PROFITMART advisory

4th Nov 2016

KEI INDUSTRIES LIMITED

BSE: 517569 | Sector: Electricals Products

Position: Close

CMP : Rs. 123

Target Price: Rs. 168 (In next 12 mths)

BUSINESS BACKGROUND

KEI Industries is an established player in the manufacturing and marketing of EHV, MV and LV power cables segments, and has recently forayed into EPC business. It has a well-diversified product basket and business model across retail (domestic & exports), institutional, EHV segments, suitably balanced to address the demands of private and public sector organizations.

Since the last two years, the focus is on EHV and retail segment along with exports.

INVESTMENT HIGHLIGHTS

Strong Q1FY17 Performance –

KEI reported revenues for Q1FY17 of Rs 560.70 Crs, Operating Profit of Rs. 55.95 Crs and PAT Rs. 16.94 Crs against Q1 last year when Net Sales totaled Rs 518.39 Crs, Operating Profit totaled Rs 54.72 Crs and a PAT of Rs. 11.70 Crs in the same quarter last year. OPM in Q1FY17 is placed at 9.98% against 10.56% in Q1 of last year because of low sales from EHV cable segment due to current expansion and capex at Chopanki Plant and non recognition of profit at Varanasi EPC project.

For FY16 the company has recorded a topline of Rs 2351 crs from Rs 2030 crs, a EBIDTA of Rs 243 crs from Rs 193 crs while PAT is placed at Rs 62.5 crs from Rs 31.6 crs last year. KEI paid a dividend of 25% for FY16.

Extensive product portfolio and wide user industries –

KEI enjoys a wide product portfolio which encompasses the complete range of power cables, house wires, winding wires and stainless steel wires. It is also engaged in EPC business. It has a diversified client's base across various industries such as power, petrochemicals, steel, cement, oil & gas to name a few. With improving outlook of these sectors, we see cable industry particularly KEI to benefit

Improving client mix to benefit KEI going ahead –

KEI's diverse range of products is designed to address the complete cabling needs of private- and public-sector customers across various sectors such as power, infra, oil refineries, railways, automobiles, and real estate. Its products are used in the domestic and overseas markets.

Currently Retail constitutes 25% of KEI's sales and Institutional Customers account for 75%. With an increase in its distribution network, this ratio should become almost equal (we see Retail at 45-50% and Institutional at 55-50% in the next 3-4 years). This shift will help improve margins and lower working capital needs.

KEY DATA

FACE VALUE Rs	2.00
DIVD YIELD %	0.42
52 WK HI/LOW	129/86
NSE CODE	KEI
BSE CODE	KEI
MARKET CAP	RS 910 CRS

SHAREHOLDING PATTERN

PROMOTERS	- 49%
BANKS, MFs & DIIs	- 11%
FIIs	- 3%
PUBLIC	- 37%

KEY FUNDAMENTALS

YE	FY16	FY17	FY18
Rev Gr%	16	14	13
EBIDTA Gr%	26	16	14
PAT Gr%	97	38	37
EPS Gr%	97	38	37
Roe %	19	21	24
Roce %	22	24	25
EPS (Rs)	8.12	11.18	15.36
P/E (x)		11	8

Strong products basket: House wires to EHV cables –

KEI is one of the leading players in the domestic cable and wire sector – its diversified product range (of 400 SKUs) covers a wide variety of cables and wires catering to the needs of the industrial and household segments. Its portfolio spans house wire cables to extra-high-voltage cables (EHV) (up to 220kV, with the underlying expectation that it will be able to manufacture up to 400KV) and includes high and medium-voltage cables (MV/HV), LT cables, control and instrumentation cables, specialty and rubber cables, stainless steel wires and winding, and flexible and housing wires. KEI is the third-largest producer of EHV cables, in technical collaboration with Switzerland-based Brugg Kabel AG

Retail (domestic) division to bring in the next leg of growth –

KEI has achieved exceptionally higher growth vs. the overall sector's growth because of its focused efforts on brand building and strengthening of its distribution and dealership network. It is currently is present in both Institutional and retail segments of cables. Within its revenues, Institutional contributes 75% and Retail 25% share.

KEI is focused on increasing its distribution network for its retail division, which comprises of household wires, and LT/HT cables – this division has already seen considerable growth in recent years and contributed 25% to its total FY16 revenues.

With strong brand equity and wide distribution network (+900 dealers as on FY16) KEI is aggressively working towards increasing its retail share (B2C) to 50% of its revenue in the next 3-4 years.

Currently, it has very strong presence in north India, followed by west, south, and east. With the dealer expansion, it is planning to strengthen its operations in the eastern and southern parts of India. Its distribution network covers most India metros and tier-1 and tier-2 cities. It is building its visibility through aggressive brand promotion and advertisement campaigns having spent Rs around Rs 5 to Rs 7 crs in advertising in FY16. These aggressive promotion activities will help the company to increase its presence in the domestic retail market.

EHV cable business also seen ramping up –

Over the past 3-4 years, the EHV segment has emerged as a major focus area for the Company. The Company has completed the pre-qualification criteria and expects increased EHV sales going forward. Margins in EHV segment are higher at 18-20%

Moving up the value chain by entering EPC segment –

With the necessary prequalification criteria for EHV cables, its turnkey EPC business is all set to scale new heights, which will add significantly to its profitability. KEI's main services offered in EPC are – execution of power transmission projects (of 66kV to 400kV sub-stations) on a turnkey basis, EPC of EHV and HV cable systems, electrical balance-of-plant for power plants, and electrical industrial projects.

In EPC, KEI has the advantage of manufacturing (in house) EHV, HV and LT cables (usually ~30% of the total EPC project value), leading to superior margins. Through this segment, KEI serves various sectors such as power, infra, SEZ, MRT/airport, and steel, with an average working capital of 90-100 days

KEI intends to focus on projects where there is significant cabling requirement ensuring that its own cable gets sold. KEI is targeting EBITDA margin of atleast 15% on such projects. Average execution period is 18-24 months

Solid financial performance – Revenue growth and margin expansion to continue –

We estimate KEI's earnings to witness a CAGR of 30-35% over FY16-18E. This will be driven by steady revenue growth (18-20% CAGR over FY16-18E) and a steady EBITDA margin expansion over the same period.

We expect a significant improvement in both ROCE and ROE over the next 2 years as we expect the domestic market to grow at a healthy clip where there is good scope for margin improvement and revenue growth.

Business Outlook & Stock Valuation –

On a rough cut basis, in FY17, Topline will see a steady rise wherein Topline is expected to touch Rs 2690 crs.

On the bottomline level we expect the company to record a PAT of Rs 86.1 crs in FY17E. Thus on a conservative basis, KEI should record a EPS of Rs 11.18 for FY17E. For FY18E our expectation is that earnings traction for KEI would continue to be strong wherein we expect a EPS of Rs 15.36 respectively.

The business environment for Cable industry is showing signs of industrial and infrastructure growth which implies better demand for the cable industry. KEI has taken right steps by venturing into Extra High Voltage (EHV) Cables and presence in Engineering, Procurement and Construction (EPC) space. These segments are expected to contribute to the incremental growth for KEI and its strategic focus towards expansion through dealer-distributor network is expected to augment its house wire, flexible wire and cables business.

With strong cashflows, minimal capex going ahead and a strong 30% EPS growth expected over the next 2 years we expect the stock to yield strong outperformance going ahead.

Hence looking at KEI's steady financial track record, strong product domain and dominant market share and strong promoters we expect the stock to get re rated in future.

Hence we believe that the KEI stock should be purchased at the current price for a price target of around Rs 168 over the next 12 months.

FINANCIALS

For the Year Ended March RsCrs	FY15A	FY16A	FY17E	FY18E
Net Sales	2030.9	2351.1	2690.1	3035.1
EBIDTA	192.8	242.6	282.0	322.1
EBIDTA %	9.49	10.32	10.48	10.61
Interest	120.4	127.4	123.0	110.1
Depreciation	24.6	25.3	28.0	32.0
Non Operational Other Income	2.4	5.8	2.0	2.0
Profit Before Tax	50.2	95.8	133.0	182.0
Profit After Tax	31.6	62.5	86.1	118.3
Diluted EPS (Rs)	4.10	8.12	11.18	15.36
Equity Capital	15.4	15.4	15.4	15.4
Reserves	288.4	351.5	429.9	540.5
Borrowings	376.0	437.0	390.0	330.0
GrossBlock	302.0	358.0	388.0	423.0
Investments	3.1	3.1	3.1	3.1

Source Company Estimates

KEY CONCERNS

Postponement in private and government investments in core sectors could impact demand for KEI

Higher raw material prices could put pressure on profit margins of KEI if it is unable to pass over such costs to customers