24 May 2016

KEI Industries

Robust volumes, focusing on brand building; Buy

Rating: **Buy**
Target Price: ₹151
Share Price: ₹112

We lower our FY17/18 EPS estimates because of the lower guidance. KEI's strong Q4 margin (which rose a steep 195bps yoy) and 61.9% yoy jump in profit lead us to retain our FY17/18 margins. With its strong order book, capex, constant debt and growing volumes, we expect a 16% revenue CAGR over FY16-18. We retain our Buy recommendation.

Flattish sales in Q4. KEI's Q4 FY16 revenue was ₹6.36bn, up only 0.3% yoy, due to its cable division's flat revenue growth of ₹5.2bn. Cable volumes grew ~20%. The turnkey business, though, shot up 61.3% yoy to ₹1.9bn. FY16 sales rose 14.5% yoy to ₹23.2bn. Exports stepped up 31% and retail sales 13.5% yoy. Overall, volumes grew ~27% in FY16.

Better gross margin leads to overall margin expansion. The 444bps yoy better gross margin led to the Q4 EBITDA margin expanding 195bps yoy to 10.6%. The EBIT margin in cables came at 11.4% (up 142bps yoy), in stainless steel 11% (up 947bps) and in turnkey projects 14.1% (up 87bps). The FY16 operating margin improved 92bps yoy to 10.4%.

61.9% increase in profit. Q4 PAT was ₹203m (up 61.9% yoy) powered by a 244% yoy increase in other income, a 4.9% yoy drop in interest cost and a 416bps yoy reduction in the tax rate on account of MAT credit of ~₹125m in the quarter. Full year PAT was ₹622m. The present order book is ~₹17.6bn.

Outlook. KEI intends to promote its brand through ad-spend, hoardings, etc. It intends to increase the proportion of retail sales in the next 3-4 years to ~45-50%. The new expansion at Chopanki for EHV cables is expected to be operational by Oct'16 at ~₹300m capex. Also, debt is planned to be stabilised through constant repayments of ~₹650m each year.

Valuation. The strong operating performance, supported by brand building, an expanding dealer network, capacity expansions and a strong order book would help the company. We maintain a Buy, with a revised target of ₹151 (earlier ₹156). At the CMP, the stock quotes at a PE of 6.6x FY18e. **Risks.** Volatile RMC and a high interest rate.

Quarterly results (YE Mar)	Q4FY15	Q4 FY16	% yoy	FY15	FY16	% yoy
Sales (₹ m)	6,345	6,363	0.3	20,310	23,256	14.5
EBITDA (₹ m)	549	675	22.8	1,929	2,423	25.6
EBITDA margin (%)	8.7	10.6	195bps	9.5	10.4	92bps
Interest (₹ m)	326	310	(4.9)	1,204	1,270	5.5
Depreciation (₹ m)	61	67	10.0	246	253	2.9
Other income (₹ m)	8	27	244.4	24	53	124.5
PBT (₹ m)	170	325	90.8	503	953	89.7
Tax (₹ m)	71	122	71.8	186	331	77.9
Tax rate (%)	41.8	37.6	-416bps	37.1	34.8	-230bps
PAT (₹ m)	125	203	61.9	343	622	81.6

Source: Company

Key data	KEII IN / KEIN.BO
52-week high / low	₹126 / ₹60
Sensex / Nifty	25230 / 7731
3-m average volume	$1m
Market cap	₹8.7bn / $132m
Shares outstanding	77.2m

Shareholding pattern (%)	Mar'16	Dec'15	Sep'15
Promoters	49.4	49.4	49.4
- of which, Pledged	-	-	-
Free Float	50.6	50.6	50.6
- Foreign Institutions	1.2	1.6	1.3
- Domestic Institutions	19.2	12.7	10.9
- Public	30.2	36.3	38.4

Estimates revision (%)	FY17e	FY18e
Sales	-4.4	-4.3
EBITDA	-4.5	-4.9
EPS	-6.9	-1.0

Financials (YE Mar)	FY17e	FY18e
Sales (₹m)	27,174	31,479
Net profit (₹m)	932	1,313
EPS (₹)	12.1	17.0
Growth (%)	49.8	41.0
PE (x)	9.3	6.6
PBV (x)	1.9	1.5
RoE (%)	23.0	26.0
RoCE (%)	28.6	32.2
Dividend yield (%)	1.2	1.2
Net gearing (x)	1.1	0.8

Source: Anand Rathi Research

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY14	FY15	FY16	FY17e	FY18e
Net revenues	16,189	20,310	23,256	27,174	31,479
Revenue growth (%)	-2.38	25.45	14.51	16.85	15.84
- Oper. expenses	14,659	18,381	20,833	24,182	27,885
EBIDTA	**1,530**	**1,929**	**2,423**	**2,992**	**3,595**
EBITDA margins (%)	9.45	9.50	10.42	11.01	11.42
- Interest	1,115	1,204	1,270	1,323	1,339
- Depreciation	210	246	253	308	327
+ Other income	13	24	53	30	31
- Tax	102	186	331	459	647
Effective tax rate (%)	46.8	33.0	33.0	33.0	33.0
Reported PAT	**116**	**316**	**622**	**932**	**1,313**
Extraordinary items	-	26	-	-	-
Adjusted PAT	116	342	622	932	1,313
PAT growth (%)	(56.0)	195.3	81.6	49.8	41.0
Adj. FDEPS (₹ / sh)	1.5	4.4	8.1	12.1	17.0
Adj. FDEPS growth (%)	(56.0)	195.3	81.6	49.8	41.0

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY14	FY15	FY16	FY17e	FY18e
Share capital	147	154	154	154	154
Reserves & surplus	2,583	2,884	3,512	4,326	5,522
Net worth	2,731	3,039	3,666	4,480	5,676
Total debt	5,106	5,285	5,251	4,853	4,733
Minority interest	0	0	0	0	0
Def. tax liab. (net)	160	235	362	362	362
Capital employed	**7,998**	**8,559**	**9,280**	**9,696**	**10,772**
Net fixed assets	3,143	3,025	3,573	3,615	3,637
Investments	31	31	31	31	31
- of which, Liquid					
Working capital	4,778	5,456	5,617	5,904	6,904
Cash	46	47	59	145	199
Capital deployed	**7,998**	**8,559**	**9,280**	**9,696**	**10,772**
Net debt / equity (x)	1.9	1.7	1.4	1.1	0.8
W C turn (days)	99	91	86	76	73
Book value (₹ / sh)	35	39	47	58	73

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY14	FY15	FY16	FY17e	FY18e
PAT	116	342	622	932	1,313
+ Non-cash items	264	246	253	308	327
Cash profit	380	588	875	1,240	1,641
- Incr. / (decr.) in WC	682	678	162	287	999
Operating cash-flow	-302	-90	713	953	641
- Capex	238	127	801	350	350
Free cash-flow	**-540**	**-217**	**-88**	**603**	**291**
- Dividend	18	36	45	117	117
+ Equity raised	49	49	0	0	0
+ Debt raised	370	178	-33	-398	-120
- Investments	0	0	-0	0	0
- Misc. items	-28	-27	-178	0	0
Net cash-flow	**-111**	**1**	**12**	**87**	**54**
+ Op. cash & bank bal.	156	46	47	59	145
Cl. Cash & bank bal.	46	47	59	145	199

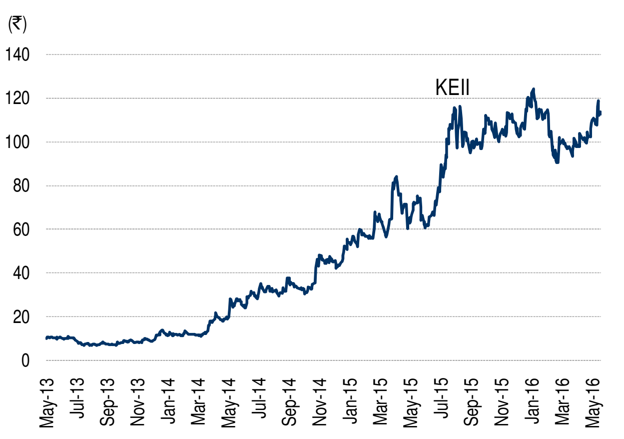
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹112

Year-end: Mar	FY14	FY15	FY16	FY17e	FY18e
P/E (x)	74.6	25.3	13.9	9.3	6.6
Cash P/E (x)	25.4	14.7	9.9	7.0	5.3
EV / EBITDA (x)	9.0	7.2	5.7	4.5	3.7
EV / sales (x)	0.8	0.7	0.6	0.5	0.4
P/B (x)	3.2	2.8	2.4	1.9	1.5
RoE (%)	4.3	11.8	18.6	23.0	26.0
RoCE (%)	17.3	20.6	24.9	28.6	32.2
Dividend yield (%)	0.2	0.4	0.4	1.2	1.2
Dividend payout (%)	13.3	9.0	6.2	10.8	7.6
Debt to equity (x)	1.9	1.7	1.4	1.1	0.8
Debtor days	95	81	81	76	76
Inventory days	94	83	75	70	73
Payables days	107	89	88	91	91
Working capital days	99	91	86	76	73
Fixed asset T/O (x)	5.2	6.7	6.5	7.5	8.7

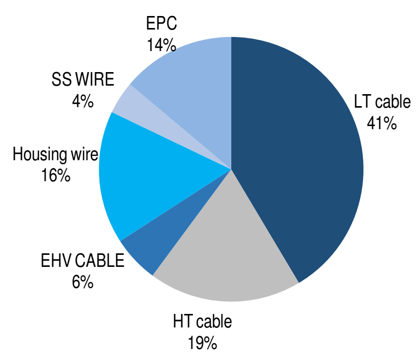
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – Segment-wise break-up (FY16)



Source: Company

Result Highlights

Fig 7 – Estimates vs Actuals

(₹ m)	Q4 FY16e	Q4 FY16	Change (%)
Revenues	7,058	6,363	(9.8)
EBITDA	685	675	(1.4)
Margin (%)	10	10.6	91bps
PAT	196	203	3.4
Margin (%)	2.8	3.2	41bps

Source: Company, Anand Rathi Research

Fig 8 – Segment-wise results

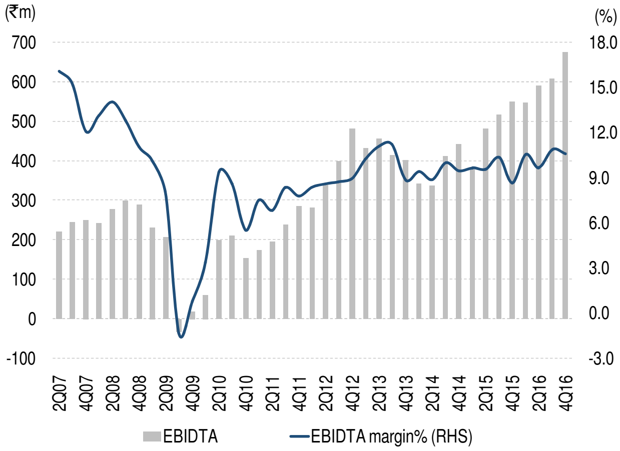
(₹ m)	Q4 FY15	Q4 FY16	% yoy	FY15	FY16	% yoy
Net revenues						
Cables	5,280	5,261	(0.4)	17,110	19,113	11.7
Stainless steel wires	244	234	(4.0)	1,052	949	(9.8)
Turnkey projects	1,226	1,977	61.3	3,566	5,893	65.2
Segment-wise PBIT						
Cables	528	601	13.8	1,978	2,246	13.5
Stainless steel wires	4	26	606.1	37	67	82.8
Turnkey projects	162	278	71.9	411	811	97.2
PBIT margin (%)						
Cables	10.0	11.4	142bps	11.6	11.8	19bps
Stainless steel wires	1.5	11.0	947bps	3.5	7.1	358bps
Turnkey projects	13.2	14.1	87bps	11.5	13.8	224bps

Source: Company, Anand Rathi Research

Strong growth in the turnkey business

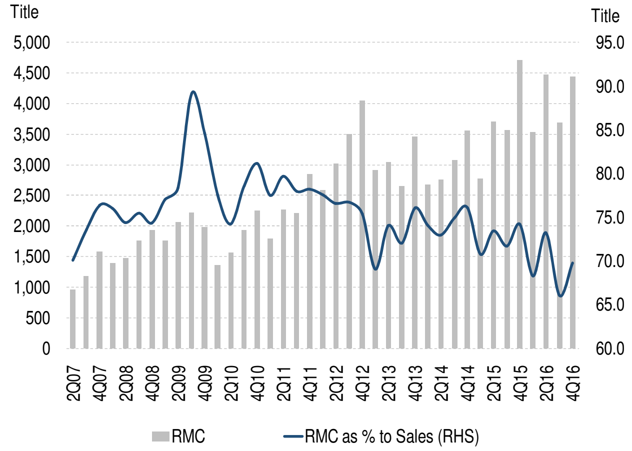
KEI's turnkey division registered 61.3% yoy sales growth, with the EBIT margin improving 87bps yoy to 14.1%. The capacity expansion, along with the strong, ₹1.4bn, order book in the EHV business, led to the margin expansion. In FY16, the EPC and EHV business grew 39% and 127% respectively with margins of ~12% and 15%. Enquiries in EHV cables are very strong and the Chopanki plant will be operational by Oct'16, with a ~55-60% capacity utilisation.

Fig 9 – Higher EBITDA margins



Source: Company, Anand Rathi Research

Fig 10 – RMC (as percent of sales) declines yoy



Source: Company, Anand Rathi Research

Other Concall Highlights

- Lower raw material costs and ~27-28% volume growth led to the better margins. The company is focusing on brand building through ad-spends, hoardings, in-shop branding, sponsorships, etc. In FY17, it plans to incur ~₹70m on publicity.
- In FY16, it added 100 dealers taking the number of dealers to 926. In the short term it plans to increase the share of retail sales to ~50% since retail is low working-capital intensive, faster realisation and requires lower inventory. It expects to push the retail business through considerable ad-spends.
- It expects ~15-20% sales growth in FY17 with margins coming above 10%.
- Gross debt in FY16 increased on account of substantial capex in FY16. Ahead, the company intends to incur the balance ₹300m in the next 4-5 months and repay about ₹650m of term loans each year, funded through internal accruals.
- It also won prestigious orders in FY16.
- It has no plans for product launches besides those in wires and cables. It intends its turnkey business to grow robustly.
- It expects the EHV segment to grow in step with industry growth at ~20-25%.
- It expects dealer addition of ~15-20% in FY17 largely in the eastern and southern regions.
- It expects its order book to improve in the next 2-3 months on account of a strong pipeline of L1 orders.
- In FY16 sales growth stemmed from growth across all the segments with transmission and distribution being the strongest. In FY17, it expects demand growth from the Railways.

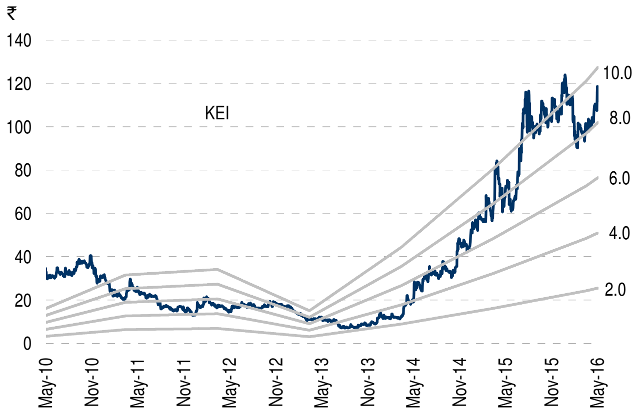
Valuation

KEI has chalked out a brand-building strategy. With 13.5% yoy growth in retail sales in FY16, we expect the proportion of retail sales to rise following vigorous dealer addition (from 600 to 1,000). Because of the 31% yoy growth in FY16 exports and its plans to increase the proportion of retail sales, we expect revenue to register a 16% CAGR over FY16-18.

In the last few years, the company has been operating at sub-optimal levels. It has opened a new project site and expects its order-book execution to grow qoq. We expect substantial fixed-cost absorption to have occurred and optimal utilisation by FY18. The minimal capex and debt repayment would lead to improved debt equity.

We expect a 45% PAT CAGR over FY16-18, supported by the rising revenue and better margins. We maintain a Buy recommendation on the stock, assigning an average of PE, PB and EV/EBITDA of respectively 10x, 1.5x, 5x to FY18e figures, and derive a price target of ₹151. The stock quotes at a PE of 6.6x FY18e EPS.

Fig 11 – PE band



Source: Bloomberg, Anand Rathi Research

Risks

- Volatile raw-material prices. Raw material (copper and aluminium) constitute around 74% of KEI's expenses. The inability to pass on the increase in raw-material prices could cut into its margins.
- Higher interest rate. KEI is highly leveraged, with debt-to-equity of more than 1x. Any upward movement in interest rates would hit it hard.

Appendix

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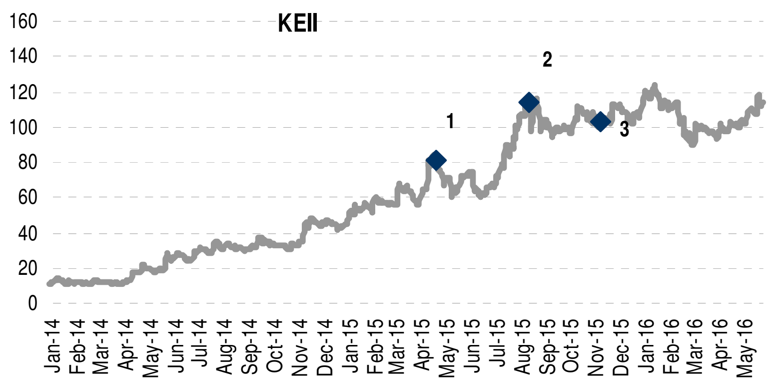

	Date	Rating	TP (₹)	Share Price (₹)
1	17-Apr-15	**Buy**	128	83
2	10-Aug-15	**Buy**	150	128
3	07-Nov-15	**Buy**	156	103

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