COMPANY UPDATE

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KNR CONSTRUCTIONS LTD

PRICE: RS.205 **RECOMMENDATION: BUY**
TARGET PRICE: RS.236 **FY19E PE: 15.1X**

KNR Constructions is focusing on growing its order book by adding new projects in road and irrigation space. The company has strong bid pipeline in road sector from Hybrid Annuity Model (HAM) based projects in south India. The company targets to add Rs 20-25 bn per annum of new orders in FY18E and FY19E. It is well placed/L1 in ~Rs 16 bn of new projects in road and irrigation space which would help it in achieving its guidance. Its strong balance sheet with low net debt to equity at 0.1x gives edge over many of its peers in meeting funding requirement in future HAM projects. Its order book of Rs 33 bn (in Q1FY18) with all of its projects moving on expected lines and strong future order pipeline gives revenue growth visibility for FY18E and FY19E. We believe that Q2FY18 revenue will not have any major impact of rainfall in south and expect KNR to exceed its annual guidance of Rs 17-18 bn of revenue. The company has track record of beating its guidance and we expect the trend to continue looking at order book and future pipeline. We maintain our estimates and upgrade our rating on the stock to **BUY** (from Accumulate) with unchanged target price of Rs 236.

Summary table - Standalone

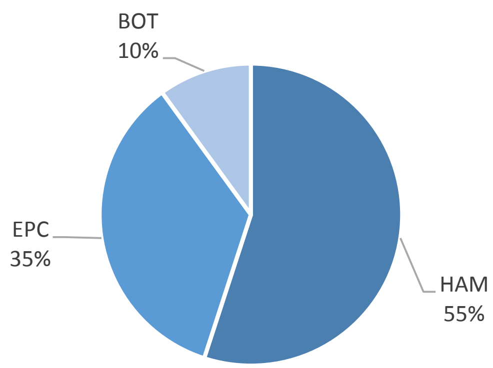
(Rs mn)	FY17	FY18E	FY19E
Revenue	15411	18714	22083
Growth (%)	70.7	21.4	18.0
EBITDA	2296	2788	3315
EBITDA margin (%)	14.9	14.9	15.0
PBT	1741	1997	2415
Adj PAT	1790	1758	1908
Adj EPS	12.0	12.5	13.6
EPS Growth (%)	80.0	4.6	8.5
CEPS (Rs)	16	18	20
Book value (Rs/share)	63	75	88
Dividend per share (Rs)	0.6	0.6	0.7
ROE (%)	19.5	18.1	16.7
ROCE (%)	18.1	18.1	18.9
Net cash (debt)	(998)	(853)	573
NW Capital (Days)	76	85	78
P/E (x)	17.1	16.4	15.1
P/BV (x)	3.2	2.7	2.3
EV/EBITDA (x)	13.0	10.6	8.5
EV/Sales (x)	1.9	1.6	1.3

Source: Company, Kotak Securities – Private Client Research

Project awarding to improve

The government has set target to award 50000 km of road projects of value Rs 5 trn in the next 2 years. The awarding activity has been subdued in FY18 YTD due to stricter land acquisition criteria. NHAI is not awarding the projects unless 90% of the land is available for construction. However, the company expect the awarding activities to improve for the rest of the financial year as land acquisition have been fast tracked by the government. NHAI has awarded more than 55% of the projects under HAM, 35% under EPC and 10% under BOT toll in FY17. Large number of HAM projects are expected to come for bidding in the coming quarters. Further, Karnataka state cabinet last week gave its approval for the development of 155 km of roads in and around Bengaluru to ease traffic congestion. The roads will be developed by the Karnataka Road Development Corporation Ltd (KRDCL) at an estimated cost of ~ Rs 21 bn. This would further improve pipeline from south India where KNR is focussing.

NHAI Awarding Breakup (%)



Source: Company

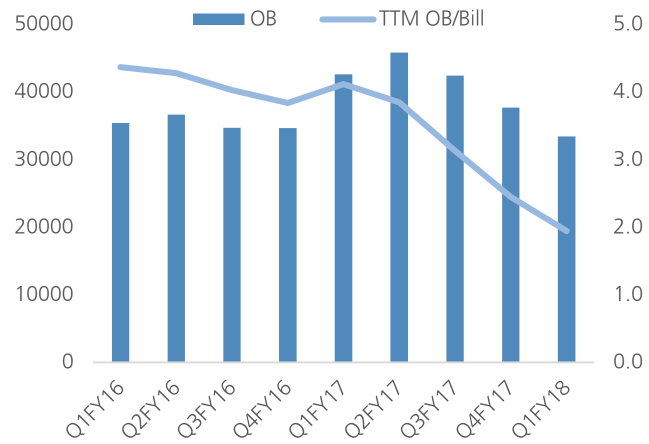
Competition in HAM reduced

As per the management, competition in HAM segment has reduced significantly. There are 6-7 active bidders in HAM segment and many of them have already got 4-5 projects. Hence, the number of bidders on HAM has reduced. On the other hand, over 80 HAM projects are there in pipeline for bidding in next few quarters. KNR is focusing on southern region which includes Karnataka, AP and Kerala.

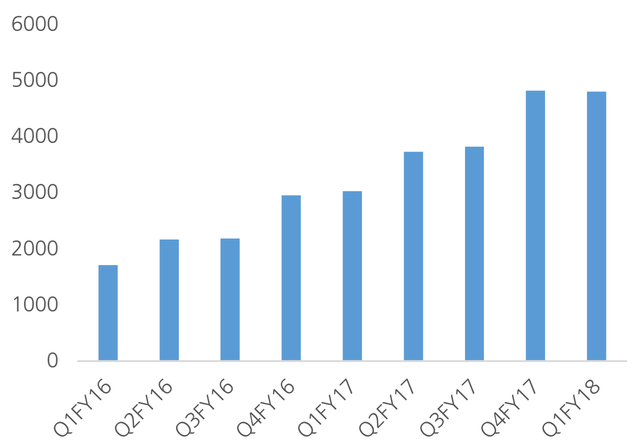
Positive on growing its order book

KNR had witnessed a decline in its order book in the past four quarters from Rs 45.8 bn in Q2FY17 to Rs 33.4 bn in Q1FY18 with TTM OB/bill declined to 1.9x. The decline is led by very sharp uptick in execution, conservative approach on HAM and no major inflows in the EPC segment. The company is positive on pickup in order inflows in the current financial year. The company has strong bid pipeline in roads and irrigation space and targets to add Rs 20-25 bn per annum of new orders in FY18E and FY19E.

OB (Rs mn - LHS) and TTM OB/bill (x - RHS)



Standalone Revenue (Rs mn)



Source: Company

Well placed in ~Rs.16 bn of new projects

Based on our discussion with the management, the company is well-placed or L1 in ~Rs 16 bn of new projects. This includes one of the ADB funded (75% of project cost) HAM road projects in Karnataka of ~Rs 11 bn and one of the irrigation project in Telangana of ~Rs 5 bn. The company targets to begin work on these projects in 6 months after signing LoI. Further, it has bid pipeline of 4 HAM projects from NHAI in Karnataka, AP and Kerala which is expected to be finalized in October 2017. The company is aiming at adding one of the projects out of same with ~Rs 14 bn size. If added successfully, KNR will be in a position to exceed its guidance of Rs 20-25 bn of order inflows in FY18. The company does not see any challenges in meeting equity in these projects as it has strong balance sheet.

On track to exceed revenue guidance in FY18

Based on execution timeline of current order book and future order pipeline, the company has maintained its guidance to achieve over Rs 17-18 bn and Rs 20 bn of revenue in FY18E and FY19E respectively. We believe that its Q2FY18 revenue will not be see any major negative impact of rainfall and believe that KNR would be able to exceed its annual guidance.

Update on BOT projects

KNR BOT projects are running as per expectations. Its Bihar project (Muzaffarpur Barauni) with 51% stake (balance 49% with JKM Infra) is completed fully. The company has got provisional COD for 75% of project length on 3rd June 2016 and has applied for full COD which is expected before the end of September 17 month. The company intends to exit from the BOT projects in future at right valuation.

Outlook and valuation

We maintain BUY on KNR Constructions with a price target of Rs.236

KNR has track record of generating positive operating cash flows and low net debt equity at 0.1x which would help it in funding HAM projects. Based on current order book of Rs 33.4 bn and robust pipeline for future projects, we expect KNR's revenue growth to remain strong. We maintain our FY18E & FY19E EPS estimates factoring in strong execution and positive outlook of the sector. The stock is trading at PE of 14.9x and 13.7x based on FY18E and FY19E EPS of Rs 12.5 and Rs 13.6 respectively after adjusting for BOT value of Rs 19 per share. We upgrade our rating on the stock to **BUY** (from Accumulate) due to recent correction and maintain target price of Rs 236 based on SOTP valuation.

Valuation Table

Segment	Parameter	Multiple (x)	Per Share (Rs)
Construction Business	PE	16	217
Road BOT	BV of equity	0.6	19
Consol KNR	Value		236

Source: Kotak Securities Private Client Research

RATING SCALE

Definitions of ratings

BUY	–	We expect the stock to deliver more than 12% returns over the next 9 months
ACCUMULATE	–	We expect the stock to deliver 5% - 12% returns over the next 9 months
REDUCE	–	We expect the stock to deliver 0% - 5% returns over the next 9 months
SELL	–	We expect the stock to deliver negative returns over the next 9 months
NR	–	Not Rated. Kotak Securities is not assigning any rating or price target to the stock. The report has been prepared for information purposes only.
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NA	–	Not Available or Not Applicable. The information is not available for display or is not applicable
NM	–	Not Meaningful. The information is not meaningful and is therefore excluded.
NOTE	–	Our target prices are with a 9-month perspective. Returns stated in the rating scale are our internal benchmark.

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