KNR Constructions

BUY

INDUSTRY	INFRASTRUCTURE
CMP *(as on 10 Aug 2018)*	Rs 231
Target Price	Rs 392
Nifty	11,430
Sensex	37,869

KEY STOCK DATA	
Bloomberg	KNRC IN
No. of Shares (mn)	141
MCap (Rs bn) / ($ mn)	33/473
6m avg traded value (Rs mn)	66

STOCK PERFORMANCE (%)			
52 Week high / low			Rs 349/193
	3M	6M	12M
Absolute (%)	(25.4)	(25.3)	14.0
Relative (%)	(32.9)	(36.6)	(6.1)

SHAREHOLDING PATTERN (%)	
Promoters	55.38
FIs & Local MFs	27.32
FPIs	3.26
Public & Others	14.04

Source : BSE

Parikshit D Kandpal
parikshitd.kandpal@hdfcsec.com
+91-22-6171-7317

Kunal Bhandari
kunal.bhandari@hdfcsec.com
+91-22-6639-3035

Outperformance continues

KNRC continues to outperform its growth guidance and delivered strong 1QFY19 revenue at Rs 5.6bn which was 18.4% above estimates. EBITDA at Rs 1.1bn was 35.7% above our estimates, with EBITDA margins expanding to 19.7% (+215bps YoY, +42bps QoQ). We estimate sustainable margins to be around 16-17% and have revised our estimates to reflect the same. APAT beat stood at 57.5%.

Order book is Rs 59.5bn with Rs 2bn addition in Arunachal Pradesh project scope. KNRC is focusing on completing financial closure of its 5 HAM projects (EPC value – Rs 39.8bn) that were won in 4QFY18. KNR has announced FC for 3 and 4th HAM FC is expected in Aug-18.

KNR continues to maintain a lean WC capital cycle with NWC days at 30, especially demonstrating strong control on receivables (28days) as compared to 50-75 days for other listed peers. We continue to maintain BUY with and increased SOTP of Rs 392/sh.

Highlights of the quarter

- **Concerns on execution more of conservatism at display:** KNRC has guided for muted revenue growth and recent media interaction suggests guidance at 10-15% revenue de-growth YoY. We have cut our Rev/APAT estimate by 12% and now project muted YoY revenue growth. KNR has booked 1QFY19 revenue of Rs 5.5bn on Rs 19.8bn order base. With Rs 39.8bn of HAM EPC projects moving into execution by 3QFY19 and new order wins over next 3-4months adding incrementally, KNRC may end up reporting YoY revenue growth.
- **Balance Sheet remains strong net D/E at 0.03x, NWC at 30days:** NWC remains comfortable at 30days (one of the best vs EPC peers). KNRC's gross debt is Rs 2.5bn, of which a large chunk is the promoter's loan at Rs 2bn. Cash and Equivalents is Rs 2bn.
- **Near-term outlook:** On account of land availability issues in few EPC projects and its impact on execution/getting appointed dates for HAM projects, we have cut down FY19E revenue estimate by 12% to Rs 20.4bn. We have increased EBIDTA margins to 16-17% range.

Financial Summary (Standalone)

Year Ending March (Rs mn)	1QFY19	1QFY18	*YoY (%)*	4QFY18	*QoQ (%)*	FY17	FY18	FY19E	FY20E
Net Sales	5,564	4,808	*15.7*	6,244	*(10.9)*	15,411	19,317	20,406	29,434
EBITDA	1,099	846	*29.9*	1,207	*(9.0)*	2,296	3,861	3,456	4,682
APAT	630	676	*(6.8)*	797	*(20.9)*	1,432	1,917	1,417	2,089
Diluted EPS (Rs)	4.5	4.8	*(6.8)*	5.7	*(20.9)*	10.2	13.6	10.1	14.9
P/E (x)						22.7	16.9	22.9	15.5
EV / EBITDA (x)						14.6	8.9	9.6	7.0
RoE (%)						17.5	18.7	11.3	14.3

Source: Company, HDFC sec Inst Research

KNRC 1QFY19 continued its strong show with revenues 18.4% above estimates at Rs 5.6bn

EBITDA at Rs 1.1bn was 35.7% above our estimates, with EBITDA margins expanding to 19.7%

Other income is high on account of Rs 40mn of labour cess reversals and Rs 50mn of subcontractor provision write back

APAT came at Rs 630mn, 57.5% ahead of our estimates

On account of slight delays in a few projects due to land availability and a possibility of delay in getting appointed dates for HAM projects, we have cut down FY19E revenue estimate by 12% to Rs 20.4bn. FY19E APAT cut by 12.4%

Increased margins in line with the sustained level of margins that KNRC is delivering over the past 5 quarters

Standalone Quarterly Financial

Particulars (Rs mn)	1QFY19	1QFY18	*YoY (%)*	4QFY18	*QoQ (%)*
Net Sales	**5,564**	**4,808**	***15.7***	**6,244**	***(10.9)***
Material Expenses	(3,585)	(3,441)	*4.2*	(4,121)	*(13.0)*
Employee Expenses	(196)	(148)	*32.4*	(200)	*(2.1)*
Other Operating Expenses	(684)	(373)	*83.1*	(716)	*(4.5)*
EBITDA	**1,099**	**846**	***29.9***	**1,207**	***(9.0)***
Interest Cost	(72)	(52)	*38.3*	(88)	*(18.3)*
Depreciation	(360)	(244)	*47.5*	(491)	*(26.7)*
Other Income (Incl. EO Items)	178	123	*45.0*	183	*(3.0)*
PBT	**844**	**673**	***25.6***	**811**	***4.1***
Tax	(104)	4	*(2,914.4)*	(14)	*645.0*
RPAT	**740**	**676**	***9.5***	**797**	***(7.1)***
E/o (adj for tax)	(110)	-	-	-	-
APAT	**630**	**676**	***(6.8)***	**797**	***(20.9)***

Source: Company, HDFC sec Inst Research

Margin Analysis

MARGIN ANALYSIS	1QFY19	1QFY18	YoY (bps)	4QFY18	QoQ (bps)
Material Expenses % Net Sales	64.4	71.6	*(712)*	66.0	*(156)*
Employee Expenses % Net Sales	3.5	3.1	*44*	3.2	*32*
Other Operating Expenses % Net Sales	12.3	7.8	*452*	11.5	*82*
EBITDA Margin (%)	19.7	17.6	*215*	19.3	*42*
Tax Rate (%)	12.4	(0.6)	*1,290*	1.7	*1,062*
APAT Margin (%)	11.3	14.1	*(274)*	12.8	*(144)*

Source: Company, HDFC sec Inst Research

Change in Estimates

	FY19E New	FY19E Old	*% Change*	FY19E New	FY19E Old	*% Change*
Revenues (Rs mn)	20,406	23,200	*(12.0)*	29,434	29,434	*0.0*
EBITDA (Rs mn)	3,456	3,622	*(4.6)*	4,682	4,594	*1.9*
Margin (%)	16.9	15.6	132.5bps	15.9	15.6	29.9bps
APAT (Rs mn)	1,417	1,617	*(12.4)*	2,089	2,138	*(2.3)*

Source: HDFC sec Inst Research

We expect steady inflows to keep the order book at comfortable levels

FY18-20E revenue CAGR 23.4%

Tax rate to increase as projects with tax exemption achieve completion

The reported PAT includes impact of MAT credit. We have adjusted this to arrive at normalized PAT

KNR to generate strong FCF

Key Assumptions And Estimates

STANDALONE (Rs mn)	FY19E	FY20E	Comments
Closing order book	67,611	68,176	We expect steady inflows to keep the order book at comfortable levels
Order book growth (%)	7.3	0.8	
New order booking	25,000	30,000	
Book to bill ratio	3.3	2.3	Book to bill ratio to remain steady
Total Revenue	**20,406**	**29,434**	**FY18-20E Revenue CAGR of 23.4%**
Growth (%)	5.6	44.2	
EBIDTA	3,456	4,682	
EBIDTA margin (%)	16.9	15.9	Margins to decline from FY19E compared to FY18 as KNRC had written back some excess provision in projects nearing completion during FY18
Depreciation	1,472	1,664	
Financial Charges	297	377	Borrowing cost to remain at comfortable levels
PBT	2,024	2,985	
PBT margin (%)	9.9	10.1	
Tax	303.6	596.9	
Tax rate (%)	15.0	20.0	Tax rate to increase as projects with tax exemption achieve completion
RPAT	1,720	2,388	
Net margin (%)	8.4	8.1	
Extraordinary	(303.6)	(298.5)	To reflect MAT rate we taken additional provisioning. KNRC numbers will be reflected in RPAT
Adjusted PAT	1,417	2,089	
Gross Block Turnover	2.2	2.8	Improvement on account of new orders inflow
Debtor days	45	45	
CFO - a	3,857	3,177	**Higher revenue growth, robust client advance to result in higher positive cash flow from operations**
CFI - b	(2,424)	(2,356)	Investments in Gross block and HAM projects
FCF - a+b	1,433	821	KNR to generate strong FCF
CFF - c	(283)	(461)	
Total change in cash - a+b+c	1,151	359	

Source: HDFC sec Inst Research

We value standalone EPC business at Rs 330/share (10x one year forward EV/EBITDA) – vs Rs 303/share earlier. Increase on account of EBIDTA revision upward for FY20E

Kerala BOT at Rs 28/share (at 1x P/BV of equity invested)

Muzaffarpur Barauni BOT at Rs 5/share (at 1x P/BV of equity invested)

Real estate at Rs 5/share (at 1x P/BV of amount invested)

HAM Projects investment at 23/share (at 1x book value of investments). Total pending HAM equity is Rs 4.4bn over next 2-3yrs

Our SOTP target price is Rs 392/share

Outlook and valuation

Maintain BUY – with an increased TP of Rs 392/sh

Valuation methodology

- We have valued KNRC's EPC business at 10x one year forward EV/EBITDA. Our rationale behind this is (1) Strong order backlog of ~Rs 59.5bn (3.1x FY18 revenue), (2) Robust balance sheet net D/E of 0.03x, (3) Superior earnings quality vs. similar-sized peers makes a case for valuation premium and (4) Tremendous opportunity in HAM projects in the Southern states in the near future.

- KNR's promoter's share of debt is Rs 2,000mn of the standalone debt of Rs 2,470mn. Adjusted for promoters' loans and Rs 2,090mn of cash and cash equivalents, KNR standalone is a net cash company. This gives us comfort on gearing. Apart from that, improvement in the working capital cycle (driven by 10% mobilisation advances on NHAI road EPC orders) will keep debt under check.

- Investments in the road sector will continue to drive stock performance. KNRC, with its strong execution skills, is likely to benefit from the pick-up in order activity.

- We value the (1) Standalone EPC business at Rs 330/share (10x Mar-20 EV/EBITDA), (2) Kerala BOT at Rs 28/share (at 1x P/BV of equity invested), (3) Muzaffarpur Barauni BOT at Rs 5/share (at 1x P/BV of equity invested), (4) Real estate at Rs 5/share (at 1x P/BV of amount invested) and (5) HAM Projects investment at 23/share (at 1x book value of investments).

SOTP Valuation

Particulars	Segments	Value (Rs mn)	Value per share (Rs)	Rationale
KNR Standalone	Core construction business	46,470	330	At 10x Mar-20 EV/EBITDA
Kerala BOT	Roads toll	3,974	28	At 1x P/BV(x) of invested equity
Muzaffarpur Barauni BOT	Roads toll	694	5	At 1x P/BV(x) of invested equity
Real Estate	Land on Book	718	5	At book value in balance sheet
HAM Projects investment	Roads BOT	3,200	23	Expected investment over next 3yrs at book value in balance sheet.
Total		**51,538**	**392**	

Source: HDFC sec Inst Research

Peer Set Comparison: Core EPC

COMPANY	MCap (Rs bn)	CMP (Rs)	RECO	TP (Rs)	Adj. EPS (Rs/sh)			P/E (x)			EV/EBITDA (x)			ROE (%)		
					FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E	FY18	FY19E	FY20E
Dilip Buildcon	115.7	846	BUY	1,434	46.5	63.1	68.5	17.4	12.8	11.8	9.8	7.9	6.3	14.6	14.4	14.6
IRB Infra Developers	67.8	193	BUY	328	22.6	29.1	26.7	3.3	4.0	3.1	3.5	3.6	2.9	30.3	25.3	30.9
NCC	59.5	99	BUY	159	5.2	5.8	7.7	17.2	15.2	11.5	8.5	8.0	6.6	4.2	3.5	3.8
Sadbhav Engineering	47.8	279	BUY	438	12.9	15.4	16.6	10.4	8.7	8.0	9.1	7.0	5.5	11.8	12.5	12.0
PNC Infratech	42.1	164	BUY	322	4.1	8.7	10.5	26.3	12.1	7.5	10.8	7.2	4.9	6.2	11.9	16.5
Ashoka Buildcon	40.7	145	BUY	348	(5.9)	6.5	7.4	8.1	7.8	7.7	6.5	6.3	5.8	12.8	12.3	11.1
KNR Constructions	**32.1**	**231**	**BUY**	**392**	**13.6**	**10.1**	**14.9**	**12.5**	**16.9**	**11.4**	**6.6**	**7.1**	**5.2**	**18.7**	**11.3**	**14.3**
ITD Cementation*	24.6	143	BUY	211	6.1	10.8	12.3	23.4	15.9	12.2	10.4	7.3	6.2	16.2	17.9	16.8
Ahluwalia Contracts	21.8	326	BUY	486	17.3	22.2	25.3	18.1	14.1	12.4	9.1	7.4	6.3	20.5	21.4	19.9
J. Kumar Infraprojects	17.3	228	BUY	415	18.1	22.2	27.7	12.6	10.3	8.2	6.9	5.3	4.7	9.4	10.7	12.2
JMC Projects	17.7	527	BUY	844	31.6	33.4	39.9	12.7	12.0	10.1	6.8	6.4	5.4	14.4	13.3	14.0
PSP Projects	17.4	483	BUY	639	18.0	27.7	35.5	26.8	17.4	13.6	15.0	9.9	7.3	31.7	28.4	28.2
HG Infra	15.9	244	NR	NR	12.9	19.6	24.7	18.9	12.5	9.9	8.8	5.7	4.7	23.5	21.1	21.5
Average (Core EPC)					**15.6**	**21.1**	**24.4**	**16.0**	**12.3**	**9.8**	**8.6**	**6.9**	**5.5**	**16.5**	**15.7**	**16.6**

Source: Company, HDFC sec Inst Research *ITD Cementation FY19E/FY20E should be read as 15MFY19E/FY20E, 10^{th} August 2018 Prices

Income Statement (Standalone)

Year ending March (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
Net Revenues (post JV partner share)	**9,025**	**15,411**	**19,317**	**20,406**	**29,434**
Growth (%)	***2.1***	***70.7***	***25.3***	***5.6***	***44.2***
Material Expenses	6,805	12,281	12,854	15,505	22,900
Employee Expenses	431	552	721	773	1,030
Other Operating Expenses	260	281	1,880	671	883
EBIDTA	**1,529**	**2,296**	**3,861**	**3,456**	**4,682**
EBIDTA (%)	***16.9***	***14.9***	***20.0***	***16.9***	***15.9***
EBIDTA Growth (%)	***13.8***	***50.1***	***68.2***	***(10.5)***	***35.5***
Depreciation	423	639	1,341	1,472	1,664
EBIT	**1,106**	**1,657**	**2,520**	**1,984**	**3,018**
Other Income (Incl. EO Items)	317	194	393	338	344
Interest	132	219	231	297	377
PBT	**1,291**	**1,632**	**2,682**	**2,024**	**2,985**
Tax	(319)	60	-39	304	597
RPAT	**1,611**	**1,573**	**2,721**	**1,720**	**2,388**
EO items (net of tax)	(165)	(141)	(805)	(304)	(298)
APAT	**1,445**	**1,432**	**1,917**	**1,417**	**2,089**
APAT Growth (%)	***97.9***	***(0.9)***	***33.9***	***(26.1)***	***47.5***
EPS	**10.3**	**10.2**	**13.6**	**10.1**	**14.9**
EPS Growth (%)	***97.9***	***(0.9)***	***33.9***	***(26.1)***	***47.5***

Source: Company, HDFC sec Inst Research

Balance Sheet (Standalone)

As at March (Rs mn)	FY16	FY17	FY18	FY19E	FY20E
SOURCES OF FUNDS					
Share Capital	281	281	281	281	281
Reserves	7,096	8,674	11,297	13,185	15,488
Total Shareholders Funds	**7,377**	**8,955**	**11,578**	**13,466**	**15,770**
Long Term Debt	1,125	1,303	2,118	2,299	2,299
Short Term Debt	-	-	82	-	-
Total Debt	**1,125**	**1,303**	**2,200**	**2,299**	**2,299**
Deferred Taxes	(374)	(432)	(1,408)	(432)	(432)
Other Non Current Liabilities	325	314	284	314	314
TOTAL SOURCES OF FUNDS	**8,453**	**10,140**	**12,654**	**15,648**	**17,951**
APPLICATION OF FUNDS					
Net Block	1,762	2,607	3,316	3,327	2,862
CWIP	59	15	0	15	15
Investments, LT Loans & Advances	3,363	4,663	5,100	6,363	7,863
Other Non Current Assets	1,663	1,850	1,561	1,973	2,109
Total Non-current Assets	**6,848**	**9,135**	**9,977**	**11,678**	**12,849**
Inventories	353	574	712	825	1,208
Debtors	1,294	1,640	2,320	2,516	3,636
Cash & Equivalents	161	246	439	1,590	1,949
ST Loans & Advances, Others	3,555	4,153	4,801	5,278	7,323
Total Current Assets	**5,364**	**6,612**	**8,272**	**10,209**	**14,117**
Creditors	1,038	1,344	2,102	2,230	3,226
Other Current Liabilities & Provns	2,721	4,263	3,493	4,010	5,790
Total Current Liabilities	**3,759**	**5,607**	**5,595**	**6,240**	**9,016**
Net Current Assets	**1,605**	**1,005**	**2,677**	**3,969**	**5,101**
TOTAL APPLICATION OF FUNDS	**8,454**	**10,140**	**12,655**	**15,647**	**17,951**

Source: Company, HDFC sec Inst Research

Cash Flow (Standalone)

Year ending March (Rs mn)	FY16	FY17	FY18P	FY19E	FY20E
PBT	1,291	1,632	2,682	2,024	2,985
Non-operating & EO items	(86)	20	(393)	(338)	(344)
Interest expenses	132	219	231	297	377
Depreciation	423	639	1,341	1,472	1,664
Working Capital Change	830	730	(2,197)	704	(908)
Tax paid	(56)	(75)	39	(304)	(597)
OPERATING CASH FLOW (a)	**2,534**	**3,165**	**1,703**	**3,857**	**3,177**
Capex	(595)	(1,383)	(2,035)	(1,498)	(1,200)
Free cash flow (FCF)	1,939	1,782	(332)	2,359	1,977
Investments	(1,944)	(1,750)	(437)	(1,263)	(1,500)
Other non operating income	-	-	393	338	344
INVESTING CASH FLOW (b)	**(2,538)**	**(3,133)**	**(2,079)**	**(2,424)**	**(2,356)**
Share capital Issuance	-	-	-	-	-
Debt Issuance	204	273	897	99	-
Interest expenses	(128)	(220)	(231)	(297)	(377)
Dividend	(68)	-	(97)	(84)	(84)
Others	-				
FINANCING CASH FLOW (c)	**9**	**53**	**569**	**(283)**	**(461)**
NET CASH FLOW (a+b+c)	**4**	**85**	**193**	**1,151**	**359**
Opening cash balance	157	161	246	439	1,590
Closing Cash & Equivalents	161	246	439	1,590	1,949

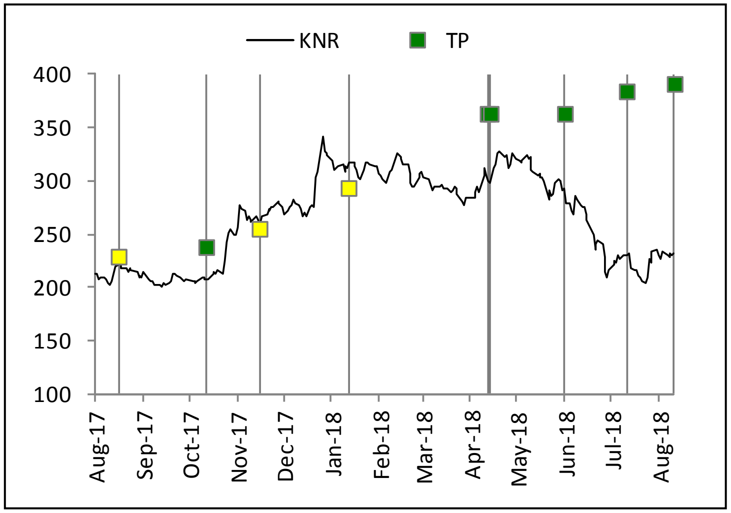
Source: Company, HDFC sec Inst Research

Key Ratios (Standalone)

	FY16	FY17	FY18	FY19E	FY20E
PROFITABILITY (%)					
GPM	24.6	20.3	33.5	24.0	22.2
EBITDA Margin	16.9	14.9	20.0	16.9	15.9
EBIT Margin	12.3	10.8	13.0	9.7	10.3
APAT Margin	16.0	9.3	9.9	6.9	7.1
RoE	22.1	17.5	18.7	11.3	14.3
Core RoCE	28.0	30.5	35.9	21.9	29.7
RoCE	19.0	16.2	17.0	10.7	13.3
EFFICIENCY					
Tax Rate (%)	(24.7)	3.7	(1.5)	15.0	20.0
Asset Turnover (x)	1.8	2.4	2.2	2.1	2.7
Inventory (days)	14	14	13	15	15
Debtors (days)	52	39	44	45	45
Payables (days)	42	32	40	40	40
Cash Conversion Cycle (days)	25	21	18	20	20
Other Current Assets (days)	144	98	91	94	91
Other Current Liab (days)	110	101	66	72	72
Net Working Capital Cycle (Days)	**58**	**18**	**42**	**43**	**39**
Debt/EBITDA (x)	0.7	0.6	0.6	0.7	0.5
Net D/E	0.13	0.12	0.2	0.1	0.0
Interest Coverage	8.4	7.6	10.9	6.7	8.0
PER SHARE DATA					
EPS (Rs/sh)	10.3	10.2	13.6	10.1	14.9
CEPS (Rs/sh)	13.3	14.7	23.2	20.5	26.7
DPS (Rs/sh)	0.0	0.0	0.6	0.5	0.5
BV (Rs/sh)	52	64	82	96	112
VALUATION					
P/E	22.5	22.7	16.9	22.9	15.5
P/BV	4.4	3.6	2.8	2.4	2.1
EV/EBITDA	21.9	14.6	8.9	9.6	7.0
OCF/EV (%)	7.6	0.1	0.0	0.1	0.1
FCF/EV (%)	5.8	5.3	(1.0)	7.1	6.0
FCFE/Market Cap (%)	6.2	5.6	1.0	6.7	4.9
Dividend Yield (%)	0.0	0.0	0.3	0.2	0.2

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
17-Aug-17	221	NEU	228
11-Oct-17	209	BUY	239
15-Nov-17	255	NEU	255
12-Jan-18	314	NEU	293
12-Apr-18	300	BUY	364
14-Apr-18	298	BUY	364
31-May-18	298	BUY	364
10-Jul-18	230	BUY	385
12-Aug-18	231	BUY	392

Rating Definitions

BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period

NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period

SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

Disclosure:

We, **Parikshit Kandpal, MBA & Kunal Bhandari, ACA**, authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. HSL has no material adverse disciplinary history as on the date of publication of this report. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

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HDFC securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066

Compliance Officer: Binkle R. Oza Email: compliianceofficer@hdfcsec.com Phone: (022) 3045 3600

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HDFC securities
Institutional Equities
Unit No. 1602, 16th Floor, Tower A, Peninsula Business Park,
Senapati Bapat Marg, Lower Parel,Mumbai - 400 013
Board : +91-22-6171 7330 www.hdfcsec.com