16 November 2017

KEI Industries

Upbeat performance continues; we maintain a Buy

Rating: **Buy**
Target Price: ₹413
Share Price: ₹322

Key data	KEII IN / KEIN.BO
52-week high / low	₹372 / ₹108
Sensex / Nifty	32942 / 10187
3-m average volume	$3.6m
Market cap	₹26bn / $397m
Shares outstanding	78m

Driven by a robust exports and strong execution in its EPC division, KEI reported healthy growth in HI FY18. Its sharper focus on order-book execution, expanding dealer network and higher exports and retail sales offer assurance of growth in the next two years. We retain our Buy recommendation, with a revised target of ₹413 (earlier ₹379).

Robust EPC-division growth. In Q2 FY18 KEI Industries' revenue grew 20% to ₹7.48bn mainly driven by 15% volume growth. The EPC and cable divisions grew respectively 15.3% and 7.4% y/y. For H1 FY18, the cables division registered 17.3% y/y revenue growth. Management maintained guidance of 15% volume growth and 20% revenue growth for FY18.

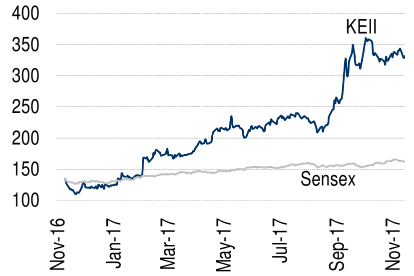
Exports and retail to expand further. Exports for the quarter jumped 33% y/y to ₹1.37bn (₹1.03bn a year ago). Management expects strong export growth in the coming two years. Its dealer network grew 25% y/y in H1 FY18 to 1,274 while sales through channels stood at ₹4.78bn vs. ₹3.8bn a year ago. KEI's strong brand equity and wide distribution network in India and abroad have helped its retail division move up the value chain.

Outlook. The company has a ₹23.5bn order book, of which, ₹14bn is EPC, ₹1.9bn for substations and ₹7.3bn for the cable division (the EHV order is ₹0.94bn and export orders, ₹0.84bn.) Reduction in GST on cables from 28% to 18% augurs well for the company. Greater brand promotion and a wider distribution network in the retail segment are other positives. Following the expansion of branches overseas, exports are expected to clock robust growth.

Valuation. We maintain a positive outlook and expect a 26% earnings CAGR over FY17-20. We introduce FY20 estimates, roll forward our valuation to FY20 and assign a target PE of 16x FY20e. We maintain a Buy. **Risks.** Volatile RMC and a high interest rate.

Shareholding pattern (%)	Sep'17	Jun'17	Mar'17
Promoters	46.3	46.6	46.6
- of which, Pledged	-	-	-
Free Float	53.7	53.4	53.4
- Foreign Institutions	5.5	4.0	4.2
- Domestic Institutions	13.8	18.6	18.8
- Public	34.4	30.8	30.4

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY16	FY17	FY18e	FY19e	FY20e
Sales (₹ m)	23,256	26,691	31,698	36,487	41,928
Net profit (₹ m)	622	986	1,236	1,637	1,995
EPS (₹)	8.0	12.7	15.9	21.0	25.8
PE (x)	41.1	25.9	20.7	15.6	12.7
EVEBITDA (x)	12.6	11.8	9.6	8.2	7.0
PBV (x)	7.0	5.4	4.4	3.5	2.8
RoE (%)	18.5	23.5	23.3	24.7	24.0
RoCE (%)	17.3	17.8	15.9	17.4	18.0
Dividend yield (%)	0.2	0.2	0.3	0.4	0.5
Net debt / equity (x)	1.3	1.4	1.1	0.9	0.7

Source: Company, Anand Rathi Research

Girish Solanki
Research Analyst
+9122 66266712
girishsolanki@rathi.com

Prateek Pareek
Research Analyst
+9122 66266814
prateekpareek@rathi.com

Surbhi Lodha
Research Associate
surbhilodha@rathi.com

Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY16	FY17	FY18e	FY19e	FY20e
Net revenues	23,256	26,691	31,698	36,487	41,928
Growth (%)	14.5	14.8	18.8	15.1	14.9
Direct costs	16,475	18,654	22,189	25,541	29,350
SG&A	4,359	5,293	6,142	6,987	8,029
EBITDA	**2,423**	**2,743**	**3,368**	**3,959**	**4,549**
EBITDA margins (%)	10.4	10.3	10.6	10.9	10.9
- Depreciation	253	280	319	335	385
Other income	53	104	66	73	84
Interest expenses	1,270	1,229	1,213	1,217	1,225
PBT	953	1,338	1,902	2,480	3,023
Effective tax rate (%)	34.8	26.3	35.0	34.0	34.0
+ Associates / (minorities)	-	-	-	-	-
Net Income	622	986	1,236	1,637	1,995
Adjusted income	622	986	1,236	1,637	1,995
WANS	78	78	78	78	77
FDEPS (₹ / sh)	8.0	12.7	15.9	21.0	25.8
FDEPS growth(%)	81.6	58.6	25.3	32.4	22.8
Gross Margin (%)	29.2	30.1	30.0	30.0	30.0

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY16	FY17	FY18e	FY19e	FY20e
Share capital	154	156	156	156	156
Net worth	3,666	4,735	5,877	7,401	9,256
Total debt	4,982	7,131	6,931	6,931	6,731
Minority interest	-	-	-	-	-
DTL / (assets)	362	427	427	427	427
Capital employed	**9,010**	**12,293**	**13,235**	**14,760**	**16,415**
Net tangible assets	3,279	4,054	4,367	4,832	4,698
Net intangible assets	-	-	-	-	-
Goodwill	-	-	-	-	-
CWIP (tang. & intang.)	293	32	-	-	-
Investments (strategic)	31	31	31	31	31
Investments (financial)	-	-	-	-	-
Current assets (ex cash)	10,968	13,623	15,357	17,478	20,011
Cash	58	370	273	202	604
Current liabilities	5,619	5,817	6,792	7,784	8,929
Working capital	5,349	7,806	8,564	9,694	11,082
Capital deployed	**9,010**	**12,293**	**13,235**	**14,760**	**16,415**
Contingent liabilities	3,334	4,161	-	-	-

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY16	FY17	FY18e	FY19e	FY20e
PBT	953	1,338	1,902	2,480	3,023
+ Non-cash items	380	345	319	335	385
Oper. prof. before WC	1,333	1,683	2,221	2,815	3,408
- Incr. / (decr.) in WC	653	2,457	758	1,130	1,388
Others incl. taxes	331	351	666	843	1,028
Operating cash-flow	349	-1,126	797	841	993
- Capex (tang.+ intang.)	801	793	600	800	250
Free cash-flow	-452	-1,919	197	41	743
Acquisitions					
- Div. (incl. buyback & taxes)	46	56	94	112	140
+ Equity raised	-	55	-	-	-
+ Debt raised	457	2,149	-200	-	-200
- Fin investments	-0	-	-	-	-
- Misc. (CFI + CFF)	(52)	(83)	0	0	0
Net cash-flow	11	312	-97	-71	402

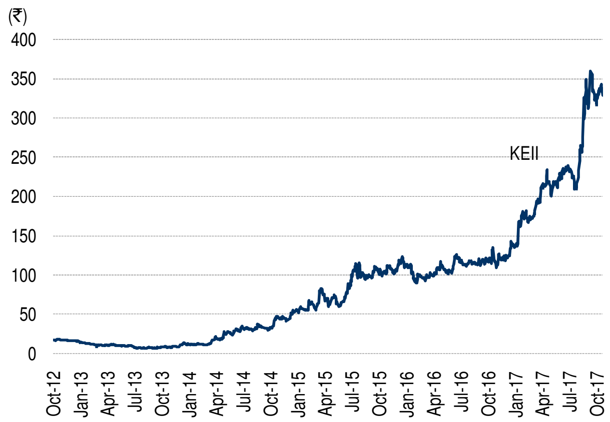
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹322

Year-end: Mar	FY16	FY17	FY18e	FY19e	FY20e
P/E (x)	41.1	25.9	20.7	15.6	12.7
EV / EBITDA (x)	12.6	11.8	9.6	8.2	7.0
EV / sales (x)	1.3	1.2	1.0	0.9	0.8
P/B (x)	7.0	5.4	4.4	3.5	2.8
RoE (%)	18.5	23.5	23.3	24.7	24.0
RoCE (%) - after tax	17.3	17.8	15.9	17.4	18.0
ROIC	17.4	18.1	16.3	17.7	18.5
DPS (₹ / sh)	0.5	0.6	1.0	1.2	1.5
Dividend yield (%)	0.2	0.2	0.3	0.4	0.5
Dividend payout (%) - incl. DDT	6.2	4.7	6.3	5.7	5.8
Net debt / equity (x)	1.3	1.4	1.1	0.9	0.7
Receivables (days)	81	88	89	89	89
Inventory (days)	75	69	73	73	74
Payables (days)	95	84	85	85	85
CFO:PAT %	56.1	-114.1	64.5	51.4	49.7

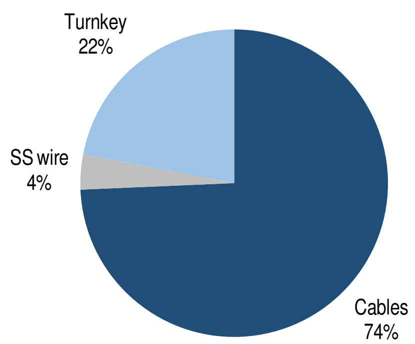
Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – Segment-wise break-up (FY17)



Source: Company

Strong segmental growth

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

Robust growth expected in EPC division

In Q2 FY18 its EPC division registered 15.3% y/y growth, with revenue rising to ₹1.67bn. About 65-70% of orders are from UP. With a strong order book, the company's focus is more on improving execution. Greater spending by state transmission companies augurs well for the company. Management expects the EPC division margin to be ~12%.

Retail and exports growing

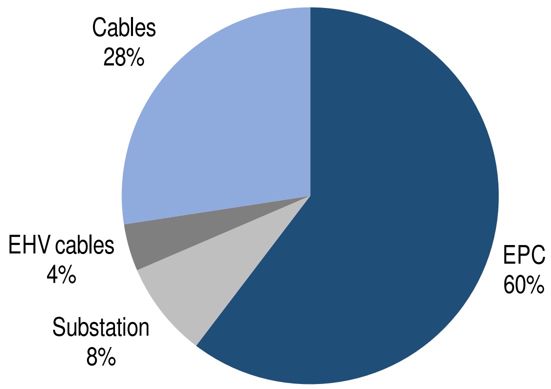
The company's persistent efforts to promote its brands and broaden its distribution reach would boost volumes overall. Its distributor base increased 25% to 1,274 dealers. In Q2 sales through its distribution channels were ₹2.3bn, up 31% from ₹1.75bn a year ago.

Exports grew 33% y/y to ₹1.37bn (₹1.03bn a year ago) as the company opened new offices and branches in overseas markets. It expects strong export growth in the next two years. Its thrust on increasing the share of exports continues. Management expects robust export growth to continue.

Capex plans

For its low-tension cables division, the company planned greenfield expansion near its Chopanki factory; capex of ₹500m would increase capacity 20%. The plant would be operational by end-Mar'18. Capacity utilisation is now 96%. Of the ₹500m capex, it has invested ₹200m till H1 FY18.

Fig 7 – Order-book mix (Sep'17)



Source: Company

Conference call highlights

- In Q2 FY18, volume registered 15% growth y/y while net sales grew 20% y/y.
- Q2 FY18 revenue break-up: LT ~₹3.15bn, HT ~₹1.16bn, EHW ~₹190m, HW ₹1.81bn, SSW ₹300m and EPC ₹1.7bn (other than cable).
- The EPC division grew 65% y/y in H1 FY18. Due to the GST amendments, ~₹1bn of billing was not done in Q2, expected to be done in Q3 FY18.
- The company is planning to spend ₹150m on advertising in FY18. In H1 FY18, it spent ₹90m.
- In H1 FY18, it incurred ₹650m on rebates, discounts and sales commissions.
- Debt increased ~₹800m on account of the GST as a few customers deferred payments. Management said that the change in the GST rate from 28% to 18% would help to better working capital. Debtors will come down after this.
- Under the JV with a Swiss company, KEI started manufacturing of 400KW cables and sent them to an outside lab for testing.
- Metals prices have been increasing in the last 10 months and the greater burden passed on to customers.
- The company expects good growth in the EHV segment.
- It expects ~15-20% volume growth in FY18.

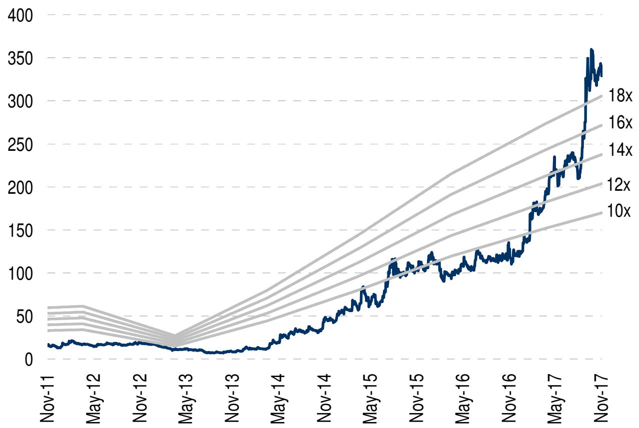
Valuation

Its strong order book across verticals provides KEI with revenue assurance for the next two years. Greater spending in the infrastructure and power T&D sectors provides 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 its 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 the company's debt levels and interest costs. Supported by the robust growth and profitability expected over FY17-20, our positive view of the company continues.

We expect a 26% CAGR in PAT over FY17-20, supported by rising revenue and better margins. We introduce FY20 estimates and roll forward our valuation to FY20. We maintain our Buy recommendation on the stock, assigning a PE of 16x FY20 earnings and derive a price target of ₹413.

Fig 8 – 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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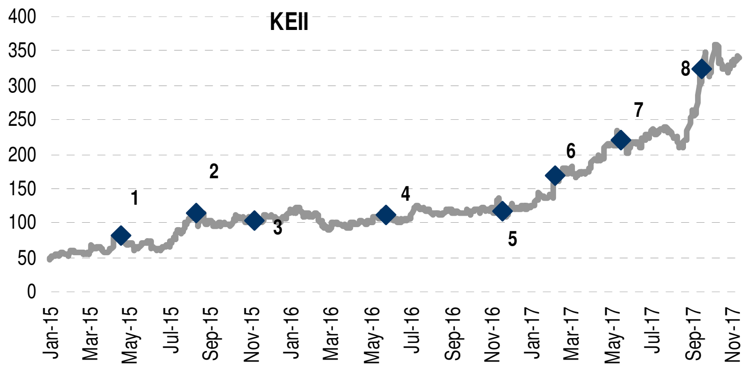
Rating and Target Price History (as of 16 November 2017)



	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
8	15-Sep-17	**Buy**	379	312

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