15 September 2017

KEI Industries

Rating: **Buy**
Target Price: ₹379
Share Price: ₹312

Robust performance; we maintain a Buy

Strong growth in its EPC and cable divisions led to KEI's robust performance in the quarter. The impact on its gross margin from high copper prices was alleviated by lower other expenses on cost-control measures. The greater focus on order-book execution, wider dealer network and more exports augur well for growth. With strong orders across verticals providing revenue assurance for the next two years, we retain our Buy recommendation, with a revised target price of ₹379 (earlier ₹276).

Robust start to FY18; Q1 sets tone for rest of year. KEI's revenue clocked robust, 44%, growth boosted by the EPC and cable divisions. EPC reported a sturdy, 119%, increase in revenue, aided by cables which rose 29% y/y. The gross margin was down 193bps due to higher copper prices. Lower other expenses, however due to cost-control efforts helped the operating margin expand 13bps. Management guided to an annual 20% growth in the top-line.

Retail, exports doing well. Exports shot up 28% y/y to ₹1.09bn (₹0.85bn a year ago). Management expects the robust growth in exports to continue. The company added 99 distributors in Q1 FY18 taking the total to 1,246 by Jun'18. Sales through its distribution channels were ₹2.3bn during the quarter, against ₹1.75bn (a 31% rise y/y). KEI's retail division is moving up the value chain, backed by the company's strong brand equity and wide distribution network in India and abroad.

Outlook. The robust order-book (₹16bn in EPC, ₹1.2bn in EHV cables, ₹5.62bn in cables, `1.9bn in substation) offers assurance of growth over the next two years. Greater spending by state transmission utilities provide growth opportunities. Relentless brand promotion and a wider distribution network augur well for the retail segment. Following the branch expansion overseas, exports are expected to clock robust growth.

Valuation. We maintain our Buy call, valuing the stock at 18x FY19 earnings.
Risks. Volatile RMC and a high interest rate.

Key financials (YE Mar)	FY15	FY16	FY17	FY18e	FY19e
Sales (Rsm)	20,310	23,256	26,691	31,698	36,487
Net profit (Rsm)	316	622	986	1,236	1,637
EPS (Rs)	4.4	8.0	12.7	15.9	21.0
Growth (%)	195.3	81.6	58.6	25.3	32.4
PE (x)	70.9	39.0	24.6	19.6	14.8
PBV (x)	8.0	6.6	5.1	4.1	3.3
RoE (%)	11.8	18.5	23.5	23.3	24.7
RoCE (%)	21.6	26.5	24.1	24.4	26.4
Dividend yield (%)	0.1	0.2	0.2	0.3	0.4
Net debt/equity (x)	1.5	1.3	1.4	1.1	0.9

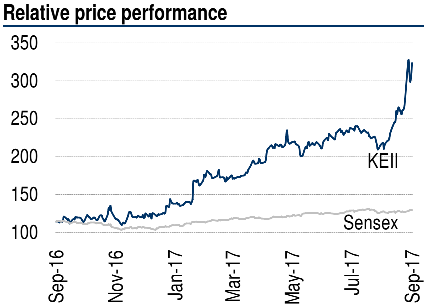
Source: Company, Anand Rathi Research

Key data	KEII IN / KEIN.BO
52-week high / low	₹346/ ₹99
Sensex / Nifty	32273/10085
3-m average volume	$2m
Market cap	₹25bn/$389.2m
Shares outstanding	78m

Shareholding pattern (%)	Jun '17	Mar '17	Dec '16
Promoters	46.6	46.6	49.0
- of which, Pledged	-	-	-
Free Float	53.4	53.4	51.0
- Foreign Institutions	4.2	4.2	5.3
- Domestic Institutions	18.8	18.8	17.7
- Public	30.4	30.4	28.0

Estimates revision (%)	FY18e	FY19e
Sales	5.2	6.4
EBITDA	1.5	3.5
PAT	2.7	6.7

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY15	FY16	FY17	FY18e	FY19e
Net revenues	20,310	23,256	26,691	31,698	36,487
Revenue growth (%)	25.5	14.5	14.8	18.8	15.1
- Oper. expenses	18,381	20,833	23,948	28,330	32,528
EBIDTA	**1,929**	**2,423**	**2,743**	**3,368**	**3,959**
EBITDA margins (%)	9.5	10.4	10.3	10.6	10.9
- Interest	1,204	1,270	1,229	1,213	1,217
- Depreciation	246	253	280	319	335
+ Other income	24	53	104	66	73
- Tax	186	331	351	666	843
Effective tax rate (%)	37.1	34.8	26.3	35.00	34.0
+ Associates / (minorities)					
Adjusted PAT	316	622	986	1,236	1,637
+ Extraordinary items	26	-	-	-	-
Reported PAT	342	622	986	1,236	1,637
Adj. FDEPS (₹ / sh)	4.4	8.0	12.7	15.9	21.0
Adj. FDEPS growth (%)	195.3	81.6	58.6	25.3	32.4

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY15	FY16	FY17	FY18e	FY19e
Share capital	154	154	156	156	156
Reserves & surplus	2,884	3,512	4,579	5,722	7,246
Net worth	3,039	3,666	4,735	5,877	7,401
Total debt	4,525	4,982	7,131	6,931	6,931
Minority interest	-	-	-	-	-
Def. tax liab. (net)	235	362	427	427	427
Capital employed	**7,799**	**9,010**	**12,293**	**13,235**	**14,760**
Net fixed assets	3,015	3,556	4,058	4,367	4,832
Intangible assets	10	17	27	0	0
Investments	31	31	31	31	31
- of which, Liquid					
Working capital	4,696	5,349	7,806	8,564	9,694
Cash	47	58	370	273	202
Capital deployed	**7,799**	**9,010**	**12,293**	**13,235**	**14,760**
Working capital (days)	84	84	107	99	97
Book value (₹ / sh)	39	47	61	76	95

Source: Company, Anand Rathi Research

Fig 3 –Cash-flow statement (₹ m)

Year-end: Mar	FY15	FY16	FY17	FY18e	FY19e
Adjusted PAT	316	622	986	1,236	1,637
+ Non-cash items	321	380	345	319	335
Cash profit	637	1,002	1,332	1,555	1,972
- Incr. / (decr.) in WC	(82)	653	2,457	758	1,130
Operating cash-flow	719	349	(1,126)	797	841
- Capex	127	801	793	600	800
Free cash-flow	592	(452)	(1,919)	197	41
- Dividend	37	46	56	94	112
+ Equity raised	49	-	55	-	-
+ Debt raised	(581)	457	2,149	(200)	-
- Investments	0	(0)	-	-	-
- Misc. items	21	(52)	(83)	0	0
Net cash-flow	1	11	312	(97)	(71)
+ Op. cash & bank bal.	46	47	58	370	273
Cl. Cash & bank bal.	47	58	370	273	202

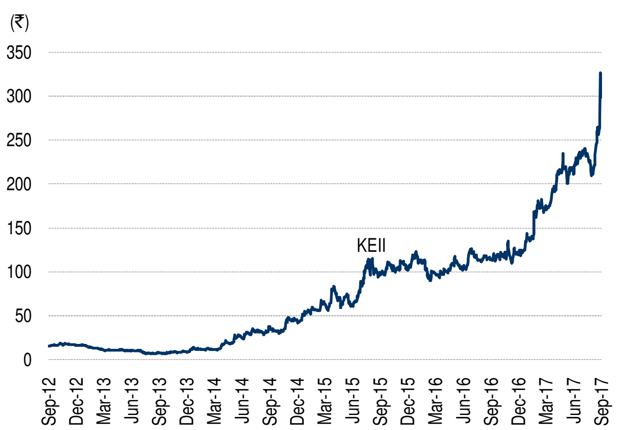
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹312

Year-end: Mar	FY15	FY16	FY17	FY18e	FY19e
P/E (x)	70.9	39.0	24.6	19.6	14.8
Cash P/E (x)	39.9	27.7	19.2	15.6	12.3
EV / EBITDA (x)	14.9	12.1	11.3	9.2	7.8
EV / sales (x)	1.4	1.3	1.2	1.0	0.8
P/B (x)	8.0	6.6	5.1	4.1	3.3
RoE (%)	11.8	18.5	23.5	23.3	24.7
RoCE (%)	21.6	26.5	24.1	24.4	26.4
Dividend yield (%)	0.1	0.2	0.2	0.3	0.4
Dividend payout (%)	9.0	6.2	4.7	6.3	5.7
Net debt / equity (x)	1.5	1.3	1.4	1.1	0.9
Debtor (days)	81	81	88	89	89
Inventory (days)	83	75	69	73	73
Payables (days)	97	95	84	85	85
RM / sales (%)	72.7	70.8	69.9	70.0	70.0
Fixed asset T/O (x)	6.7	6.5	6.5	7.3	7.6

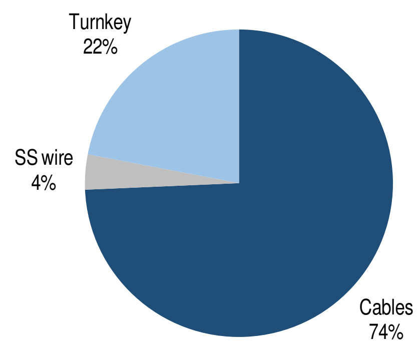
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – Segment-wise break-up (FY17)



Source: Company

Growth across segments

Its diversified product mix has led to KEI emerging as a comprehensive cable-and-wire operator in the past two years. It now has operations in all segments of cables, from house wires to extra-high-voltage cables.

Robust performance in EPC division

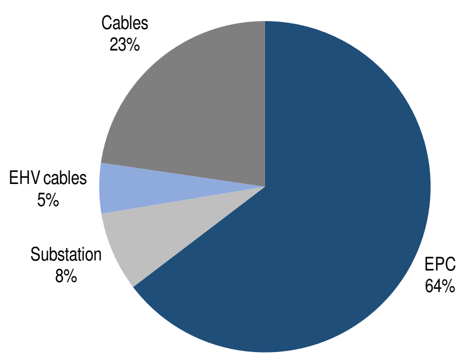
The turnkey division registered 119% yoy growth in Q1 FY18, with revenue rising to ₹2.95bn. About 65-70% of orders are from UP. The company expects orders of ₹5bn-6bn in the coming two quarters, largely from West Bengal, Madhya Pradesh and Rajasthan. With a strong order book, the focus now is more on improving execution. Greater spending by state transmission companies augurs well for the company. Its EPC order book was ₹16bn in Jun'17.

Retail and exports growing

The company's persistent efforts to promote its brands and broaden its distribution reach would boost volumes overall. It added 99 distributors during the quarter taking the number of its distributors to 1,246 in Jun'18. Sales through its distribution channels were ₹2.3bn during the quarter, against ₹1.75bn (31% growth y/y).

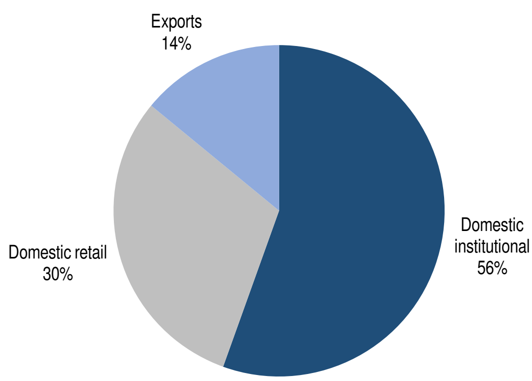
Exports grew 28% yoy to ₹1.09bn (₹0.85bn a year ago) as the company opened offices and branches in overseas markets. It expects strong growth in exports in the coming two years. The thrust on increasing the overall share of exports continues.

Fig 7 – Order-book mix (Jun'17)



Source: Company

Fig 8 – Revenue break-up - geographical (Q1 FY18)



Source: Company

Other concall highlights

- In Q1 FY18, the cables & wire division sales grew 29% y/y. Margins of the SSW division declined sharply, chiefly due to the rise in copper prices. The company expects normal margins next quarter.
- In Q1, the share of domestic institutions, retail and exports were respectively 56%, 14% and 29%.
- During the quarter, 99 dealers were added, taking the total dealers to 1,246, a 23% increase y/y. The company is planning to broaden its dealer network by 10-15% annually, focusing on tier-2 and tier-3 cities.
- Sales through its dealer/distribution channel were ₹2.3bn, registering 31% y/y growth.

- The company expects sales from EPC division in FY18 at ₹9bn, at ~60% blended growth as it expects orders of ₹5bn-6bn that year, largely from West Bengal, Madhya Pradesh and Rajasthan. Now, it laying greater emphasis on executing projects.
- At present, UP contributes 65-70% to the EPC division; the rest comes from other states. The company is focusing on increasing business in other states and expects their share to rise in next two years.
- Other expenses increased during the quarter due to a change in the product mix and to the EPC business.
- The company expects finance costs to go down, aided by repayment of term loans. Management stated that the company would repay all its long-term debt of ₹1.6bn over the next three years.
- The company now has a ₹24.8bn order-book, of which, ₹16bn is for EPC, ₹1.22bn for EHV including jointing kits and erection/ commissioning, ₹5.62bn for cables and ₹1.92bn for sub-stations. Its cables export order-book is ₹1.2bn.
- The company expects its metro-rail business to see robust growth as it continues to secure orders such as the Pune and Nagpur metro rail.
- It expects ~20% revenue growth in FY18, mainly driven by ~15% volume growth, the rest from price increases, at the same margin level or some betterment.
- Management stated that strong brand-building, increasing retail sales and reduced debt would drive margin growth in coming years.
- The company is planning to improve its brand-positioning and increase its presence in small towns and rural areas. For this, it expects to invest ₹120m-130m on brand-building in FY18.
- Management stated that it is planning to expand its low-tension cable capacity at the Chopanki factory, at ₹500m capex. The plant would be operational in Q1 FY19. Total capex in FY18 would be ₹600m.
- Current capacity utilisation at the Bhiwadi plant is 90-93%.
- At the Chopanki plant, the overall utilisation level is 70%. At the EHV plant, it is 35%.
- At the Silvassa plant, the utilisation level for low-tension control cables is ~90%. The company is utilising 50-55% of its capacity of house wires and winding wires due to the expansion last year.

Valuation

Its strong order book across verticals provides KEI with revenue assurance for the next two years. Increased spending in infrastructure and power T&D sectors offer immense opportunities to the company's institutional business. Its sharper focus on deeper penetration and on a brand-building strategy would help it gain a foothold in the retail arena. The wider reach and greater acceptability of the company's products overseas would give it a higher share in exports.

During FY17, the company restructured its vendor financing, leading to recognition of buyers' credit as part of debt. The exercise would aid assessment of debt levels and interest costs. Supported by the robust growth and profitability expected over FY17-19, our positive view of the company persists.

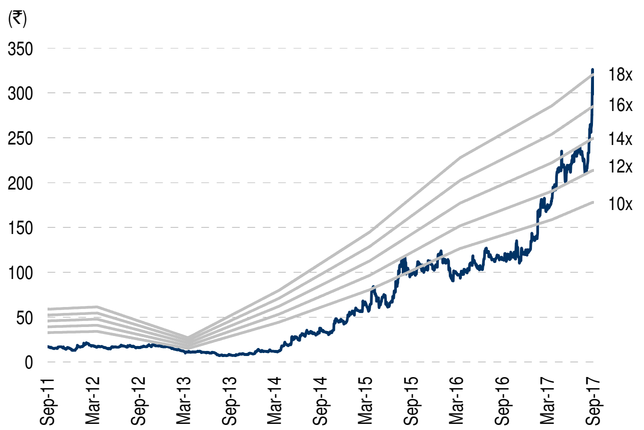
We expect a 29% CAGR in PAT over FY17-19, supported by the rising revenue and better margins. We maintain our Buy recommendation on the stock, assigning a PE of 18x FY19e earnings and derive a target price of ₹379.

Fig 9 – Change in estimates

(₹ m)	Original Estimates		Revised Estimates		Change (%)	
	FY18e	FY19e	FY18e	FY19e	FY18e	FY19e
Revenue	30,126	34,304	31,698	36,487	5.2	6.4
EBITDA	3,318	3,825	3,368	3,959	1.5	3.5
PAT	1,204	1,534	1,236	1,637	2.7	6.7

Source: Anand Rathi Research

Fig 10 – PE band



Source: Bloomberg, Anand Rathi Research

Risks

- **Volatile raw-material prices.** Raw material (copper, aluminium) constitutes ~65-70% of KEI's expenses. The inability to pass on any increase in raw-material prices could eat into its margins.
- **Higher interest rate.** KEI is highly leveraged, with debt-to-equity of more than 1x. Any rise in interest rates would hit it hard.

Appendix

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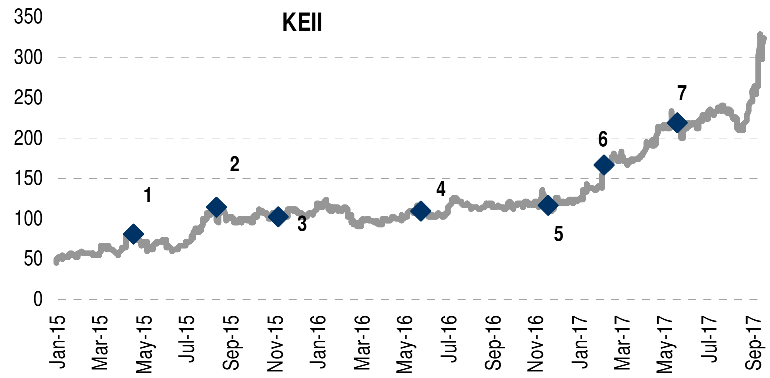

	Date	Rating	TP (₹)	Share Price (₹)
1	17-Apr-15	Buy	128	83
2	10-Aug-15	Buy	150	128
3	07-Nov-15	Buy	156	103
4	24-May-16	Buy	151	112
5	17-Nov-16	Buy	160	117
6	03-Feb-17	Buy	202	168
7	15-May-17	Buy	276	220

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