Company Visit Note

KNR CONSTRUCTIONS LTD

PRICE RS. 325 **TARGET RS. 348** **ACCUMULATE**

Stock Details

Market cap (Rs mn)	:	45560
52-wk Hi/Lo (Rs)	:	349 / 185
Face Value (Rs)	:	2
3M Avg. daily volume (mn)	:	268,895
Shares o/s (m)	:	141

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY18E	FY19E	FY20E
Revenue	18,114	21,883	26,042
Growth (%)	17.5	20.8	19.0
EBITDA	3,432	3,579	4,259
EBITDA margin (%)	18.9	16.4	16.4
PAT	2,121	2,114	2,455
EPS	15.1	15.0	17.5
EPS Growth (%)	26.2	-0.3	16.1
BV (Rs/share)	78	92	109
Dividend/share (Rs)	0.8	0.8	0.9
ROE (%)	21.3	17.7	17.4
ROCE (%)	21.0	18.9	21.1
P/E (x)	21.4	21.5	18.5
EV/EBITDA (x)	13.5	12.7	10.3
P/BV (x)	4.1	3.5	3.0

Source: Kotak Securities - PCG; Company

Shareholding Pattern (%)

(%)	Mar-18	Dec-17	Sep-17
Promoters	55.4	55.4	57.4
FII	3.8	4.3	3.6
DII	28.1	28.7	28.5
Others	12.8	11.7	10.5

Source: Company

Price Performance (%)

(%)	1M	3M	6M
KNR Constructions	12.4	2.1	44.1
Nifty	6.2	(4.3)	4.0

Source: Bloomberg

Price chart

Source: Bloomberg

We recently visited KNR's Pollachi to Coimbatore EPC project where we interacted with the top management of the company. The company is positive on its construction business in the longer run and believes that traction in order inflows in Q4FY18 and robust pipeline of projects gives strong revenue growth visibility for the next 2-3 years.

KNR added four HAM projects with bid project cost of Rs 44.7 bn in Q4FY18 and is confident of achieving financial closure of these projects.

Based on current order book of ~Rs 59 bn (including EPC component of new HAM projects), L1 HAM project of ~Rs 11.5 and robust pipeline for future projects in road, flyovers, irrigation, etc, we expect KNR's revenue growth to remain strong for next 2-3 years.

We maintain our earnings estimates. The construction business of the company is available at FY20E PE of 16.7x. We recommend **ACCUMULATE** (from Buy earlier) and maintain target price of Rs 348 based on SOTP valuation.

Addition of HAM projects strengthens KNR's order book

KNR has added 4 HAM projects of total bid project cost of Rs 44.67 bn and estimated EPC cost of Rs 31 bn. This would strengthen its order book which was at Rs 33.3 bn at the end of Q3FY18. After adjusting for Q4 revenue estimates (Rs5.5 bn), the current order book will stand at ~Rs 59 bn. The company is also targeting to add Rs 20-30 bn of new projects in FY19 which excludes the Karnataka state government HAM projects where KNR is presently L1. The company is bidding for both EPC as well as HAM projects in road space, but bidding environment is relatively sensible in HAM space as against higher competition in EPC projects.

Targeting for Rs 20-30 bn of new order from road space in FY19

The company is already L1 in Karnataka state government HAM project of bid project cost ~Rs 11.5 bn. The finalization of the project has been delayed and is now expected to be finalized after elections in the state. Apart from this, the company is expecting Rs 150-160 bn of irrigation projects to be announced in Telangana and is aiming at Rs 6-10 bn of project. The company has already submitted bid for Rs 20 bn HAM project recently. The company is also expecting a large size flyover project of Rs 7 bn where it would be participating for bidding. The company expects huge opportunity to continue in road space in FY19 as new projects expected from Bharatmala, Mumbai Nagpur Expressway, Delhi Mumbai expressway, etc.

Revenue growth to pickup from H2FY19

The company is confident of achieving over Rs 20 bn of revenue in FY19E and 25% growth in FY20E with EBITDA margins of 13-14% on conservative basis as the company keeps buffer for 2-3% of margins on account of variation in raw material prices and other contingencies. As per the management, revenue in H1FY19 may be relatively slower, on account of new projects to pick up in H2FY19 and also due to land acquisition related issue in some of the projects.

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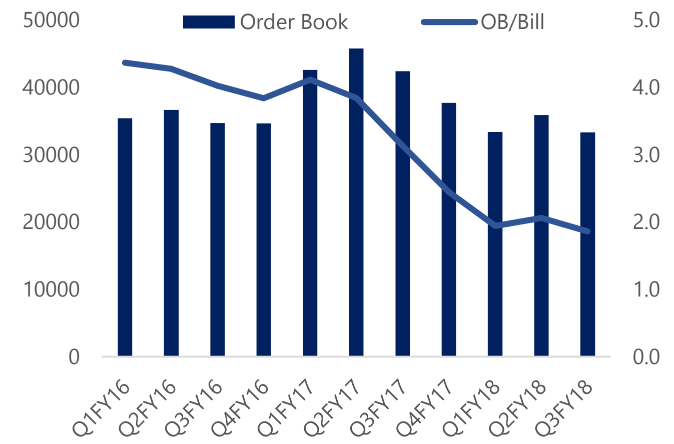
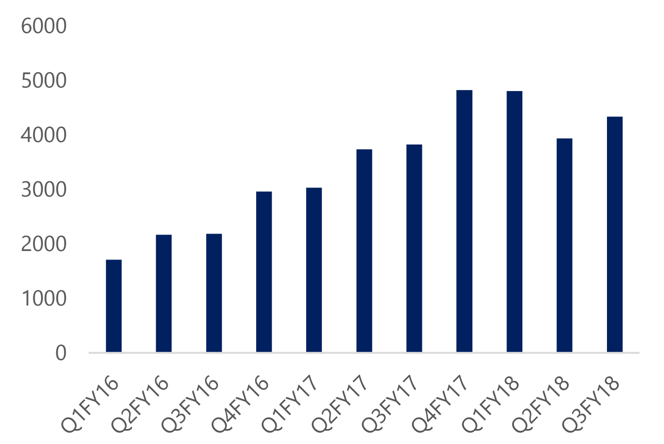
Order Book (Rs mn) and TTM OB/bill (x) trend



Quarterly Standalone Revenue (Rs mn)



Source: Company

Targeting Rs 700 mn to Rs 1 bn capex in FY19

The company might not require any major capex to execute its current order book including new HAM projects as some of its older projects are on verge of completion and equipment can be mobilized from there. The company is expecting Rs 700 mn of capex for new machinery and another Rs 300 mn of regular maintenance capex for FY19.

Focus on increasing ticket size in longer run

As a strategy, KNR would focus on large size projects rather than large number of smaller projects. As per management the current team size and management bandwidth is capable of executing ~20 projects of upto ~Rs 20 bn. In the longer run, the company intends to participate in larger size project. In irrigation also, KNR is capable of doing Rs 10-12 bn of project size.

Confident to achieve financial closure in HAM projects

KNR has bagged 4 NHAI Hybrid Annuity Projects (HAM) with bid project cost of Rs. 44.67 bn in state of Tamil Nadu, AP and Telangana and is also L1 in one Karnataka HAM project of value ~Rs 11.5 bn. The company is confident of achieving financial closure of these HAM projects in next 5 months. Altogether, the company is required to infuse ~ Rs 3.75 bn of equity in four HAM projects. Based on its strong balance sheet (standalone net debt equity at 0.1x) and decent internal accruals, achieving financial closure in these projects would not be a challenge for KNR. In addition, the company has option to monetize its BOT assets and land bank which would help its future growth.

HAM Project Details

Date of Announcement	HAM Projects	Lanes	Bid Project Cost (Rs mn)
1 Mar 2018	Trichy to Kallagam (TN)	4 laning	10206
8 Mar 2018	Meensurutti to Chidambaram (TN)	2 laning	4820
26 Mar 2018	Chittor to Mallavaram (AP)	6 laning	17301
26 Mar 2018	Ramsanpalle to Mangloor (Telangana)	4 laning	12340
	Total confirmed		**44667**
L1	KSHIP (Magadi to Somwarpet)		11470
	Total (Confirmed+L1)		**56137**

Source: Company

Update on BOT projects

Toll collections in both Kerala and Bihar BOT projects has improved on sequential basis as the company is collecting Rs 1.6 mn toll per day in each of these projects. In Q3FY18, KNR reported Rs 1.4 mn toll per day in Kerala project (Walayar – Vadakkancherry) and Rs 1.3 mn per day in Bihar project (Muzaffarpur Barauni) project where it has already got 100% COD. The company is yet to achieve refinancing of term loan in Bihar project. The company intends to exit from these BOT projects in future at right valuation.

Road projects awarding to be strong in FY19

The government has targeted to award 20,000 km of national highways in FY19 which is 17% higher than 17055 km of projects awarded in FY18. The awarding activity has been strong in FY18 led by pick up in awarding in Q4FY18. The government has awarded 17,055 km of road projects in FY18 of which 8652 km was awarded by MoRTH, 7397 km by NHAI and 1006 km by NHIDCL. The project awarded by NHAI in FY18 is 70% higher than 4335 km awarded in FY17. In value terms, NHAI awarded Rs 1.22 trn of projects in FY18. Out of total 7397 km of projects awarded by NHAI, 46% (3396 km) of the projects were awarded on Hybrid Annuity based model (HAM), 51% (3791 km) on EPC basis and very small portion of 3% (209 km) of projects was awarded on BOT Toll model. The government has set highway construction target for FY19 at 16,420 km with per day construction target of 45 km as against ~27 km per day achieved in FY18. We believe that the both awarding and construction pace is expected to remain strong in FY19.

Coimbatore Site visit

Source: Company, Kotak Private Client Research

Outlook and valuation

KNR has track record of generating positive operating cash flows and net cash balance sheet which would help it in funding HAM projects. Based on current order book of ~Rs 59 bn (including EPC component of new HAM projects), L1 HAM project of ~Rs 11.5 and robust pipeline for future projects in road, flyovers, irrigation, etc, we expect KNR's revenue growth to remain strong for next 2-3 years. We maintain our earnings estimates factoring in strong order pipeline, robust execution and positive outlook of the sector. The construction business of the company is available at PE of 19.5x and 16.7x, based on FY19E and FY20E EPS of Rs 15 and Rs 17.5 respectively, after adjusting for BOT value of Rs 33 per share. We revise our rating on the stock to **ACCUMULATE** (from Buy earlier) after recent price appreciation and maintain target price of Rs 348 based on SOTP valuation.

Valuation Table

Segment	Parameter	Multiple (x)	Per Share (Rs)
Standalone Construction Business	PE	18	315
Road BOT	BV of equity	1	33
Consol KNR	Value		348

Source: Kotak Securities Private Client Research

Company Background

KNR Constructions Ltd (KNR), incorporated in 1995, is Hyderabad based construction company promoted by Mr. K. Narasimha Reddy. The company is broadly present in construction of roads and highways with small presence in irrigation space. Over 90% of its order book is located in South India. The company has a track record of executing 6000 lane km of projects across 12 states in India with top management is actively involved at all stages of project execution. It has portfolio of four BOT projects of 778 lane Kms projects in the state of Telangana, Karnataka, Kerala and Bihar of this two are BOT toll based and two are annuity based. The company has securitized its annuity based projects. Further, it has also won four HAM projects in south India. The company executes its road projects through in-house construction equipment with gross block of Rs 7.3 bn.

Financials - Standalone

Profit and Loss Statement (Rs mn)

(Year-end March)	FY17	FY18E	FY19E	FY20E
Revenues	**15,411**	**18,114**	**21,883**	**26,042**
% change yoy	70.7	17.5	20.8	19.0
Direct Cost	11,145	12,362	15,656	18,762
Employee Cost	552	690	773	866
Other Expenses	1,417	1,630	1,874	2,156
Total Expenses	13,115	14,682	18,304	21,783
EBITDA	**2,296**	**3,432**	**3,579**	**4,259**
% change yoy	47.7	49.5	4.3	19.0
Depreciation	639	1,129	1,129	1,070
EBIT	**1,657**	**2,302**	**2,450**	**3,189**
Other Income	303	250	250	250
Interest	219	196	213	209
Profit Before Tax	1,741	2,357	2,487	3,230
% change yoy	34	35	6	30
Tax	60	236	373	775
as % of EBT	3	10	15	24
PAT	**1,790**	**2,121**	**2,114**	**2,455**
% change yoy	4.3	26.2	-0.3	16.1
Shares outstanding (mn)	141	141	141	141
EPS (Rs)	12.0	15.1	15.0	17.5
DPS (Rs)	0.6	0.8	0.8	0.9
CEPS(Rs)	15.7	23.1	23.1	25.1
BVPS(Rs)	63.7	78.0	92.2	108.8

Source: Company, Kotak Securities - Private Client Research

Balance sheet (Rs mn)

(Year-end March)	FY17	FY18E	FY19E	FY20E
Paid - Up Equity Capital	281	281	281	281
Reserves	8,674	10,684	12,689	15,016
Net worth	8,955	10,966	12,970	15,297
Borrowings	1,441	1,441	1,441	1,441
Net Deferred tax	(432)	(432)	(432)	(432)
Total Liabilities	**9,963**	**11,974**	**13,978**	**16,306**
Gross Block	6,403	7,803	8,803	9,803
Accumulated Depreciation	3,796	4,925	6,054	7,124
Net block	2,607	2,878	2,748	2,679
Capital work in progress	15	0	0	0
Total fixed assets	2,622	2,878	2,748	2,679
Investments	5,966	5,966	5,966	5,966
Inventories	574	1,985	2,398	3,211
Sundry debtors	1,640	1,985	3,597	4,638
Cash and equivalents	246	372	1,233	3,160
Loans and advances & Others	3,465	3,965	4,465	4,465
Total current assets	5,924	8,307	11,693	15,473
Sundry creditors and others	5,341	5,955	7,194	8,562
Provisions	128	141	155	171
Total CL & provisions	5,470	6,096	7,349	8,732
Net current assets	455	2,210	4,344	6,741
Other assets	920	920	920	920
Total Assets	**9,963**	**11,974**	**13,978**	**16,306**

Source: Company, Kotak Securities - Private Client Research

Cash Flow Statement (Rs mn)

(Year-end March)	FY17	FY18E	FY19E	FY20E
Pre-Tax Profit	1,524	2,357	2,487	3,230
Depreciation	639	1,129	1,129	1,070
Change in WC	788	(1,630)	(1,272)	(470)
Other operating activities	(346)	(236)	(373)	(775)
Operating Cash Flow	**2,605**	**1,620**	**1,971**	**3,054**
Capex	(1,439)	(1,385)	(1,000)	(1,000)
Free Cash Flow	1,165	235	971	2,054
Change in Investments	(1,467)	0	0	0
Investment cash flow	**(2,906)**	**(1,385)**	**(1,000)**	**(1,000)**
Equity Raised	0	0	0	0
Debt Raised	273	0	0	0
Dividend & others	(103)	(110)	(110)	(127)
CF from Financing	**170**	**(110)**	**(110)**	**(127)**
Change in Cash	(132)	125	862	1,927
Opening Cash	378	246	372	1,233
Closing Cash	246	372	1,233	3,160

Source: Company, Kotak Securities - Private Client Research

Ratio Analysis

(Year-end March)	FY17	FY18E	FY19E	FY20E
EBITDA margin (%)	14.9	18.9	16.4	16.4
EBIT margin (%)	10.8	12.7	11.2	12.2
Net profit margin (%)	11.6	11.7	9.7	9.4
EPS growth (%)	80.0	26.2	(0.3)	16.1
Receivables (days)	38.8	40.0	60.0	65.0
Inventory (days)	13.6	40.0	40.0	45.0
Loans & Advances (days)	82.1	79.9	74.5	62.6
Payable (days)	126.5	120.0	120.0	120.0
Net Working Capital (days)	8.0	39.9	54.5	52.6
Asset Turnover	1.5	1.5	1.6	1.6
Net Debt/ Equity	0.1	0.1	0.0	(0.1)
RoCE (%)	18.3	21.0	18.9	21.1
RoE (%)	19.3	21.3	17.7	17.4
P/E (x)	27.0	21.4	21.5	18.5
P/BV (x)	5.1	4.1	3.5	3.0
EV/EBITDA (x)	20.3	13.5	12.7	10.3
EV/Sales (x)	3.0	2.6	2.1	1.7

Source: Company, Kotak Securities - Private Client Research

Rating Scale

Definitions of ratings

BUY	–	We expect the stock to deliver more than 12% returns over the next 12 months
ACCUMULATE	–	We expect the stock to deliver 5% - 12% returns over the next 12 months
REDUCE	–	We expect the stock to deliver 0% - 5% returns over the next 12 months
SELL	–	We expect the stock to deliver negative returns over the next 12 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
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NOTE	–	Our target prices are with a 9-month perspective. Returns stated in the rating scale are our internal benchmark.

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- **Level 1**: For Trading related queries, contact our customer service at 'service.securities@kotak.com' and for demat account related queries contact us at ks.demat@kotak.com or call us on: Online Customers - 30305757 (by using your city STD code as a prefix) or Toll free numbers 18002099191 / 1800222299, Offline Customers - 18002099292
- **Level 2:** If you do not receive a satisfactory response at Level 1 within 3 working days, you may write to us at ks.escalation@kotak.com or call us on 022-42858445 and if you feel you are still unheard, write to our customer service HOD at ks.servicehead@kotak.com or call us on 022-42858208.
- **Level 3:** If you still have not received a satisfactory response at Level 2 within 3 working days, you may contact our Compliance Officer (Mr. Manoj Agarwal) at ks.compliance@kotak.com or call on 91- (022) 4285 8484.
- **Level 4:** If you have not received a satisfactory response at Level 3 within 7 working days, you may also approach CEO (Mr. Kamlesh Rao) at ceo.ks@kotak.com or call on 91- (022) 4285 8301.