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KALPATARU POWER TRANSMISSION LTD

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Kalpataru Power Transmission Ltd (KPTL) is one of the largest and fastest growing EPC companies of India, engaged in the power transmission & distribution, oil & gas pipeline, infrastructure development, railway works etc. With a strong foot-hold across 31 nations, the company stands firm with a robust order book of ₹59 billion in the current fiscal. Going further, the company intends to climb the value chain to an asset owner by focusing on BOOT projects.

Investor's Rationale

- With the ₹3,800 billion market opportunity in the Indian power space in the next five years, the power transmission & distribution (T&D) company, KTPL is well-positioned to have its slice of the pie. Considering the strong order backlog, growth in T&D segment and performance of the subsidiaries, we continue to remain optimistic on the future prospects of KPTL.

- Robust book to bill ratio of 2x of its FY'11 revenues, ensure earning visibility for the company. Backed by elevated investments lined up by PGCIL and a number of State Electricity Boards, the order book is expected to witness a firm growth and rise over ₹75 billion in the next two years, while the book to bill ratio is expected to remain around 1.9X.

- Kalpataru has a diversified business portfolio across transmission EPC, oil & gas pipelines, biomass energy, agri-logistics, real estate and infrastructure etc, which provide a blanket from slowdown in any particular segment. The company is moving on the ladder to become a major Infrastructure player.

- With the Government of India's increased focus on providing "Power for All" by 2012, the installed power generation capacity of the country is expected to reach 200,000MW by 2012. The demand for a diverse and capable EPC and transmission will significantly increase in the coming years on the back tremendous expansion needed in transmission capacity from 20,750MW currently to over 37,000MW by 2012. KPTL is the front-runner in the power T&D EPC sector and hence, is well-placed to benefit from the opportunity.

- KPTL is expanding its transmission tower manufacturing capacity by 30,000 MT to 138,000 MT from 108,000 currently. The company currently operates with over 90% capacity utilization with elevated levels of execution capability, which is expected to be maintained post expansion, enabling the company to enjoy goodwill among its clients and add value to the margins.

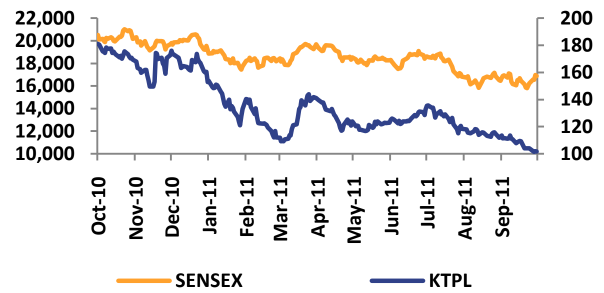
Market Data

Rating	**BUY**
CMP (₹)	100
Target (₹)	**140**
Potential Upside	~40%
Duration	Long Term
52 week H/L (₹)	187.8/100.5
All time High (₹)	1,959.9
Decline from 52WH (%)	79.9
Rise from 52WL (%)	7.4
1 year relative return	(43.8%)
Mkt. Cap (₹ bn)	15.4
Enterprise Val (₹ bn)	18.4

Fiscal Year Ended

	FY10A	FY11A	FY12E	FY13E
Revenue (₹mn)	25,868.4	28,787.0	33,752.8	38,562.5
Net Profit(₹mn)	1,697.4	1,905.6	2,284.4	2,496.4
Share Capital	265.0	307.0	307.0	307.0
EPS (₹)	11.1	12.4	14.8	16.3
PE (x)	9.0	8.1	6.8	6.1
P/BV (x)	1.6	1.0	0.9	0.8
EV/EBITDA (x)	6.1	5.5	3.7	3.6
ROE (%)	17.3	12.0	12.8	12.5
ROCE (%)	21.8	16.5	17.4	16.4

Relative Price Chart



Shareholding Pattern	Jun'11	Mar'11	Diff.
Promoters	55.0%	55.0%	-
Institutional	35.0%	35.1%	(0.10)
General Public	6.6%	6.5%	0.10
Others	3.5%	3.4%	0.10

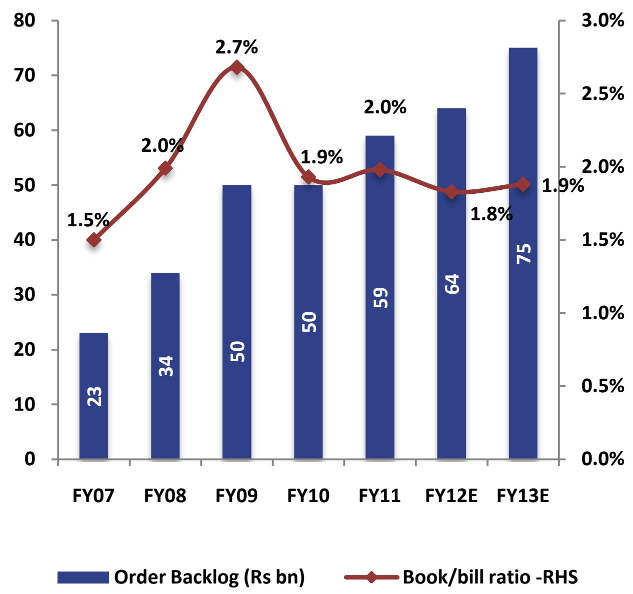
Robust order book ~ Book bill ratio @ 2x FY'11

KPTL current order book stands over ₹59 billion (excluding L1 contracts) translating into book to bill ratio of 2x of its FY'11 revenues amounting ₹25.9 billion, providing good earning visibility for the next 1.5–2 year. KPTL also witnessed considerable shift in the geographical composition with overseas orders contributing over ~35% to the company's order book, domestic transmission ~50%, infrastructure ~14% and 1% contributed through distribution projects. During Q1FY'12 gross order inflow stood at ₹15 billion, this mainly came in from international market and SEBs. From a client exposure perspective, PGCIL, Private and utilities comprise 35%, 25% and 40% share respectively out of the total domestic transmission projects. Dependence on PGCIL continues to be low at 35% in the overall backlog, 80% of KPTL's order book has price variation clause which provides cushion against the rise in raw material prices.

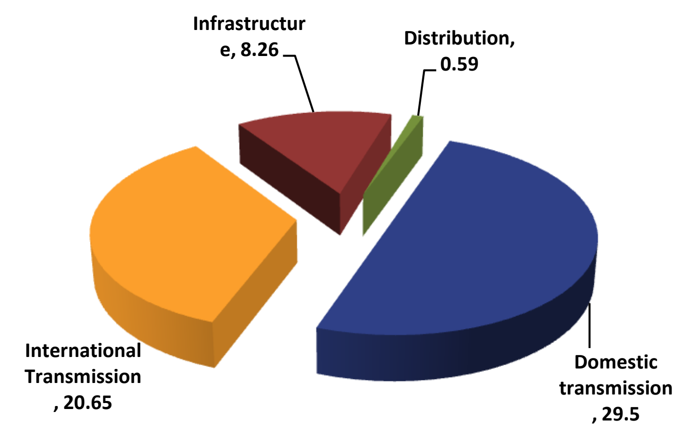
The management is expecting strong inflows from PGCIL to continue in the future. However majority of orders are expected to get released in fourth quarter of FY'12 with Q2 and Q3 to remain flat. In management's view, the delay in PGCIL ordering can be attributed to right-of-way issues and slowdown in power generation side. The company has already placed its offering for PGCIL tenders worth over ₹40 billion and expects lot of tenders to come from SEBs on account of UMPP renderings.

Order book for JMC remains healthy at ₹47 billion, of which, 50% comes from factories & buildings, 35% from infrastructure, 12% from power and the balance from railways. Considering the order book of JMC, the consolidated order book position stood over ₹106 billion. It is expected that the investments lined up by PGCIL and a number of State Electricity Boards will create gigantic opportunity for various players in T&D segment, while KPTL led by its strong track record and firm execution know-how is seen as one of the prime recipient of the same. The order backlog of the company is expected to witness a firm growth and increase over ₹75 billion in the next two years, while the book to bill ratio is expected to remain around 1.9x. Additionally, robust demand for oil & gas pipelines in India over the next few years is likely to drive infrastructure segment orders. Consequently, we project the company's order book and revenues will grow at 17% CAGR and 16% CAGR to ₹75 billion and ₹38.6 billion in FY'11-13E, respectively.

Book – Bill ratio @ 2x ~ earning visibility for FY'12



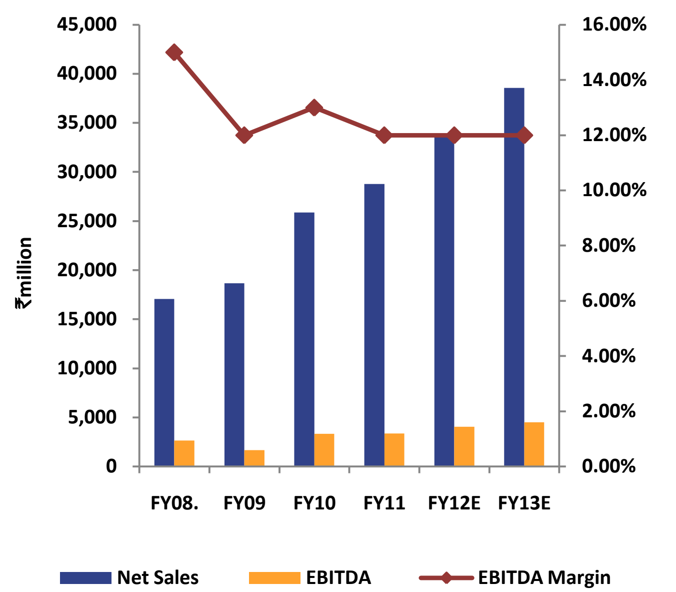
Branch out order backlog (₹billion)



T&D ~ revenue driver for KPTL

As of Q1FY'12, the T&D segment accounted for ~85% of KPTL's order book. Of this, the contribution from domestic transmission projects stood at ~50%. With a diverse domestic customer base (PGCIL, state utilities and private sector clients), credible project execution track record and large power sector opportunity, we believe KPTL is well placed to expand its T&D order book in FY'11-13E. It is expected that the order backlog will grow at 17% CAGR over FY'11-FY'13E. Although the order intake in Q1FY'12 has been subdued on domestic front, we expect it to pick up over Q4FY'12E and FY'12E-FY'13E driven by PGCIL and state utilities (to meet their XIth and XIIth Plan targets). Investments amounting to ₹580 billion have been planned by PGCIL for setting up nine high-capacity transmission corridors, which would take interregional transmission capacity from the present 20,750MW to 37,150MW by 2012 and further to 75,000MW by 2017. This provides a growth path for companies involved in the transmission line tower business. Historically KPTL ensures healthy order inflow from both PGCIL and SEBs.

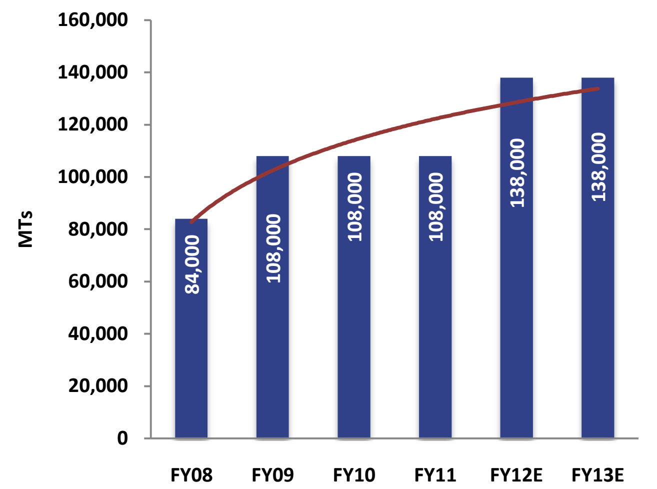
Sales to grow @16% CAGR during FY'11-13E



Expanding tower manufacturing capacity to caters domestic demand

KPTL is expanding its transmission tower manufacturing capacity by 30,000 MT to 138,000 MT from 108,000 currently. A new Greenfield facility will be set up in Raipur, Central India, to cater to the demand in the central and eastern belt of the country (and achieve savings in freight cost). The existing Gandhi Nagar facility will continue to cater to the western belt and export markets. The company currently operates with over 90% capacity utilization with elevated levels of execution capability, which is expected to be maintained post expansion, which enabled the company to enjoy goodwill among its clients and add value to the margins.

Expanding tower manufacturing capacity



Expanding aggressively its warehousing and logistics business

KPTL is expanding its warehousing and logistics business through its 85% subsidiary Shree Shubham-SSLL, with the presence across the entire value chain including warehousing, cold chains, commodity funding, collateral management, testing and certification, fumigation, pest control, commodity trading, exports, retail and other business support services. It is creating around ~150,000 MT of warehousing capacity additionally in Madhya Pradesh and Maharashtra at a capex of ~₹400 million over next one and half years. Additionally, KPTL is also looking to tie up with retail superstores like Hyper Mart etc. SSLL currently owns 30 Agri-logistics parks with ~190,000 MT of capacity. It also has revenue sharing agreement with Rajasthan Warehousing Corporation (RSWC) on 60:40 bases for its ~400,000 MT of warehousing capacity. Under the agreement, SSLL will be operating all the warehouses of RSWC and also enjoys the power to fix up the rates. Prompted by the gigantic prospects in the Agri-business space, the company plans to further augment its footholds in different states in India and targets total owned storage capacity of approximately 10,00,000 MT over the subsequent years.

KPTL ~ expanding its business in different geographies

Over the past few years, KPTL has cemented its international presence by bagging number of orders from Africa, the Middle East and Southeast Asia. Outside India, the company has effectively carry out transmission line tower projects in Africa, US, Australia, Middle East and Southeast Asia. Adding, it has also supplied transmission line towers to international EPC contractors and Power utilities in more than 28 countries. For taking the full advantage of the opportunities presented by the global Power Transmission and Distribution markets, the company has consistently formed consortia and joint ventures with local and international partners and has set-up projects offices in Algeria, Djibouti, Ethiopia, the Philippines, UAE, Kenya, South Africa, Nepal and Kuwait. To cement its place in overseas markets, in order to reduce its domestic concentration, the company is planning to take inorganic route.

International capex cycle ~ (WEO)

Region	Capacity Addition (GW)	Generation (US$ bn)	Transmission (US$ bn)	Distribution (US$ bn)
OECD	514	982	279	656
E. Europe	137	180	55	183
Asia	781	794	433	894
Middle East	78	59	32	67
Africa	59	59	28	58
Latin America	121	123	41	84
World	1,691	2,197	867	1,941

US factor

It is expected that from CY'12 onward, US will be the largest spender on T&D sector. There will a huge demand for replacement of transmission and distribution infrastructure in the US, we are expecting that these orders from the US would bagged by India and Kalpataru will have its slice of share.

Power generation ~ escalation opportunity

The Government of India, in the Eleventh Plan alone, is expected to add ~50-55 GW generation capacity, which is more than what was added in the past fifteen years. Further, with the government likely to add 100GW of capacity in the Twelfth Plan, which implies doubling of India's power generation capacity from the present; this translates into an investment opportunity of ₹3,800 billion in 2008-17. India's inter-regional power transmission capacity is likely to increase from ~20,750MW currently to ~37,700MW at the end of the Eleventh Plan (FY'12E-end). Power Grid Corporation of India (PGCIL) is likely to invest ~ ₹500 billion over FY'10-13E period to upgrade India's power transmission network, with the expected pick-up of tendering activity by PGCIL and state utilities to meet their plan targets and with ordering for mega projects expected to commence, we believe the sector is due for a re-rating. KPTL is the front-runner in the power T&D EPC sector, and hence, is well-placed to leverage from the opportunity.

Oil & gas pipeline business ~ next growth driver

Pipeline network addition by domestic oil & gas companies is expected to grow robustly during the next few years, fuelled by the low levels of pipelines penetration in India, high growth of natural gas usage and the fresh oil & gas discoveries. This opens up an opportunity of over ₹500 billion over the next few years as pipeline laying contracts of ~10,000 km are expected to be offered by domestic public and private sector companies. KPTL has a presence in this sector and has laid 1,800 km of pipelines over the past five years. It has secured large projects from Bharat Oman Refinery, GAIL, HPCL-Mittal Energy JV and OIL India in recent years. Although the segment's contribution in the order book is currently low at 8% in Q1FY'12, it is believed the segment holds attractive growth prospects given the scale of investment planned. The management is also eyeing opportunities in the global markets in addition to executing projects crossways to full value chain of the oil & gas pipeline business.

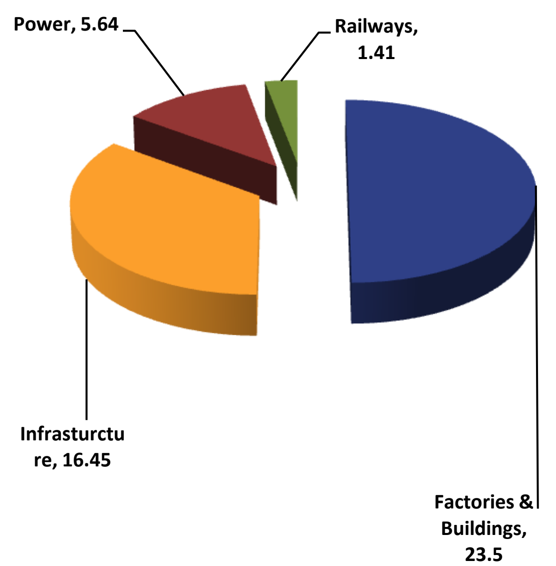
JMC Projects ~ revenue to accelerate

JMC Projects (the infrastructure subsidiary) has a healthy order backlog of ₹47 billion with 50% coming from factories & buildings, 35% from infrastructure, 12% from power and the balance from railways ~ offers the diversified infra exposure, which should nurture in the future, as bidding for road projects gains momentum in the current quarter, with NHAI is expected to award orders for 8,000km road projects. The company has reported a 44% YoY and 47% YoY jump in revenues and PAT in Q1FY'12, respectively.

We opine that, with Government's augmented focus of on developing national highways, NHAI has targeted to award orders worth ~ ₹570 billion (~8,000kms) till January 2012 and another 1,000kms on Annuity/EPC basis projects are also expected to be awarded in FY'12. Given the focus and impetus on the road sector, the magnitude of opportunity for the players cannot be undermined from the escalation prospective available in Indian Road sector, both on EPC contracting and BOOT.

JMC currently has three BOOT projects 'Kurukshetra Expressway JV with SREI Infra', 'Brij Bhoomi Expressway', and 'Nagpur-Wainganga Road project', with total capex required at ₹18 billion, the company has secured financial closure for its Kurukshetra Expressway and Brij Bhoomi Expressway while the LoI has been received for Nagpur –Wainganga road project. For FY'12, the company has maintained guidance for a 30-35% rise in revenues along with margin expansion. Currently company operates at low margins to the tune of 4-5%.

Order book break-up (₹billion) ~ JMC Projects



Risk Factor

Delay in execution will disrupt the earning visibility

Since the projects undertaken by KPTL have a relatively long gestation period, risk of lower-than-expected revenues exists from execution delays both in term of escalation of cost and loss of revenue.

Hold up in the power generation capacity

The Indian government is still committed to its long term goals of "Power for All", by enhancing the current power generation capacity. Although it might seem unlikely in the near term, any long-term hold up in the power sector will have a direct bang on the transmission sector, thereby impacting the earning capabilities of the company.

Ever rising competition level

The company's margins could come under pressure due to higher competition in the sector. KPTL's competitors (domestic and international) have in the past bid aggressively for PGCIL and state utilities projects.

Heavy working capital

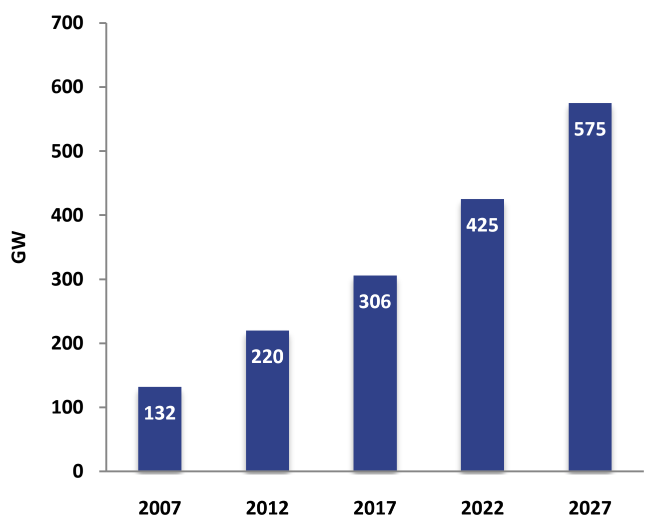
KPTL has high working capital requirements (over 20% of net sales in FY'11) due to high share of government projects in the order book. Majority of borrowings constitute working capital loans. Hence, a higher-than-expected rise in interest rates would result in higher interest expenses and lower profitability.

The Power Industry

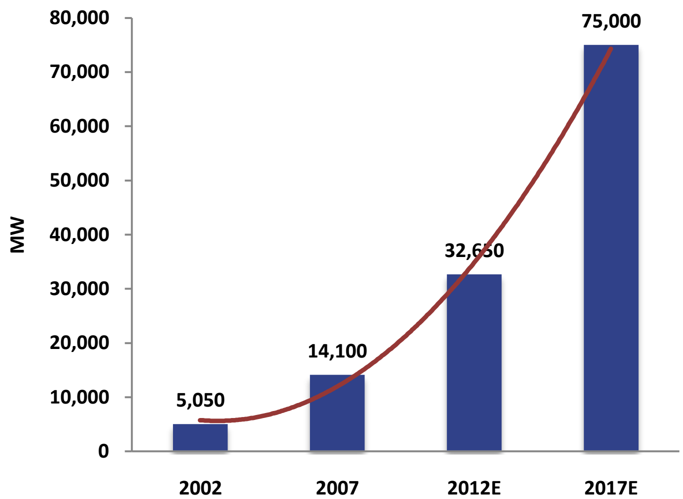
The contribution of the private sector to India's electricity output has grown from 11.6% in 2006 to 30% as of date and is likely to go up by about 60% in the 12th plan (2012-2017). The average plant load factor of Indian generation units improved to 77.5% during 2009-10 from 73.6%in 2006. Further, 15,795MW of power got synchronized and 12,161MW commissioned during 2010-11, which was the highest-ever capacity addition achieved in a single year since Independence, and 80,000MW is under construction as of now. Also, per capita consumption of electricity has grown from 600 kwh to 785 kwh in a span of five years. In the forthcoming 12th Five-Year Plan (2012-2017), the funding requirement of the Indian power sector has been estimated at US$230 billion. To facilitate private investment in power generation, transmission and distribution projects, 100% foreign direct investment is permitted under the automatic route by the government.

Around 82GW of power capacities to be added over the next 5 years as compared to only 33GW added in the previous 5 years, translating to a supply increase of 9.1% CAGR between 2009-10 and 2014-15. Under a public-private partnership model, 16 ultra-mega power projects and 14inter-state transmission schemes have been identified for development by the private sector on the basis of competitive bidding. While the bidding for 4 ultra-mega power projects and six transmission project has been completed, more than five UMPPs are in the pipeline and offer unique opportunities for investment. Each UMPP is of 4,000MW capacities and requires estimated US$ 4.5 billion investment; all this offers gigantic demand for transmission lines. India's inter-regional power transmission capacity is likely to increase from ~20,750MW currently to ~37,700MW at the end of the Eleventh Plan (FY'12E-end). Power Grid Corporation of India (PGCIL) is likely to invest ~ ₹500 billion over FY'10-13E period to upgrade India's power transmission network.

Installed power capacity required ~ GW



National grid ~ inter regional transfer capacity



Outlook

This sizeable capacity addition is expected to translate to an investment potential of ₹9.3 trillion over the next 5 years, with generation (both utilities and captives) contributing a major chunk at ₹5.8 trillion (63%). The remaining ₹3.4 trillion would be invested in transmission and distribution (T&D). Though investments in T&D are lower than investments in generation, it is significantly higher than the previous outlays. This is primarily due to the government's focus on reducing T&D losses. Investments in T&D is expected to grow by 16% CAGR over the next 5 years vis-à-vis a compounded growth of 15% in generation during the same period, leading to considerable opportunities in the T&D equipment space over the next few years. The catalyst for the growth in the transmission sector will be the formation of the high capacity transmission corridors. This also requires the introduction of higher transmission voltages for bulk power transmission, with the aim of limiting transmission losses. The total demand for transmission towers in the Twelfth Plan stands at 1.9mn MT as per CEA projections.

Balance Sheet (Consolidated)

(₹billion)	FY10A	FY11A	FY12E	FY13E
Share Capital	265.0	307.0	307.0	307.0
Reserve and surplus	9,615.6	15,606.3	17,514.7	19,635.2
Net Worth	9,880.6	15,913.3	17,821.7	19,942.2
Loan Funds	6,043.2	4,531.0	5,250.0	6,870.0
Net Deferred Tax Liability	140.8	107.0	285.0	274.0
Capital Employed	**16,064.6**	**20,551.3**	**23,356.7**	**27,086.2**
Gross fixed assets	4,712.6	5,213.0	5,753.0	6,602.0
Less: accumulated depreciation	1,363.3	1,823.0	2,321.6	2,850.9
Capital Work in Progress	35.5	351.0	351.0	351.0
Net Fixed assets	3,384.8	3,741.0	3,782.4	4,102.1
Investment	1,265.1	3,956.0	3,956.0	3,956.0
Net Current Assets	11,414.7	12,854.0	15,618.0	19,028.3
Capital Deployed	**16,064.6**	**20,551.3**	**23,356.7**	**27,086.2**

Profit & Loss Account (Consolidated)

(₹billion)	FY10A	FY11A	FY12E	FY13E
Net Sales	**25,868.4**	**28,787.0**	**33,752.8**	**38,562.5**
Expenses	22,548.4	25,424.4	29,702.4	35,204.0
EBITDA	**3,320.0**	**3,362.6**	**4,050.3**	**4,493.5**
EBITDA Margin %	12.6	11.7	12.0	11.7
Depreciation	382.0	459.0	489.0	567.8
EBIT	**2,937.6**	**2,903.6**	**3,561.3**	**3,925.8**
Interest	1,015.0	802.0	902.0	976.0
Other income	594.0	464.0	470.0	470.0
Profit Before Tax	**2,276**	**2,565.6**	**3,129.3**	**3,419.8**
Tax	571.4	660	844.9	923.3
Profit after Tax	**1,697.4**	**1,905.6**	**2,284.4**	**2,496.4**
NPM %	6.6	6.6	6.8	6.5

Key Ratios

	FY10A	FY11A	FY12E	FY13E
EBITDA Margin (%)	12.6	11.7	12.0	11.7
EBIT Margin (%)	11.1	10.1	10.5	10.2
NPM (%)	6.6	6.6	6.8	6.5
ROCE (%)	21.8	16.5	17.4	16.4
ROE (%)	17.3	12.0	12.8	12.5
EPS (₹)	11.1	12.4	14.8	16.3
Cash EPS (₹)	13.6	15.4	18.1	20.0
P/E (x)	9.0	8.1	6.8	6.1
BVPS	64.4	103.7	116.1	129.9
P/BVPS (x)	1.6	1.0	0.9	0.8
EV/Sales(x)	0.8	0.6	0.4	0.4

Valuation

Though there has been a de-rating in valuation multiples for T&D equipment manufacturers, as well as EPC players, but the company is confident to showcase its dominant position on the back of strong order inflows excepted from state and private sector players.

However, we believe that worst is already factored in the stock price. Considering the strong order backlog, growth in T&D segment and performance of the subsidiaries, we continue to remain optimistic on the future prospects of KPTL. The CMP of ₹100, implies a P/E of ~ 6.8x FY'12 EPS of ₹14.8 and 6.1x on FY'13E EPS of ₹16.3 respectively. Amidst all the concerns, we believe execution to be robust in FY'12E & maintain our positive rating on the stock, with a target price of ₹140 based on a SOTP valuation.

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