June 28, 2021

KEC International Limited: Long-term and short-term ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based Limits	2,400.00	2,400.00	[ICRA]AA- (Stable); reaffirmed
Non-fund Based Limits	14,600.00	14,600.00	[ICRA]AA- (Stable) / [ICRA]A1+; reaffirmed
Fund-based – Term loans	0.00	150.00	[ICRA]AA- (Stable); reaffirmed
Short term Fund-based facility	1000.00	850.00	[ICRA]A1+; reaffirmed
Total	**18,000.00**	**18,000.00**	

Instrument*	Previous Rated Amount (million USD)	Current Rated Amount (million USD)	Rating Action
External Commercial Borrowing (Foreign Currency Term Loan)	20.00	20.00	[ICRA]AA- (Stable); reaffirmed

**Instrument details are provided in Annexure-1*

Rationale

The rating reaffirmation factors in KEC International Limited's (KEC) strong market position as an engineering, procurement and construction (EPC) company in the power transmission and distribution (T&D) segment and its healthy order book of ~Rs. 19,109 crore as on March 31, 2021 (i.e. 1.46 times of FY2021 revenue), which provides near-to-medium-term revenue visibility. The orders from the T&D segment constituted 58% of the order book position as on March 31, 2021 and the balance orders are from the non-T&D segments such as railways, civil, cables, etc. The fresh order intake in FY2021 increased by 5% on a YoY basis, with majority of the fresh orders from the T&D segment. The order inflow from the non-T&D verticals remained tepid in FY2021, due to high competitive intensity and delays in issuance of tenders in the railways segment caused by the Covid-19 pandemic. Despite the adverse impact of the pandemic, the company was able to achieve a revenue growth of 9.60% in FY2021 reflecting its strong execution capabilities, supported by a healthy order position. Moreover, the demand prospects for KEC remain healthy with the Government's focus on increasing infrastructure spending including in T&D, railways and urban infrastructure. The ratings favourably note the improved business diversification, depicted by the growing share of revenue contribution from other (non-T&D) business verticals such as railways and civil segments over the last few years. The share of revenues from the non-T&D segment increased to 44% in FY2021 from 34% in FY2020. The ratings take into account KEC's diversified geographical presence (40–45% of its revenues comes from the overseas projects), as well as its entry into new geographies in South-East Asia and Africa. International projects constituted ~38% of the order book as on March 31, 2021 and a significant proportion of FY2021 order intake has been from the international T&D segment. The company's acquisition of SAE Towers in 2010 has enabled access to global markets, enhanced tower manufacturing capacity and provided wider scope for EPC opportunities. Further, the acquisition of a tower manufacturing facility in Dubai in February 2020 is likely to augment its presence in the Middle East and North Africa (MENA) region. This apart, the ratings draw comfort from KEC's healthy return indicators, low leverage level and the comfortable liquidity position.

The ratings, however, are constrained by the high working capital intensity inherent in the EPC business due to the long execution period of projects, milestone based payments in non-T&D businesses and the retention money requirement that is released post the defect liability period. This, in turn, results in dependence on short-term borrowing and extended credit period to the supplier and sub-contractors, as reflected in the relatively high ratio of total outside liabilities (TOL) to tangible net worth (TNW) of 3.2 times as on March 31, 2021. The ratings also remain constrained by the exposure of KEC's operating profit margins to the volatility in key raw material prices, particularly for international EPC contracts that are fixed price in nature. The fixed-price contracts typically constitute ~30-35% of the company's order book. Headwinds in the commodity prices, particularly steel, along with the weak performance of SAE Towers (SAE) led to a decline in operating margins to 9.5% in FY2021 from 11.1% FY2020. SAE reported operating losses in FY2021 on account of cost and time overruns in execution of T&D projects in Brazil owing to the Covid-19 pandemic-related challenges. The margins are likely to remain under pressure in the near term, considering the surge in commodity prices. While the company follows a price hedging mechanism for commodities such as aluminium and zinc to minimise the commodity price risk, it remains exposed to adverse movement in steel prices in case of the fixed-priced contracts. This apart, the ratings are constrained by the high competitive pressure in the company's various business segments and the relatively lower margins from non-T&D verticals. Nonetheless, the margins from the non-T&D verticals are witnessing a gradual improvement as the company is achieving economies of scale in these segments. Further, KEC's operations remain exposed to project execution risks arising from right of way challenges, geo-political risks, currency fluctuations and counterparty credit risks, given its presence in many overseas countries. To mitigate the credit risks from overseas customers in regions such as Middle East, Africa and Central Asia, the company focusses on projects funded by multi-lateral agencies, insurance covers and hedges currency risk through forward contracts to a certain extent.

The Stable outlook assigned to KEC reflects ICRA's opinion that the company's revenues and profitability would be supported by its healthy order book position, strong execution capabilities as well as by the diversity in the business segments.

Key rating drivers and their description

Credit strengths

Globally established and diversified EPC player, with leadership position in domestic power transmission segment – During the last seven decades, KEC has successfully diversified its business profile (both segment wise as well as geography wise). At present, the company executes power T&D, railways infrastructure, civil and smart infra on an EPC basis. It is one of the largest power transmission EPC companies in the world with presence in over 70 countries. The company has also established itself as a leader in the domestic power transmission segment.

Healthy order book position provides near-to-medium-term revenue visibility; improving diversification in non-T&D segments – KEC's order book stood at Rs. 19,109 crore as on March 31, 2021 on a consolidated basis, i.e. 1.46 times the revenues of FY2021. Additionally, the company also derives ~15% of its revenue from short cycled order book business such as cables, tower supplies and industrial civil works orders. The T&D segment constituted 58% of the order book position as on March 31, 2021, while the balance pertained to the non-T&D segment. The company obtained fresh orders of about Rs. 11,876 crore in FY2021, primarily from the international T&D segment. While the fresh order intake for the non-T&D segment declined in FY2021 due to high competitive intensity in bidding and delays in issuance of tenders in the railways segment, the order inflows were higher to the T&D segment, resulting in a 5% YoY growth in the order intake. The share of T&D segment in the company's overall revenue mix has witnessed a gradual decline to 56% in FY2021 from 66% in FY2020, indicating greater diversification into non-T&D segments.

Strong long-term demand prospects for power T&D infrastructure – In the domestic market, Power Grid Corporation of India Limited (PGCIL), private sector transmission lines developers and state transmission entities are the key customers for transmission and distribution. The demand for transmission line and substation is expected to remain strong in the long-term, given the strong need to augment the existing inter-regional transmission capacity to manage regional differences in power generation and power demand and meet the growing power demand. In the international markets, Middle East, SAARC, the under-developed markets of Africa, and Latin America present a favourable market potential to the company for setting up transmission lines and sub-station infrastructure. (Source: Industry). This apart, the demand prospects are supported by the Government's focus on increasing infrastructure spending including in railways and urban infrastructure.

Diversified geographical presence across the globe – KEC has a wide geographical presence, deriving a substantial portion of revenues (~40-45%) from its overseas projects. The company has an established presence in the Middle East, Africa, Brazil, SAARC and South-East Asia region. International projects constituted about 38% of unexecuted order book position as on March 31, 2021.

Access to global markets and enhanced transmission tower manufacturing capacity from past acquisitions – The company has access to global markets as a result of the acquisitions undertaken in the past. Acquisition of the US-based SAE Towers Holdings LLC (SAE Towers) provided KEC access to the American markets for design, manufacture and supply of transmission towers. The acquisition also increased KEC's manufacturing capacity for transmission towers with addition of production facilities of SAE in Mexico and Brazil (annual tower production capacity of 1,00,000 metric tonnes). The company acquired a tower manufacturing facility in Dubai (50,000 metric tonnes capacity) in February 2020 that would cater to orders from the MENA region. The Dubai plant is operating at full capacity since March 2021.

Credit challenges

High working capital intensity in EPC business – The working capital intensity remains inherently high in the EPC business due to the long execution period of projects, milestone based payments in non-T&D businesses and the retention money requirement that is released post the defect liability period. As a result, the company's overall debtor days have remained high around 280 days during the last three years. The debtor days are on the higher side since the receivables include retention money of projects and contact assets. The working capital position is, however, supported to some extent by creditor days in the range of 225-250 days. High working capital intensity is further evident from the Net Working Capital/Operating Income of 26% in FY2021, albeit improved from 30% in the previous year. The working capital borrowings (including acceptances) stood at Rs. 2,783 crore as on March 31, 2021. The total outside liabilities to tangible net worth improved to 3.2 times in FY2021 against 3.6 times in FY2020, wherein the total outside liabilities also captures the trade creditors and acceptances. However, the TOL/TNW continues to remain on the higher side.

Intense competition in domestic and international markets for T&D business – KEC derives a significant proportion of its revenue (66% in FY2020 and 56% in FY2021) from the transmission and distribution segment, which remains highly competitive in domestic as well as international markets. Moreover, the competition has further increased for domestic orders due to removal of bid-bond requirement for some PSU tenders and reduction in performance bank guarantee required (3% against 10% earlier) as a part of the GoI's initiatives to support the domestic small/mid-sized players.

Operating margins vulnerable to volatile raw material prices, particularly for fixed-price international EPC contracts – The key raw materials for tower manufacturing (steel and zinc), the cost of several other bought-out components required for installation of transmission line projects make up for KEC's raw material cost. Given the long order execution period of about 18-24 months, the operating profitability remains vulnerable to volatility in the prices of key raw materials, particularly in case of international contracts that are normally fixed price in nature. Headwinds in the commodity prices, particularly steel, resulted in a decline in KEC's margins (standalone level) in FY2021. Nonetheless, the risk is mitigated to some extent by the commodity price hedging undertaken by the company.

Moderation in consolidated margins due to weak performance of SAE Towers – Apart from the commodity price headwinds, the company's consolidated operating margin moderated to 9.5% in FY2021 from 11.1% in FY2021 owing to the weak performance of SAE Towers. SAE reported operating losses in FY2021 on account of cost and time overruns in execution of projects in Brazil owing to the Covid-19 pandemic-related challenges. The losses in SAE could be attributed to additional expenses incurred by the company due to the pandemic, intermittent stoppage in work, challenges in procurement of steel (supply shortages and higher prices) and depreciation of Brazilian Real. Though SAE operations are expected to normalise by Q2 FY2022, its performance in the near to medium term and impact on the consolidated financial credit profile of KEC will continue to remain a key monitorable from the credit perspective.

Operations exposed to currency fluctuations and counterparty credit risks – Overseas sales/projects continue to contribute significantly to KEC's overall revenues. Therefore, its operations are exposed to currency fluctuations, counterparty credit risks as well as geo-political risks. The moderation in the operating profit margins of SAE Towers in FY2021 was partly due to the steep depreciation of the Brazilian Real. The risk of currency fluctuations, however, is mitigated to some extent by the natural hedge (expenses incurred in foreign currency), forward contracts and utilisation of the foreign currency-denominated borrowings.

Challenges to project execution arising from right-of-way and geopolitical issues – The company is exposed to project execution risks arising from right-of-way and geo-political issues for overseas and domestic projects. As a result, its ability to execute the projects in a timely manner within the budgeted costs remains critical from the credit perspective. Given that a few of its orders are in technologically-enabled areas such as urban infrastructure (metro electrification), flue gas de-sulphurisation, high-speed trains, hydrocarbons etc, where the company has recently forayed, the ability to execute these projects in a timely manner within the budgeted costs remains critical.

Liquidity position: Adequate

The company's liquidity position remains **adequate** with free cash and liquid investments of Rs. 199.79 crore as on March 31, 2021, along with ~Rs. 1,240-crore undrawn line of credit. The average utilisation of the sanctioned fund-based working capital limits stood comfortable, at ~54%, for the last twelve months ending in March 2021. The drawing power (DP) of the company for March 2021 stood at Rs. 3,051 crore. In addition, KEC is not required to deposit any margin money for the non-fund based limits. As on March 31, 2021, it had an outstanding long-term debt of Rs. 300.57 crore on a consolidated basis, and the company is expected to service the debt repayments from its internal accruals. The routine capex plan of ~Rs.200 crore is likely to be funded from KEC's internal accruals.

Rating sensitivities

Positive factors – ICRA could upgrade KEC's ratings if the company is able to demonstrate a significant reduction in the working capital requirement leading to TOL/TNW falling below 2.25 times on a sustained basis and an improvement in operating profitability (> 10.5%) and return on capital employed (> 20%), in a sustained manner, along with a sustained improvement in revenues and margins from the non-T&D business segments.

Negative factors – The outlook may be revised to Negative or the ratings can be downgraded for KEC in case of increase in the company's working capital intensity leading to an increase in TOL/TNW to more than 4.0 times or decline in operating profitability to below 8% or if there is any sharp decline in fresh order inflows affecting the order book position and revenue growth prospects.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Methodology for Construction Entities
Parent/Group Support	Not applicable
Consolidation/Standalone	The ratings are based on the consolidated financial profile of the company. The list of companies that are consolidated to arrive at the rating are given in Annexure 2 below.

About the company

KEC was established in 1945 and was taken over by R. P. Goenka (RPG) Enterprises in 1982 and renamed KEC International Limited in 1984. The company executes power transmission and distribution, railways, civil and solar projects on an EPC basis. It also manufactures power and telecom cables. KEC is one of the largest power transmission EPC companies in the world with presence in over 70 countries, a strong presence in India, the Middle East, Africa, South Asia the Americas and Central Asia. In

September 2010, KEC acquired SAE Towers LLC, headquartered in Houston (USA), which is involved in the business of design, manufacture and supply of transmission towers. At present, KEC has three tower-manufacturing facilities in India (Nagpur, Jaipur and Jabalpur) and one tower-manufacturing facility each in Mexico, Brazil and Dubai, with a combined manufacturing capacity of 4,22,200 metric tonnes per annum. KEC also has cable-manufacturing (power and telecom) facilities in Mysore and near Vadodara.

Key financial indicators (audited)*

KEC Consolidated	FY2020	FY2021
Operating Income (Rs. crore)	11965.4	13114.2
PAT (Rs. crore)	565.5	552.7
OPBDIT/OI (%)	11.1%	9.5%
PAT/OI (%)	4.7%	4.2%
Total Outside Liabilities/Tangible Net Worth (times)	3.6	3.2
Total Debt/OPBDIT (times)	1.9	1.7
Interest Coverage (times)	3.3	3.4

**Ratios are as per ICRA's computation; PAT: Profit after Tax; OPBDITA: Operating Profit before Depreciation, Interest, Taxes and Amortisation*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of March 31, 2021 (Rs. crore)	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019	
					Jun 28, 2021	Nov 30, 2020	Jan 17, 2020	Dec 28, 2018	Jul 23, 2018
1	Fund-based Limits	Long Term	2,400	-	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)
2	Non-fund Based Limits	Long Term /Short Term	14,600	-	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+	[ICRA]AA- (Stable)/ [ICRA]A1+
3	Term Loans	Long Term	150	150	[ICRA]AA- (Stable)	-	-	-	-
4	Short term Fund based facility	Short Term	150	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-
5	Unallocated Limits	Short Term	700	-	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-
6	Foreign Currency Term Loan (ECB)	Long Term	20 mn USD	3 mn USD	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	-	-	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Fund-based Limits	Simple
Non-fund Based Limits	Very Simple
Fund-based – Term loans	Simple
Short term Fund based facility	Simple
External Commercial Borrowing (Foreign Currency Term Loan)	Simple

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional, or legal aspects. Details on the complexity levels of the instruments, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
-	Fund-based Limits	-	-	-	2,400.00	[ICRA]AA- (Stable)
-	Non-fund Based Limits	-	-	-	14,600.00	[ICRA]AA- (Stable)/ [ICRA]A1+
-	Fund-based – Term loans	March 2021	-	FY2024	150.00	[ICRA]AA- (Stable)
-	Short-Term Fund Based Limits	-	-	-	150.00	[ICRA]A1+
-	Unallocated limits	-	-	-	700.00	[ICRA]A1+
-	Foreign Currency Term Loan (ECB)	August 2020	-	FY2026	20.00 mn USD	[ICRA]AA- (Stable)

Source: *KEC International Limited*

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
RPG Transmission Nigeria Limited	100.00%	Full Consolidation
KEC Global FZ-LLC-Ras UL Khaimah	100.00%	Full Consolidation
KEC Investment Holdings, Mauritius	100.00%	Full Consolidation
KEC Global Mauritius	100.00%	Full Consolidation
KEC Power India Private Limited	100.00%	Full Consolidation
SAE Towers Holdings LLC, United States (along with step-down subsidiaries)	100.00%	Full Consolidation
KEC International (Malaysia) SDN BHD	100.00%	Full Consolidation

Source: *KEC International Limited*

ANALYST CONTACTS

Sabyasachi Majumdar
+91 124 4545 304
sabyasachi@icraindia.com

Girishkumar Kadam
+91 22 6114 3441
girishkumar@icraindia.com

Vikram V
+91 40 4067 6518
vikram.v@icraindia.com

Tushar Bharambe
+91 22 6169 3347
tushar.bharambe@icraindia.com

Abhilash Dash
+91 22 6169 3358
abhilash.dash@icraindia.com

RELATIONSHIP CONTACT

L Shivakumar
+91 22 6114 3406
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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ICRA Limited

Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001
Tel: +91 11 23357940-45

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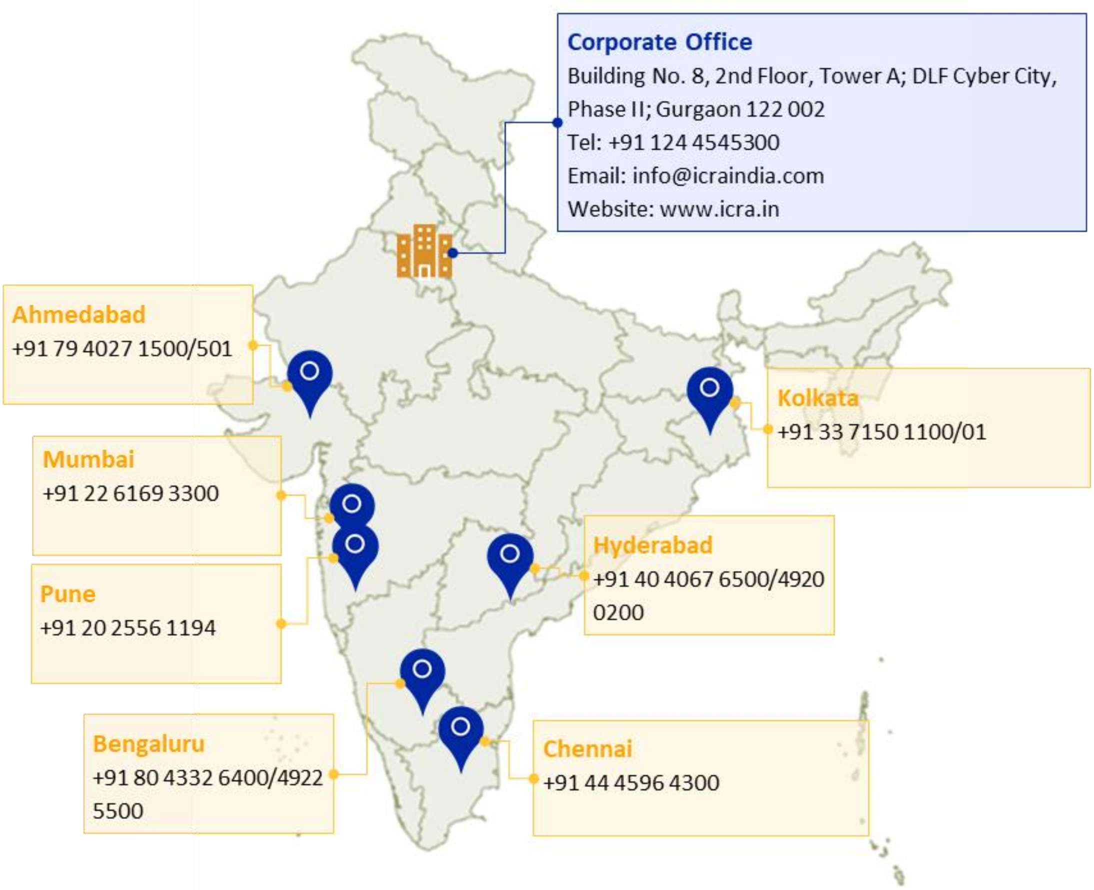

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