

Focus on profitability

Kalpataru Power Transmission, which contributes the bulk of the group's turnover, is expected to reward investors handsomely



Munot (Mofatraj) and Ajay: taking advantage of the upturn in the economy

Kalpataru Power Transmission (KPT), launched in 1981, has overtaken Kalpataru Construction, the group's flagship, by a huge margin, with KPT's Rs567 crore turnover for 2004-05 being double the flagship's. It accounted for nearly 50 per cent of the group turnover last year; and, after registering a top line growth of over 55 per cent in the three of the last four years, it has emerged as the star performer of the group. KPT's profit before tax was Rs43.4 crore in 2004-05, against Rs18.3 crore reported in 2003-04.

KPT is now the group's launch pad for its various diversification moves in India's booming infrastructure sector. "Seen in a wider context, its success is

yet another example of how Indian engineering companies have been making their mark in the global markets during the last few years," says Rajeev Mehrotra, executive vice-president, Edelweiss Capital. KPT was set up by a technocrat entrepreneur Dhirubhai Patel, with the backing of Mofatraj Munot. But, as is often the case, Munot had few options but to buy out Patel's stake after the latter's death in 1986.

"We realised that, to attract professional talent and to grow to a respectable size in transmission tower manufacturing and erection business, it was essential to corporatise the company," says Munot. "So, we made our initial public offer in December 1994," he explains. With this, the promoter

holding in the company came down to 78 per cent. Reflecting rapid improvements in its bottomline during the last few years, the company's Rs10 share is quoting at Rs615 (as on 28 October), against an annual high of Rs700 and a low of Rs132.

After the nuclear test in 1998, international funding agencies stopped financing India's cash-starved state electricity boards' power generation and T&D projects. This hit hard the companies that were dependent for growth on this sector and landed many of them in financial troubles. But, with a carefully crafted approach, KPT survived. To overcome the collapse of demand caused by this in the domestic market, it focused on what it calls the physical exports of transmission towers (as opposed to complete turnkey tower erection and supply) and other related equipment to the overseas contractors.

In the four years that followed, it notched up \$100 million of sales from just the exports of its towers to various countries in the Middle East and Africa. Of course, the infrastructure boom, especially in the power sector after the Power Grid Corporation of India stepped up its investments in the inter-regional transmission lines in the last few years, has provided a long-awaited fillip to the sector. KPT, like its major competitors KEC of the APG group and L&T, has been one of the major beneficiaries of this change in the investment climate. As a result, KPT's sales and net profits have grown briskly at a CAGR of over 50 per cent in the past few years. "While the company may have taken the full advantage of the upturn in the economy in recent years, there is no guarantee that it will last," says a critic.

However, all indications are that at least the company's power transmission division, which constitutes the bulk of its turnover, is well set on a high growth trajectory for the next few years. "It has sound business model and, in terms of its cost structure, it looks better than its peers," Mehrotra says. "Besides, the

management's hunger for growth is unsatiated and the company is systematically adding businesses that have direct synergy with its main business," he adds. Indeed, there can be few doubts that KPT has consistently reported far better profit margins (see graph) in the last few years, in comparison with its peers. It couldn't have achieved this without the cost advantage over the rest of the industry.

Ajay Munot, executive director, KPT, and Mofatraj's nephew, says, "The design to weight specification of our transmission towers is far more advantageous than the rest of the industry. This allows us to be competitive, while earning better margins." However, K.V. Mani, managing director of KPT, qualifies, "It is primarily in the international jobs, where we have the full freedom to offer designs, that we are able to bring to bear our R&D skills to our full advantage."

In contrast, the clients give tower designs in India and, hence, the margins are determined by project execution skills. There is yet another reason for KPT to be more cost effective, says an equity analyst: "For example, unlike KEC, which is now globally the largest player in this business, KPT's fabrication facilities are located at a single site in Gandhinagar, the capital of Gujarat. This gives it the advantage of large scale production." But how does this help? Does it not lose out on transportation costs?

According to Ajay Munot, the key element in this business in which the lowest bid wins is the cost control. "Tenders are won and lost on wafer

thin margins," he adds. "In this situation, cost leadership is the only way to survive. And, for this, effective co-ordination between various activities is the key." He feels that, "Having manufacturing under one roof allows better co-ordination between it and the activities at the project sites." Mehrotra concurs: "KPT has built up its cost leadership by combining the economies of scale in production with the effective co-ordination of activities at project levels."

This is reflected in its various parameters, such as the strong receivables management and low financing costs. An ability to execute projects well in time is another reason KPT has been able to maintain its cost leadership in the industry. "Time overruns require approvals which add further to the delays and often result in penalty payments and liquidated damages," says an equity analyst. KPT's record in this respect has been without blemish. "In fact, it has often completed its contracts well ahead of schedule," the analyst adds. "We completed several of the 400 kV double circuit Rihand-Patiala line 2-6 months ahead of their schedule," avers a KPT official, stressing the point.

Cost structure

"If one looks at the overall cost structure, it will be obvious why transmission tower costs are so important," says Ajay Munot. "One-third of the total cost in any transmission line project is the tower cost, another third is the bought-out items, whereas the remaining third is the construction cost," he

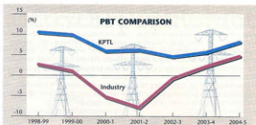
explains. "While the second of this is almost uniform across the players, it is the latter two and, more particularly, the transmission tower cost that varies significantly between the players." And that's where KPT is ahead of others. "In fact, not just KPT, but Indian companies in this business in general, have now emerged as the global leaders, pricing out even players as large as ABB, Areva and Alstom," says an analyst.

KEC is now globally the number one and Kalpataru, is number three, with Hyundai of South Korea at the second position. While North America and Europe are stagnant, with almost no new transmission lines being added, most of the new business is now in the Middle East, Africa, South East Asia, China and India. Except Mexico and Brazil, where ABB is still strong, Indian companies have outshone these global giants in other markets. According to Ajay Munot, "Out of every five bids overseas, at least two are from Indians." There is, of course, the looming threat of Chinese undercutting, but this has remained confined mainly to the countries under government-to-government protocol and to markets such as Vietnam and Cambodia that are logistically closer to it.

As far as KPT is concerned, this advantage is strongly reflected in its overseas order book. It recently received two turnkey projects (one worth Rs127 crore in Algeria for erection of the 400 kV Berrouaghi-El Khemis and 220 kV A Bir Ghebalou transmission lines and, the other, a letter of intent for Rs153 crore, 132 kV,



*Per equity share, excluding revaluation reserve



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transmission line project in Ethiopia). This has raised its order book of international projects to over Rs500 crore. Its overall order position stands at over Rs2,000 crore for its transmission division (with an execution period of 6-24 months).

With the addition of a 24,000 tonne, export-oriented unit to its fabrication capacity at Gandhinagar, its total capacity has increased to 78,000 tonnes. This has made it the largest plant of its kind in the world. Besides, the company has a testing station and an R&D centre at this site, which, it claims, is the largest in the world. Clearly, the company is increasingly positioning itself to acquire a large chunk of the global pie but, if you ask Ajay Munot, he insists, "We are not in the market share game. The focus is on remaining the most profitable player in the industry."

To reduce its over-dependence on the transmission business and sensing fresh opportunities in India's infrastructure, which it felt were synergistic with its existing business, KPT began diversifying into oil pipelines, road and

electricity distribution segments (33 kV and 11 kV lines) three years back. Recently, despite competition from the well entrenched players, the company, with a Russian partner, has won an Rs83 crore contract for laying the feeder pipeline between Laban (near Kota) and Bijwasan (near Delhi) for Bhaat Petroleum. Of the 10 pipeline projects going this season, this is one of the largest and it marks KPT's entry into a market, where the main players have been Punj Lloyd and Dodsai.

To get into roads and other infrastructure projects, KPT acquired 48 per cent in the Ahmedabad-based Rs235 crore JMC (a leading civil contractor in roads, bridges, subways and metro stations, besides industrial structures, software parks, residential and commercial buildings) in February of this year. JMC's current order book of Rs450 crore includes 125 km, Madurai-Trichy, four lane road project, in 50:50 partnership with a consortium, under NEHAL. KPT's aim is to leverage its strong financial and commercial clout to push aggressively for JMC's growth in the immediate future.

Under Rajiv Gandhi Gramin Vidyutikaran Yojna, the Indian government has set aside Rs5,000 crore as subsidy (90 per cent of the costs) in its first phase of the 10th Plan to electrify villages. Under this, Rural Electrification Corporation is to provide 33 kV lines and substations, as well as 11 kV lines and distribution transformers to the villages, to distribute electricity to the rural households. Earlier, the jobs were given out to small-time contractors, who did the work in a slipshod manner. To avoid this, the government is now inviting larger players, by floating tenders in the range of Rs70-80 crore.

While power generation may not be a large business, the company invested Rs30 crore in biomass-based power generation plant of 7.8 MW, in Padampur, Rajasthan, in September 2003. After modifying the boiler of this plant to suit the specific fuel, its plant load factor has gone up to 90 per cent in the current year. It's the second plant in India to have received UNFCCC registration for 300,000 CDM's (certificates for emission reduction) till 2012 carbon credits. While the company is unwilling to reveal the rate at which it sold these credits to the Dutch government in 2004, the rate ruling then was between €7-9 on international commodity exchanges.

KPT is commissioning a plant of 7 MW at Uniar, Tonk district in Rajasthan, at an investment of Rs30 crore. In 2005, the CDMs have been trading at around €17 and the company will be entitled to fresh carbon credits once this project goes on stream. While KPT's power plants, which are meant to supply power to the state electricity grids, may not contribute as significantly to the company's top line as its other businesses, "They will be significant money spinners, generating noticeable cash flows," says an analyst.

So, what does the future hold? Unlike KEC, which went to Iraq and Afghanistan just two years back, KPT is comparatively less adventurous and yet more profitable. With the opportunities in India's infrastructure accelerating and its strong focus on the profitability, one can expect it to reward investors handsomely in the near future.