January 17, 2020

KEC International Limited: Long-term and short-term ratings reaffirmed; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based Limits	1,800	2,400	[ICRA]AA- (Stable); reaffirmed
Non-fund Based Limits	11,200	14,600	[ICRA]AA- (Stable) / [ICRA]A1+; reaffirmed
Short term Fund based facility	1000	1000	[ICRA]A1+; reaffirmed
Non-convertible Debenture (NCD) Programme	250	250	[ICRA]AA- (Stable); reaffirmed
Total	**14,250**	**18,250**	

Instrument details are provided in Annexure-1

Rationale

The reaffirmation in the ratings takes into account the company's strong market position as engineering, procurement and construction (EPC) company in the power transmission & distribution (T&D) segment and favourably factors its increasing diversification in the other (non-T&D) business segments such as railways & civil works in the last 12-month period. The company's order book is healthy (i.e. at ~Rs.18085 crore as on September 30, 2019, i.e. 1.5 times of FY2019 revenue) and provides revenue visibility in the near-to-medium term. The T&D segment comprised 64% in the order book position while the balance pertained to non-T&D segment as on September 2019. While the fresh order intake for the transmission and distribution (T&D) business declined in H1FY2020 due to low tendering activity in the T&D industry, the order inflow in the railway division increased by 8% (Rs.1883 crore in H1FY2020 vis-à-vis Rs.1745 crore in H1FY2019), supporting the growth in the company's pending order-book position. The ratings also take into account the increase in profitability levels witnessed in FY2019, supported by improvement in execution efficiency, faster turnaround and lower execution cycle. The ratings further continue to take into account KEC's diversified geographical presence, with 40–50% of its revenues earned from overseas projects, including the market entry into new geographies such as South-East Asia and African regions. In addition, projects from foreign countries constituted ~51% of the current order book. With the acquisition of SAE Towers (with manufacturing capacities in Brazil and Mexico) in September 2010, the company gained access to the American markets as well as to the EPC opportunities in Brazil. The long-term demand prospects of the power transmission and distribution project business in India as well as in key foreign countries, where KEC operates, also remain favourable.

The ratings, however, are constrained by the high working capital intensity inherent in the EPC business due to the long execution period of the transmission projects; the long credit periods offered to customers; and the retention money requirement that is released as and when the orders are completed. ICRA has also taken note of the decline in receivables (from Rs.1114 crore as on September 2018 to Rs.540 crore as on September 2019) for the project executed in Saudi Arabia, a large part of which is in the form of retention money for the current contracts. In addition, domestic and international markets for the transmission & distribution business continue to be highly competitive. The ratings remain constrained by the exposure of KEC's profit margins to price volatility of the key raw materials, particularly for international EPC contracts that are fixed price in nature. However, the company has a price hedging mechanism for commodities such as aluminium and zinc, thereby minimising this risk to a certain extent. Given that the company operates in many overseas countries, its operations remain exposed to geo-political risks, currency risks and counterparty credit risks. To mitigate the credit risks from overseas customers in regions such as Middle East, Africa and Central Asia, most of the projects are funded by multilateral funding as well as hedged through forward contracts. The company is also exposed to project execution risks arising from right-of-way and geopolitical issues of overseas projects. As a result, the company's ability to execute the projects in a timely manner within the budgeted costs remains critical from the credit perspective, also given that few of the company's orders are in Metro civil works, wherein the company has forayed recently.

The Stable outlook assigned to KEC reflects that the company's revenue growth and profitability would be supported by its healthy order book position, strong execution capabilities as well as an improving diversity in the business segments that comprise T&D, Railways and Civil works.

Key rating drivers and their description

Credit strengths

Globally established and diversified EPC player, with leadership position in domestic power transmission segment – Over the last seven decades, KEC has successfully diversified its business profile (both segment wise as well as geography wise). Today, the company executes power transmission and distribution, railways infrastructure, civil and solar projects on an EPC basis. KEC is one of the largest power transmission EPC companies in the world with presence in about 68 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.18085 crore as on September 30, 2019 on a consolidated basis, i.e. 1.5 times the revenues of FY2019. T&D segment comprised 64% in the order book position as on September 30, 2019 while the balance pertained to non-T&D segment. In H1FY2020, the company obtained orders of about Rs.3766 crore, of which order inflows from the railway segment accounted for about 50%. Order inflows from the transmission and distribution segment declined and accounted for only 25% of the orders obtained in H1FY2019. While the fresh order intake for the transmission and distribution (T&D) business declined in H1FY2020 due to low tendering activity in the T&D industry, the order inflows in the Railway division increased by 8% (Rs.1883 crore in H1 FY2020 vis-à-vis Rs.1745 crore in H1 FY2019), thereby supporting the growth in the company's pending order-book position.

Profitability levels supported by improvement in execution efficiency, faster turnaround and lower execution cycle - The operating profitability levels (OPBDITA/OI of 11.3% in FY2019 and 10.4% in H1 FY2020) are supported by the enhancement of the execution efficiency with faster turnaround and the margin improvement in the railways segment due to scale expansion.

Strong long-term demand prospects for power transmission and distribution 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 owing to inadequacy/capacity constraints as well as the need to manage regional differences in power generation and power requirements. In international markets, the underdeveloped markets of Africa, SAARC, Middle East and Latin America present a favourable market potential for setting up transmission lines and substation infrastructure. (Source: Industry).

Diversified geographical presence across the globe - The company has a wide geographical presence; about 51% of its current order book contributed by foreign countries. It has an established presence in the Middle East, Africa, Brazil, SAARC and South-east Asia region. The company derives a substantial portion of revenues (~40-50%) from its overseas projects.

Acquisition of SAE Towers (USA) in September 2010 provided KEC access to American markets - Acquisition of 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 100,000 metric tons).

Credit challenges

High working capital intensity in the EPC business - The company's working capital intensity remains inherently high in the EPC business due to the long execution period of the transmission projects, long credit periods offered to customers, and the retention money requirement that is released with linkage to completion of orders. As a result, the overall debtor's days have historically remained high in the range of 250-280 days. The working capital position is however supported to some extent by creditor days of ~200 days. High working capital intensity is further evident from the Net Working Capital / Operating Income of 35% in H1FY20; albeit improved from 43% in FY 2018-19. The working capital borrowings (including acceptances) stood at Rs.3148.8 crore as on September 30, 2019. Further, Total Outside Liabilities/ Tangible Net Worth remained at 3.8 times and 3.7 times in FY 2018-19 and H1 FY 2019-20 respectively, wherein total outside liabilities also capture the trade creditors and acceptances.

High competitive pressures in the domestic and international markets for the transmission & distribution business – KEC derives a significant proportion of its revenue (65-70%) from the transmission and distribution segment, which remains highly competitive in domestic as well as international markets.

Operating margins remain vulnerable to price volatility of key raw materials, 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 fact that order execution takes about 18-24 months, the operating profitability remains vulnerable to volatility in the prices of key raw materials, particularly in the case of international contracts that are normally fixed price in nature. However, the risk is mitigated to some extent by the commodity price hedging undertaken by the company.

Operations exposed to currency risks and counterparty credit risks - Overseas sales/projects continue to contribute significantly to KEC's overall revenues. Therefore, its operations are exposed to currency risks and counterparty credit risks as well as geo-political risks. The currency risk, however, is mitigated to some extent by the natural hedge (expenses incurred in foreign currency), forward contracts and utilisation of the foreign currency-denominated working capital borrowings.

Challenges to project execution arising from right-of-way and geopolitical issues - The company is also exposed to project execution risks arising from right-of-way and geopolitical issues for overseas projects. As a result, the company's ability to execute the projects in a timely manner within the budgeted costs remains critical from the credit perspective. Moreover, a few of the company's orders are in Metro civil works, wherein the company has forayed recently.

Liquidity position: Adequate

The company's liquidity position remains adequate with free cash and liquid investments of Rs.278 crore as on September 2019 end along with ~Rs.670 crore undrawn line of credit, which is also supported by a cushion of ~Rs.1785 crore in the drawing power. The drawing power (DP) of the company for month of November 2019 is assessed at Rs.3444 crore. The average utilisation of fund based limits and commercial paper facility availed (as a percentage of DP) was comfortable at 54% for the last 15 months ending November 30, 2019. The average utilisation of non-fund based limits was 77% during the same period. In addition, the company is not required to deposit any margin money for the non-fund based limits.

Rating sensitivities

Positive triggers – ICRA could upgrade KEC International Limited's rating if the company demonstrates a) significant reduction in the working capital requirement leading to Total Outside Liabilities/ Tangible Net Worth less than 2 times and EBITDA / Interest & finance expenses i.e. interest coverage of more than 4 times in a sustained manner b) Improvement in operating profitability (> 11%) in a sustained manner c) successful diversification into newly identified business segments.

Negative triggers – The outlook may be revised to Negative in case a) TOL /TNW is more than 4 times or b) decline in operating profitability below 8% or c) any further increase in the working capital intensity of the company leading to an increase in debt levels or d) any sharp decline in fresh order inflows affecting the order book position.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
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 about 68 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 and Brazil, with a combined manufacturing capacity of 311,200 metric tonne per annum. KEC also has cable-manufacturing (power and telecom) facilities in Mysore and near Vadodara.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	10058.0	11000.5
PAT (Rs. crore)	460.4	486.4
OPBDIT/OI (%)	11.1%	11.3%
RoCE (%)	27.1%	28.0%
Total Debt/TNW (times)	0.9	0.8
Total Debt/OPBDIT (times)	1.6	1.5
Interest Coverage (times)	3.3	3.1
DSCR	2.0	1.9

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

			Current Rating (FY2020)			Chronology of Rating History for the past 3 years					
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. Crore)	Date and Rating	Date and Rating in FY2019		Date and Rating in FY2018		Date and Rating in FY2017	
					January 17, 2020	28-December 2018	23-July 2018	08-January 2018	08-Sep 2017	29-December 2016	27-October 2016
1	Fund-based Limits	Long Term	2,400	-	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (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]A+ (Positive) / [ICRA]A1+	[ICRA]A+ (Stable)/ [ICRA]A1+	-
3	NCD programme	Long Term	250	250	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]A+ (Positive)	[ICRA]A+ (Stable)	[ICRA]A+ (Stable)
4	Short term Fund based facility^	Short Term	1000	-	[ICRA]A1+	[ICRA]A1+	-	-	-	-	-

^includes bill discounting facility

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the 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	[ICRA]AA- (Stable)
-	Non-fund Based Limits	-	-	-	14,600	[ICRA]AA- (Stable)/ [ICRA]A1+
-	Bill Discounting	-	-	-	1000	[ICRA]A1+
INE389H07037	NCD programme-I	October 2016	Nil	FY 2021	150	[ICRA]AA- (Stable)
INE389H07045	NCD programme-II	October 2016	Nil	FY2022	50	[ICRA]AA- (Stable)
INE389H07052	NCD programme-III	October 2016	Nil	FY2022	50	[ICRA]AA- (Stable)

Source: KEC International Limited

Annexure-2: List of companies considered for consolidation

Company Name	Ownership	Consolidation Approach
RPG Transmission Nigeria Limited	100%	Fully consolidated
KEC Global FZ-LLC-Ras UL Khaimah	100%	Fully consolidated
KEC Investment Holdings, Mauritius	100%	Fully consolidated
KEC Global Mauritius	100%	Fully consolidated
KEC Power India Private Limited	100%	Fully consolidated
SAE Towers Holdings LLC, United States (along with step-down subsidiaries)	100%	Fully consolidated
KEC International (Malaysia) SDN BHD	100%	Fully consolidated

Source: KEC International Limited

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About ICRA Limited:

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