kotak Institutional Equities

Infrastructure

India

ATTRACTIVE

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T&D: Revival of the fittest. Meetings with the managements of Techno Electric (market cap.: ₹32 bn; substation EPC) and Skipper (market cap.: ₹18 bn; tower manufacturing) brought out the robustness of the substation EPC business versus the transmission line EPC business. Further, we learn that global clients increasingly prefer Indian transmission towers and that the respite in competitive intensity could last a while. KEC could face challenges in its substation EPC foray. We prefer KPTL (₹260, BUY, TP: ₹310, ₹320 earlier) to KEC (₹159, ADD, TP: ₹165).

Techno Electric: supportive sector dynamics and margin focus yield superior business returns

- **Drivers: sector dynamics and internal strategies.** The inherent structure of the substation EPC business supports better business returns: (1) partnerships with strong technology providers (entailing the integration of supply from across several technology products) and (2) insulation from delays in land acquisition etc. that plague transmission line EPC players. (3) The current environment is also supportive as small domestic competitors cede ground to incumbents. We could also see MNCs decide to partner rather than compete with more cost-efficient and reliable EPC contractors. Techno Electric follows a conservative cash basis of accounting, selective bidding criteria and consistent focus on margin and cash flows.

- **Risks: partnerships, breach of contract.** Techno Electric's key partners for products/technologies are from China. In the absence of details of these relationships, we look at the company's operating history and find it devoid of litigation or large delays in getting back retention money. Key equipment supplying partners could possibly breach the terms of their contracts (e.g. flouting commitments on domestic manufacturing). However, Techno is unlikely to be impacted significantly by such a turn of events as typically, key clients, like PGCIL, sign separate contracts for such key substation equipment.

Skipper: strong domestic demand and overseas opportunity sans EPC risks

- **Recovery highlights inherent strengths.** The recent rise in ordering leverages Skipper strengths: scale and capability for backward integration, high level of automation and high level of repeat business. We also expect growth to benefit from (1) the strong domestic EPC pipeline, (2) growing contract sizes, (3) global opportunity, and (4) the company's ability to scale-up throughput with limited capex and limited competition.

- **Shift to EPC: too early to tell.** Skipper has recently started bidding for EPC jobs through JVs and is in process of acquiring requisite pre-qualification. The timing of its entry into EPC has been opportune (it is spared the cost of entry) and it is early to assess its value addition/impact on Skipper's business. Skipper's business returns are 1.5-2X that of the tower EPC business.

We iterate our relative preference for KPTL over KEC, more so at the current price

Takeaways from our meetings highlight the difficulties a transmission line EPC player like KEC faces as it moves into the substation EPC business (about 15% of KEC's backlog). Unlike KEC, KPTL does not operate in the substation EPC space. Notably, both managements stressed that they have liked working with KPTL in the past. We retain our relative preference for KPTL (₹260, BUY, TP: ₹310), over KEC (₹159, ADD, TP: ₹165).

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Techno Electric

Substation EPC: Better risk/reward over transmission line EPC

The management considers substation EPC business involves integrating intelligent electrical systems (switch gears, breakers, CT, VT, structures, SAS). This yields some advantages (1) key/ancillary substation equipment suppliers would want to partner with credible EPC contractors, which reduces the risks associated with typical transmission line contracts; (2) construction delays in terms of time and cost overruns; and (3) commodity price increases and segregated nature of contracts for key PGCIL orders; and (4) insulates EPC substation contractors from the risk of the key equipment supplier reneging on obligations (for e.g. mandated 'Make in India' components).

- **Strength of partnerships**. Given the nature of EPC work (integration of intelligent electrical systems) and past experience of several EPC substation players (exited business after their balance sheets bloated), equipment suppliers will be more cautious before partnering with EPC substation contractors. Key challenges in the business are (1) dealing with multiple suppliers, (2) managing to operate within one's resources (inherent in the EPC business), (3) adhering to one's commercial obligations (to receive payments on time) and (4) staying away from the attraction of growing one's backlog and top-line (this has doomed many of Techno Electric's peers).
- **Insulated from working capital build-up due to project delays**. An EPC substation contractor is handed over a site by the client, unlike a transmission line company. Post this hand-over, the client cannot change the work plan (L2 network).
- **EPC work involves more of integration of supply**. Land is provided to the EPC substation contractor and thus it does not get impacted by related delays. Transmission line players, on the other hand, having already mobilized labor, are impacted more by such delays.
- **Less impacted by commodity price risk**. The company does not take substantial risks over change in commodity prices. Essentially its job is to integrate intelligent electrical systems, unlike a transmission line company.
- **Does not share joint liability for PGCIL contracts**. Separate contracts are signed with the main equipment provider and the EPC contractor. Thus, in case the equipment provider is not able to comply with its requirements (*"Make in India"* for instance), Techno Electric's contract is not impacted.

Competition declines; may take time before reviving

The shift from AIS to GIS has increased the need for credible partnerships with product and technology providers. This has helped reduce competition to 6-7 players. Key competitors are EMC, BHEL, Alstom, ABB and KEC.

- **Key European substation peers opening up to partnerships**. Competition usually is from Europeans, Chinese and Koreans. Of these competition is more from Europeans (they have domestic presence) and less from Chinese (it wants to be a vendor, not a partner) and Koreans. European companies have been averse to parting with their EPC/O&M work and opt for partnership. However, this will eventually happen, as per the company. As such work requires cost and time efficiencies, it is the monopoly of specialized EPC contractors. During a recent visit to India, ABB's global CEO saw the need for taking on partners for such work. Alstom has still not opted for dividing its substation contracts with others, though this may change post the GE transaction (GE's offering and growth strategy is focused on products).
- **Limited competition from domestic peers**. In the past few years, many peers of Techno Electric have shut down. Key reasons (1) partnering with questionable product or technology providers, (2) booking revenue before client requirements and thus building inventory/receivables and (3) booking some bad orders.

For BHEL, EPC substation is not a focus area. For KEC, the transition from a commoditized transmission line EPC business to intelligent systems EPC business will be difficult, as per the company.

- **As the size of projects increase**, there are twin benefits for large EPC substation players (1) with the same number of locations (defines the bandwidth of one's management), more revenues can be earned and (2) smaller players find it more difficult to compete.

We derive comfort from Techno Electric's nature of working and financial reporting

- **Bidding criteria**. Its bidding criterion limits it to bid for select projects (bilaterally funded) and with specific, disciplined clients (PGCIL, AP, UP, MP, Rajasthan and now Odisha).
- **Portfolio approach**. Techno Electric follows a portfolio approach of bagging contracts rather than going after a few large sized contracts. The company is working on 25 odd projects at present. There is low risk of bad debts when dealing with state and central agencies. There are delays in payments at times and such blips do not impact the health of a portfolio of projects.
- **Asset light model with an EPC focus**. Techno Electric's focus is not on asset ownership but on growing its EPC business. It may pick up some BOOT projects with such EPC intentions in mind. It aims to sell the remaining ~120 MW of wind power projects.
- **Stable operating history**. The company has not faced any litigation yet, nor has it seen its retention money put on hold.
- **Cash basis of accounting**. From an accounting basis, the company does not follow a percentage-of-completion method and works on a cash-accrual basis. This, coupled with consistency of its reported margin, lends more credibility to its reported financials.
- **Steady backlog providing growth visibility**. Techno Electric can double its revenues with the same manpower and management bandwidth. It presently has ₹22 bn in backlog, comprising ₹18 bn of T&D, ₹3 bn of distribution and ₹1 bn of captive jobs.

Large opportunity as highlighted by Techno Electric

- Techno Electric highlighted that ₹1.5-2 tn will be spent over the next few years with PGCIL allocating ₹400 bn annually and states allocating another ₹800 bn. Investment of this kind is needed to transform the transmission system into a grid from developing sources of evacuation presently. Transformer capacity has to grow 2.5X for developing such a grid.
- Of the huge outlay, 25% or about ₹400-500 bn will be for setting up substations of which 40% share or ₹100 bn will be the share of EPC.
- On the distribution side, the opportunity is more remunerative with margin of about 20-25% possible. Against this margin, one has to weigh the associated risks. The amendment separating carriage of content is yet to get passed and this would be a game-changer. At present, new schemes announced (Deen Dayal Upadhyay and others) have not had any material impact on ordering. Techno Electric has a rural electrification project in Bihar in its current backlog.

Nature of a typical EPC substation contract

- In the past five years, the execution period for a typical substation has come down to two years from three years. Clients are pressing Techno Electric to complete projects faster, in 18 months.
- A typical EPC contract takes two years, with the work reaching its peak at nine months.

Skipper

Strong demand pipeline, improving competitive intensity, less EPC risks

Skipper is another long-standing player in the tower/transmission line ecosystem. Its key business is the manufacture of transmission towers to cater to domestic and overseas demand. It is aiming to further expand its presence in the T&D business. (1) it has entered the transmission line EPC business through PGCIL contracts and (2) it is setting up monopole capacity in the country (an expensive, though low occupancy substitute to lattice towers).

- **The nature of business**. From a business perspective, the following are the positives – (1) It is a made-to-order business (about 100 combinations across the voltage range), (2) there are no risks related to EPC business (retention money, delays in execution) and (3) it allows complete pass through of commodity price risk. The challenge to the business is more from the supply chain than from manufacturing.
- **Competitive intensity reasonable.** While PGCIL's pre-approved manufacturers' list is long (30-40 names), Skipper's competitors are limited to the top 6-7 serious players. Within these, Skipper leads in terms of throughput, with the next biggest competitor merely one-third its size in throughput and capacity. Skipper's capacity utilization is higher than 75% in the country as a whole.
- **Global opportunity**. About 90% of the global supply of towers is concentrated in India and China. The Chinese offering lacks on two key counts of (1) product quality (the steel used is made by the arc-furnace method against the blast-furnace method in India) and (2) contract adherence (has not been the best of partners over a 2-3 year project life span). Recent currency appreciation has further increased the competitiveness of the Indian products. Low logistics cost and cost leadership make Indian produce competitive across key emerging geographies (South America, Africa).
- **Skipper the preferred supplier on multiple counts**
    - **Larger share of in-house business**. The nearly ₹1 bn it has invested in rolling mills helps the company earn an additional 150-200 bps margin over peers. Earlier, the billets of steel (key RM for tower manufacturing) used to be brought from east India to Nagpur (where the rolling mills are) and return to Skipper's facilities in eastern India. The ₹1 bn investment in the rolling mill has saved this cost. Do note that the company does not have tower-testing facilities in-house (a requirement for exports but not for domestic demand).
    - **Locational advantage**. With Skipper's facilities situated close to the largest source of steel (Duragpur), the company saves on logistics cost as well. Such an advantage is relevant as most of the country's manufacturing capacities for towers are situated a long distance away at Nagpur. The related cost savings makes Skipper's offerings cost and time competitive, for both domestic and overseas markets. The company said that its location helps it incur lower logistics cost for catering to export orders versus domestic orders.
    - **Larger contract size will hobble competition.** The move to take up higher rated tower/transmission lines may not pose manufacturing obstacles but will test the operating (spare capacity, profitability) and financial capabilities of peers (bank guarantees, liquid assets). Skipper anticipates this will further reduce competition
- **Financial takeaways**
    - **EBITDA margin has improved to 13% in FY2015**. The closure of the steel pipe business, increase in the domestic business and scale-up in the export business helped the company improve EBITDA margin to 13.3% in FY2015. Here, we have adjusted for ₹420 mn in income from forward contracts in FY2015.
    - **High interest cost factors in bill discounting costs**. The interest cost of 14-15%, over the total debt of the company is high. While actual cost of debt is lower, the interest cost includes other costs such as those related to bill discounting. Essentially, the higher interest cost helps maintain working capital at lower levels.

- **Return ratios have increased in FY2015.** Pre-tax RoCE of 24% in FY2015 (excludes other income and cash investments) is reflective of the increase in margin.

New initiatives

- **Entry into EPC at an opportune time.** Skipper entered into the EPC business a few years ago. It has set up an EPC division and has decided to expand this business. This division is being headed by an old hand in the company. As per the management, it has not had to incur any cost on entering the EPC business (note that typically initial contracts of an EPC contractor is bid at low margin to get the needed pre-qualification). The management believes the timing of its entry was correct considering that potential JV partners need to win projects to sustain business. The company does not intend to scale up the EPC business in the near term.

- **Investment in the monopoles business may benefit in the medium term.** Monopoles are a substitute to lattice towers. As issues related to the right of way become prominent, acceptance of such substitutes would increase (one-fourth the occupancy). Presently, acceptance is limited due to the difference in pricing (monopoles cost 2X). Skipper has invested a small sum (₹250 mn) to manufacture monopoles for voltage up to 220 kV. The capacity for galvanizing is large at 600 tonnes per day versus typically 80-90 tons per day. Key capability is to design it so that it remains light weight and has the requisite strength. Other companies in this business are Valmont and Bajaj Electricals.

Exhibit 1: Key financials of Techno Electric, March fiscal year-ends, 2011-1HFY16 (Rs mn)

	2011	2012	2013	2014	2015	1HFY15	1HFY16
Financials							
Net sales	6,778	7,258	5,515	5,941	6,891	3,091	3,957
EBITDA	**1,342**	**1,401**	**964**	**887**	**1,136**	**532**	**714**
EBIT (excl. other income)	1,192	1,251	814	735	1,001	455	645
Other income	285	193	197	209	240	180	98
Interest cost	(217)	(285)	(254)	(207)	(209)	(88)	(62)
PBT	1,260	1,160	757	737	1,032	531	671
Income tax	(251)	(232)	(151)	(118)	(188)	(82)	(161)
PAT	**1,009**	**928**	**606**	**619**	**844**	**449**	**510**
Shareholder's funds	4,578	5,305	5,711	6,234	6,849	6,539	7,359
Debt	2,387	1,849	2,105	1,614	1,757	1,641	1,561
Total liabilities	**6,964**	**7,154**	**7,815**	**7,848**	**8,606**	**8,180**	**8,920**
Net fixed assets	2,487	2,354	2,210	2,073	1,936	1,997	1,867
Investments	3,551	3,926	3,924	4,389	4,335	4,166	4,624
Cash	185	145	618	422	195	235	437
Net working capital	741	730	1,063	963	2,140	1,782	1,992
Total assets	**6,964**	**7,154**	**7,815**	**7,847**	**8,606**	**8,180**	**8,920**
Ratios (%)							
EBITDA margin	19.8	19.3	17.5	14.9	16.5	17.2	18.0
Tax rate	20.0	20.0	20.0	16.1	18.2	15.5	24.0
Interest cost	9.1	15.4	12.1	12.8	11.9		
Working capital (days of sales)	39.9	36.7	70.3	59.2	113.3	105.2	93.7
D/E (X)	0.5	0.3	0.4	0.3	0.3	0.3	0.2
RoCE	21.2	20.2	12.9	12.0	14.4		
RoCE (ex cash and investments)	36.9	40.6	24.9	24.2	24.6		

Notes:
(a) RoCE has been calculated on a pre-tax basis.

Source: Company, Kotak Institutional Equities

Exhibit 2: Key financials of Skipper, March fiscal year-ends, 2011-1HFY16 (Rs mn)

	2011	2012	2013	2014	2015	1HFY15	1HFY16
Financials							
Net sales + other operating income	5,025	7,403	9,003	10,404	12,708	4,481	5,866
Operating EBITDA	469	612	853	1,102	1,731	570	782
EBIT (excl. other income+income from forward contracts)	403	495	727	951	1,511	466	665
Other income + income form forward contracts	45	19	14	21	437	429	213
Interest cost	(195)	(367)	(464)	(605)	(583)	(256)	(262)
PBT	253	146	278	367	1,365	639	617
Income tax	(76)	(47)	(91)	(98)	(474)	(220)	(214)
PAT	177	99	187	269	891	419	403
Shareholder's funds	1,572	1,635	2,061	2,312	3,039	2,726	3,442
Debt	3,497	3,670	4,230	4,384	3,812	4,810	4,352
Total liabilities	5,068	5,305	6,291	6,695	6,850	7,536	7,794
Net fixed assets	2,416	2,848	3,298	3,468	3,547	3,562	3,636
Investments	—	—	—	—	—		
Cash	69	86	128	263	561	286	583
Net working capital	2,584	2,371	2,865	2,964	2,742	3,688	3,575
Total assets	5,068	5,305	6,291	6,695	6,850	7,536	7,794
Ratios (%)							
EBITDA margin	9.3	8.3	9.5	10.6	13.6	12.7	13.3
Tax rate	30.2	32.2	32.6	26.7	34.7	34.5	34.7
Interest cost	5.6	10.0	11.0	13.8	15.3		
Working capital (days of sales)	187.7	116.9	116.1	104.0	78.8	150.2	92.6
D/E (X)	2.2	2.2	2.1	1.9	1.3	1.8	1.3
RoCE	8.8	9.7	11.8	14.5	28.4		
RoCE (ex cash, investments, other income)	8.1	9.5	11.8	14.8	24.0		

Notes:
(a) RoCE has been calculated on a pre-tax basis
(b) EBITDA margin has been caluclated excluding the benefit of forward contract income.
(c) Adjusted RoCE does not include forward contract income in FY2015 as related execution would happen in FY2016

Source: Company, Kotak Institutional Equities

Exhibit 3: Key financials of Kalpataru (standalone), March fiscal year-ends, 2011-1HFY16 (Rs mn)

	2011	2012	2013	2014	2015	1HFY15	1HFY16
Financials							
Net sales	28,741	30,327	33,354	40,553	44,223	22,042	21,160
EBITDA	**3,398**	**3,214**	**3,126**	**3,640**	**4,272**	**2,101**	**2,289**
EBIT (excl. other income)	2,939	2,733	2,603	2,944	3,421	1,674	1,871
Other income	511	512	477	484	522	301	269
Interest cost	(883)	(1,004)	(1,125)	(1,237)	(1,414)	(696)	(774)
PBT	2,566	2,241	1,955	2,191	2,529	1,279	1,366
Income tax	(660)	(592)	(579)	(727)	(873)	(434)	(472)
PAT	**1,906**	**1,649**	**1,377**	**1,464**	**1,656**	**846**	**894**
Shareholder's funds	15,911	17,429	18,463	19,542	20,708	20,359	21,721
Debt	4,531	4,721	5,911	7,850	9,714	8,076	7,221
Total liabilities	**20,442**	**22,150**	**24,374**	**27,392**	**30,422**	**28,434**	**28,942**
Net fixed assets	3,740	4,529	5,386	5,918	5,590	5,779	5,274
Investments+L&A to subs	6,401	7,025	8,070	8,243	8,733	8,243	8,739
Cash	1,443	1,034	569	647	753	554	585
Net working capital	8,858	9,563	10,349	12,584	15,346	13,858	14,344
Total assets	**20,442**	**22,150**	**24,374**	**27,392**	**30,422**	**28,434**	**28,942**
Ratios (%)							
EBITDA margin	11.8	10.6	9.4	9.0	9.7	9.5	10.8
Tax rate	25.7	26.4	29.6	33.2	34.5	33.9	34.5
Interest cost	19.5	21.3	19.0	15.8	14.6		
Working capital (days of sales)	112.5	115.1	113.2	113.3	126.7	114.7	120.8
D/E (X)	0.3	0.3	0.3	0.4	0.5	0.4	0.3
RoCE	16.9	14.6	12.6	12.5	13.0		
RoCE (ex cash and investments	23.3	19.4	16.5	15.9	16.3		

Notes:
(a) RoCE has been calculated on a pre-tax basis
(b) For 1HFY15 and 1HFY16, we assume same level of L&A to subsidiaries as of previous fiscal year

Notes:
(a) RoCE has been calculated on a pre-tax basis.
(b) For 1HFY15 and 1HFY16, we assume same level of L&A to subsidiaries as of previous fiscal year.

Source: Company, Kotak Institutional Equities

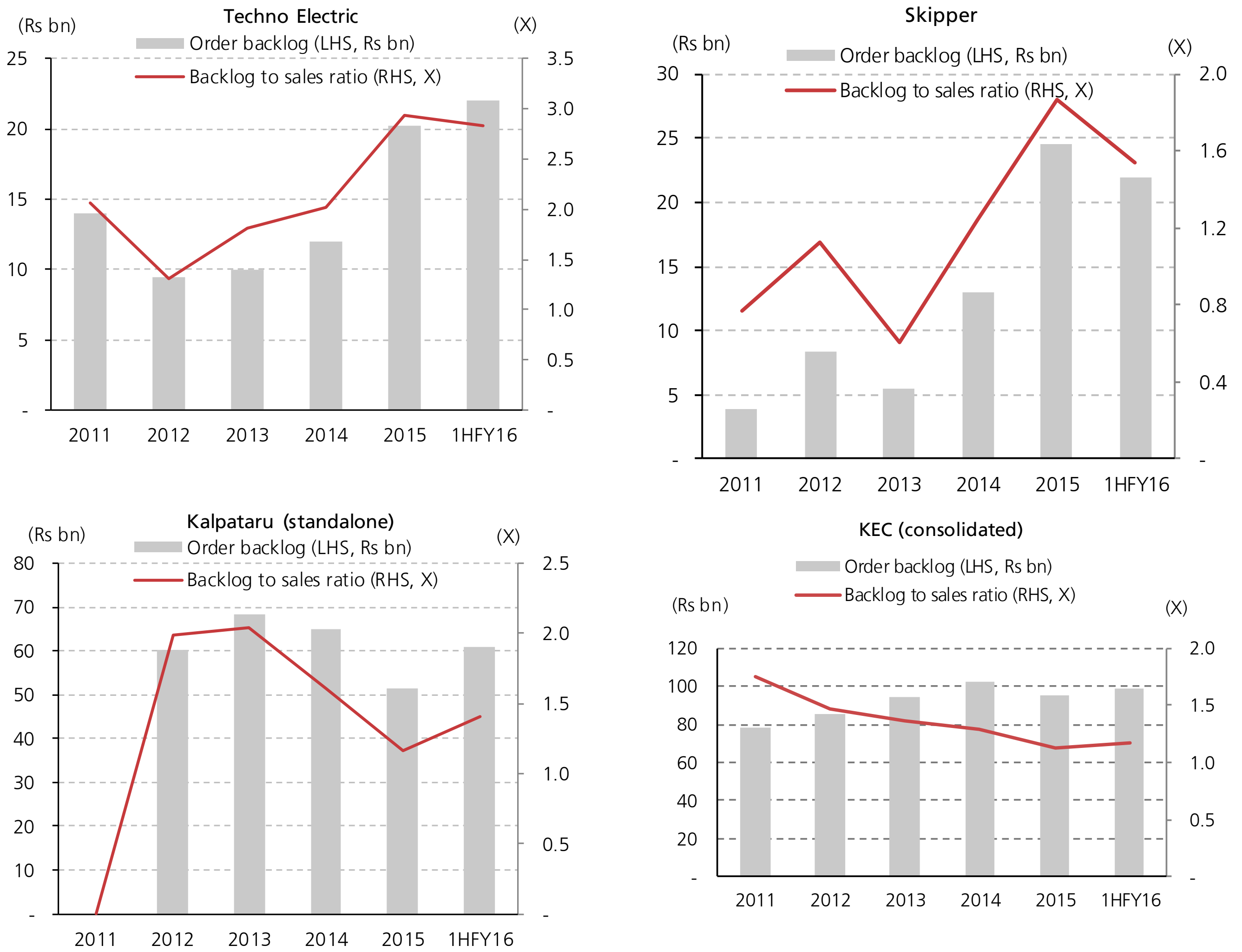
Exhibit 4: Key financials of KEC (consolidated), March fiscal year-ends, 2011-1HFY16 (Rs mn)

	2011	2012	2013	2014	2015	1HFY15	1HFY16
Financials							
Net sales	44,742	58,147	69,795	79,018	84,678	38,934	38,989
EBITDA	**4,626**	**4,654**	**3,814**	**4,933**	**5,118**	**2,226**	**2,955**
EBIT (excl. other income)	4,217	4,175	3,253	4,228	4,237	1,794	2,518
Other income	26	12	160	138	1,462	26	69
Interest cost	(1,075)	(1,448)	(1,944)	(2,633)	(3,089)	(1,569)	(1,395)
PBT	3,168	2,739	1,470	1,733	2,611	250	1,193
Income tax	(1,111)	(971)	(818)	(883)	(1,001)	66	(448)
PAT	**2,057**	**1,768**	**652**	**850**	**1,610**	**316**	**745**
Shareholder's funds	9,466	11,078	11,472	11,916	13,298	12,269	14,136
Debt	14,322	12,392	16,690	21,273	21,894	24,796	22,842
Total liabilities	**23,788**	**23,470**	**28,162**	**33,188**	**35,192**	**37,065**	**36,978**
Net fixed assets	11,221	12,557	13,539	13,700	12,753	13,652	12,890
Investments+L&A to subs	—	—	—	—	—		
Cash	1,614	2,102	1,556	1,440	2,063	1,669	954
Net working capital	10,953	8,810	13,068	18,049	20,375	21,743	23,134
Total assets	**23,788**	**23,470**	**28,162**	**33,188**	**35,192**	**37,065**	**36,978**
Ratios (%)							
EBITDA margin	10.3	8.0	5.5	6.2	6.0	5.7	7.6
Tax rate	35.1	35.5	55.6	51.0	38.3	(26.4)	37.5
Interest cost	7.5	11.7	11.6	12.4	14.1		
Working capital (days of sales)	89.4	55.3	68.3	83.4	87.8	101.9	99.7
D/E (X)	1.5	1.1	1.5	1.8	1.6	2.0	1.6
RoCE	17.8	17.8	12.1	13.2	16.2		
RoCE (ex cash and investments)	19.0	19.5	12.2	13.3	12.8		

Notes:
(a) RoCE has been calculated on a pre-tax basis.

Source: Company, Kotak Institutional Equities

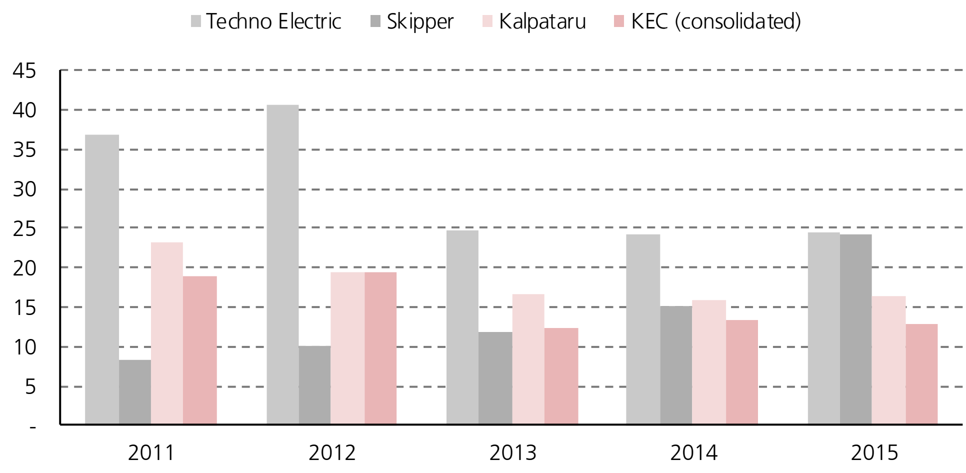
Exhibit 5: Order backlog and backlog to sales ratio of key players, March fiscal year-ends, 2011-1HFY16



Notes:
(a) Trailing four quarter sales are considered for the above analysis.

Source: Company, Kotak Institutional Equities

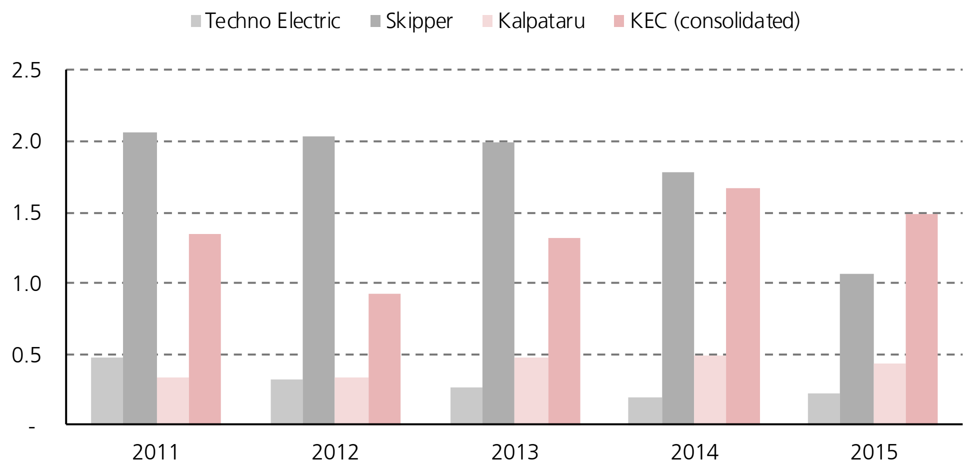
Exhibit 6: ROCE of key industry players, March fiscal year-ends, 2011-2015 (%)



Notes:
(a) RoCE is pre-tax and adjusted for cash, investments and other income.

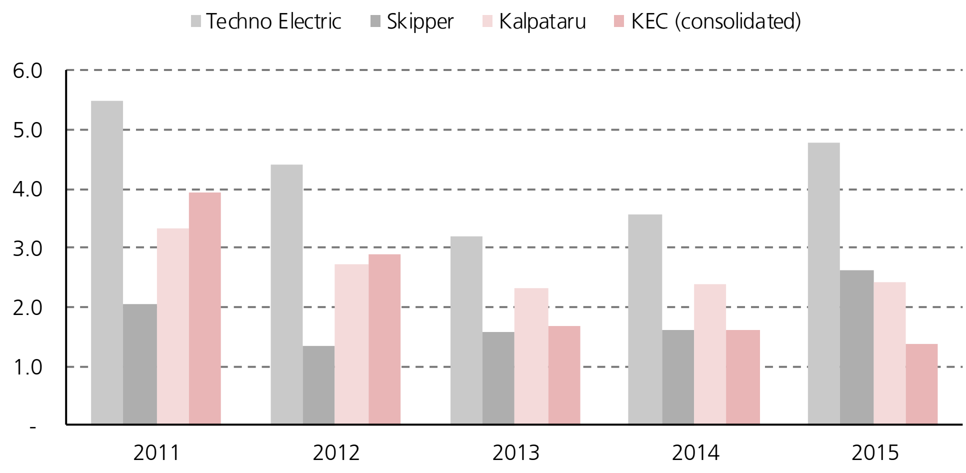
Source: Company, Kotak Institutional Equities

Exhibit 7: Net debt to equity ratio of key industry players, March fiscal year-ends, 2011-2015 (X)



Source: Company, Kotak Institutional Equities

Exhibit 8: Interest coverage ratio of key industry players, March fiscal year-ends, 2011-2015 (X)



Source: Company, Kotak Institutional Equities

Exhibit 9: Revision in estimates of KPTL, March fiscal year-ends, 2015-18E (Rs mn)

		New estimates			Old estimates			% revision		
	2015	2016E	2017E	2018E	2016E	2017E	2018E	2016E	2017E	2018E
Income statement										
New orders	30,402	70,555	59,972	65,969	70,555	59,972	65,969	-	-	-
Yoy growth (%)	(53.2)	132.1	(15.0)	10.0	132.1	(15.0)	10.0			
Net revenue	44,223	44,385	57,175	60,502	46,398	57,394	60,661	(4.3)	(0.4)	(0.3)
Yoy growth (%)	9.1	0.4	28.8	5.8	4.9	23.7	5.7			
EBITDA	4,267	4,743	6,133	6,595	5,058	6,299	6,870	(6.2)	(2.6)	(4.0)
EBITDA margin (%)	9.6	10.7	10.7	10.9	10.9	11.0	11.3	-22 bps	-25 bps	-43 bps
Interest & finance charge	(1,409)	(1,397)	(1,034)	(1,066)	(1,404)	(1,042)	(1,068)	(0.5)	(0.7)	(0.1)
PBT	2,529	2,994	4,596	4,945	3,239	4,708	5,174			
Tax	(873)	(1,018)	(1,526)	(1,642)	(1,101)	(1,563)	(1,718)			
PAT	1,656	1,976	3,070	3,303	2,138	3,145	3,456	(7.6)	(2.4)	(4.4)
EPS (Rs)	10.8	12.9	20.0	21.5	13.9	20.5	22.5	(7.6)	(2.4)	(4.4)

Source: Company, Kotak Institutional Equities estimates

Exhibit 10: We arrive at SOTP-based target price of Rs312 / share for KPTL

KPTL's SOTP-based target price

	Earnings / book (Rs mn)	Valn multiple (X)	Value (Rs mn)	KPTL share (%)	Value for KPTL share (Rs mn)	Per share value (Rs)	Valuation basis
Kalpataru valuation							
Core construction business (Ex-other income from	**2,728**	**12.0**	**32,739**	**100.0**	**32,739**	**213**	**12X Mar-17E EPS**
Investments (Ex-JMC)							
Jhajjar KT Transco			2,865	49.7	1,424	9	Mar-17 valuation
Satpura Transco			2,049	100.0	2,049	13	Mar-17 valuation
Shubham Logistics	1,822	2.0	3,643	65.2	2,375	15	2X Mar-17E book value
Energylink (Indore commercial-residential project)	1,946	1.0	1,946	100.0	1,946	13	1 X book
Amber Real Estate (Thane commercial project)	1,350	1.0	1,350	100.0	1,350	9	1 X book
Kalpataru Power Transmission Ukraine	12	8.0	94	100.0	94	1	8X FY2015 earnings
Other investments	282	1.0	282	100.0	282	2	1 X book
Internal loans to subsidiaries (Shubham and others)	868	1.0	868	100.0	868	6	1 X book
Investments total			**13,097**		**10,388**	**68**	
JMC valuation							
Core construction business	547	8.0	4,380	67.2	2,943	19	8X Mar-17E EPS
Kurukshetra Expressway			2,120	34.3	727	5	Mar-17 valuation
Brij Bhoomi Expressway			384	67.2	258	2	Mar-17 valuation
Wainganga Expressway			(80)	67.2	(54)	(0)	Mar-17 valuation
Vindhyachal Expressway			2,673	67.2	1,796	12	Mar-17 valuation
Internal loans to road SPVs			457	67.2	307	2	1 X book
JMC total			**7,947**		**4,781**	**31**	**20% hold co. discount on SOTP**
Total value			**53,784**		**47,909**	**312**	

Source: Company, Kotak Institutional Equities estimates

Exhibit 11: Standalone income statement of KPTL, March fiscal year-ends, 2010-18E (Rs mn)

	2010	2011	2012	2013	2014	2015	2016E	2017E	2018E	FY2015-18 CAGR (%)
Income statement										
Net revenue	**26,316**	**28,741**	**30,327**	**33,354**	**40,553**	**44,223**	**44,385**	**57,175**	**60,502**	**11**
Yoy growth (%)	39.8	9.2	5.5	10.0	21.6	9.1	0.4	28.8	5.8	
Expenditure	(23,246)	(25,390)	(27,035)	(30,133)	(36,690)	(39,955)	(39,642)	(51,042)	(53,907)	
Material cost	(11,448)	(12,768)	(14,886)	(16,492)	(19,095)	(19,253)	(18,863)	(24,299)	(25,713)	
Manufacturing & operating expens	(8,387)	(8,641)	(7,347)	(8,551)	(10,414)	(11,974)	(11,984)	(15,437)	(16,335)	
Employee expenses	(1,560)	(1,934)	(1,702)	(2,006)	(2,602)	(3,136)	(2,885)	(3,430)	(3,630)	
Admin and other expenses	(1,747)	(1,922)	(2,956)	(3,885)	(5,011)	(5,980)	(5,909)	(7,875)	(8,228)	
EBITDA	**3,070**	**3,350**	**3,292**	**3,221**	**3,863**	**4,267**	**4,743**	**6,133**	**6,595**	**16**
EBITDA margin (%)	11.7	11.7	10.9	9.7	9.5	9.6	10.7	10.7	10.9	
Other income	346	511	512	477	484	522	506	446	461	
Interest & finance charges	(758)	(836)	(1,082)	(1,220)	(1,460)	(1,409)	(1,397)	(1,034)	(1,066)	(9)
Depreciation	(382)	(459)	(481)	(523)	(696)	(852)	(858)	(949)	(1,045)	7
PBT	2,276	2,566	2,241	1,955	2,191	2,529	2,994	4,596	4,945	
Tax	(571)	(660)	(592)	(579)	(727)	(873)	(1,018)	(1,526)	(1,642)	
PAT	**1,705**	**1,906**	**1,649**	**1,377**	**1,464**	**1,656**	**1,976**	**3,070**	**3,303**	**26**
EPS (Rs)	**11.1**	**12.4**	**10.7**	**9.0**	**9.5**	**10.8**	**12.9**	**20.0**	**21.5**	
Balance sheet										
Shareholder funds	9,881	15,911	17,429	18,463	19,542	20,708	22,414	25,215	28,249	
Share capital	265	307	307	307	307	307	307	307	307	
Reserves & surplus	9,616	15,604	17,122	18,156	19,235	20,401	22,107	24,908	27,942	
Loan funds	6,043	4,531	4,721	5,911	7,850	9,714	9,000	9,000	7,000	
Deferred tax liabilities	141	107	98	118	138	54	54	54	54	
Total sources of funds	**16,065**	**20,548**	**22,248**	**24,492**	**27,529**	**30,475**	**31,468**	**34,268**	**35,302**	
Total net fixed assets	3,385	3,740	4,529	5,386	5,918	5,590	5,672	5,922	6,278	
Investments	1,265	3,956	4,049	3,351	3,836	3,939	3,939	3,939	3,939	
Cash and bank balance	369	1,443	1,034	569	647	753	1,115	466	825	
Net current assets	11,046	11,410	12,636	15,186	17,129	20,193	20,682	23,881	24,201	
Total application of funds	**16,065**	**20,548**	**22,248**	**24,492**	**27,530**	**30,475**	**31,468**	**34,268**	**35,302**	

Source: Company, Kotak Institutional Equities estimates

Exhibit 12: Profit and loss, balance sheet and cash-flow statement of KPTL (consolidated), March fiscal year-ends, 2010-18E (Rs mn)

	2010	2011	2012	2013	2014	2015	2016E	2017E	2018E
Income statement									
Net reveneus	40,319	43,547	53,080	60,850	70,903	71,982	75,629	93,755	100,720
Expenditure	(35,914)	(38,716)	(48,076)	(56,106)	(65,006)	(64,939)	(66,926)	(83,059)	(88,957)
EBITDA	4,404	4,830	5,004	4,745	5,897	7,043	8,703	10,696	11,763
Other income	247	418	333	357	233	250	239	198	224
Interest & finance charges	(1,260)	(1,469)	(1,576)	(1,938)	(2,488)	(3,370)	(4,425)	(4,308)	(4,397)
Depreciation	(745)	(880)	(986)	(1,224)	(1,490)	(1,683)	(1,952)	(2,072)	(2,221)
PBT	2,647	2,899	2,774	1,940	2,153	2,241	2,566	4,513	5,369
Tax	(691)	(773)	(735)	(595)	(914)	(1,086)	(1,258)	(1,881)	(2,117)
PAT	1,777	2,001	1,887	1,295	1,222	1,204	1,572	2,801	3,280
Key ratios (%)									
EBITDA margin	10.9	11.1	9.4	7.8	8.3	9.8	11.5	11.4	11.7
PAT margin	4.4	4.6	3.6	2.1	1.7	1.7	2.1	3.0	3.3
Effective tax rate	26.1	26.7	26.5	30.7	42.4	48.5	49.0	41.7	39.4
EPS (Rs)	11.6	13.0	12.3	8.4	8.0	7.8	10.2	18.3	21.4
Balance sheet									
Shareholder funds	10,271	16,430	18,514	19,473	20,991	22,166	23,469	26,000	29,011
Share capital	265	307	307	307	307	307	307	307	307
Reserves & surplus	10,006	16,123	18,207	19,166	20,685	21,859	23,162	25,693	28,704
Minority interest	1,254	1,120	1,286	1,316	1,436	1,422	1,157	989	961
Loan funds	9,014	8,318	12,812	18,313	27,314	36,841	38,239	39,141	37,265
Deferred tax liabilities	196	139	30	(24)	96	90	90	90	90
Total sources of funds	20,735	26,007	32,642	39,078	49,837	60,519	62,955	66,220	67,327
Total net fixed assets	8,739	10,828	14,955	23,177	30,376	35,816	36,100	36,371	36,652
Investments	66	1,357	836	112	102	113	113	113	113
Goodwill on consolidation	83	202	202	202	202	201	201	201	201
Cash and bank balance	557	1,873	1,720	1,029	1,172	1,381	1,827	1,127	1,873
Net current assets	11,281	11,745	14,929	14,559	17,986	23,007	24,713	28,408	28,488
Miscellaneous expenditure	9	2	—	—	—	—	—	—	—
Total application of funds	20,735	26,007	32,642	39,078	49,837	60,519	62,955	66,220	67,327
Cash flow statement									
Operating cash before working capital changes	3,961	4,475	4,602	4,506	5,216	6,207	7,684	9,013	9,870
Change in working capital/other adjustments	841	(464)	(3,184)	370	(3,427)	(5,021)	(1,706)	(3,695)	(80)
Net cash flow from operating activities	4,802	4,011	1,418	4,877	1,789	1,186	5,979	5,318	9,790
Cash (used)/realised in investing activities	(3,004)	(4,198)	(4,584)	(8,668)	(8,499)	(7,014)	(2,236)	(2,343)	(2,501)
Free cash flow	1,830	1,103	(3,686)	(4,516)	(6,720)	(5,816)	3,743	2,975	7,289

Source: Company, Kotak Institutional Equities

Exhibit 13: Key segmental financials for KEC (consolidated), March fiscal year-ends, 2011-18E (Rs mn)

	2011	2012	2013	2014	2015	2016E	2017E	2018E
Total								
Order inflows	55,280	65,870	78,770	84,905	82,230	106,988	127,003	145,511
Yoy growth (%)	30.2	19.2	19.6	7.8	(3.2)	30.1	18.7	14.6
Revenues	**44,740**	**58,150**	**69,790**	**79,010**	**84,680**	**89,563**	**108,327**	**125,453**
Yoy growth (%)	14.5	30.0	20.0	13.2	7.2	5.8	21.0	15.8
Order backlog	78,000	85,720	94,700	102,000	95,080	110,604	129,280	149,338
Bill to book ratio (%)	54.1	52.4	55.8	57.6	59.2	60.3	62.2	62.1
EBITDA	4,533	4,720	3,885	4,951	5,045	7,100	8,930	10,366
EBITDA margin (%)	**10.1**	**8.1**	**5.6**	**6.3**	**6.0**	**7.9**	**8.2**	**8.3**
T&D total								
Inflows	46,090	47,873	57,506	59,544	55,916	75,145	90,174	103,700
Inflows growth (%)	—	3.9	20.1	3.5	(6.1)	34.4	20.0	15.0
Revenues	35,490	41,480	49,980	61,160	64,840	65,546	76,127	88,741
Backlog	63,640	70,033	77,559	80,784	71,310	80,909	94,957	109,916
Bill to book ratio (%)	35.8	37.2	39.2	44.6	47.4	44.8	44.5	44.7
EBITDA	3,899	3,510	2,706	4,520	5,319	6,041	7,232	8,437
EBITDA margin (%)	11.0	8.5	5.4	7.4	8.2	9.2	9.5	9.5
Cables								
Inflows	5,440	5,927	5,104	8,567	11,512	13,815	15,887	17,476
Inflows growth (%)	277.8	9.0	(13.9)	67.8	30.0	20.0	15.0	10.0
Revenues	4,800	5,710	5,520	6,310	9,070	10,720	14,231	16,314
Backlog	1,240	1,457	1,042	2,448	5,705	8,799	10,455	11,617
Bill to book ratio (%)	79.5	79.7	84.1	65.7	65.0	85.0	85.0	85.0
EBITDA	120	114	(110)	(316)	(272)	536	712	816
EBITDA margin (%)	2.5	2.0	(2.0)	(5.0)	(3.0)	5.0	5.0	5.0
Railways								
Inflows	3,440	1,179	3,627	2,375	2,467	4,194	5,032	6,039
Inflows growth (%)	173.0	(65.7)	207.7	(34.5)	(25.0)	70.0	20.0	20.0
Revenues	910	1,640	2,700	1,690	1,330	2,055	3,293	4,078
Backlog	3,890	3,429	4,356	4,488	4,754	6,892	8,632	10,593
Bill to book ratio (%)	29.5	36.6	51.5	30.5	23.2	30.0	35.0	35.0
EBITDA	18	—	—	(51)	(40)	82	132	163
EBITDA margin (%)	2.0	—	—	(3.0)	(3.0)	4.0	4.0	4.0
Water								
Inflows	310	3,137	2,464	4,411	—	1,500	1,725	1,984
Inflows growth (%)		912.1	(21.5)	79.0	(20.0)	—	15.0	15.0
Revenues	—	190	1,270	1,310	1,410	911	1,314	1,449
Backlog	310	3,257	4,451	5,712	3,803	4,393	4,804	5,339
Bill to book ratio (%)	—	10.1	28.3	19.7	24.7	20.0	25.0	25.0
EBITDA	—	—	—	(39)	(42)	27	53	58
EBITDA margin (%)	—	—	—	(3.0)	(3.0)	3.0	4.0	4.0
SAE								
Inflows	—	7,753	10,069	10,009	12,335	12,335	14,185	16,312
Inflows growth (%)	—	—	29.9	—	—	—	15.0	15.0
Revenues	3,540	9,130	10,320	8,540	8,030	10,330	13,362	14,871
Backlog	8,920	7,543	7,292	8,568	9,508	9,611	10,433	11,874
Bill to book ratio (%)		71.3	82.1	69.5	54.5	75.0	80.0	80.0
EBITDA	496	1,096	1,290	837	80	413	802	892
EBITDA margin (%)	14.0	12.0	12.5	9.8	1.0	4.0	6.0	6.0

Source: Company, Kotak Institutional Equities estimates

Exhibit 14: Key financials for KEC (consolidated), March fiscal year-ends, 2011-18E (Rs mn)

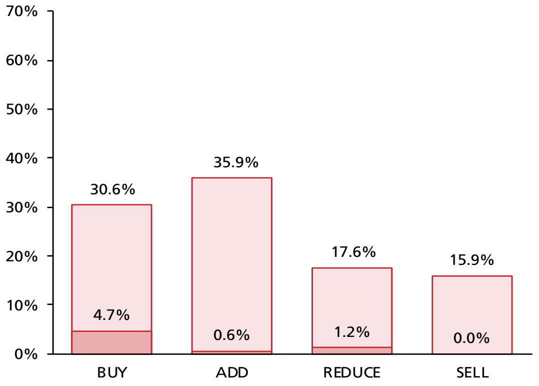
	2011	2012	2013	2014	2015	2016E	2017E	2018E
Income statement								
Total operating income	**44,742**	**58,147**	**69,795**	**79,018**	**84,678**	**89,563**	**108,327**	**125,453**
Total operating costs	**(40,116)**	**(53,493)**	**(65,981)**	**(74,085)**	**(79,560)**	**(82,491)**	**(99,433)**	**(115,128)**
Raw materials consumed	(32,358)	(43,173)	(53,301)	(59,594)	(64,527)	(65,381)	(79,079)	(91,581)
Employee expenses	(2,832)	(4,284)	(4,829)	(5,661)	(5,865)	(6,811)	(8,438)	(9,748)
Operating and other expenses	(4,926)	(6,037)	(7,852)	(8,831)	(9,168)	(10,300)	(11,916)	(13,800)
EBITDA	**4,626**	**4,654**	**3,814**	**4,933**	**5,118**	**7,071**	**8,894**	**10,325**
Other income	26	12	160	138	1,462	136	169	241
Interest expense	(1,075)	(1,448)	(1,944)	(2,633)	(3,089)	(2,852)	(2,691)	(2,744)
Depreciation	(408)	(479)	(561)	(705)	(881)	(863)	(900)	(964)
PBT	**3,168**	**2,739**	**1,470**	**1,733**	**2,611**	**3,492**	**5,473**	**6,857**
Taxes paid	(1,111)	(971)	(818)	(883)	(1,001)	(1,257)	(1,916)	(2,400)
Net PAT	**2,057**	**1,768**	**652**	**850**	**1,610**	**2,235**	**3,557**	**4,457**
Key ratios (%)								
EBITDA margin	**10.3**	**8.0**	**5.5**	**6.2**	**6.0**	**7.9**	**8.2**	**8.2**
PAT margin	4.6	3.0	0.9	1.1	1.9	2.5	3.3	3.6
Effective tax rate	35.1	35.5	55.6	51.0	38.3	36.0	35.0	35.0
Earnings per share (Rs)	**8.0**	**6.9**	**2.5**	**3.3**	**6.3**	**8.7**	**13.8**	**17.3**
Balance sheet								
Shareholders funds	**9,466**	**11,078**	**11,472**	**11,916**	**13,298**	**15,199**	**18,158**	**21,865**
Equity share capital	514	514	514	514	514	514	514	514
Reserves & surplus	8,952	10,564	10,958	11,402	12,784	14,684	17,644	21,351
Loan funds	**14,322**	**12,392**	**16,690**	**21,273**	**21,894**	**18,894**	**18,394**	**18,394**
Deferred tax liability	497	513	621	514	527	527	527	527
Total source of funds	**24,285**	**23,983**	**28,783**	**33,702**	**35,719**	**34,620**	**37,079**	**40,787**
Net fixed assets	**8,409**	**9,348**	**10,114**	**9,922**	**8,811**	**7,759**	**7,859**	**7,895**
Goodwill on consolidation	2,812	3,209	3,424	3,778	3,943	3,943	3,943	3,943
Cash balances	1,614	2,102	1,556	1,440	2,063	1,815	3,018	3,858
Net current assets excluding cash	11,450	9,324	13,689	18,562	20,902	21,102	22,259	25,091
Total application of funds	**24,285**	**23,983**	**28,783**	**33,702**	**35,719**	**34,620**	**37,079**	**40,787**
Cash flow statement								
Operating profit before working capital changes	3,541	3,695	3,157	4,188	5,579	5,950	7,148	8,166
Change in working capital/other adjustments	(3,149)	2,126	(4,365)	(4,873)	(2,340)	(200)	(1,157)	(2,832)
Net cash flow from operating activites	**392**	**5,821**	**(1,209)**	**(686)**	**3,239**	**5,750**	**5,991**	**5,334**
Cash (used)/realised in investing activities	(4,429)	(1,815)	(1,542)	(866)	65	189	(1,000)	(1,000)
Free cash flow (OCF + net capex)	**(4,067)**	**4,006**	**(2,751)**	**(1,552)**	**3,305**	**5,939**	**4,991**	**4,334**
Cash (used)/realised in financing activities	4,917	(3,858)	2,098	1,725	(2,695)	(6,237)	(3,789)	(3,494)
Cash generated/utilised	**916**	**164**	**(546)**	**(116)**	**623**	**(248)**	**1,203**	**840**
Net cash at end of year	**1,614**	**1,777**	**1,556**	**1,440**	**2,063**	**1,815**	**3,018**	**3,858**

Source: Company, Kotak Institutional Equities estimates

"I, Aditya Mongia, hereby certify that all of the views expressed in this report accurately reflect my personal views about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report."

Kotak Institutional Equities Research coverage universe

Distribution of ratings/investment banking relationships



Percentage of companies covered by Kotak Institutional Equities, within the specified category.

Percentage of companies within each category for which Kotak Institutional Equities and or its affiliates has provided investment banking services within the previous 12 months.

* The above categories are defined as follows: Buy = We expect this stock to deliver more than 15% returns over the next 12 months; Add = We expect this stock to deliver 5-15% returns over the next 12 months; Reduce = We expect this stock to deliver -5-+5% returns over the next 12 months; Sell = We expect this stock to deliver less than -5% returns over the next 12 months. Our target prices are also on a 12-month horizon basis. These ratings are used illustratively to comply with applicable regulations. As of 30/09/2015 Kotak Institutional Equities Investment Research had investment ratings on 170 equity securities.

Source: Kotak Institutional Equities

As of September 30, 2015

Ratings and other definitions/identifiers

Definitions of rating

BUY. We expect this stock to deliver more than 15% returns over the next 12 months.

ADD. We expect this stock to deliver 5-15% returns over the next 12 months.

REDUCE. We expect this stock to deliver -5-+5% returns over the next 12 months.

SELL. We expect this stock to deliver <-5% returns over the next 12 months.

Our target prices are also on a 12-month horizon basis.

Other definitions

Coverage view. The coverage view represents each analyst's overall fundamental outlook on the Sector. The coverage view will consist of one of the following designations: Attractive, Neutral, Cautious.

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