

BUY

TP: Rs 365 | ▲ 28%

KNR CONSTRUCTIONS

Infrastructure

10 June 2019

Management meet update – On track for a sustainable growth

KNR Constructions (KNRC) Q4FY19 executable order backlog expanded 2.6x QoQ to Rs 40.2bn (1.9x FY19 revenue) led by the award of appointed dates (AD). FY19 order backlog including L1 projects remains robust at Rs 59bn (2.8x FY19 revenue) and additionally the company expects inflows of ~Rs 25bn in FY20. We expect revenue CAGR of 23% over FY19-FY21 led by likely award of AD in two HAM projects in Q2FY20 and likely order inflows of ~Rs 16bn worth of irrigation projects by Sep'19 (in final discussion). We raise our earnings estimates and revise our Mar'20 TP to Rs 365 (vs. Rs 330).

Irrigation segment orders to drive revenue/margin growth: The company is in advanced discussion with Mega Engineering and Navayuga Engineering to bag sub-contracting work for irrigation projects in the state of Telangana worth ~Rs 16bn (Rs 8bn each). These are high margin projects (23%-24%) which are executable over 18 months. The contracts are likely to get confirmed by Sep'19 and the company expects revenue contribution of ~Rs 4bn in FY20. Overall, the company targets revenue of ~Rs 25bn in FY20. Led by contribution from fast pace high-margin irrigation projects, revenue momentum is likely to pick up pace from H2FY20 and we expect revenue CAGR of 23.1% over FY19-FY21.

More divestment on the cards: KNRC is planning to divest its stake in Walayar BOT (Toll) project (100% stake) at par or below its book value (equity invested - Rs 4bn) by end of this financial year. Proceeds from this project will aid the company to bid for more projects and support order inflow accretion. However, the stake sale of Muzaffarpur BOT (Toll) project (51% stake) is unlikely due to NHAI's interest in lane expansion on the project stretch.

Maintain BUY: We raise FY20E/FY21E EPS estimates by 4.7%/14.4% to bake in improvement in revenues and margins on the back of contribution from fast pace high-margin irrigation projects, leading to a revised Mar'20 TP to Rs 365.

KEY FINANCIALS (STANDALONE)

Y/E 31 Mar	FY17A	FY18A	FY19A	FY20E	FY21E
Adj. net profit (Rs mn)	1,681	2,721	2,468	2,122	2,772
Adj. EPS (Rs)	12.0	19.3	17.6	15.1	19.7
Adj. EPS growth (%)	50.7	61.8	(9.3)	(14.0)	30.6
Adj. ROAE (%)	20.6	26.5	19.2	14.0	15.8
Adj. P/E (x)	23.9	14.8	16.3	18.9	14.5
EV/EBITDA (x)	17.9	10.7	9.8	10.4	7.4

Source: Company, BOBCAPS Research

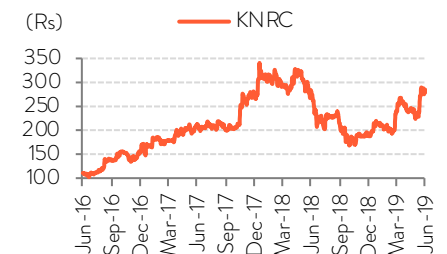
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Ticker/Price	KNRC IN/Rs 286
Market cap	US\$ 577.9mn
Shares o/s	141mn
3M ADV	US\$ 0.5mn
52wk high/low	Rs 303/Rs 165
Promoter/FPI/DII	55%/3%/30%

Source: NSE

STOCK PERFORMANCE



Source: NSE



Other key takeaways

- Order inflows for FY20:** The order inflow guidance for FY20 stands at ~Rs 25bn of which ~Rs 16bn is likely to get awarded from irrigation segment and balance is expected to get awarded from roads segment (mix of EPC and HAM). The capex for the new irrigation projects is expected at ~Rs 800mn.
- Irrigation projects from Telangana:** Order inflows of ~Rs 16bn from sub-contracting of two irrigation projects expected to get confirmed in Q2FY20, most likely in Sep'19 (execution is expected to commence post monsoon). These projects are likely to get awarded from Mega Engineering and Navayuga Engineering (~Rs 8bn each) within the state of Telangana. These are part of the Mallanna Sagar and Palamuru lift irrigation projects.
- Updates on the meeting with NHAI:** The management updated that the NHAI is planning to award projects on BOT (Toll) basis. The company had its reservation for not bidding for these projects mainly due to challenges faced during FC; bankers are still reluctant to fund such type of projects. Further, NHAI is considering to relax norms related to defect liability period for EPC contracts from current 10 years to 2-4 years. If implemented, it would free up the developer's non-fund-based limit and bring down the finance cost. With this measure the non-fund-based limit can be efficiently utilised as against getting it blocked for 10 years. KNRC's fund-based limit stands at Rs 1.4bn (~Rs 400mn utilised) and non-fund-based limit stands at Rs 13.5bn (70% utilised).
- Increase in interest rate:** The cost of funding for the NHAI HAM projects has gone up 35bps to 9.8%. This was largely due to increase in bank rate over the last six months.
- Stake sale in HAM projects:** The company is in discussions to sell its stake in the Ramsanpalle-Mangloor NHAI HAM project to Cube Highways. Due diligence is underway and the deal is likely to conclude soon. Further, Cube highways has also shown interest to buy stake in the NHAI HAM project of Oddanchatram-Madathukulam, which was awarded to the company in Q4FY19. The company had earlier signed share purchase agreement (SPA) with Cube Highways for its stake sale in three NHAI HAM projects, details as under.

FIG 1 – DETAILS OF SPA WITH CUBE FOR THREE NHAI HAM PROJECTS

Project (Rs mn)	Total equity requirement	Equity investment (KNRC's share at 51%)	Equity investment (Cube's share at 49%)	Consideration for KNRC's 51% stake	P/Bv (x)
Trichiraopalli - Kallagam	962	491	472	736	1.5
Meensurutti - Chidambaram	455	232	223	365	1.6
Chittor - Mallavaram	1,433	731	702	1,521	2.1

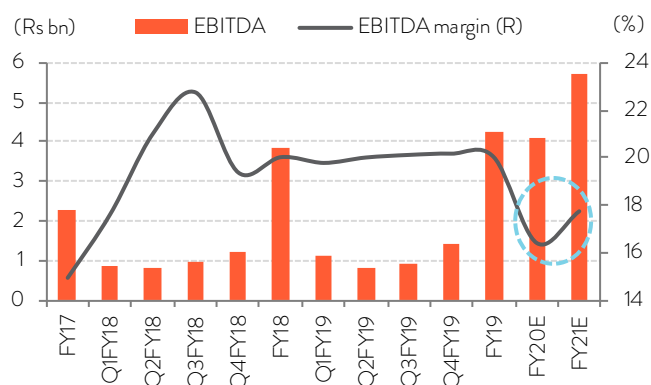
Source: Company, BOBCAPS Research

FIG 2 – ORDER BACKLOG AT RS 59BN INCL. L1 OF RS 18.9BN; EXECUTABLE SHARE AT ~68%

Particulars (Rs mn)	FY17	Q1FY18	Q2FY18	Q3FY18	Q4FY18	FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	FY19
Order inflows	17,581	-	-	5,607	39,830	45,437	-	-	-	-	10,198
Order backlog	37,689	33,388	35,872	33,326	23,266	23,266	19,800	18,315	15,408	40,156	40,156
Book-to-bill (x)	-	1.9	2.1	1.9	1.2	1.2	1.0	0.9	0.8	1.9	1.9
Order backlog break-up											
Roads	32,118	28,380	27,283	24,328	16,519	16,519	15,446	13,685	12,194	38,421	38,421
Irrigation	5,571	5,008	8,562	8,998	6,747	6,747	4,337	4,613	3,199	1,721	1,721
Others	-	-	27	-	-	-	17	17	15	14	14
Total order backlog	37,689	33,388	35,872	33,326	23,266	23,266	19,800	18,315	15,408	40,156	40,156
% share											
Roads	85.2	85.0	76.1	73.0	71.0	71.0	78.0	74.7	79.1	95.7	95.7
Irrigation	14.8	15.0	23.9	27.0	29.0	29.0	21.9	25.2	20.8	4.3	4.3
Others	-	-	0.1	-	-	-	0.1	0.1	0.1	0.0	0.0
Total order backlog	100	100	100	100	100	100	100	100	100	100	100

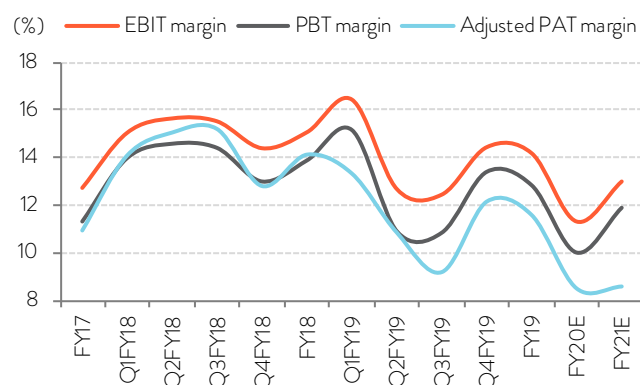
Source: Company, BOBCAPS Research

FIG 3 – MARGINS LIKELY TO IMPROVE LED BY CONTRIBUTION FROM IRRIGATION PROJECTS



Source: Company, BOBCAPS Research

FIG 4 – TREND IN EBIT / PBT / ADJUSTED PAT MARGINS



Source: Company, BOBCAPS Research

FIG 5 – HAM PROJECTS; BALANCE EQUITY COMMITMENT OF RS 4.2BN TO BE INVESTED OVER 2.5 YEARS

(Rs bn)	Authority	State	Length (km)	BPC	TPC	Equity	Grant**	Debt	Equity invested up to Mar-19	Balance equity requirement	Appointed Date / Status
Trichiraopalli – Kallagam*	NHAI	Tamil Nadu	38.7	10.2	9.1	1.0	4.3	3.8	0.1	0.9	>80% - 3H complete; Memorandum of agreement signed with a local project director of NHAI and it has been sent to the NHAI for final clearance; AD likely by end of Jun'19 / early Jul'19. FC: 5-Sep-19; FC done with Axis Bank.
Meensurutti – Chidambaram*	NHAI	Tamil Nadu	31.5	4.8	4.3	0.5	2.0	1.8	0.1	0.4	>80% - 3H complete; however, land owners are asking for higher compensation, resulting in delay; negotiation is going on and is likely to get concluded soon; AD likely to get delayed; expected by Jul'19. FC: 7-Sep-19; FC done with HDFC Bank.
Ramsanpalle - Mangloor	NHAI	Telangana	46.8	12.3	10.5	1.0	5.2	4.2	0.1	0.9	AD: 02-May-19; FC done with Axis Bank.
Chittor – Mallavaram*	NHAI	Andhra Pradesh	61.1	17.3	14.6	1.4	7.4	5.7	0.7	0.7	AD: 04-Jan-19; FC done with HDFC Bank.
Magadi - Somwarpath	KSHIP	Karnataka	166.0	11.4	10.2	0.5	7.5	2.1	-	0.5	Concession agreement signed on 18-Jan-19; FC likely by end of Jun'19; land acquisition will take 3-4 months to complete (~40% in possession); 75% funded by ADB and 25% contribution by the company. Likely FC with L&T Finance and Tata Cleantech
Oddanchatram - Madathukulam (Pkg -2)	NHAI	Tamil Nadu	45.4	9.2	8.8	0.8	3.7	4.3	-	0.8	LOA received on 7-Mar-19
Total				65.3	57.4	5.2	30.2	22.0	1.1	4.2	

Source: Company, BOBCAPS Research | Note: BPC – Bid Project Cost; FC – Financial Closure; TPC – Total Project Cost | * Share purchase agreement signed with Cube Highways and Infrastructure III Pte. Ltd. | ** Grant includes estimated Price Index Multiple of Rs 1.1bn

Valuation methodology

Improved contract wins and a stronger order backlog substantially raise KNRC's EPC revenue visibility over the next two years. Moreover, the company's positive operating cash flows, lean working capital and low net D/E (0.2x as on Mar'19) will help it fund new HAM projects. Equity requirements for existing HAM projects are unlikely to be a concern due to its recent deal with Cube (49% stake to be monetised during the construction period). We have not considered this transaction in our valuation as Cube will begin investing only once 90% of right of way (ROW) is available. We expect revenue CAGR of 23.1% over FY19-FY21 led by likely award of AD in two HAM projects in Q2FY20 and likely order inflows of ~Rs 16bn worth of irrigation projects by Sep'19 (in final discussion). Additionally, led by contribution from high margin irrigation projects, we expect EBITDA margins to remain high at 16.4%/17.7% for FY20/FY21 as against management guidance of 15.5%-16%.

The stock is trading at 14.3x/11x FY20E/FY21E standalone earnings after adjusting Rs 70/sh for the value of its assets. These valuations are fairly attractive considering KNRC's impressive execution track record, strong balance sheet, superior margins and favorable return ratios. We raise FY20/FY21 EPS estimates by 4.7%/14.4% led by improvement in revenues and margins on the back of contribution from fast pace high-margin irrigation projects. Maintain BUY with a revised Mar'20 SOTP target price of Rs 365 (from Rs 330).

For our SOTP model, we value:

- (i) the EPC business at Rs 296/sh based on 15x FY21E earnings;
- (ii) BOT assets at Rs 35/sh on P/BV basis (implied P/BV of 1x for invested equity in the two assets as on Mar'20);
- (iii) HAM projects at Rs 30/sh on P/BV (implied P/BV of 1-1.2x for equity investment in six projects as on Mar'20); and
- (iv) land at Rs 5/sh on P/BV (of 1x for investment made as per balance sheet).

FIG 6 – REVISED ESTIMATES

(Rs mn)	FY20E			FY21E		
	Old	New	Change (%)	Old	New	Change (%)
Revenue	24,518	25,026	2.1	30,447	32,402	6.4
EBITDA	3,887	4,098	5.4	4,923	5,737	16.5
EBITDA margin (%)	15.9	16.4	52bps	16.2	17.7	154bps
Adjusted PAT	2,027	2,122	4.7	2,422	2,772	14.4
PAT margin (%)	8.3	8.5	21bps	8.0	8.6	60bps

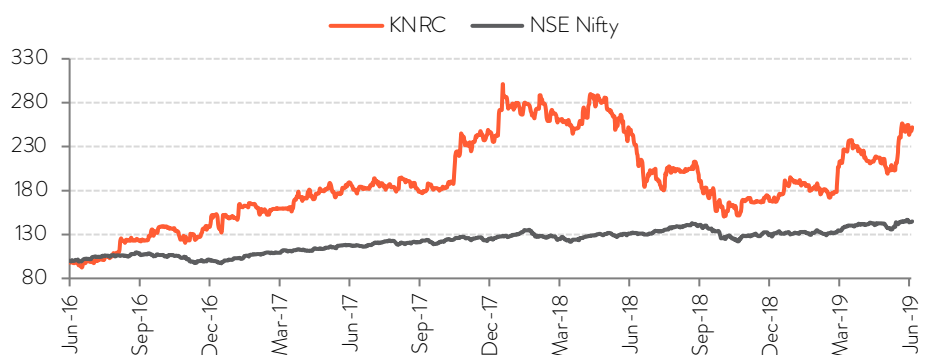
Source: Company, BOBCAPS Research

FIG 7 – SOTP-BASED TARGET PRICE OF RS 365

Business (Rs mn)	Basis of valuation	Value	Multiple (x)	Valuation	Value per share (Rs)
Standalone business (EPC)	P/E FY21E EPS	2,772	15	41,573	296
Equity investment in BOT and HAM road assets and real estate	Equity investment as on Mar'20	8,598	-	9,805	70
Equity investment in BOT projects	P/BV	4,878	-	4,878	35
-Walayar		3,974	1.0	3,974	28
-Muzaffarpur		903	1.0	903	6
Equity investment in HAM projects	P/BV	3,720	-	4,189	30
-Trichiraopalli - Kallagam		818	1.2	982	7
-Meensurutti - Chidambaram		309	1.2	371	3
-Ramsanpalle - Mangloor		709	1.0	709	5
-Chittor - Mallavaram		1,218	1.2	1,461	10
-Magadi - Somwarpeth		267	1.0	267	2
-Oddanchatram - Madathukulam		400	1.0	400	3
Land	P/BV	738	1.0	738	5
Target price (Rs)		-	-	51,378	365
O/s shares (in mn)					141

Source: Company, BOBCAPS Research

FIG 8 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- **Slowdown in road sector capex:** Capex in the road sector has witnessed some revival over the last two years. Any slowdown in project awarding would impact the company's growth and our estimates.
- **Delay in execution of projects in hand:** Execution delays due to land acquisition hurdles or delay in appointed dates or other regulatory bottlenecks could adversely affect KNRC's revenue prospects.
- **Execution risk:** While KNRC has excellent execution skills, a potential entry into new segments and geographies exposes it to execution risks. Also, with the average size and complexity of projects increasing, the company faces the challenge of completing large projects within the stipulated time and cost.

- **Profitability risks:** Historically, KNRC's operating profitability has been higher than peers due to its backward integration model and concentration in the roads space in South India. If the company enters new geographies, it may not always have access to cheaper raw material sources/quarries and may face other challenges to sustaining profitability.
- **Unpredictable traffic:** KNRC's presence in the toll road segment exposes it to risks associated with unpredictability in traffic growth.

FINANCIALS (STANDALONE)

Income Statement

Y/E 31 Mar (Rs mn)	FY17A	FY18A	FY19A	FY20E	FY21E
Total revenue	15,411	19,317	21,373	25,026	32,402
EBITDA	2,296	3,861	4,270	4,098	5,737
EBIT	1,657	2,520	2,589	2,477	3,854
Net interest income/(expenses)	(219)	(231)	(291)	(329)	(361)
Other income/(expenses)	303	393	444	348	357
Exceptional items	0	0	0	0	0
EBT	1,741	2,682	2,741	2,496	3,849
Income taxes	(60)	39	(273)	(374)	(1,078)
Extraordinary items	(109)	0	165	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	1,573	2,721	2,633	2,122	2,772
Adjustments	0	0	0	0	0
Adjusted net profit	1,681	2,721	2,468	2,122	2,772

Balance Sheet

Y/E 31 Mar (Rs mn)	FY17A	FY18A	FY19A	FY20E	FY21E
Accounts payables	1,427	2,184	2,236	2,400	3,063
Other current liabilities	0	0	0	0	0
Provisions	145	184	165	193	250
Debt funds	1,441	2,204	2,641	2,650	2,500
Other liabilities	4,212	3,508	3,519	5,168	6,684
Equity capital	281	281	281	281	281
Reserves & surplus	8,674	11,297	13,862	15,916	18,620
Shareholders' fund	8,955	11,578	14,143	16,197	18,901
Total liabilities and equities	16,179	19,658	22,704	26,608	31,398
Cash and cash eq.	246	438	130	178	365
Accounts receivables	2,698	3,560	3,785	4,737	6,040
Inventories	574	712	951	1,234	1,633
Other current assets	0	0	0	0	0
Investments	5,966	5,976	7,078	9,499	10,737
Net fixed assets	2,607	3,315	3,710	3,889	3,806
CWIP	15	0	0	0	0
Intangible assets	0	0	0	0	0
Deferred tax assets, net	815	1,408	1,739	1,864	2,056
Other assets	3,258	4,248	5,311	5,208	6,759
Total assets	16,179	19,658	22,704	26,608	31,398

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY17A	FY18A	FY19A	FY20E	FY21E
Net income + Depreciation	2,211	4,062	4,314	3,743	4,655
Interest expenses	219	231	291	329	361
Non-cash adjustments	0	0	0	0	0
Changes in working capital	840	(2,134)	(1,760)	584	(1,211)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	3,270	2,160	2,845	4,656	3,805
Capital expenditures	(793)	(2,035)	(2,076)	(1,800)	(1,800)
Change in investments	(2,113)	(11)	(1,101)	(2,421)	(1,238)
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(2,906)	(2,045)	(3,177)	(4,221)	(3,038)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	316	763	437	9	(150)
Interest expenses	(219)	(231)	(291)	(329)	(361)
Dividends paid	(66)	(66)	(68)	(68)	(68)
Other financing cash flows	(310)	(389)	(54)	0	0
Cash flow from financing	(279)	77	24	(387)	(579)
Changes in cash and cash eq.	85	192	(308)	48	188
Closing cash and cash eq.	246	438	130	178	365

Per Share

Y/E 31 Mar (Rs)	FY17A	FY18A	FY19A	FY20E	FY21E
Reported EPS	11.2	19.3	18.7	15.1	19.7
Adjusted EPS	12.0	19.3	17.6	15.1	19.7
Dividend per share	0.4	0.4	0.4	0.4	0.4
Book value per share	63.7	82.3	100.6	115.2	134.4

Valuations Ratios

Y/E 31 Mar (x)	FY17A	FY18A	FY19A	FY20E	FY21E
EV/Sales	2.7	2.1	2.0	1.7	1.3
EV/EBITDA	17.9	10.7	9.8	10.4	7.4
Adjusted P/E	23.9	14.8	16.3	18.9	14.5
P/BV	4.5	3.5	2.8	2.5	2.1

DuPont Analysis

Y/E 31 Mar (%)	FY17A	FY18A	FY19A	FY20E	FY21E
Tax burden (Net profit/PBT)	96.6	101.5	90.0	85.0	72.0
Interest burden (PBT/EBIT)	105.1	106.4	105.9	100.8	99.9
EBIT margin (EBIT/Revenue)	10.8	13.0	12.1	9.9	11.9
Asset turnover (Revenue/Avg TA)	107.1	107.8	100.9	101.5	111.7
Leverage (Avg TA/Avg Equity)	1.8	1.7	1.6	1.6	1.7
Adjusted ROAE	20.6	26.5	19.2	14.0	15.8

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY17A	FY18A	FY19A	FY20E	FY21E
YoY growth (%)					
Revenue	70.7	25.3	10.6	17.1	29.5
EBITDA	50.1	68.2	10.6	(4.0)	40.0
Adjusted EPS	50.7	61.8	(9.3)	(14.0)	30.6
Profitability & Return ratios (%)					
EBITDA margin	14.9	20.0	20.0	16.4	17.7
EBIT margin	10.8	13.0	12.1	9.9	11.9
Adjusted profit margin	10.9	14.1	11.5	8.5	8.6
Adjusted ROAE	20.6	26.5	19.2	14.0	15.8
ROCE	18.7	23.0	18.9	15.5	21.2
Working capital days (days)					
Receivables	64	67	65	69	68
Inventory	14	13	16	18	18
Payables	34	41	38	35	35
Ratios (x)					
Gross asset turnover	2.5	2.6	2.3	2.2	2.5
Current ratio	1.2	1.5	1.7	1.5	1.5
Net interest coverage ratio	7.6	10.9	8.9	7.5	10.7
Adjusted debt/equity	0.1	0.2	0.2	0.2	0.1

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: KNR CONSTRUCTIONS (KNRC IN)



B – Buy, A – Add, R – Reduce, S – Sell

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