

KALPATARU POWER

Linjemontage acquisition: The Nordic connection

India Equity Research | Engineering and Capital Goods

Kalpataru Power (KPTL) has forayed into the Nordic region by acquiring 85% of Swedish company Linjemontage i Gastorp AB (Linjemontage) for an enterprise value of USD24mn (equity value INR1.4bn). This acquisition is relatively small (6% of net worth and 3% of PAT), and we view it positively considering: 1) the business is scalable as the replacement opportunity is large (about USD1bn per year)—moreover, KPTL's expertise will allow it to enter the 400kVA market (50% of existing market); 2) more cost-effective procurement of raw materials and entry into high-value chain implies scope for improvement in EBITDA and PAT margins (currently 3.7% and 2.5%, respectively). Factoring in the buyout, we are raising FY20E and FY21E earnings by 2% each. We are tweaking up the target P/E for KPTL standalone from 12x to 15x, which is towards the high end of its trading band, factoring in the strong business momentum and potential value unlocking from transmission BOOT assets. Maintain 'BUY' with a revised TP of INR540 (from INR450).

Gaining a foothold in Nordic markets

Linjemontage, established in 1993, has a strong foothold in Sweden with a market share of 20–25% in less than 220 kVA market. The company caters to three main businesses – substation, transmission and O&M – and has an order book of USD77mn. KPTL plans to first capitalise on the Swedish market (annual opportunity of USD800–900mn over the next four–five years) and then expand to the Norwegian market.

Synergy benefits to drive margin expansion

KPTL's low-cost manufacturing in India will result in more cost-effective procurement of raw materials for Linjemontage. This coupled with Linjemontage's experienced management team and technological capabilities provide ample room for margin expansion in a potentially high-growth market in the Nordic region.

Outlook and valuation: Re-rating triggers; maintain 'BUY'

The Linjemontage buyout is small, but scalable in our view and could contribute about 10% of KPTL's profit by FY22 versus 3% currently. We believe KPTL's strong businesses momentum across verticals is likely to sustain. Besides, value unlocking from sale of real estate projects, road assets and SSL are the key triggers. Maintain 'BUY/SO'.

Financials

(INR mn)

Year to March	FY18	FY19E	FY20E	FY21E
Revenues	57,412	69,012	79,770	90,310
EBITDA	6,312	7,625	8,754	10,069
Adjusted Profit	3,220	3,953	4,442	5,230
Adjusted diluted EPS (INR)	21.0	25.8	28.9	34.1
Diluted P/E (x)	20.7	16.9	15.0	12.8
EV/EBITDA (x)	11.5	9.7	8.7	7.5
ROAE (%)	12.3	13.4	13.3	13.9

EDELWEISS 4D RATINGS

Absolute Rating	BUY
Rating Relative to Sector	Outperform
Risk Rating Relative to Sector	Medium
Sector Relative to Market	Overweight

MARKET DATA (R: KAPT.BO, B: KPP IN)

CMP	: INR 435
Target Price	: INR 540
52-week range (INR)	: 508 / 267
Share in issue (mn)	: 153.5
M cap (INR bn/USD mn)	: 67 / 797
Avg. Daily Vol.BSE/NSE('000)	: 104.6

SHARE HOLDING PATTERN (%)

	Current	Q2FY19	Q1FY19
Promoters *	59.3	59.3	59.3
MF's, FI's & BK's	24.5	22.9	21.9
FII's	4.6	4.7	4.8
Others	11.6	13.1	14.0
* Promoters pledged shares (% of share in issue)	:		26.0

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Capital Goods Index
1 month	25.2	6.2	9.3
3 months	20.1	6.5	(1.4)
12 months	(2.5)	12.8	(1.0)

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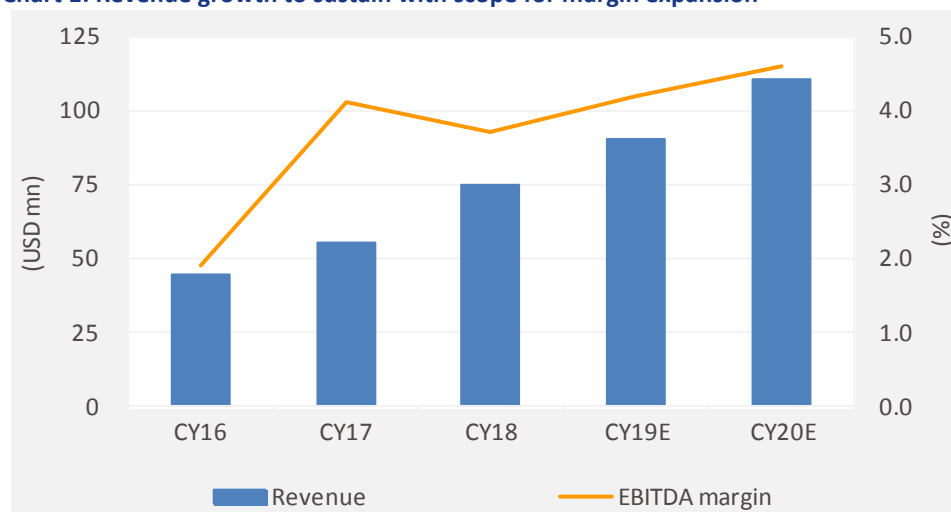
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Table 1: Linjemontage key assumptions

Key assumptions	CY18	CY19E	CY20E
Market size (USD mn)	800	840	882
Order inflow (USD mn)	110	130	146
Revenue (USD mn)	75	90	110
EBITDA margin (%)	3.7%	4.2%	4.6%
PAT (USD mn)	1.9	2.8	3.8
KPTL share (INR mn)		172	231

Source: Company, Edelweiss research

Chart 1: Revenue growth to sustain with scope for margin expansion



Source: Company, Edelweiss research

Conference call highlights

About Linjemontage i Gastorp AB

- The company is well-established in Sweden and establishing a presence in Norway. It has set up an office in Norway.
- It procures towers from Turkey and Poland.
- The company does not have manufacturing capabilities.
- It has faced growth challenges owing to funding constraints (run by a single promoter).
- Order book: 65% sub-stations and 35% TLT and O&M. By revenue, 60–65% comes from the sub-station business.
- The current order book mainly made up of 0.4 kVA to 220 kVA (20–25% market share). The company is not bidding for higher kVA lines. About 50% of the upcoming market is the 400 kVA market.
- Employee cost is 14–15% of revenue.

Financial comments

- The acquisition is funded by internal cash accruals (about INR1.4bn). Only if required, the company will resort to short-term debt (in India). Management is confident that debt levels would not change due to this acquisition.
- KPTL will leverage its low-cost manufacturing base in India.
- 4.5–5.0% margin expected in FY19. Low-cost sourcing will help improve profitability.
- 30–45 days working capital as advances generally compensate for working capital requirements. Non-fund-based limits would be required, but it will not have a bearing on margins.
- No significant capex requirement at the company level.
- The company follows a standard 10% advance policy. The final payment is received upon delivery. The payment cycle is 7–15 days from the date of the issue of the bill.

Other comments

- The addressable opportunities in Sweden and Norway are huge (USD800–900mn per year for the next five–seven years). The focus is on tapping opportunities in Sweden (400 kVA) and then look into Norway.
- Denmark and Finland have different rules in terms of visa and labour requirements. The overall opportunity could be USD500mn to USD1bn annually, which is yet to be explored.
- At the PAT margin level, the acquired company should turn in similar returns as KPTL consolidated (about 5%).
- Management is Intent on paying dividend from the company from the first year itself. However, a final call will be made depending on the need for growth capital.

Table 2: SoTP

SOTP based target price	
Kalpataru standalone	
Valuation Methodology	P/E
PAT - Jun-20E (INR mn)	4,826
Multiple (x)	15
Implied value (INR mn)	70,937
No of shares	153
Value per share (INR)	463
JMC SA (67% stake)	
Valuation Methodology	P/E
PAT - June-20E (INR mn)	1,758
Multiple (x)	8.0
Implied value (INR mn)	9,450
No of shares - KPP	153
Value per share (INR) for KPP	62
Value per share after Hold Co. dis@20% (INR)	49
JMC Road BOT projects	
Valuation Methodology	1x P/BV
Equity Invested (INR mn)	5,000
Value per share (INR) for Kalpataru Power	22
Value per share after Hold Co. discount @30% (INR)	15
KPTL transmission BOT projects	
Valuation Methodology	DCF valuation
NPV	888
No of shares	153
Value per share (INR)	6
Shree Shubham Logistics - 80% stake	
Valuation Methodology	P/E
PAT - June-20E (INR mn)	151
Multiple (x)	8.0
Implied value (INR mn)	964
No of shares	153
Value per share (INR)	6
Total value	540

Source: Company, Edelweiss research

Company Description

KPTL has three business divisions viz., transmission line, biomass energy and infrastructure. It has an in-house tower testing station with a capacity to test square/rectangular base towers of up to 800 kV D/C as well as multi-circuit towers. KPTL is exposed to construction segment with a 67% stake in JMC Projects (JMC); JMC is primarily engaged in the construction of industrial buildings, and residential and commercial complexes. Off late, JMC has ventured into the infrastructure segment with projects in roads, bridges, flyovers, and transportation structures.

Investment Theme

T&D spending in India is expected to be around INR1,800bn and INR2,300bn over 12th and 13th Plans against INR1,400bn in the Eleventh Plan. It augurs well for KPTL which has maintained market share of 12-13% over the past 5-6 years in PGCIL ordering. Also, expansion in regional transmission network in Africa and Middle East is likely to supplement domestic demand and present a large business opportunity. KPTL is the front-runner in the power T&D EPC sector, and hence, is well-placed to leverage from the opportunity. Further, KPTL's foray into Railways business further enhances ordering prospects.

Key Risks

Power T&D investments are executed by state utilities, which, in turn, are mandated by the government. Hence, any change in the political environment can potentially impact the pace of execution in the industry, thus impacting the timing of revenue growth.

Additionally, customer concentration risk is high in the business, which in turn, impacts the bargaining power of transmission tower companies.

Financial Statements

Key Assumptions

Year to March	FY18	FY19	FY20E	FY21E
Macro				
GDP(Y-o-Y %)	6.7	7.1	7.1	7.3
Inflation (Avg)	3.6	3.7	4.0	4.5
Repo rate (exit rate)	6.0	6.3	5.8	5.8
USD/INR (Avg)	64.5	70.0	72.0	72.0
Company				
KPP SA Order intake (%)	50.8	(3.4)	11.0	11.3
JM order intake (%)	3.9	60.0	(15.0)	2.0
KPP SA sales growth (%)	17.3	20.2	15.6	13.2
JMC sales growth (%)	16.8	18.0	17.6	15.9
Tax rate (%)	35.5	35.0	35.0	35.0

Income statement

(INR mn)

Year to March	FY18	FY19	FY20E	FY21E
Income from operations	57,412	69,012	79,770	90,310
Materials costs	41,215	49,862	58,174	65,701
Employee costs	3,487	4,486	4,627	5,238
Other mfg expenses	6,397	7,039	8,216	9,302
Total operating expenses	51,100	61,387	71,017	80,241
EBITDA	6,312	7,625	8,754	10,069
Depreciation	766	864	889	945
EBIT	5,546	6,761	7,865	9,125
Less: Interest Expense	1,033	1,206	1,488	1,546
Add: Other income	480	526	458	468
Profit Before Tax	4,993	6,081	6,834	8,047
Less: Provision for Tax	1,773	2,128	2,392	2,816
Reported Profit	3,220	3,953	4,442	5,230
Adjusted Profit	3,220	3,953	4,442	5,230
Shares o /s (mn)	153	153	153	153
Adjusted Basic EPS	21.0	25.8	28.9	34.1
Diluted shares o/s (mn)	153	153	153	153
Adjusted Diluted EPS	21.0	25.8	28.9	34.1
Adjusted Cash EPS	26.4	31.4	34.7	40.2
Dividend per share (DPS)	2.5	3.5	3.5	3.5
Dividend Payout Ratio(%)	15.9	15.9	14.1	12.0

Common size metrics

Year to March	FY18	FY19	FY20E	FY21E
Materials costs	71.8	72.3	72.9	72.8
Staff costs	6.1	6.5	5.8	5.8
Other mfg expenses	11.1	10.2	10.3	10.3
Operating expenses	89.0	89.0	89.0	88.9
Depreciation	1.3	1.3	1.1	1.0
Interest Expense	1.8	1.7	1.9	1.7
EBITDA margins	11.0	11.0	11.0	11.1
Net Profit margins	5.6	5.7	5.6	5.8

Growth ratios (%)

Year to March	FY18	FY19	FY20E	FY21E
Revenues	17.3	20.2	15.6	13.2
EBITDA	19.3	20.8	14.8	15.0
Adjusted Profit	19.7	22.8	12.4	17.7
EPS	19.7	22.8	12.4	17.7

Balance sheet		(INR mn)			
As on 31st March	FY18	FY19	FY20E	FY21E	
Share capital	307	307	307	307	
Reserves & Surplus	27,394	30,963	35,021	39,868	
Shareholders' funds	27,700	31,269	35,328	40,175	
Long term borrowings	3,912	4,912	4,912	4,912	
Short term borrowings	2,497	3,297	4,597	4,097	
Total Borrowings	6,409	8,209	9,509	9,009	
Long Term Liabilities	1,750	1,750	1,750	1,750	
Def. Tax Liability (net)	(312)	(312)	(312)	(312)	
Sources of funds	35,548	40,917	46,276	50,623	
Gross Block	7,394	8,654	9,464	10,274	
Net Block	5,268	5,664	5,585	5,450	
Capital work in progress	167	177	187	197	
Total Fixed Assets	5,434	5,840	5,771	5,647	
Non current investments	7,849	9,099	12,249	12,249	
Cash and Equivalents	816	831	125	402	
Inventories	4,828	6,240	7,523	8,462	
Sundry Debtors	33,805	39,706	44,802	51,959	
Loans & Advances	5,390	5,660	5,773	6,062	
Other Current Assets	14,351	12,916	13,561	14,918	
Current Assets (ex cash)	58,374	64,521	71,659	81,400	
Trade payable	24,710	28,005	32,673	36,901	
Other Current Liab	12,217	11,369	10,857	12,176	
Total Current Liab	36,926	39,374	43,530	49,077	
Net Curr Assets-ex cash	21,448	25,146	28,130	32,324	
Uses of funds	35,548	40,917	46,276	50,623	
BVPS (INR)	180.5	203.8	230.2	261.8	

Free cash flow		(INR mn)			
Year to March	FY18	FY19	FY20E	FY21E	
Reported Profit	3,220	3,953	4,442	5,230	
Add: Depreciation	766	864	889	945	
Interest (Net of Tax)	666	784	967	1,005	
Others	219	(784)	(967)	(1,005)	
Less: Changes in WC	3,836	3,699	2,983	4,194	
Operating cash flow	1,035	1,118	2,348	1,981	
Less: Capex	1,063	1,270	820	820	
Free Cash Flow	(29)	(152)	1,528	1,161	

Cash flow metrics		FY18	FY19	FY20E	FY21E
Year to March					
Operating cash flow		1,035	1,118	2,348	1,981
Financing cash flow		(488)	1,416	916	(884)
Investing cash flow		(1,876)	(2,520)	(3,970)	(820)
Net cash Flow		(1,329)	14	(706)	277
Capex		(1,063)	(1,270)	(820)	(820)
Dividend paid		(363)	(384)	(384)	(384)

Profitability and efficiency ratios		FY18	FY19	FY20E	FY21E
Year to March					
ROAE (%)		12.3	13.4	13.3	13.9
ROACE (%)		18.7	19.8	19.7	20.4
Inventory Days		41	41	43	44
Debtors Days		198	194	193	196
Payable Days		195	193	190	193
Cash Conversion Cycle		44	42	46	47
Current Ratio		1.6	1.7	1.6	1.7
Gross Debt/EBITDA		1.0	1.1	1.1	0.9
Gross Debt/Equity		0.2	0.3	0.3	0.2
Adjusted Debt/Equity		0.2	0.3	0.3	0.2
Net Debt/Equity		0.2	0.2	0.3	0.2
Interest Coverage Ratio		5.4	5.6	5.3	5.9

Operating ratios		FY18	FY19	FY20E	FY21E
Year to March					
Total Asset Turnover		1.7	1.8	1.8	1.9
Fixed Asset Turnover		11.0	12.6	14.2	16.4
Equity Turnover		2.2	2.3	2.4	2.4

Valuation parameters		FY18	FY19	FY20E	FY21E
Year to March					
Adj. Diluted EPS (INR)		21.0	25.8	28.9	34.1
Y-o-Y growth (%)		19.7	22.8	12.4	17.7
Adjusted Cash EPS (INR)		26.4	31.4	34.7	40.2
Diluted P/E (x)		20.7	16.9	15.0	12.8
P/B (x)		2.4	2.1	1.9	1.7
EV / Sales (x)		1.3	1.1	1.0	0.8
EV / EBITDA (x)		11.5	9.7	8.7	7.5
Dividend Yield (%)		0.6	0.8	0.8	0.8

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		P/B (X)		ROAE (%)	
		FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
Kalpataru Power	797	16.9	15.0	2.1	1.9	13.4	13.3
KEC International	856	14.8	12.9	3.0	2.5	22.6	21.1
Median	-	15.9	14.0	2.6	2.2	18.0	17.2
AVERAGE	-	15.9	14.0	2.6	2.2	18.0	17.2

Source: Edelweiss research

Additional Data

Directors Data

Mofatraj P Munot	Chairman	Manish Mohnot	Managing Director & CEO
Narayan Seshadri	Non Executive Independent Director	Sajjanraj Mehta	Non Executive Independent Director
Vimal Bhandari	Non Executive Independent Director	K V Mani	Independent Director
Parag Munot	Promoter - Director	Imtiaz Kanga	Non Executive Director
Anjali Seth	Independent Director		

Auditors - B S R & Co. LLP, Chartered Accountants

Holding – Top10

	Perc. Holding		Perc. Holding
Kalpataru constructi	15.22	Kc holdings pvt ltd	13.78
Kalpataru properties	8.89	Munot parag mofatraj	8.77
Hdfc asset managemen	8.55	Munot mofatraj pukhr	7.43
Icici prudential lif	3.28	Reliance capital tru	2.54
Hsbc global inv maur	2.15	Dsp investment manag	2.04

**in last one year*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

**in last one year*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
No Data Available			

**in last one year*

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
ABB India	HOLD	SP	M	Bharat Forge	REDUCE	SP	M
Bharat Heavy Electricals	BUY	SP	M	CG Power and Industrial Solutions	HOLD	SP	M
Cummins India	HOLD	SP	M	Engineers India Ltd	REDUCE	SU	M
Greaves Cotton	HOLD	SP	M	Kalpataru Power	BUY	SO	M
KEC International	BUY	SO	M	Larsen & Toubro	BUY	SO	M
Praj Industries	HOLD	None	None	Ramkrishna Forgings	BUY	SP	M
Siemens	HOLD	SP	L	Techno Electric & Engineering	BUY	SP	M
Thermax	REDUCE	SP	L	Triveni Turbine	BUY	None	None
VA Tech Wabag	BUY	None	None				

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

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Coverage group(s) of stocks by primary analyst(s): Engineering and Capital Goods

ABB India, Bharat Heavy Electricals, Bharat Forge, CG Power and Industrial Solutions, Engineers India Ltd, Greaves Cotton, KEC International, Cummins India, Kalpataru Power, Larsen & Toubro, Praj Industries, Ramkrishna Forgings, Siemens, Techno Electric & Engineering, Thermax, Triveni Turbine, VA Tech Wabag

Recent Research

Date	Company	Title	Price (INR)	Recos
19-Mar-19	Larsen & Toubro	Focus on RoE accretion through services; <i>Event Update</i>	1,379	Buy
13-Mar-19	Voltas	Leveraging competitive edge to gain scale; <i>Visit Note</i>	619	Buy
01-Mar-19	ABB India	On track; embarking on a new journey; <i>Result Update</i>	1,244	Hold

Distribution of Ratings / Market Cap

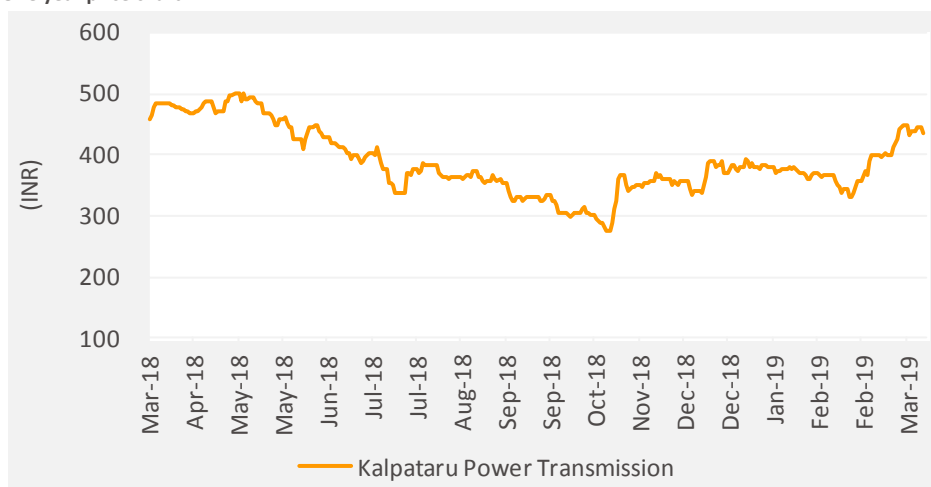
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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