7 July 2016

KEI Industries

All charged up

Strong product suite in cables: beneficiary of distribution capex

KEI Industries (KEII IN) is a leading player in the domestic cables and wires market in India. Across its three factories, it manufactures cables (65% of FY16 revenue), house wires (16%) and stainless steel wires (4%). It would benefit from higher capex by power distribution utilities with an estimated 25% of outlay towards cables. EPC (14% of FY16 revenue), with in-house cable sourcing and targeting funded projects, would help KEII achieve a 10-11% margin over FY17-19E. KEII is among three firms in India involved in the manufacture of EHV cables (66kV to 220kV, 6% FY16 revenue). Brownfield expansion at Chopanki by Q3FY17 would raise capability to 400kV at 14-15% margin.

Targeting higher retail sales: brand building, adding dealers

KEII has set a target of achieving 45-50% of revenue from the retail segment (direct sales via dealers) by FY20 from 31% in FY16 (up 450bp in two years; Elara estimate: 35% by FY19). Since FY11, it has increased dealer networks by 7x to 926 in FY16 and plans to add 100 new every year. KEII has stepped up efforts on brand-building and spent INR 70mn on advertising in FY16 (vs average of INR 20mn over FY12-15).

High finance cost is a concern: expected to fall 120bp as debt falls

KEII has a high finance cost at 5.5% of sales in FY16 at INR 1.3bn, which is higher than other capital goods companies. It comprises: 1) interest on term loan + WC loan at 3% share, and 2) LC interest & charges and bank guarantee & charges at 2.5% share. We estimate finance cost will shrink to 4.3% of sales by FY19 on loan repayment.

Earnings CAGR of 27% (below Consensus): average ROE of 20%

We expect an EBITDA CAGR of 14% over FY16-19E (vs 12% over FY13-16) with an average margin of 10%. This, coupled with lower finance cost and lower taxes, would drive an EPS CAGR of 27% over FY16-19E vs 29% over FY13-16. This would lead to an average ROE of 20.5% over FY17-19E vs 18.6% in FY16 and an average ROCE of 18.6%.

Rating: Accumulate

Target Price: INR 140

Upside: 13%

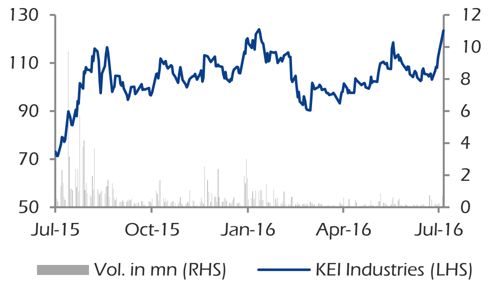
CMP: INR 124 (as on 5 July 2016)

Key data

Bloomberg /Reuters Code	KEII IN/KEIN.BO
Current /Dil Shares O/S (mn)	772/772
Mkt Cap (INR bn/USD mn)	10/141
Daily Volume (3M NSE Avg)	173,334
Face Value (INR)	2
1 USD = INR 67.5	

Note: *as on 5 July 2016; Source: Bloomberg

Price & Volume



Source: Bloomberg

Shareholding (%)	Q1FY16	Q2FY16	Q3FY16	Q4FY16
Promoter	49.4	49.4	49.4	49.4
Institutional Investor	1.1	12.2	14.3	20.4
Other Investor	21.7	15.2	14.9	10.9
General Public	27.8	23.2	21.5	19.3

Source: BSE

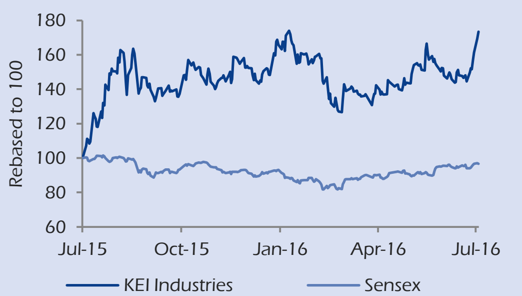
Price performance (%)	3M	6M	12M
Sensex	9.2	6.2	(3.3)
KEI Industries	26.7	3.3	73.3

Source: Bloomberg

Valuation

We value KEII using an average of 9x June 2018E exit P/E (25% premium to a three-year average), and 5x June 2018E exit EV/EBITDA (25% premium). Accordingly, we arrive at a TP of INR 140/share, implying potential upside of 13%. We initiate on KEII with a **Accumulate** rating. Our sensitivity analysis suggests: 1) 5% lower FY17-18E revenue can lead to a fall in EPS of 31% in FY17E & 27% in FY18E and a drop in TP of 23%, and 2) a 100bp higher RM-sales ratio can lead to a fall in EPS of 25% in FY17E and 23% in FY18E with a 20% drop in TP. **Key downside risk**: significant fall in distribution capex affecting revenue, sharp uptick in commodity (copper &aluminum) prices and slower expansion in retail.

Price Performance



Source: Bloomberg, Elara Securities Research

Key Financials

YE March	Revenue (INR mn)	YoY (%)	EBITDA (INR mn)	EBITDA margin (%)	Adj PAT (INR mn)	YoY (%)	Fully DEPS (INR)	RoE (%)	RoCE (%)	P/E (x)	EV/EBITDA (x)
FY16	23,256	14.5	2,423	10.4	622	81.6	8.1	18.6	16.0	12.2	5.2
FY17E	27,588	18.6	2,807	10.2	759	22.1	9.8	18.9	16.7	12.6	5.2
FY18E	32,399	17.4	3,226	10.0	1,005	32.3	13.0	20.8	18.4	9.5	4.5
FY19E	35,780	10.4	3,635	10.2	1,289	28.3	16.7	21.8	20.6	7.4	3.8

Note: pricing as on 5 July 2016; Source: Company, Elara Securities Estimate

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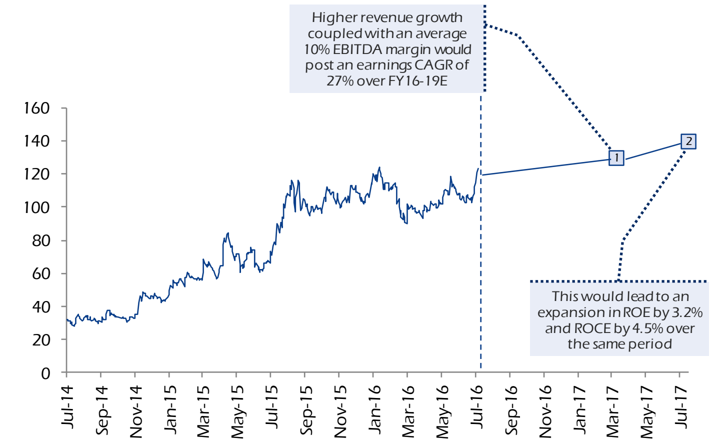
Valuation trigger



Source: Bloomberg, Elara Securities Estimate

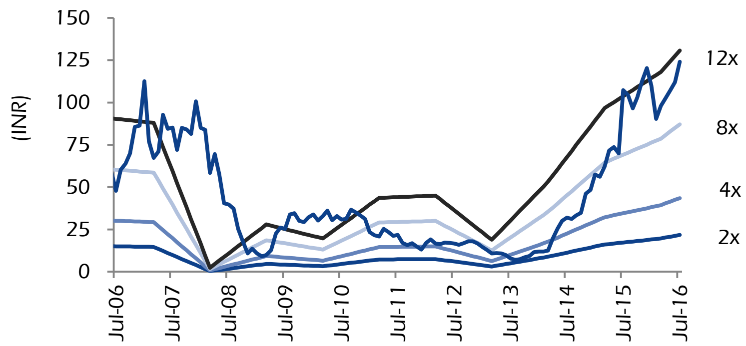
Valuation overview

P/E (x)	9.0
EPS June 2018E (INR)	13.9
Target Price (INR)	125
EV/EBITDA (x)	5.0
EBITDA June 2018E	3,328
Equity value (INR mn)	11,906
Target Price (INR)	154
Average TP (INR)	140

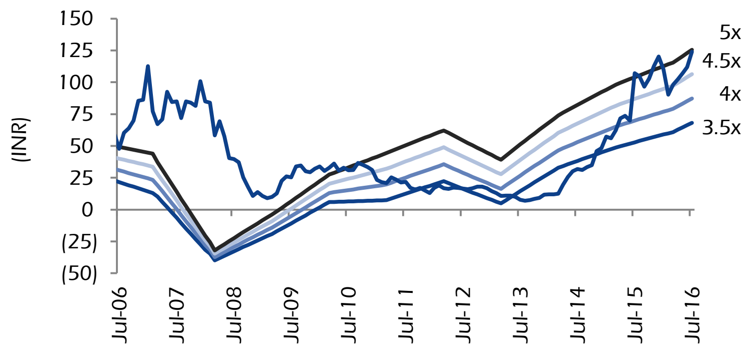
Source: Elara Securities Estimate

Valuation driver

One-year forward P/E at 11.4x



One-year forward EV/EBITDA at 5x



Source: Bloomberg, Company, Elara Securities Estimate

Investment summary

- Focus on brand-building and dealer network expanding to increase the share of house wires products from 31% in FY16 to 45-50% by FY20E (we assume 35% by FY19E)
- Higher order inflows would drive EPC business revenue CAGR of 34% during FY16-19E. In-house cable manufacturing adds a competitive advantage translating into a healthy EBITDA margin of 10-11%
- Among the top three firms in the EHV segment upto 220kV and expansion into 400kV in FY17 should boost revenue and deliver a high EBITDA margin of ~15%.

Valuation trigger

1. Higher revenue growth coupled with an average 10% EBITDA margin would post an earnings CAGR of 27% over FY16-19E
2. This would lead to an expansion in ROE by 3.2% and ROCE by 4.5% over the same period

Key risks

- Significant fall in distribution capex affecting revenue; sharp uptick in commodity (copper & aluminum) prices and slower-than-anticipated expansion in the retail business
- Our sensitivity analysis suggests: 1) 5% lower FY17-18E revenue can lead to a fall in EPS of 31% in FY17E & 27% in FY18E and a drop in TP of 23%, and 2) a 100bp higher RM-sales ratio can lead to a fall in EPS of 25% in FY17E and 23% in FY18E with a 20% drop in TP

Our assumptions

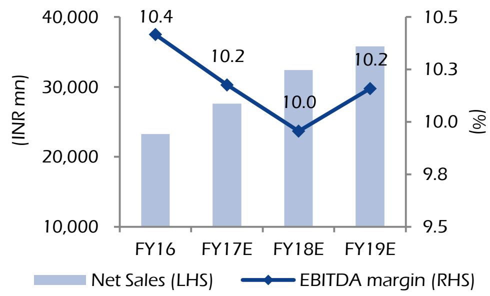
- We estimate cables revenue CAGR of 12% over FY16-19E with a retail CAGR of 20%
- EPC business CAGR of 34% during FY16-19E
- Average EBITDA margin of 10% over FY17-19E with retail at 11.0-11.5%, EPC at 10-11% while EHV segment margin to be at 14.0-14.5%

Financials (YE March)

Income Statement (INR mn)	FY16	FY17E	FY18E	FY19E
Net Sales	**23,256**	**27,588**	**32,399**	**35,780**
EBITDA	**2,423**	**2,807**	**3,226**	**3,635**
Margin (%)	10.4	10.2	10.0	10.2
Add:- Non operating Income	53	67	84	104
Depreciation	253	324	338	352
EBIT	**2,223**	**2,550**	**2,971**	**3,388**
Less:- Interest Expenses	1,270	1,400	1,494	1,547
PBT	**953**	**1,150**	**1,478**	**1,841**
Less :- Taxes	331	391	473	552
PAT	**622**	**759**	**1,005**	**1,289**
Adjusted PAT	**622**	**759**	**1,005**	**1,289**
Balance Sheet (INR mn)	**FY16**	**FY17E**	**FY18E**	**FY19E**
Share Capital	154	154	154	154
Reserves	3,512	4,215	5,150	6,355
Net Worth	**3,666**	**4,370**	**5,305**	**6,510**
Loans	4,980	5,283	5,276	4,603
Net Deferred Tax Liability	362	362	362	362
Capital Employed	**9,009**	**10,015**	**10,943**	**11,475**
Gross Block	4,446	5,646	5,896	6,146
Less:- Accumulated Depreciation	1,723	2,048	2,386	2,737
Add:- Capital work in progress	850	250	250	250
Net Fixed Assets	**3,573**	**3,848**	**3,760**	**3,659**
Investments	31	31	31	31
Net Working Capital	**5,346**	**6,005**	**6,795**	**7,360**
Cash & Bank Balance	59	130	356	425
Application of Funds	**9,009**	**10,015**	**10,943**	**11,475**
Cash Flow Statement (INR mn)	**FY16**	**FY17E**	**FY18E**	**FY19E**
Cash Profit adjusted for non cash items	**2,603**	**2,874**	**3,309**	**3,739**
Add/Less : Working Capital Changes	(650)	(659)	(790)	(565)
Operating Cash Flow before Tax	**1,953**	**2,216**	**2,519**	**3,175**
Tax	(331)	(391)	(473)	(552)
Operating Cash Flow	**1,622**	**1,824**	**2,046**	**2,623**
Less:- Capex	(801)	(600)	(250)	(250)
Free Cash Flow	**821**	**1,224**	**1,796**	**2,373**
Investing Cash Flow	0	-	-	-
CF from Fin. Activity	(809)	(1,153)	(1,570)	(2,304)
Net Change in Cash	**12**	**72**	**226**	**69**
Ratio Analysis	**FY16**	**FY17E**	**FY18E**	**FY19E**
Income Statement Ratios (%)				
Revenue growth	14.5	18.6	17.4	10.4
EBITDA growth	25.6	15.9	14.9	12.7
PAT growth	86.1	22.1	32.3	28.3
EBITDA margin	10.4	10.2	10.0	10.2
Net margin	2.7	2.8	3.1	3.6
Per Share data (INR)				
Diluted EPS	8.1	9.8	13.0	16.7
DPS	0.5	0.6	0.8	0.9
Book value per share	47	57	69	84
Payout (incl. Div.Tax) (%)	6.2	6.1	5.8	5.4
Dividend yield (%)	0.5	0.5	0.6	0.7
Valuation (x)				
P/E	12.2	12.6	9.5	7.4
EV/EBITDA	5.2	5.2	4.5	3.8
EV/Sales	0.5	0.5	0.4	0.4
P/B	2.1	2.2	1.8	1.5
Return and Liquidity Ratios				
Net debt/Equity (x)	1.3	1.2	0.9	0.6
ROE (%)	18.6	18.9	20.8	21.8
ROCE (%)	16.0	16.7	18.4	20.6

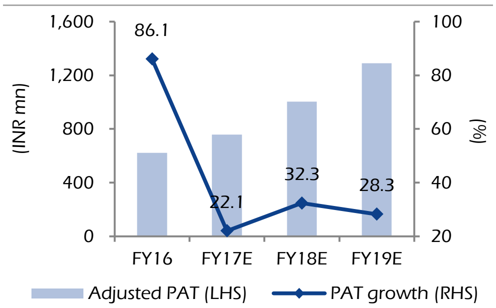
Note: pricing as on 5 July 2016; Source: Company, Elara Securities Estimate

Revenue & margin growth trend



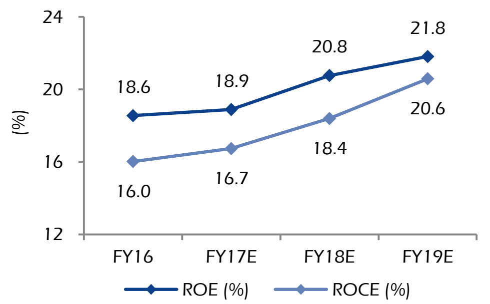
Source: Company, Elara Securities Estimate

Adjusted profit growth trend



Source: Company, Elara Securities Estimate

Return ratios



Source: Company, Elara Securities Estimate

Riding a new high

- **Leading cable manufacturer catering to industries as well as power T&D segment**
- **Cables contribute to 82% of FY16 revenue; domestic business contributes >90%**
- **Among Top 3 in the EHV segment (6% of FY16 sales)**

Leading cable manufacturer in India

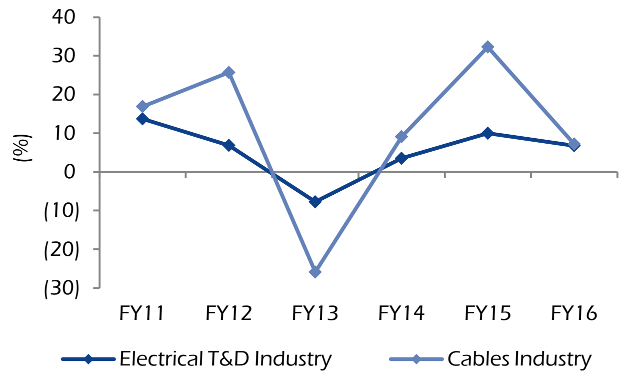
KEI Industries is one of India's leading cables and wires companies. Its key product segments include:

- Cables (LT, HT & EHV), controls & instrumentation, rubber and thermocouple cables
- House and winding wires
- Stainless steel wires
- Specialty cables used in marine & offshore industries

Cables: largest module of T&D equipment industry

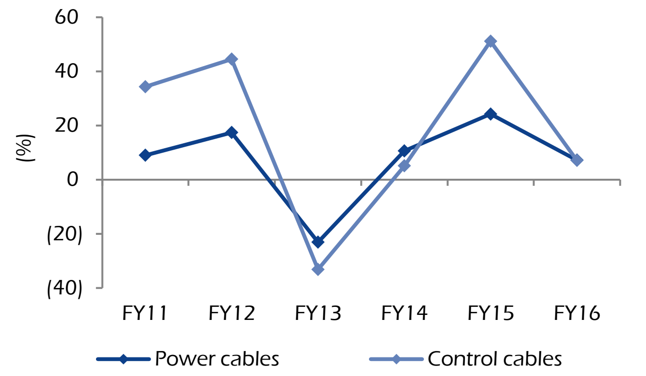
Cables form the largest component within the electrical T&D industry with a weightage of ~31%. As per IEEMA, the cables segment has consistently outperformed industry growth in the trailing five years (except in FY13 when it fell 26%, sharper than the industry contraction of 8%). During FY16, the segment grew by 7.2% while the overall electrical equipment index was up 6.8%.

Exhibit 1: Growth of cables vs electrical T&D industry at an average of 7% in FY16



Source: Indian Electrical and Electronics Manufacturers' Association (IEEMA), Elara Securities Research

Exhibit 2: Control cables grow faster than power



Source: IEEMA, Elara Securities Research

KEII caters to institutional as well as retail customers. It addresses cabling requirements of sectors, such as power, oil & gas, railways, automobiles, cement, steel, fertilizers, textiles and real estate.

Exhibit 3: Customer profile

Cement	Refineries and Petrochemicals	Power
ACC	Oil marketing PSUs like BPCL, HPCL, IOCL	ABB India
Ambuja Cement	Essar	Alstom T&D
L&T	GAIL	BHEL
Tata Cement	MRPL	Thermax
	ONGC	Crompton Greaves
	Punj Lloyd	NTPC
	Reliance Industries	L&T
	Fertilizer companies like Deepak Fertilizer, IFFCO, GSFC	JSPL
		Siemens

Source: Company, Elara Securities Research

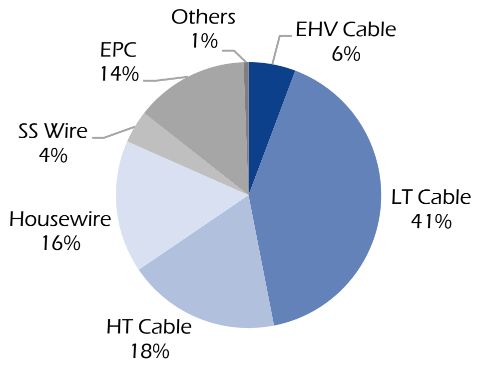
Within cables, power cables have a weightage of 21% and the rest (10%) is for control & other varieties. During FY16, power cables growth slowed to a three-year low of 7.2% and control & others cables was up 7.1% in FY16.

Cables still biggest share of revenue in FY16

Cables is the largest revenue segment for KEII, contributing 82% of FY16 sales. However, its share has fallen from the peak of 93% in FY11 after the company ventured into EPC. Cables grew at a CAGR of 10% over FY11-16 to INR 19.1bn. This includes sales from LT, HT, EHV and house wire products as well as cables that are used in the EPC segment. HT cables (11kV-33kV; 19%) revenue grew at a CAGR of 19% over FY13-16 to INR 4.4bn, LT cables (<11kV; 42% — the largest segment in cables) reported a CAGR of 2% to INR 9.6bn. House wires (16%) revenue posted a strong CAGR of 16% to INR 3.8bn.

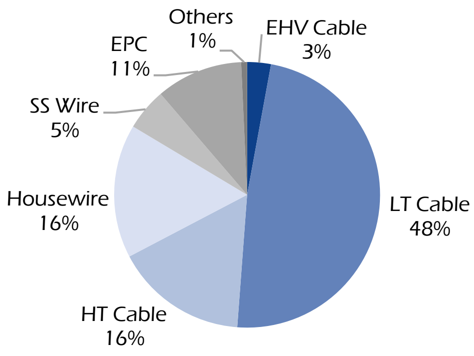
Stainless steel wires is the smallest revenue segment, contributing to 4% of FY16 revenue at INR 930mn.

Exhibit 4: Cables constitute 82% of FY16 revenue



Note: Cables (LT,HT. EHV & House Wire)
Source: Company, Elara Securities Research

Exhibit 5: Cables constitute 83% of FY15 revenue



Note: Cables (LT,HT. EHV & House Wire)
Source: Company, Elara Securities Research

Domestic market contributes to 92% of sales

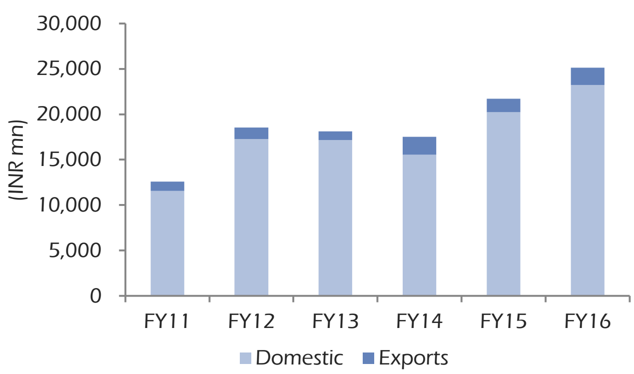
The domestic cables and wires market contributes 92% of FY16 revenue at INR 23.2bn. The rest comes from exports. Further, the domestic business has grown at a faster pace i.e. at a CAGR of 15% over FY11-16 vs a lower CAGR of 13% for exports during the same period.

Exports bounce back in FY16

The company exports its entire range of cables (EHV, HV & LV) and has a presence in 45 countries. It meets prequalification requirements for large projects in the Middle East and South Africa (already participated in large tender value of INR 5bn).

KEII operates in export markets in the UAE, Singapore, Nigeria and Kazakhstan. It also has branch offices in Australia and South Korea. Exports touched a high of INR 2bn in FY14, but shrank 25% in FY15 to INR 1.5bn, owing to lower spend by customers in the target markets as a result of a fall in crude oil prices. However, exports bounced back to INR 1.9bn in FY16 on the back of order inflows from Singapore and Australia in Q4FY15.

Exhibit 6: Domestic business grows at a faster clip



Source: Company, Elara Securities Research

Among top 3 players in EHV (6% of FY16 sales)

KEII entered into a technical collaboration with Brugg Kabel AG, Switzerland, to manufacture EHV cables in India (most requirements still being met through imports) in January 2010. Accordingly, it became the third company in India to manufacture EHV cables above 66KV upto 220kV by setting up a factory at Chopanki at Rajasthan of capacity 500km. Another Rajasthan plant at Bhiwadi manufactures EHV cables of 66kV level upto 100km.

After the pre-qualification process with various state electricity boards (SEB) over the past 2-3 years, the company now derives 6% of total FY16 revenue from this segment. It has received several orders from states, such as Uttar Pradesh & Karnataka, and utilities & public transport systems like Power Grid Corporation and Delhi Metro Rail, respectively. The roll-out of integrated power development scheme (IPDS) in various urban centers by distribution utilities, the upcoming metro rail network, large realty projects (IT parks & residential townships) can drive demand for EHV cables.

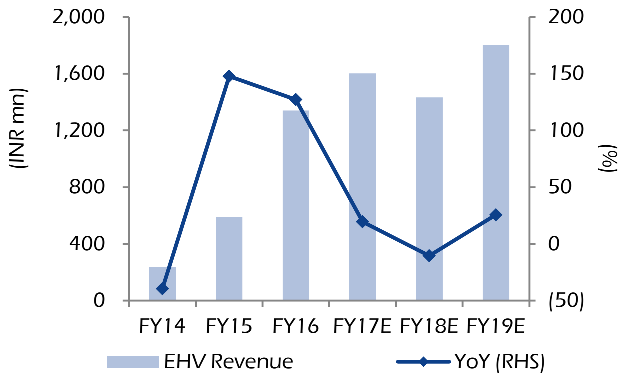
EHV cables posted a revenue CAGR of 50% over FY13-16 to INR 1.34mn. The current order book stands at INR 1.45bn as on March 2016. However, unlike the other cables segment, EHV is highly profitable with a ~15% EBITDA margin.

Next goal: expand into 400kV EHV segment in FY17

KEII has undertaken a Brownfield expansion at its Chopanki factory to start manufacturing EHV cables upto 400kV. This would add an incremental 500km of EHV capacity, taking total to 1,000km of capacity above 66kV level. Capex is estimated at INR 1.2bn and the plant is expected to become operational by Q3FY17. About INR 850mn has already been incurred in FY16. While the company has to undergo the pre-qualification process again with various SEB for 400kV EHV cable supply, this expansion would result in a potential INR 2bn in additional revenue.

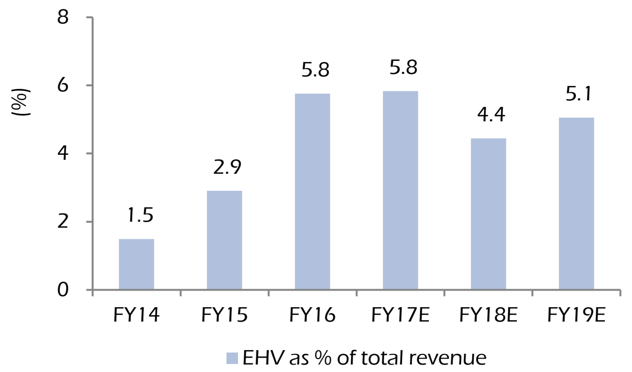
Capital Goods

Exhibit 7: EHV revenue CAGR of 10% in FY16_19E



Source: Company, Elara Securities Estimate

Exhibit 8: EHV revenue share at 5% in FY19E



Source: Company, Elara Securities Estimate

Higher order inflows to drive EPC biz (14% of sales)

In 2010, the company ventured into the EPC business by undertaking turnkey projects for power transmission of 66kV–400kV substation in India. It has bagged an order from Madhya Pradesh distribution companies for the survey, supply, erection, testing and commissioning of 33kV & 11kV substations and distribution lines. Since then, the company has executed several projects:

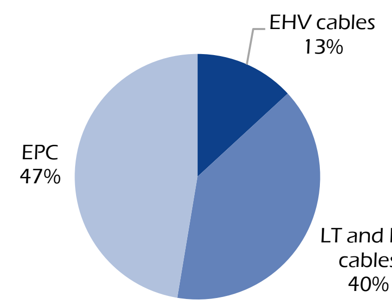
- HT cabling system for Jaipur distribution utility
- MES for 100kV transform and electrical system of Air Force Station, Gurgaon
- EPC projects for power transmission utilities in Maharashtra, Kerala, Tamil Nadu and Rajasthan
- Projects for Reliance Infrastructure at its 400kV switchyard for 1.2GW TPP at Hissar
- RAPDRP/DDUGY Project at Mathura, Vrindavan

In-house manufacturing of cables gives a strong competitive edge to KEIL, translating into a sustainable EBITDA margin of about 10-11%. It has also collaborated with Woosun Electric based in South Korea for power projects and Spain-based Cobra Engineers for substation execution. The completion project timeline is between 4 and 24 months. The company posted a revenue CAGR of 33% over FY13-16 to INR 3.2bn or 14% of sales. It has already won an order of INR 3.1bn and is L1 qualified in projects worth more than INR 6bn, all from Uttar Pradesh state distribution utilities, with 25% cable content. Accordingly, we estimate EPC revenue will increase to 22% of overall revenue by FY18.

Overall order book up 4% YoY

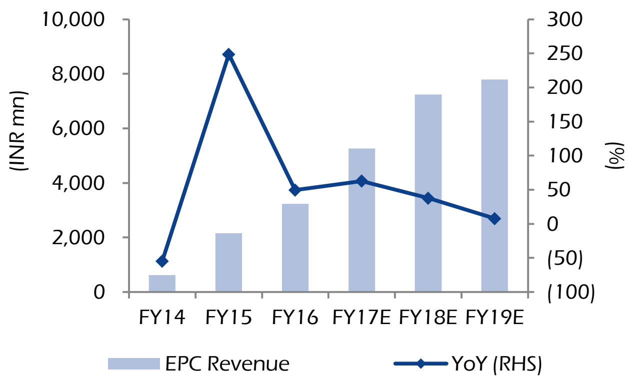
As on March 2016, order book across various business segments stands at INR 17.6bn, up 4% YoY but down 7% QoQ. The EPC segment order book stands at INR 7bn, down 23% YoY. LT & HT cables have an order book of INR 6bn while the rest (INR 1.45bn) is for EHV cables. Of the cable order book of INR 6.1bn as on March 2016, exports stand at INR 1.9bn.

Exhibit 11: Order book – FY16



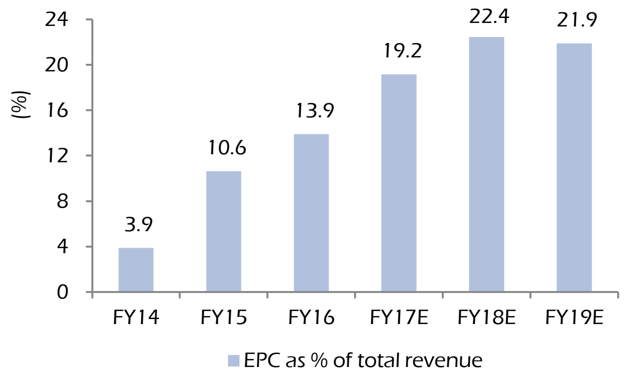
Source: Company, Elara Securities Research

Exhibit 9: EPC revenue CAGR of 34% in FY16_19E



Source: Company, Elara Securities Estimate

Exhibit 10: EPC revenue share at 22% in FY19E



Source: Company, Elara Securities Estimate

Retail therapy

- ❑ **Contributes to 31% of total sales in FY16**
- ❑ **Guidance of 45-50% of sales by FY20**
- ❑ **Focus on brand-building via higher ad spend and dealer network expansion**

Retail contributes to 31% of total sales in FY16

The cables and wires are sold through the retail channel (via direct dealers) and institutional tendering. Currently, KEII sell ~69% of its products through the institutional route. The retail segment contributes 31% of sales at INR 7.2bn in FY16 (similar in FY15). Among various products, house wires are sold only through dealer networks. Within cables, ~23% of LT+HT cables are sold through the retail network.

Guidance: 45-50% of revenue from retail by FY20

Over the years, KEII has strategically increased its focus on the retail segment. It has set a target of achieving 45-50% of revenue from the retail segment by FY20. The company has strengthened its top management team by appointing a new business head for the retail business at the start of FY15.

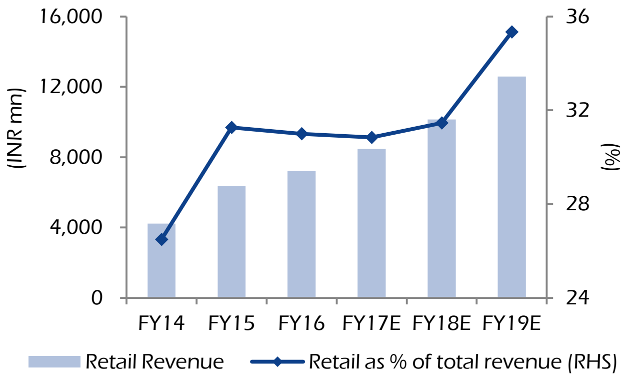
We assume revenue growth of 15-18% in the house wire segment over FY17-19E and 20-30% revenue growth from the LT+HT retail revenue sales on the back of larger footprints achieved through expanding the dealer network. Accordingly, we estimate the share of revenue from retail will reach to 35% by FY19.

Brand-building: higher spend, larger dealer network

KEII has embarked on a brand-building exercise for the past several years. Accordingly, it spent INR 70mn in FY16 on advertising in both print and TV. This is significantly higher than average advertisement spend of just INR 20mn over FY12-15.

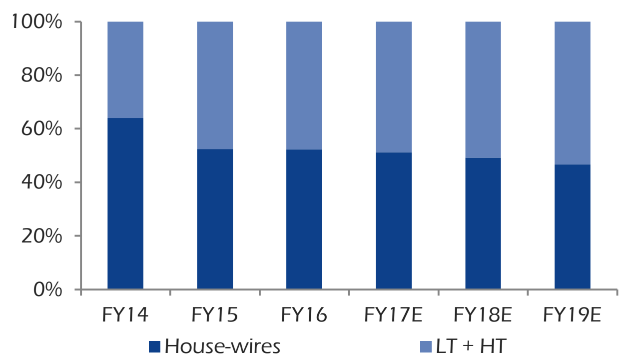
Likewise, the company has been continuously adding to its retail network and closed FY16 with 926 dealers. This is a 7x jump over the past six years wherein it had just 130 dealers in FY11.

Exhibit 12: Share of retail revenues is increasing to 35% by FY19



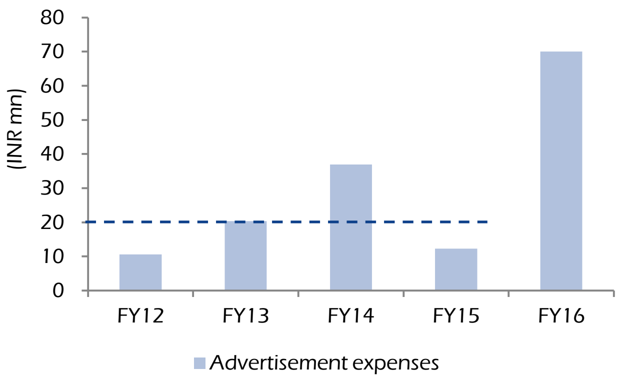
Source: Company, Elara Securities Estimate

Exhibit 13: All of housewires and about 23% of LT + HT cables are sold in retail in FY16



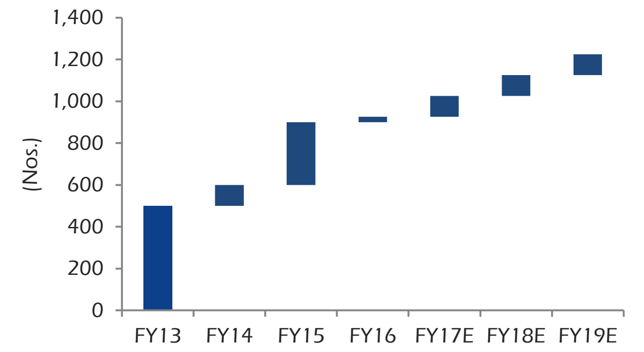
Source: Company, Elara Securities Estimate

Exhibit 14: Advertising spend up 3x over FY12-15



Source: Company, Elara Securities Estimate

Exhibit 15: Distribution network jumps 7x in 6 years



Source: Company, Elara Securities Estimate

Finance cost is high, to fall on debt repayment

- **Finance cost at 5.5% of sales to decline as turnover rises and debt is repaid**
- **Term loan and WC interest as a percentage of sales to fall by 100bp**
- **LC interest as a percentage of sales to remain constant**

Gradual decline in finance cost as % of sales

KEII finance cost stands at INR 1.27bn, up 5.5% YoY, which translates at ~5.5% of sales in FY16. The key components of finance cost are interest on term loan, interest on working capital loan, interest on Letter of Credit (LC) on raw material, and bank charges on LC, guarantee and processing fees. These comprise: 1) interest on term loan + WC loan at 3% share, and 2) LC interest & charges and bank guarantee & charges at 2.5% share. Although finance cost has increased over FY14-16, finance cost as a percentage of sales has been trending down from the highs of 6.9% in FY14 to 5.5% in FY16. Total debt remains at ~INR 4.5-5.0bn in the past five years. We estimate finance cost will decline by 120bp as a percentage of sales over FY17-19E, primarily due to the repayment of term loan.

Term loan + WC interest at 3% of sales

The interest on term and working capital loan stands at INR 690mn or 3% of sales in FY16. Debt of INR 5bn is equally split between term and working capital loans. The interest rate on term is at ~11% while working capital is about 16-18%. Outstanding long-term debt of INR 2.5bn is expected to be paid over the next four years which would subsequently reduce interest as a percentage of sales on term loan and working capital to 2% by FY19E.

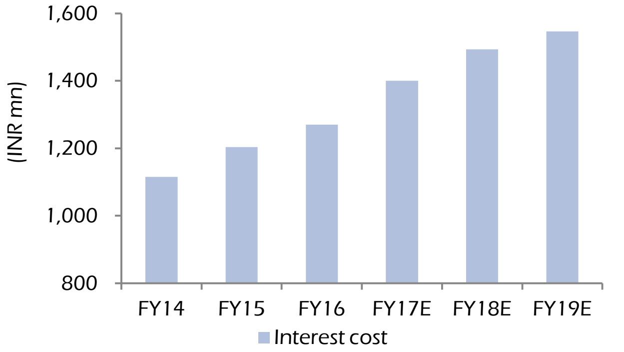
LC interest on material at 1.4% of sales

The interest on letter of credit (LC) used by the company to procure copper & aluminum stands at INR 330mn or 1.4% of sales in FY16. We estimate LC charges as a percentage of sales will remain constant at about ~1.4% during FY17-19E.

Other finance cost at 1.1% of sales

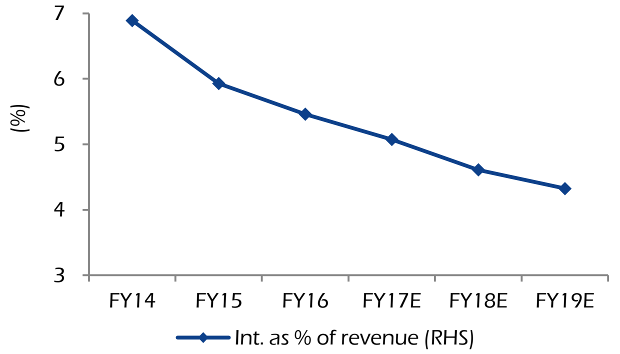
Other finance cost which includes bank charges on LC on material, bank guarantee charges and processing fees, is at 1.1% of sales in FY16. The company has given bank guarantees of INR 1.3bn and charges stand at 7% in FY15. We expect other finance cost to fall to 0.9% by FY19E.

Exhibit 16: Though interest cost rises...



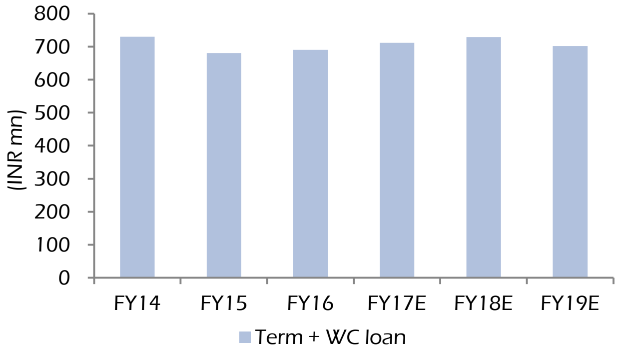
Source: Company, Elara Securities Estimate

Exhibit 17: ...it has fallen as a % of sales to 4.3% by FY19E



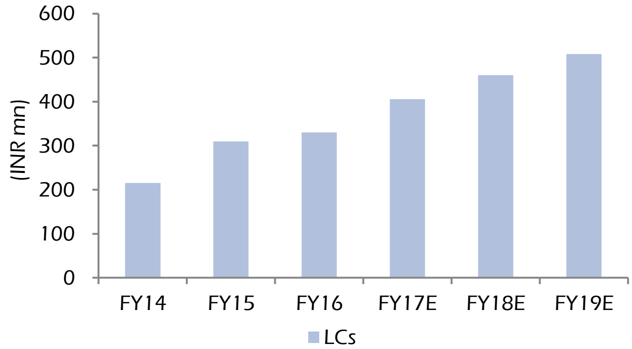
Source: Company, Elara Securities Estimate

Exhibit 18: Interest on term loan + WC stable



Source: Company, Elara Securities Estimate

Exhibit 19: LC interest on material rises



Source: Company, Elara Securities Estimate

Earnings CAGR of 27% over FY16-19E

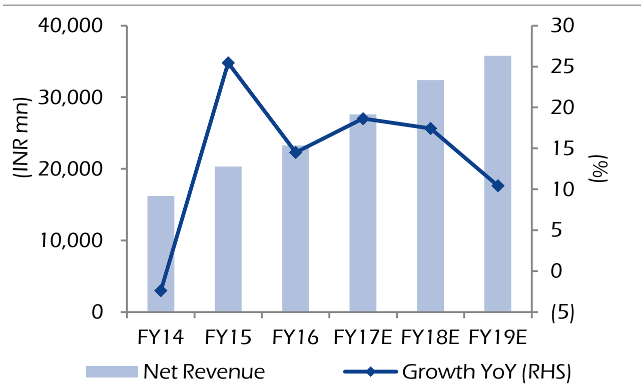
- ❑ **Revenue CAGR of 15% over FY16-19E**
- ❑ **Net profit CAGR of 27% over FY16-19E**
- ❑ **Initiate with a Accumulate and a TP of INR 140 (upside: 13%)**

Revenue at 15% CAGR over FY16-19E

We expect a revenue CAGR of 15% to INR 35.7bn during FY16-19E (vs 12% during FY13-16) on the back of 1) higher growth in HT cables (both in institutional & retail, 2) high order inflow to drive EPC sales, and 3) acceleration in the retail business.

Over the past decade, KEII registered revenue CAGR of 16% to INR 23bn, the highest to date, over FY07-16. Revenue growth was driven by enhancing the existing portfolio of LT cables (LT; <11kV), moving up in the cable value chain into HT cables (HT; 11kV – 33kV) and EHV cables (EHV above 66kV–220kV), venturing into the house wires retail segment and forward integration to the EPC business. But growth slowed to an 8% CAGR over FY12-16, primarily due to a fall of 4% in FY13 and 2% in FY14 based on a downturn in the entire electrical T&D sector. Subsequently, growth recovered with a 20% CAGR over FY14-16.

Exhibit 20: Revenue growth rate is falling gradually

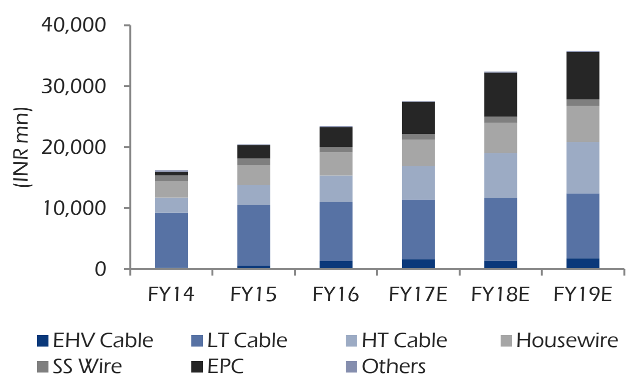


Source: Company, Elara Securities Estimate

EBITDA margin estimated at ~10%

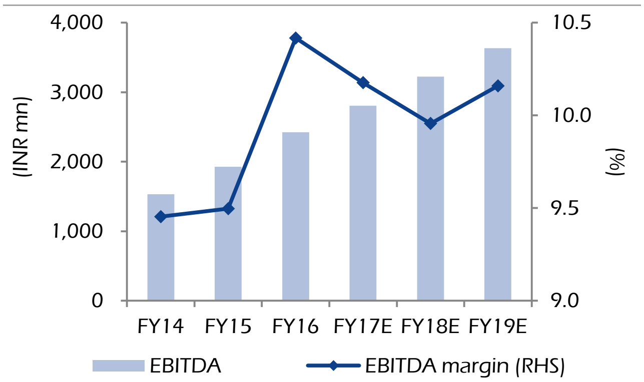
Raw material expenses comprise: 1) basic materials used for manufacturing, such as copper, PVC, stainless steel wires & rods, and aluminum wire rod, and 2) bought out items for turnkey projects. Copper constitutes the biggest chunk at 47%, followed by aluminum wire rod at 19% of total raw material costs in FY15. Import content in raw materials has gradually increased to 7% in FY15 vs 4% in FY11. But, owing to a change in revenue mix (turnkey solution), the RM-sales ratio has gradually declined by 700bp over FY12-16 to 69.4% in FY16. We assume an increase in the RM-sales ratio of 60bp in FY17E and 100bp in FY18E. While the number of permanent employees stands at 812 as on FY15, it additionally hired 290 workers and 2,100 contract laborers. At the EBITDA level, the retail segment is estimated to earn a higher 11% EBITDA margin. The institutional segment comprising LT & HT cables has a lower 8-9% margin.

Exhibit 21: Top three contributors to revenue are LT cable, HT cable and EPC



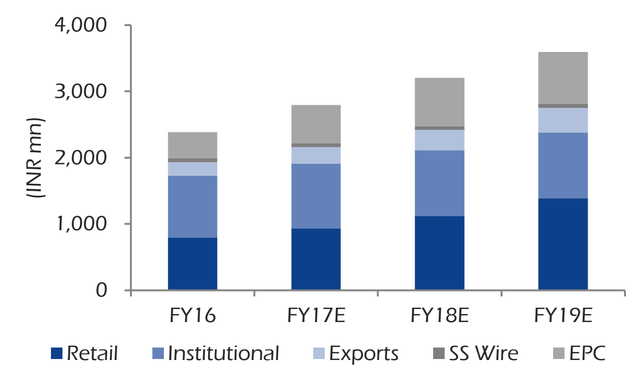
Source: Company, Elara Securities Estimate

Exhibit 22: EBITDA margin to average at 10% over FY17_19E



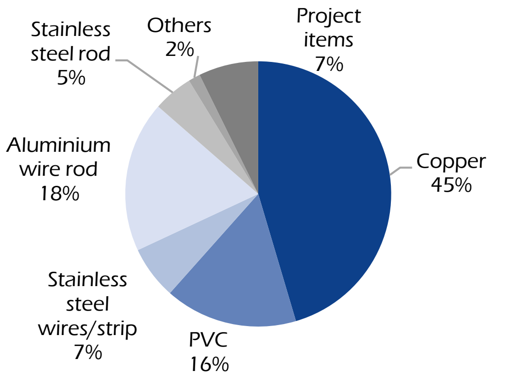
Source: Company, Elara Securities Estimate

Exhibit 23: Breakdown of EBITDA for various customer segments



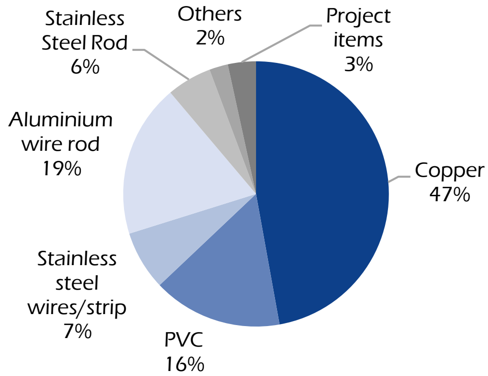
Source: Company, Elara Securities Estimate

Exhibit 24: Raw materials – FY15



Source: Company, Elara Securities Research

Exhibit 25: Raw materials – FY14



Source: Company, Elara Securities Research

Within the institutional segment, EHV is the most profitable cable segment at ~14-15% margin. EPC margin is expected to remain at 10-11%, owing to the inherent advantage of in-house souring of cables. Accordingly, we expect an average of 10% EBITDA margin over FY17-19E. This would lead to an EBITDA CAGR of 14% over FY16-19E (vs 12% over FY13-16).

Peers like Havells India and V-Guard Industries have multiple lines of business. When we look at the cables business segment, Havells and Finolex Cables have significantly higher EBIT margin than KEII. EBIT margin of KEII's cables segment as per segment-wise reporting works out to be 11.6% and 11.8% for FY15 and FY16 respectively, excluding unallocable overheads.

Exhibit 26: Peer comparison

(INR mn)	FY13	FY14	FY15	FY16
Net Revenue				
KEI Industries*	15,818	14,564	17,110	19,113
Havells India*	16,925	19,264	21,904	22,081
Finolex Cables	19,852	20,160	20,927	20,603
Shilpi Cables#	6,549	9,858	14,064	19,058
Apar Industries*	4,185	5,733	5,601	6,747
V Guard Industries	4,463	5,466	5,837	5,886
EBIT margin (%)				
KEI Industries**	11.2	12.1	11.6	11.8
Havells India*	9.1	11.0	12.1	14.2
Finolex Cables	12.2	12.8	13.7	16.1
Shilpi Cables#	10.4	9.0	7.8	8.3
Apar Industries*	(0.2)	(0.6)	3.6	4.1

Note: *cables segment revenue and margin, **prior to unallocable expenses in segment reporting which is estimated at 2.8% of net revenue in FY15 and 3.3% in FY16, # parent. Source: Company, Elara Securities Research

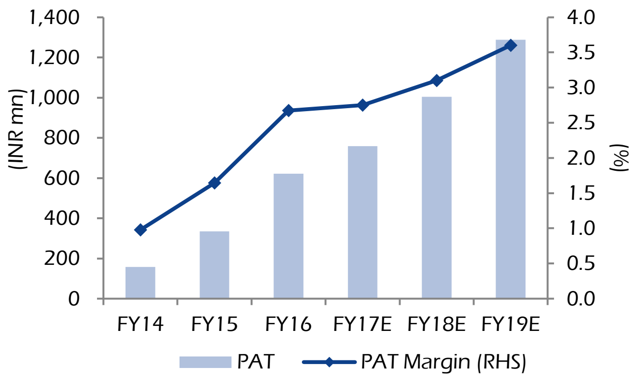
Improving working capital

Working capital has increased to 100 days in FY14 from 79 in FY11 and down to 88 days in FY16. Debtor days reduced to 89 days in FY16 from 97 in FY14 and inventory days were lower to 66 from 91 while creditor days reduced to 68 from 87. We assume a net working capital (inventory add debtors less creditors) at 95 in FY17E (vs 88 in FY16, high owing to higher EPC share), and gradually reducing to 80 days by FY19E.

Earnings CAGR at 27% over FY16-19E

Based on our assumptions, coupled with a fall in finance cost as a percentage of sales and lower corporate taxes by FY19, we estimate earnings CAGR of 27% to INR 1.29bn over FY16-19E vs a 33% during FY13-16.

Exhibit 27: Earnings growth of 27% over FY16-19E

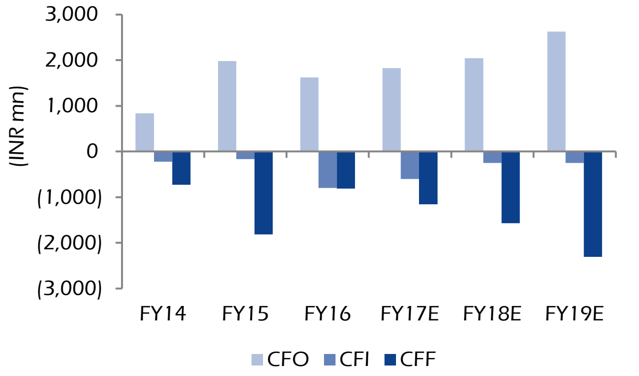


Source: Company, Elara Securities Estimate

Accordingly, ROE would jump to an average of 20.5% over FY17-19E vs 12% over FY13-16. Likewise, ROCE is expected to average at 18.6% during FY17-19E, significantly higher than 13% achieved during FY13-16.

We estimate KEII will generate free cash flow from operations of INR 1.8bn in FY17E, up 13% YoY, and further INR 2bn in FY18E, up 12% YoY.

Exhibit 28: Cash flow from operations is rising steadily

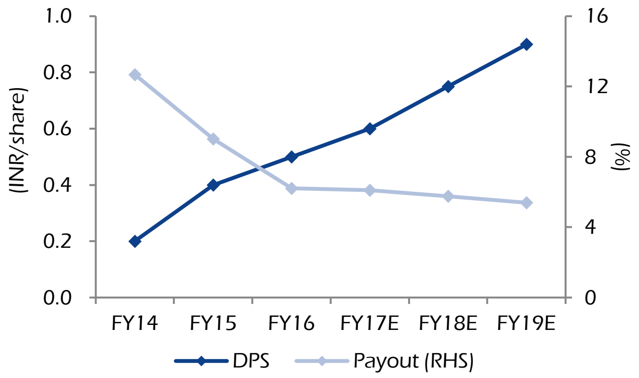


Source: Company, Elara Securities Estimate

Consistency in dividend

The company has consistently paid dividend for the past 10 years. During FY11-14, it paid dividend of INR 0.20/share (for a dividend of 10% and face value of INR 2). This increased to INR 0.40/share in FY15 and further INR 0.50 in FY16 (implying a less than 1% yield). We assume a dividend payout of 5-6% over FY17-19E.

Exhibit 29: Improving dividend history



Source: Company, Elara Securities Estimate

Valuation: Accumulate with TP INR 140

We estimate an EPS of INR 9.8 in FY17, INR 13 in FY18 and INR 16.7 in FY19. We have used an average of P.E and EV/EBITDA to value the company. We assign 9x June 2018E P/E (25% premium to the average three-year) and 5x June 2018E EV/EBITDA (25% premium to the average three-year) to arrive at an average target price of INR 140/share, implying potential upside of 13% from the current levels. The stock is trading in the top quartile of its historical 1-year trading band. Thus, we initiate coverage with **Accumulate** rating.

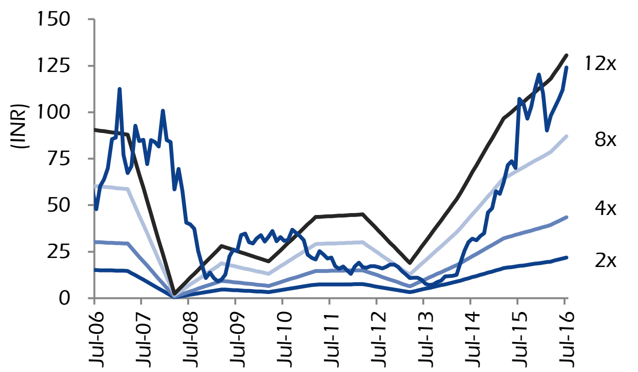
EBIT margin of cable segment of Finolex Cables has been higher than KEII's cables division over FY13-16. The gap between these margins has increased in the past four years with a sizeable difference in FY16. Finolex Cables EBIT margin stood at 16.1% vs 11.8% in KEII cables segment in FY16. Average ROE of Finolex Cables is significantly higher at 17.5% while KEII stands at 12% over FY14-16. Consequently, Finolex Cables trades at a higher average P/E of 12x than KEII, which trades at average P/E of 8x over FY18-19E.

Exhibit 30: Peer comparison

Company	P/E (x)			EV/EBITDA (x)		
	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E
KEI	12.6	9.5	7.4	5.2	4.5	3.8
Finolex Cables*	14.6	12.9	11.3	12.9	11.3	10.1
Havells India*	35.7	31.1	26.7	23.3	20.4	18.1
V Guard	30.5	25.2	-	19.8	16.6	-
Apar *	13.0	10.6	-	5.3	4.7	-
Average	**23.4**	**20.0**	**19.0**	**15.3**	**13.2**	**14.1**

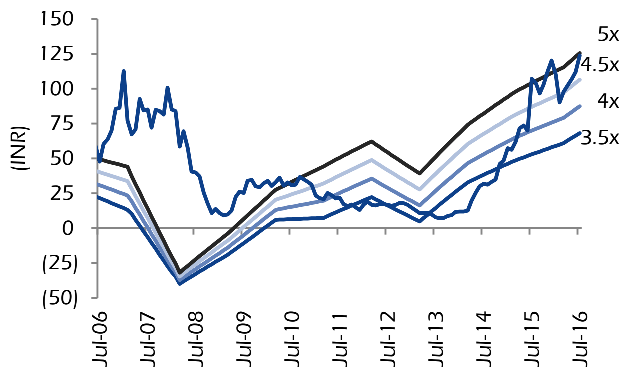
Note: *consolidated; Source: Bloomberg, Elara Securities Estimate

Exhibit 31: One-year forward P/E at 11.4x



Source: Bloomberg, Company, Elara Securities Research

Exhibit 32: One-year forward EV/EBITDA at 5x



Source: Bloomberg, Company, Elara Securities Research

Capital Goods

Our earnings estimates are lower than Consensus

Our estimate of KEII revenue is in line with Consensus for FY17 and FY18. However, our earnings estimates are below Consensus by 17% and 21% in FY17E and FY18E, respectively.

Exhibit 33: Consensus vs Elara estimates

(INR mn)	FY17E			FY18E		
	Elara	Consensus	Chg (%)	Elara	Consensus	Chg (%)
Sales	27,588	27,802	(1)	32,399	32,277	0
% YoY	18.6	19.5		17.4	16.1	
EBITDA	2,807	2,993	(6)	3,226	3,576	(10)
Margin (%)	10.2	10.8		10.0	11.1	(112.3)
PAT	759	915.7	(17)	1,005	1,267.0	(21)
% YoY	22.1	47.2		32.3	38.4	
EPS (INR)	9.8	11.9	(17)	13.0	16.4	(21)

Source: Bloomberg, Elara Securities Estimate

Sensitivity analysis

Our sensitivity analysis is based on three parameters:

- **Fall in revenue**: if revenue falls by 5% vs our estimate, then EBITDA is likely to fall by 14% each in FY17E, FY18E and FY19E and EPS in the range of 24-31% over FY17-19E. Accordingly, TP is expected to fall by 23% to INR 107.
- **Higher RM-sales ratio**: If RM-sales ratio is higher by 100bp vs our estimates, then EBITDA is likely to decline by 10% each in FY17E, FY18E and FY19E and EPS in the range of 20-25% over FY17-19E. As result, TP is expected to drop by 20% to INR 112.
- **Higher finance cost**: If interest cost rises by 10% vs our estimate, then EPS is likely to fall in the range of by 7-11% over FY17-19E and TP by fall 6% to INR 132.

Exhibit 34: Scenario analysis

	EBITDA (INR mn)			EPS (INR)			TP (INR)
	FY17E	FY18E	FY19E	FY17E	FY18E	FY19E	
Base scenario	**2,807**	**3,226**	**3,635**	**9.8**	**13.0**	**16.7**	**140**
If revenue falls 5%	2,413	2,778	3,141	6.78	9.54	12.74	107
% Change vs Base scenario	(14.0)	(13.9)	(13.6)	(31.0)	(26.6)	(23.7)	(23.3)
If RM/Sales increases 100bp	2,532	2,902	3,277	7.4	10.1	13.4	112
% Change vs Base scenario	(9.8)	(10.0)	(9.8)	(24.6)	(22.5)	(19.9)	(19.6)
If finance cost increases by 10%	2,807	3,226	3,635	9.2	11.6	14.9	132
% Change vs Base scenario	-	-	-	(6.8)	(10.7)	(11.0)	(5.7)

Source: Elara Securities Estimate

Company Description

KEI Industries (erstwhile Krishna Electrical Industries) was established in 1968 as a partnership firm with primary business of rubber cables. In 1985, the company ventured into manufacturing control, instrumentation and thermocouple cables. Adding to its cables profile, it produced low tension (LT) power cables up to 3.3kV in 1993. In 1996, through the acquisition route, the company manufactured stainless steel wires. Over the past 20 years, it has swiftly progressed to cover a gamut of power cables from low tension-high tension-extra high voltage upto 220kV. It has a technological tie-up with Brugg Kables, AG, Switzerland for EHV cables.

Presently, KEI manufactures extra high voltage (EHV) cables ranging from 66kV to 220kV, high tension (HT) cables from 11kV to 33kV and low tension (LT) cables below 11kV, control & instrumentation cables, specialty cables, rubber cables, flexible and house wires, submersible cables, winding wires and, stainless steel wires and EPC.

Board of Directors

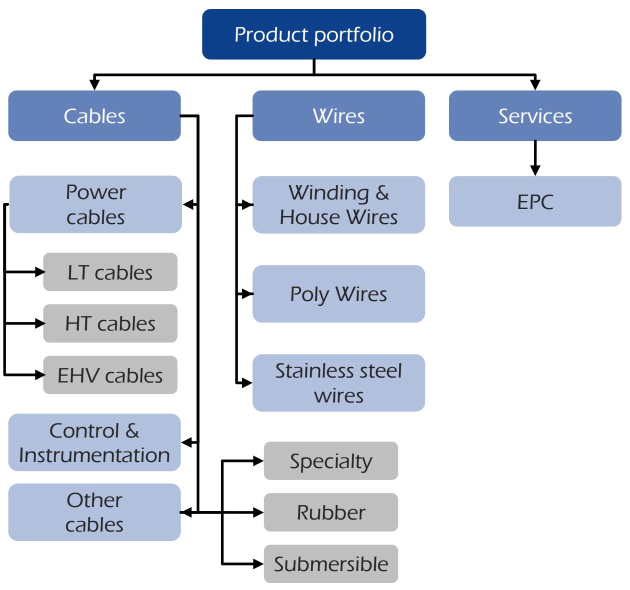
The seven-member board is headed by Anil Gupta, Chairman and Managing Director. The company has four Independent Directors, one Executive Director and one Non Executive Director.

Exhibit 35: Board of directors

Member	Designation
Anil Gupta	Chairman & Managing Director
Archana Gupta	Non Executive Director
KG Somani	Non Executive and Independent Director
Pawan Bholsouria	Non Executive and Independent Director
Vijay Bhushan	Non Executive and Independent Director
Vikram Bhartiya	Non Executive and Independent Director
Rajeev Gupta	Executive Director (Finance) & CFO

Source: Company

Exhibit 36: Product portfolio



Source: Company, Elara Securities Research

Shareholding pattern

KEI promoter (Anil Gupta & family) holds a majority stake of 49.4% as on March 2016. Over the past six years, the stake has increased from 41.6% FY11 to 44.4% in FY13, 47% in FY14 and 49.4% in FY16. The promoter stake has increased owing to the issuance of 10.3mn shares preferential shares (3.3mn) and warrants (7mn) to the promoter & promoter group over FY13-15.

Over the past 10 years, KEI's equity share capital has increased to INR 154.4mn in FY15 from INR 100.9mn in FY06. Equity capital has increased due to conversion of FCCBs (INR 3.7mn), the issuance of ESOPs (INR 0.3mn) & preferential shares (INR 12.6mn) and conversion of warrants (INR 37mn).

Exhibit 37: Change in share capital

Month	Equity capital (INR mn)	Increase in Equity capital (INR mn)	Issue Price (INR)	Reasons for increase in equity capital
Mar-06	101	-	-	-
Jan-07	118	17	28	Conversion of warrants
Jun-07	118	0	86	Bond conversion
Jan-08	122	3	81	Bond conversion
Jan-08	120	(1)	81	Bond conversion
Sep-08	122	1	2	ESOP scheme
May-10	128	6	28	Preferential issue
Feb-11	134	6	28	Conversion of warrants
Sep-12	140	7	18	Preferential issue
Jul-13	147	7	14	Conversion of warrants
May-14	154	7	14	Conversion of warrants

Source: Company

Manufacturing location

KEI has three cables manufacturing plants at Chopanki and Bhiwadi in Rajasthan and Silvassa at Dadra & Nagar Haveli. The following table gives a breakup of the installed capacities across each of the three manufacturing locations. During FY16, the company has added 6,500km of cables capacity at Bhiwadi and 4,000km at Silvassa. Further, it added 10,000km of winding wire capacity at Bhiwadi and 85,000 wire capacity at Silvassa. The company is expanding its EHV capacity by 500km at Chopanki plant at 400kV level and is expected to become operational during Q3FY17.

Exhibit 38: Installed capacity

Installed capacity (plant-wise)	FY15	FY16	FY17E
Chopanki (km)	12,600	12,600	13,100
Bhiwadi (km)			
Cables	38,000	43,900	43,900
Rubber cables	3,000	3,600	3,600
Winding wires	40,000	50,000	50,000
Silvassa (km)			-
Cables	19,000	23,000	23,000
Wires	240,000	325,000	325,000
Bhiwadi – stainless steel wires (MT)	4,800	4,800	4,800

Source: Company, Elara Securities Estimate

Capacity utilization

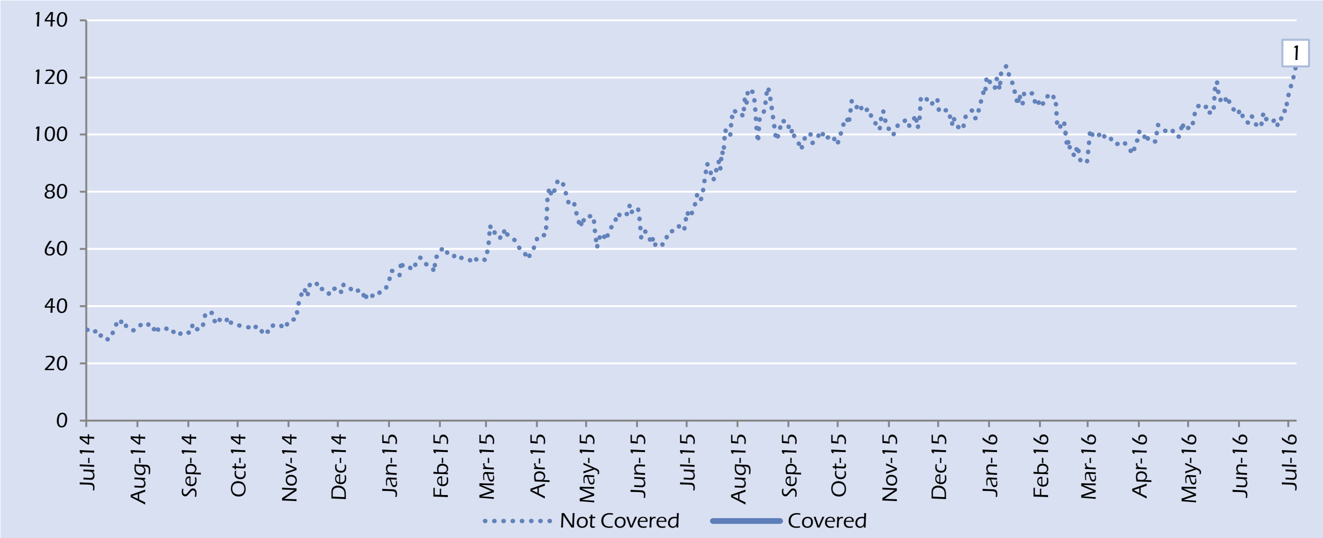
Overall, the Chopanki facility has the lowest capacity utilization amongst its three manufacturing plants. The Bhiwadi's cables and Silvassa cables plants have capacity utilization in the range of 80-95% in FY16. Bhiwadi's winding wires facility capacity utilization has fallen to 54% in FY16 from 62% in FY14.

Exhibit 39: Capacity utilization across three plants

Utilization (%)	FY14	FY15	FY16
Chopanki	36	37	40
Bhiwadi – cables	84	86	81
Bhiwadi - winding wires	62	57	54
Silvassa - cables	91	113	93

Source: Company

Coverage History



	Date	Rating	Target Price	Closing Price
1	5-July-2016	Accumulate	INR 140	INR 124

Guide to Research Rating

BUY	Absolute Return >+20%
ACCUMULATE	Absolute Return +5% to +20%
REDUCE	Absolute Return -5% to +5%
SELL	Absolute Return < -5%

Capital Goods

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