash</b>	<b>97.0</b>	<b>295.0</b>	<b>504.0</b>	<b>162.8</b>

Source: Company, ICICI Direct Research

Exhibit 12: Balance sheet				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
<b>Liabilities</b>				
Equity Capital	51.4	51.4	51.4	51.4
Reserve and Surplus	3,205.5	3,436.7	3,652.4	4,275.5
Total Shareholders funds	3,256.9	3,488.1	3,703.8	4,326.9
Total Debt	1,843.4	2,862.7	3,112.7	2,762.7
Deferred Tax Liability	55.2	43.8	48.8	53.8
Minority Interest / Others	0.0	0.0	0.0	0.0
<b>Total Liabilities</b>	<b>5,282.4</b>	<b>6,575.8</b>	<b>7,056.5</b>	<b>7,344.6</b>
<b>Assets</b>				
Gross Block	1,895.4	1,897.6	2,067.6	2,247.6
Less: Acc Depreciation	779.6	933.8	1,111.9	1,305.7
Net Block	1,115.7	963.9	955.8	941.9
Capital WIP	17.9	30.0	40.0	40.0
Total Fixed Assets	1,133.6	993.9	995.8	981.9
Investments	50.4	67.0	107.0	147.0
Inventory	842.2	1,066.5	1,034.1	1,194.8
Debtors	5,384.7	5,106.1	6,480.6	7,092.0
Loans and Advances	99.7	110.9	126.5	143.4
Other Current Assets	5,306.7	7,128.9	6,416.8	7,265.7
Cash	97.0	295.0	504.0	162.8
Total Current Assets	11,730.2	13,707.3	14,562.0	15,858.8
Creditors	6,174.9	6,847.3	7,151.0	8,105.2
Provisions	65.1	87.8	85.8	97.3
Total Current Liabilities	8,662.7	9,592.1	10,126.3	11,229.7
Net Current Assets	3,067.6	4,115.3	4,435.7	4,629.2
Others Assets	0.0	0.0	0.0	0.0
<b>Total Assets</b>	<b>5,282.4</b>	<b>6,575.8</b>	<b>7,056.5</b>	<b>7,344.6</b>

Source: Company, ICICI Direct Research

Exhibit 13: Key ratios				
	₹ crore			
(Year-end March)	FY21	FY22	FY23E	FY24E
<b>Per share data (₹)</b>				
EPS	21.5	12.9	15.5	29.6
Cash EPS	27.4	19.1	23.8	38.6
BV	126.7	135.7	144.1	168.3
DPS	4.0	4.0	4.2	4.5
Cash Per Share	3.8	11.5	19.6	6.3
<b>Operating Ratios (%)</b>				
EBITDA Margin	8.7	6.6	6.8	8.5
PBT / Total Operating income	5.8	2.9	3.3	5.7
PAT Margin	4.2	2.7	2.4	4.1
Inventory days	23.4	28.3	23.1	23.6
Debtor days	149.9	135.6	145.0	140.0
Creditor days	171.9	181.9	160.0	160.0
<b>Return Ratios (%)</b>				
RoE	17.0	10.6	10.8	17.6
RoCE	19.8	11.9	13.5	19.3
RoIC	23.9	15.4	17.9	24.3
<b>Valuation Ratios (x)</b>				
P/E	20.7	34.4	28.6	15.0
EV / EBITDA	11.5	15.5	12.7	8.9
EV / Net Sales	1.0	1.0	0.9	0.8
Market Cap / Sales	0.9	0.8	0.7	0.6
Price to Book Value	3.5	3.3	3.1	2.6
<b>Solvency Ratios</b>				
Debt/EBITDA	1.6	3.2	2.8	1.8
Debt / Equity	0.6	0.8	0.8	0.6
Current Ratio	1.3	1.4	1.4	1.4
<b>Quick Ratio</b>	<b>1.2</b>	<b>1.3</b>	<b>1.3</b>	<b>1.3</b>

Source: Company, ICICI Direct Research

**Exhibit 14: ICICI Direct coverage universe (Capital Goods)**

Company	CMP			M Cap (₹ Cr)	EPS (₹)			P/E (x)			RoCE (%)			RoE (%)		
	(₹)	TP(₹)	Rating		FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
L&T (LARTOU)	1,780	2,175	Buy	249770	56.8	65.0	76.7	31.3	27.4	23.2	8.9	10.2	11.6	12.1	12.7	13.6
Siemens Ltd	2,654	2,900	Buy	94514	29.5	36.6	48.2	90.0	72.4	55.1	13.9	15.7	18.4	10.1	11.6	13.7
AIA Engineering (AIAENG)	2,437	2,570	Buy	22986	64.6	79.6	85.7	37.7	30.6	28.4	16.5	17.8	17.0	13.2	14.2	13.6
Thermax (THERMA)	2,075	2,405	Buy	24725	26.2	38.7	53.4	79.2	53.6	38.8	11.3	15.4	18.7	8.9	12.0	14.6
KEC International (KECIN)	445	474	Hold	11441	12.9	15.5	29.6	34.5	28.7	15.0	11.9	13.5	19.3	10.6	10.8	17.6
Greaves Cotton (GREAVE)	163	179	Buy	3766	0.7	2.6	3.3	230.1	61.8	49.4	2.5	8.9	10.2	1.3	6.3	7.3
Elgi Equipment (ELGEQU)	421	390	Buy	13342	5.7	6.6	8.7	73.7	63.8	48.4	18.9	17.8	20.2	18.7	18.5	20.3
Bharat Electronics (BHAELE)	284	315	Buy	69199	9.6	11.3	12.6	29.5	25.2	22.6	26.2	28.5	28.6	19.6	21.3	21.4
Cochin Shipyard (COCSHI)	332	340	Hold	4367	42.9	38.6	42.3	7.7	8.6	7.8	10.9	12.5	12.7	12.7	10.8	11.1
SKF (SKFIND)	4,318	4,920	Buy	21347	77.0	104.8	122.9	56.1	41.2	35.1	26.0	29.8	30.1	20.6	22.7	22.4
Timken India (TIMIND)	2,996	2,810	Buy	22536	43.5	54.8	62.5	99.3	78.8	69.1	25.3	32.3	36.8	19.7	24.9	28.4
NRB Bearing (NRBBEA)	145	220	Buy	1402	7.8	9.2	12.1	20.6	17.3	17.3	15.0	15.3	19.2	12.6	12.6	14.8
Action Construction (ACTCON)	221	230	Buy	2637	9.8	11.5	13.6	22.6	19.3	16.3	22.5	20.9	21.3	15.1	14.5	14.7
Data Patterns (DATPAT)	801	900	Buy	4158	18.1	21.7	28.0	44.3	36.9	28.6	23.8	24.4	26.4	16.4	18.1	19.6
HAL (HINAER)	2,000	2,200	Buy	66865	151.9	123.6	137.4	13.2	16.2	14.6	27.4	29.7	30.5	26.3	22.5	23.2

Source: Company, ICICI Direct Research

## ANALYST CERTIFICATION

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