May 06, 2024

KEC Spur Infrastructure Private Limited: Long term ratings downgraded to [ICRA]A+ (Stable) with change in outlook and short term ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long term/Short Term – Non-fund-based limits	467.00	467.00	[ICRA]A+ /[ICRA]A1+; Long term ratings downgraded from [ICRA]AA-; Outlook revised to Stable from Negative and short-term rating reaffirmed
Long term – Fund based working capital limits	38.00	38.00	[ICRA]A+; downgraded from [ICRA]AA-; Outlook revised to Stable from Negative
Long term/Short Term – Interchangeable Limits – CC Limits	(15.00)	(15.00)	[ICRA]A+ /[ICRA]A1+; Long term ratings downgraded from [ICRA]AA-; Outlook revised to Stable from Negative and short-term rating reaffirmed
Long term/Short Term – Unallocated Limits	95.00	95.00	[ICRA]A+ /[ICRA]A1+; Long term ratings downgraded from [ICRA]AA-; Outlook revised to Stable from Negative and short-term rating reaffirmed
Total	**600.00**	**600.00**	

**Instrument details are provided in Annexure-I*

Rationale

While assigning the rating, ICRA has taken a consolidated view of KEC International Limited (KEC) and its subsidiaries, including its 100% subsidiary KEC Spur Infrastructure Private Limited (rated [ICRA]A+(Stable)/A1+).

The downgrade of ratings factors in persistent weakness in the operating profit margin (OPM) vis-à-vis earlier levels of ~10-11% during FY2017-FY2020. OPM had declined to 5.3% and 6.8% (adjusted - bank charges excluded from expenses) in FY2023 and FY2022 respectively and is expected at ~6.8-7% during FY2024. While the OPM is expected to improve further to ~7.75-8.25% during FY2025, it would still be subdued compared to pre-Covid levels, which is likely to continue to keep the interest coverage ratio under pressure. Further, downgrade in the ratings also factors in elevated debt levels due to high working capital intensity (especially for slow moving railways, state transmission and metro projects), alongwith rise in benchmark interest rates globally as well as domestically, which in turn has led to sharp increase in finance costs over FY2023-FY2024. While the operating margin is expected to improve over the next few quarters with the improvement in the profitability in the SAE Brazil subsidiary along with completion of some of the old low margin orders , the debt coverage and profitability metrics may not reach higher pre-Covid levels.

The ratings continue to factor in KEC's strong market position as an engineering, procurement and construction (EPC) company in the power transmission and distribution (T&D) segment coupled with an improving order book from the non-T&D segments as well. The company's order book improved further from December 31, 2022 level and stood at Rs. 30,161 crore as on December 31, 2023 (~1.7 times TTM revenue), which provides strong medium-term revenue visibility. While the T&D segment dominates the company's order book mix (~49% as on December 31, 2023 vs ~46% as on Dec 31, 2023), the diversification has improved over the years with higher contribution from non T&D segments, such as civil (33%), railways (12%), cables (2%) and, oil and gas (2%).

However, the order intake momentum has slowed down in the civil and railways/metros segment, which has led to lower estimated order inflows in FY2024 at Rs. ~18,000 crore crore vis-à-vis Rs. 22,378 crore order inflows in FY2023, even as T&D order intake continued to be healthy. KEC's order intake continues to be driven by healthy capex among end users, especially the civil segment (including metros, airports, water, industrial and residential). ICRA also takes cognisance of KEC's diversified geographical presence across the globe, deriving ~38-50% of its total revenues from overseas projects in the last few years. Moreover, KEC's domestic demand prospects remain healthy because of the Government's focus on increasing infrastructure spending and the expected uptick in private capex cycle.

The ratings, however, continue to be constrained by the high working capital intensity of the EPC business due to the long execution period of projects, milestone-based payments in the non-T&D businesses (especially railways and metros projects) and the retention money requirement that is released post the defect liability period. This, coupled with some slow-moving receivables have elongated the overall working capital cycle. This, in turn, results in dependence on short-term borrowing and extended credit period to the suppliers and sub-contractors, reflected in the relatively high ratio of total outside liabilities (TOL) to tangible net worth (TNW) estimated at ~3.6-3.8 times as on March 31, 2024 (PY: 3.9 times).

The ratings also remain constrained by the exposure of KEC's operating profit margins to the volatility in key raw material prices, for domestic as well as international contracts that are fixed price in nature. ~40-50% of the order book is effectively fixed price in nature. Headwinds in commodity prices, particularly steel, along with the weak performance of SAE Towers (SAE), lowered the operating margins to 6.8% in FY2022 and further to 5.3% in FY2023 (9.4% in FY2021). With receding of commodity headwinds and reducing share of legacy loss making/lower margin projects being executed (all Brazil EPC projects were completed by FY2023, apart from other projects), OPM improved to ~6.8% in 9MFY2024. The protracted trajectory of improvement is expected to continue till H1FY2025, by when the OPM is expected to normalize to ~7.5-8%.

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 the adverse movement in steel prices in case of the fixed-priced contracts. The company now follows a policy of fully hedging aluminum exposure. Further, KEC's operations remain exposed to project execution risks arising from right of way challenges, geopolitical 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 multilateral 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 and 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 – In the last seven decades, KEC has diversified its business profile across segments and geographies. At present, the company executes EPC projects and provides supplies in various infrastructure-related verticals – power transmission and distribution (T&D), railways, civil, cables, solar, smart infra and oil and gas. It is one of the largest power transmission EPC companies in the world with presence in over 110 countries (includes EPC, supply of towers and cables). Further, it has acquired KEC Spur Infrastructure Private Limited (rated [ICRA]ICRA A+(Sable)/ A1+) in FY2022 to foray into the domestic oil and gas pipeline segment. The company has also established itself as a leader in the domestic power transmission segment and is strengthening its presence in non-T&D segment.

Robust order book position provides healthy revenue visibility; improving diversification in non-T&D segments – KEC's order book stood at Rs. 30,161 crore as on December 31, 2023 on a consolidated basis, i.e. ~1.7 times of the TTM revenues, thus providing strong medium-term revenue visibility. The T&D segment constituted ~49% of the order book as on December 31, 2023 (46% as on December 31, 2022 and 58% as on Mar 31, 2021), while the balance pertained to the non-T&D segment, thus suggesting an improved segment diversification. The company witnessed its highest order intake in FY2023 of Rs. 22,378 crore (30% YoY growth) with the non-T&D segment contributing ~53% of the order intake. However, the order intake momentum slowed down in the civil and railways/metros segment, which has led to lower estimated order inflows in FY2024 at Rs. ~18,000 crore, even as T&D order intake continued to be healthy.

Currently, the company is witnessing healthy demand from various end-user sectors, especially in civil segments such as metros, water, solar, data centres and residential, given the healthy private and government capex. However, the completion of projects within the agreed timelines, while maintaining the desired performance parameters, is critical to minimise the liabilities arising from project delays and performance issues.

Diversified geographical presence across the globe – KEC has a wide geographical presence, deriving a substantial portion of its revenues (~38-50%) from overseas projects in the last few years. The company has an established presence in Middle East, Africa, Brazil, SAARC and South-East Asia areas. Further, international projects comprised ~31% of the unexecuted order book position as on December 31, 2023. Going forward, the management expects a healthy order intake from Middle Eastern countries and Americas in the T&D segment and it plans to foray into international oil and gas over the medium term.

Access to global markets and enhanced transmission tower manufacturing capacity from past acquisitions – The company has access to the global markets as a result of the acquisitions undertaken in the past. The acquisition of the US-based SAE Towers Holdings LLC (SAE) provided KEC access to the American markets for the design, manufacture and supply of transmission towers. The acquisition also increased KEC's manufacturing capacity for transmission towers with the 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 MTPA capacity being expanded to 60,000 MTPA) in February 2020 that caters to the orders from the MENA region and has scaled up sizeably since March 2021.

Credit challenges

High working capital intensity in EPC business and operating losses in certain large projects has led to elevated debt levels – The working capital intensity remains inherently high in the EPC business due to the long execution period of projects, back-ended milestone-based payments in the non-T&D businesses (especially railways and metros) 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 277 days in FY2023 (PY: 296 days), and around ~268 days as on Dec-2023 on TTM revenue. The debtor days are on the higher side since the receivables include retention money of projects and contract assets.

The working capital position is, however, supported to some extent by creditor days of ~170-185 days and customer advances. A high working capital intensity is further evident from the net working capital/operating income of 41% (acceptances considered as part of debt and not creditors) in FY2023 (PY: 50%) as well as TOL/TNW of 3.7 times estimated as on March 31, 2024. The working capital intensity is estimated to have reduced in FY2024 with sizeable collections during Q4FY2024, and expected to improve further gradually, with normalization of certain large debtors in the railways and T&D segments. KEC has also realized collections of around Rs. ~400 crore from Afghanistan projects till date.

Increased working capital requirements in addition to the losses certain legacy projects in the standalone order book in FY2023 as well as 9MFY2024 have resulted in higher debt levels, with total net debt (including acceptances) of Rs. 6,045 crore as on December 31, 2023 (Rs. 5215 crore as on Mar 31, 2023 and Rs. 3391 crore as on Mar 31, 2021). The higher debt and finance cost levels led to very weak debt metrics with interest coverage for 9MFY2024 at 1.54 times (1.40 times in FY2023 and 3.4 times in FY2021) and total net debt (including acceptances) to TNW at 1.6 times as on Dec 31, 2023 (1.4 times as on Mar 31, 2023 and 1.0 times as on Mar 31, 2021). However, with the expected improvement in operating profits and the reduction in debt levels, the debt metrics are likely to improve over the medium term.

Intense competition in domestic and international markets for T&D business; increasing competition in other segments – KEC derives a significant proportion of its revenues (~51% in 9MFY2024 as well as FY2023) from the transmission and distribution segment, which remains highly competitive in the domestic and international markets. Further, competitive intensity in railways and various civil sub-segments has increased with entry of small/mid-sized players.

Operating margins vulnerable to volatile raw material prices, particularly for fixed-price international EPC contracts – The cost of key raw materials for tower manufacturing (steel and zinc) and several other bought-out components required to install transmission line projects make up for KEC's raw material cost. Given the long order execution period of about ~15-24 months, the operating margin remains vulnerable to the volatility in the prices of key raw materials, particularly for international contracts that are generally fixed-price in nature. Further, some of the recent orders from PGCIL (awarded to it via TBCB route) are fixed price in nature as compared to earlier PGCIL orders (awarded to it on nomination/cost plus basis) which had price variation clauses, which may also leads to pressure on profitability in the event of adverse movement in raw material prices. However, the company hedges the base metals (excluding steel) as a part of its board approved policy.

Continued losses in SAE and headwinds in the commodity prices as well as logistics cost (especially for exports) coupled with time and cost over-runs during Covid-19, resulted in a decline in KEC's consolidated OPM in FY2023 to 5.3%, after declining to 6.8% in FY2022 from 9.4% in FY2021. The OPM improved gradually to 6.8% in 9MFY2024, with receding contribution from large loss-making projects which were getting completed.

Operations exposed to currency fluctuations, counterparty credit risks and geopolitical issues – Overseas projects continue to contribute significantly to KEC's overall revenues. Therefore, its operations are exposed to currency fluctuations, and counterparty credit and geo-political risks. However, the risk of currency fluctuations is mitigated to some extent by the natural hedge (expenses incurred in foreign currency), forward contracts and utilisation of foreign currency-denominated borrowings. The counterparty credit risk is also partially mitigated for international projects as most of them are funded by multilateral funding agencies.

Challenges to project execution from right-of-way – 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 a credit perspective. Given that a few of its orders are in technologically-enabled areas such as urban infrastructure (metro electrification), flue gas desulphurisation, , hydrocarbons etc., where the company has recently forayed, the project execution risk is slightly higher. Nevertheless, this gets mitigated to an extent on account of project-specific technical collaborations/joint ventures entered.

ESG related comments

Environmental considerations: The company is exposed to the risks arising from tightening regulations on environment, specifically pertaining to discharge/treatment of effluents, and on the safety front. These have necessitated KEC to increase its investments towards meeting the evolving and tighter regulatory standards. As per the disclosures made by KEC, the company undertakes continuous assessment of the potentiality of environmental risk, including internal and external audits. Further, it has undertaken several initiatives towards clean technology, including use of induction heating to eliminate fossil fuel furnace, use of micro processor dual burners for using of LPG/LNG and use of renewable source of energy (solar/wind energy). Further, the emissions/waste generated by KEC are within the permissible limits of the Central Pollution Control Board (CPCB)/State Pollution Control Board (SPCB). Also, there were no pending show cause/ legal notices from CPCB/SPCB at the end of FY2023. This indicates that KEC has been able to mitigate the regulatory risks by demonstrating a sound operational track record and ensuring regulatory compliance.

Social considerations: KEC's success depends critically on its competent workforce with talent as the primary source of competitive edge. Failure to hire, motivate and retain talent pool with necessary competencies may impact the organisation's ability maintain and expand its business operations, and consequently its profitability. As per the disclosures, the company continues to focus on capability building by creating a talent pool, through dedicated talent pipelines and competency upgradation through behavioural, technical, functional, and digital learning and development initiatives. Additionally, customer satisfaction remains critical for KEC's successful operations and for ensuring the same it conducts surveys on a regular basis and has achieved a customer satisfaction rating of 90.7% in FY2023 (88.5% in FY2022 and 83.5% in FY2021). Further, slowdown in infrastructure investments can lead to lower order intake and thus lower sales, however, with KEC being highly diversified with respect to end-users as well as geography, this risk is mitigated to an extent. Therefore, while KEC remains exposed to the aforementioned social risk, it does not materially affect its credit profile as of now.

Liquidity position: Adequate

The company's liquidity profile is adequate with the presence of free cash balance of over Rs. ~200 crore as on December 31, 2023 and average cushion in drawing power (restricted to sanctioned fund based-limits including interchangeable limits) of Rs. ~780 crore in 11MFY2024. Further, retained operating cash flows are likely to improve to healthier levels in FY2025 with the improvement in operating margins with execution of projects with better profitability and expectations of gradual improvement in working capital cycle. ICRA expects KEC to comfortably meet its debt repayment obligations estimated at Rs. ~200-300 crore in FY2025. ICRA also notes that KEC is expected to incur a maintenance capex of Rs. ~150-200 crore per annum in the medium term.

Rating sensitivities

Positive factors – ICRA could upgrade the ratings if the company is able to demonstrate an improvement in operating profitability in a sustained manner. Further, moderation in the working capital intensity on a sustained basis can also result in upward rating movement.

Negative factors –The ratings may be downgraded if KEC is not able to maintain its operating profitability above 7% on a sustained basis. Ratings can also be revised in case of further elongation in the working capital cycle, exerting pressure on the interest coverage ratio.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology - Construction
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 Spur Infrastructure Private Limited (KSIPL), a wholly owned subsidiary of KEC International Limited (KEC), is an Indian EPC company engaged in the setting up of cross-country oil & gas pipelines and city gas distribution networks. The company was incorporated in March 2016 as Spur Infrastructure Private Limited and was acquired by KEC in October 2021 post which the name of the company was changed to KEC Spur Infrastructure Private Limited in February 2022. KSIPL is executing projects for customers such as Indian Oil Corporation Limited (IOCL), Gas Authority of India Limited (GAIL), IHB Ltd., Indraprastha Gas Limited (IGL) and Bharat Gas Resource Limited (BGRL). Further, KSIPL's acquisition will provide KEC access to the parent's technical knowhow and relevant pre-qualifications which will enable it to capture growth opportunities in the oil and gas cross country pipeline EPC sector.

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 and 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 3,62,200 metric tonnes per annum (MTPA). KEC also has cable manufacturing (power and telecom) facilities in

Mysore and near Vadodara with a combined capacity of 48,000 MTPA in addition to 12,000 MTPA of solar manufacturing capacity.

Key financial indicators (audited)

KEC Consolidated	FY2022	FY2023	9M FY2024*
Operating income	13,742.4	17,281.7	13,749.3
PAT	332.1	176.0	195.0
OPBDIT/OI (adjusted)	6.8%	5.3%	6.76%
PAT/OI	2.4%	1.0%	1.4%
Total outside liabilities/Tangible net worth (times)	3.5	3.9	NA
Total debt/OPBDIT (times)	5.5	5.9	~5.1**
Interest coverage (times)	2.3	1.4	1.5

*Source: Company, ICRA Research; * Provisional numbers; All ratios as per ICRA's calculations; Amount in Rs. Crore; PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; ** annualised OPBIDT*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current rating (FY2025)				Chronology of rating history for the past 3 years					
		Type	Amount rated (Rs. crore)	Amount outstanding as of Dec 31, 2023 (Rs. crore)	Date & rating in FY2025	Date & rating in FY2024	Date & rating in FY2023				Date & rating in FY2022
					May 06, 2024	-	Mar 31, 2023	Feb 22, 2023	Sep 06, 2022	Apr 27, 2022	-
1	**Non-fund-based limits**	Long term/Short Term	467.00	--	**[ICRA]A+ (Stable)/ [ICRA]A1+**	-	**[ICRA]AA- (Negative)/ [ICRA]A1+**	**[ICRA]AA- (Negative)/ [ICRA]A1+**	**[ICRA]AA- (Stable)/ [ICRA]A1+**	-	-
2	**Fund based working capital limits**	Long term	38.00	--	**[ICRA]A+ (Stable)**	-	**[ICRA]AA- (Negative)**	**[ICRA]AA- (Negative)**	**[ICRA]AA- (Stable)**	-	-
3	**Interchangeable Limits – CC Limits**	Long term/Short Term	(15.00)	--	**[ICRA]A+ (Stable)/ [ICRA]A1+**	-	**[ICRA]AA- (Negative)/ [ICRA]A1+**	-	-	-	-
4	**Unallocated Limits**	Long term/Short Term	95.00	--	**[ICRA]A+ (Stable)/ [ICRA]A1+**	-	**[ICRA]AA- (Negative)/ [ICRA]A1+**	**[ICRA]AA- (Negative)/ [ICRA]A1+**	**[ICRA]AA- (Stable)/ [ICRA]A1+**	**Provisional [ICRA]AA-(CE) (Stable)/ Provisional [ICRA]A1+ (CE)**	-

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long term/Short Term – Non-fund-based limits	Very Simple
Long term – Fund based working capital limits	Simple
Long term/Short Term – Interchangeable Limits – CC Limits	Very Simple
Long term/Short Term – Unallocated Limits	Not Applicable

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 are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Long term/Short Term – Non-fund-based limits	NA	NA	NA	467.00	[ICRA]A+ (Stable)/ [ICRA]A1+
NA	Long term – Fund based working capital limits	NA	NA	NA	38.00	[ICRA]A+ (Stable)
NA	Long term/Short Term – Interchangeable Limits – CC Limits	NA	NA	NA	(15.00)	[ICRA]A+ (Stable)/ [ICRA]A1+
NA	Long term/Short Term – Unallocated Limits	NA	NA	NA	95.00	[ICRA]A+ (Stable)/ [ICRA]A1+

Source: Company

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis

Company Name	LTHL Ownership	Consolidation Approach
RPG Transmission Nigeria Limited	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
Al-Sharif Group and KEC Ltd. Co, Saudi Arabia	51.1%	Equity
KEC Towers LLC, Dubai, UAE	100.00%	Full Consolidation
KEC EPC LLC, Dubai, UAE	100.00%	Full Consolidation
KEC Spur Infrastructure Private Limited (formerly known as Spur Infrastructure Private Limited)	100.00%	Full Consolidation

Source: Company

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About ICRA Limited:

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