ANANDRATHI

India I Equities

Construction

Company Update

Change in Estimates ☑ Target ☑ Reco ☐

15 June 2020

KNR Construction

Rating: **Buy**
Target Price: ₹272
Share Price: ₹197

Doesn't fail to surprise positively; retaining a Buy

Its penchant to deliver better than expected on execution and margins continued even during the Covid-impacted Q4. More inspiring were pruned gross and net debt, implying management continues to strike a fine balance between the income statement and balance sheet. With its sound strategy intact, we see the Covid-disruption as short-lived, and KNR recovering from this largely unscathed (consequently, better placed). It also appears insulated from an expected near-term slowdown in ordering, thanks to the recently added irrigation orders. Its proven execution capabilities, augmented order backlog and a well-placed balance sheet give us confidence to retain our Buy call.

OB, immediate slowdown-proof. Two recent irrigation orders of ~₹23bn (KNR's share: ~₹20bn) couldn't have come at a better time, and insulates it from any slow ordering in the immediate future. The gross OB (~₹79bn, incl. post-Q4 irrigation orders and yet-to-be appointed ~₹6.4bn hybrid annuity) provides healthy revenue assurance (book-to-bill at ~3.5x FY20 revenues).

Labour returning, key to normalcy. With the raw-material chain already on its way to recovery (on the recently relaxed lockdown restrictions), labour returning holds the key to realise the true potential of the augmented OB. Operating at ~60% currently, normalcy is expected by H1-end.

Debt shrinks. Notwithstanding a protracted receivable cycle (up 38 days y/y, 16 q/q), net debt shrunk (~₹1.3bn q/q, ~₹0.5bn y/y, to ~₹2bn) on mobilisation receipts and higher trade payables.

Walayar-Vadakancherry monetisation. With lenders already on board and in-principal approval in place from the NHAI, management expects to consummate this by H1-end. A dialogue with the buyer is not ruled out, in view of the current situation.

Valuation. Adjusting for the Covid-impact, FY21e earnings are ~35% lower and raised margin-expectation leaves FY22e earnings up ~4%. At present, the stock (excl. investments) trades at 8.7x FY22e EPS. **Risk.** Prolonged Covid-19 impact.

Key financials (YE Mar)	FY18	FY19	FY20P	FY21e	FY22e
Sales (₹ m)	19,317	21,373	22,442	21,790	29,937
Net profit (₹ m)	2,721	2,658	2,359	1,333	2,448
EPS (₹)	19.4	18.9	16.8	9.5	17.4
Growth (%)	61.8	-2.3	-11.2	-43.5	83.6
PE (x)	14.7	13.8	11.7	20.7	11.3
EV / EBITDA (x)	10.8	9.2	6.1	7.3	5.2
PBV (x)	3.4	2.6	1.7	1.6	1.4
RoE (%)	24.4	20.6	15.5	7.9	13.1
RoCE (%)	26.3	23.5	22.0	13.1	19.4
Net debt / equity (x)	0.2	0.2	0.1	0.1	0.2

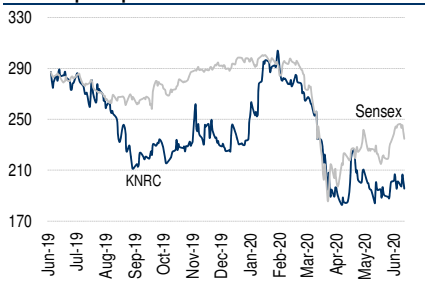
Source: Company, Anand Rathi Research *P- Provisional*

Key data	KNRC IN / KNRL.BO
52-week high / low	₹312 / 171
Sensex / Nifty	32767 / 9674
3-m average volume	$0.8m
Market cap	₹27.6bn / $364m
Shares outstanding	141m

Shareholding pattern (%)	Mar'20	Dec'19	Sep'19
Promoters	55.2	55.2	55.2
- of which, Pledged	-	-	-
Free float	44.8	44.8	44.8
- Foreign institutions	1.9	2.5	2.8
- Domestic institutions	34.0	32.5	32.4
- Public	8.9	9.8	9.6

Estimates revision (%)	FY21e	FY22e
Sales	-22.5	-5.4
EBITDA	-22.7	3.1
EPS (₹)	-35.0	4.3

Relative price performance



Source: Bloomberg

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Research Analyst

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Quick Glance – Financials and Valuations (standalone)

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY18	FY19	FY20P	FY21e	FY22e
Order backlog	23,266	40,156	52,297	67,550	73,538
Order inflows	4,723	37,919	34,583	37,044	35,924
Net revenues	**19,317**	**21,373**	**22,442**	**21,790**	**29,937**
Growth (%)	*25.3*	*10.6*	*5.0*	*-2.9*	*37.4*
Direct costs	14,297	15,725	15,845	15,842	21,929
SG&A	1,180	1,378	1,727	1,797	2,043
EBITDA	**3,839**	**4,270**	**4,871**	**4,152**	**5,966**
EBITDA margins (%)	*19.9*	*20.0*	*21.7*	*19.1*	*19.9*
Depreciation	1,341	1,681	1,918	2,114	2,316
Other income	393	634	566	299	297
Interest expenses	209	291	474	559	656
PBT	2,682	2,931	3,044	1,778	3,291
Effective tax rate (%)	*-1.5*	*9.3*	*22.5*	*25.0*	*25.6*
+ Associates / (Minorities)	-	-	-	-	-
Net income	2,721	2,633	2,252	1,333	2,448
Adjusted income	2,721	2,658	2,359	1,333	2,448
WANS	141	141	141	141	141
FDEPS (₹ / sh)	19.4	18.9	16.8	9.5	17.4

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY18	FY19	FY20P	FY21e	FY22e
Share capital	281	281	281	281	281
Net worth	11,578	14,143	16,239	17,487	19,851
Debt	2,204	2,641	2,297	2,841	3,789
Minority interest	0	0	0	0	0
DTL / (Assets)	-1,408	-1,739	-1,610	-1,610	-1,610
Capital employed	**12,375**	**15,045**	**16,926**	**18,718**	**22,030**
Net tangible assets	3,934	4,339	4,463	4,036	4,268
Net intangible assets	2	1	1	1	1
Goodwill	0	0	0	0	0
CWIP (tang. & intang.)	0	0	102	0	0
Investments (strategic)	396	1,431	7,149	9,566	11,103
Investments (financial)	0	1	0	0	0
Current assets (ex cash)	13,444	15,054	13,523	13,224	16,358
Cash	438	130	330	321	307
Current liabilities	5,839	5,911	8,642	8,431	10,006
Working capital	7,604	9,143	4,881	4,793	6,351
Capital deployed	**12,375**	**15,045**	**16,926**	**18,718**	**22,030**
Contingent liabilities	555	1,315	-	-	-

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY18	FY19	FY20P	FY21e	FY22e
PBT + Net interest expense	2,498	2,589	2,952	2,038	3,649
+ Non-cash items	1,341	1,681	1,918	2,114	2,316
Oper. prof. before WC	3,839	4,270	4,871	4,152	5,966
- Incr. / (decr.) in WC	2,182	1,539	-4,262	-88	1,558
Others incl. taxes	194	551	685	444	843
Operating cash-flow	**1,463**	**2,180**	**8,448**	**3,796**	**3,564**
- Capex (tang. + intang.)	2,040	2,086	2,144	1,586	2,548
Free cash-flow	**-577**	**95**	**6,304**	**2,210**	**1,017**
Acquisitions	-	-	-	-	-
- Div.(incl. buyback & taxes)	85	68	153	85	84
+ Equity raised	-	-	-	-	-
+ Debt raised	171	106	-215	543	949
- Fin investments	-278	1,036	5,717	2,418	1,537
-Net interest expense + Misc.	-404	-594	19	260	359
Net cash-flow	**192**	**-308**	**200**	**-9**	**-14**

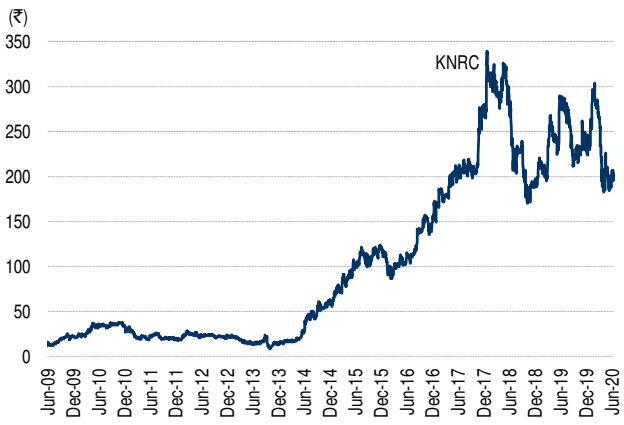
Source: Company, Anand Rathi Research *P- Provisional*

Fig 4 – Ratio analysis

Year-end: Mar	FY18	FY19	FY20P	FY21e	FY22e
P/E (x)	14.7	13.8	11.7	20.7	11.3
EV / EBITDA (x)	10.8	9.2	6.1	7.3	5.2
EV / Sales (x)	2.2	1.8	1.3	1.4	1.0
P/B (x)	3.4	2.6	1.7	1.6	1.4
RoE (%)	24.4	20.6	15.5	7.9	13.1
RoCE (%)	26.3	23.5	22.0	13.1	19.4
Sales / FA (x)	4.9	4.9	4.9	5.4	7.0
DPS (₹ / sh)	0.5	0.4	0.9	0.5	0.5
Dividend yield (%)	0.2	0.2	0.5	0.3	0.3
Dividend payout (%) - incl. DDT	3.1	2.6	6.5	6.4	3.4
Net debt / equity (x)	0.2	0.2	0.1	0.1	0.2
Receivables (days)	44	40	77	81	65
Inventory (days)	13	16	20	15	17
Payables (days)	41	38	41	40	40
CFO : PAT %	53.8	82.0	358.1	284.7	145.6

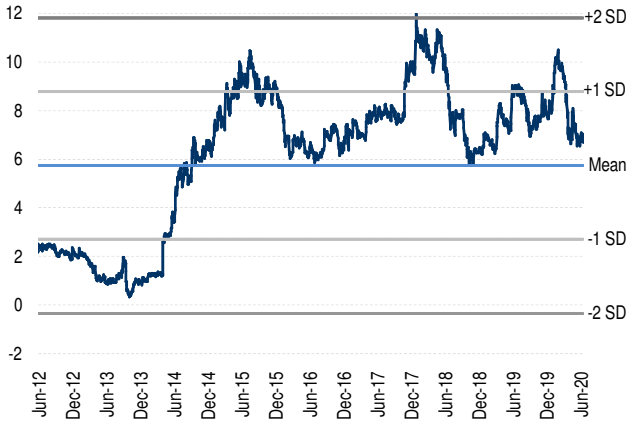
Source: Company, Anand Rathi Research *P- Provisional*

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – EV / EBITDA band



Source: Company

Concall highlights

Income statement

- **Covid disrupts execution; pace otherwise healthy.** Barring the Covid'19-disruption toward the second half of Mar'20, the pace of execution in Q4 was otherwise healthy and amply manifest in the ~21% sequentially higher revenues (~₹6.8bn). Y/y though, revenue from operations was ~6% lower and could largely be attributed to the Covid-19 hitch. For the year, revenue from operations was up ~5% y/y to ~₹22.4bn, largely assisted by the ~10% y/y growth in the first nine months.
- **EBITDA margin, boosted by greater share of hybrid annuities and irrigation.** These two (relatively higher margin) combined accounted for ~71% of Q4 revenue. Consequently, the EBITDA margin was a sturdy ~21.7% (expanding ~161bps y/y). Irrigation's share was ~23% and the hybrid annuity portfolio contributed ~48%. The FY20 EBITDA margin expanded ~173bps y/y to ~21.7%, the result of a better project-mix and arbitration claims (~₹0.2bn).

Fig 7 – Financial highlights

(₹ m)	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	% Y/Y	% Q/Q	FY19	FY20	% Y/Y
Sales	6,244	5,564	4,163	4,489	7,157	4,646	5,462	5,579	6,756	-5.6	21.1	21,373	22,442	5.0
EBITDA	1,187	1,098	831	899	1,441	900	1,258	1,244	1,469	1.9	18.1	4,270	4,871	14.1
EBITDA margins (%)	*19.0*	*19.7*	*20.0*	*20.0*	*20.1*	*19.4*	*23.0*	*22.3*	*21.7*	*161bps*	*-56bps*	*20.0*	*21.7*	*173bps*
Interest	67	72	74	70	75	90	98	142	145	93.1	2.1	291	474	62.9
Depreciation	491	360	393	450	478	389	475	517	538	12.4	4.0	1,681	1,918	14.1
Other income	183	178	88	217	151	168	256	70	73	-51.9	4.4	634	566	-10.7
Exceptional	-	-	-	-	25	-	40	67	-	-100.0	-100.0	25	107	320.5
PBT	811	844	453	595	1,014	589	901	588	859	-15.2	46.1	2,906	2,937	1.1
Tax	14	104	3	74	92	112	200	186	187	103.3	0.8	273	685	150.5
PAT	797	740	450	521	922	477	701	402	672	-27.1	67.1	2,633	2,252	-14.5
Adjusted PAT	797	740	450	521	947	477	741	469	672	-29.0	43.2	2,658	2,359	-11.2

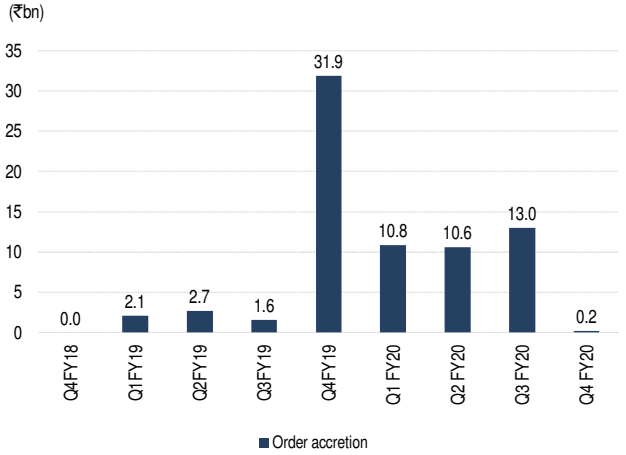
Source: Company

- **Slightly better operating profitability, but earnings down.** On the steep (~93% y/y) jump in finance costs, ~52% y/y lower other income and ~12% y/y higher depreciation, adjusted PAT contracted ~29% y/y to ~₹672m.
  - Higher finance cost arose largely as the result of mobilisation advances availed of from hybrid annuity SPVs, and the y/y higher opening gross debt.
  - Greater utilisation of CC limits and, hence, lower interest on FDRs pulled down other income.
  - On waning 80-IA benefits, the higher effective tax rate (~22%, against ~9% a year ago), too, had a role to play in the earnings slide.
  - For FY20, even a ~14% y/y higher EBITDA could not cover for the higher finance cost, lower other income and waning 80-IA tax benefits. Consequently, adjusted PAT was down ~11% y/y.

Order backlog and scope

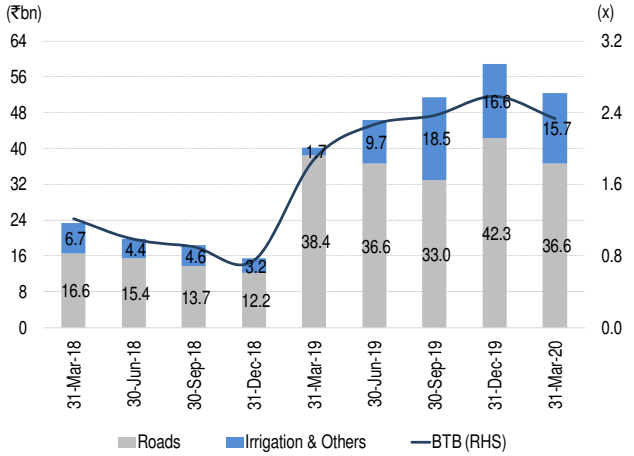
- The general slowdown in tendering, postponing of tenders for some identified prospects and the Covid-led disruption toward end-Mar'20 meant there were no new orders for the company during Q4.
- While it may have missed its guidance of bagging orders of another ~₹10bn-15bn in Q4, it has more than made up for this, post-Q4.
  - Through two JVs, it recently bagged from the Telangana government two irrigation orders of ~₹23bn, from which economic benefits of ~₹20bn would accrue to KNR.
  - The first project, bid in a JV with HES, entails EPC potential of ~₹7bn, and would be jointly executed by the two partners. Based on its 60% share, KNR is entitled to ~₹4.2bn of EPC work.
  - The second project, a consortium of KNR, Navayuga and NCC, boasts of ~₹16bn EPC potential, and would be executed entirely by KNR.
- With no new inflows during the quarter to cover for the orders executed, the order backlog slid by ~₹6.6bn q/q to ~₹52.3bn at end-FY20. Though down, this still implied respectable revenue assurance of ~2.3x FY20 revenues.
  - Including its yet-to-be appointed hybrid annuity project (~₹6.4bn EPC potential) and KNR's share in the recently bagged irrigation orders, the executable backlog jumps to ~₹78.9bn. Consequently, the revenue assurance, at ~3.5x (based on FY20 revenues), turns inspiring.

Fig 8 – ~₹30bn more orders targeted in FY21, mostly roads



Source: Company, Anand Rathi Research Notes: Inflows include change in scope

Fig 9 – Year-end OB: ~₹52.3bn ; current OB: ~₹78.9bn



Source: Company

- With two recent irrigation orders, the start to FY21 has been strong. These two mean the percentage of irrigation orders has risen significantly; thus, management seeks to sharpen its focus ahead on bagging road orders (primarily from the NHAI).
  - Given the scale of operations and execution timelines in place, management looks at further orders of ~₹30bn in FY21 as ideal. On its radar are EPC and hybrid annuity orders from the NHAI.
- The latter has an immediate bid-pipeline of ~20 projects, but bids on these have been delayed continuously.

- Of these, KNR has its eyes on ~5-6 hybrid annuity projects (in Tamil Nadu, Telangana and Andhra Pradesh); cumulative potential: ~₹60bn-70bn.

- Management also bid for, and awaits, the opening of a ~₹5bn BOT-annuity opportunity from a Tamil Nadu state authority.

Hybrid annuity projects and equity infusion updates

- **Chittoor-Mallavaram.** Physical progress at end-FY20 touched ~54.4%, up from ~35.2% a quarter ago. Cumulatively, ~₹0.7bn of equity has already been infused, which is only ~₹5m short of KNR's share (~51%) of equity required. Given that the project has over 90% RoW, KNR has an option to seek equity from Cube Highways toward the latter's ~49% share. The SPV received a ~₹1.5bn grant in the quarter, which took cumulative receipts to ~₹4.5bn. No construction-finance was drawn up to 31st Mar'20, but a request has recently been made.

- **Ramsanpalle-Mangloor.** The project has already attained ~43.7% physical progress, up from ~34.8% a quarter ago. Management is ~₹14m short of its share of ~₹0.7bn equity infusion (for its ~51% stake). The SPV, cumulatively, has received grants of ~₹2bn, incl. ~₹1bn in Q4. The project SPV also drew debt of ~₹1bn during Q4.

Fig 10 – Hybrid annuities @ a glance

Particulars	Trichy-Kallagam	Chittoor-Mallavaram	Ramsanpalle-Mangloor	Magadi-Somwarpeth	Oddanchatram- Madathukulam
Authority	NHAI	NHAI	NHAI	KSHIP	NHAI
Project length (km)	39	61	47	166	45
Award dates	Mar-18	Mar-18	Mar-18	May-18	Mar'19
Financial closure	Achieved	Achieved	Achieved	Achieved	Documents submitted with NHAI
Appointed dates	1st Mar'19	4th Jan'19	2nd May'19	12th Feb'20	Awaited
Scheduled construction period	2 years	2.5 years	2 years	2 years	2 years
Concession period after COD	15 years	15 years	15 years	9 years	15 years
Bid project cost (₹ m)	10,206	17,301	12,340	11,445	9,200
EPC value (₹ m)	7,230	12,256	8,742	9,000	6,400
Means of finance					
Grant (₹ m)	4,318	7,393	4,936	7,485	NA
Debt (₹ m)	3,820	5,730	4,169	2,570	
Equity (₹ m)	962	1,433	1,351	1,221	813
Equity Invested (₹ m)	481	725	676	69	41

Source: Company

- **Trichy-Kallagam.** The project has already made ~37.4% progress, up from ~25.4% a quarter back. Management has already infused ~₹0.5bn equity for its ~51% stake (only ~₹10m still pending). Milestone-linked grants of ~₹1.8bn have already been received, incl. ~₹1bn in Q4. Besides this, during the quarter the SPV availed of a further ~₹0.6bn construction finance, taking total debt availed of to ~₹0.8bn.

- **Magadi-Somwarpeth (KSHIP).** Physical progress at the year-end was only ~7% as the project has only very recently been appointed (Feb'20). The project has ~72% RoW, up from ~65% in the previous quarter. Of the required equity infusion of ~₹1.2bn, only ~₹69m has been infused; another ~₹1bn is expected in FY21.

- **Oddanchatram- Madathukulam.** This, KNR's most recent hybrid annuity project, has ~₹6.4bn EPC potential. Having already signed a concession agreement the previous quarter, the company in May'20 submitted financing documents to the NHAI and hopes for the

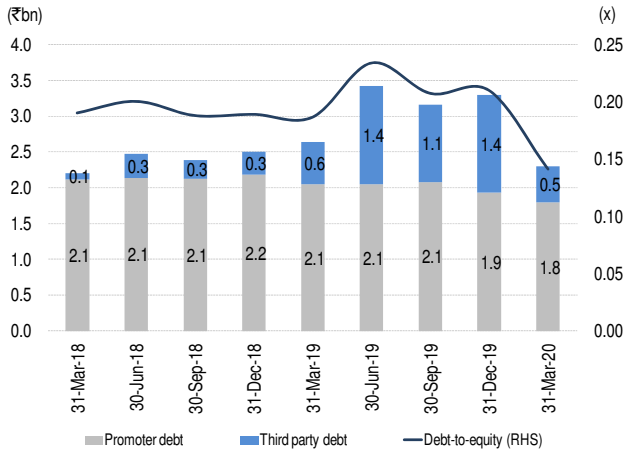
appointed date by Jul'20. The land acquisition is still underway for the project, but management hopes to have majority in place by the time appointed date is approved. The project finance has been arranged at an attractive sub-9% interest rate.

- **Equity commitment, infusion schedule.** For the five hybrid annuity projects, KNR's share of equity is estimated at ~₹3.9bn. Another ~₹1.8bn is due from Cube Highways toward its 49% stake in the first three hybrid annuity projects.
  - Having already infused ~₹2bn equity (~₹1bn in FY20), management looks to infuse another ~₹1.5bn in FY21. This would largely comprise ~₹1bn for the KSHIP project and ~₹0.4bn toward the Palani project, and balance for its share in the older hybrid annuities.
  - Besides the above ~₹1.5bn, KNR could infuse ~₹1bn in FY21 in the three assets agreed to be sold to Cube Highways. This is being considered to delay Cube's equity infusion toward its 49% stake in these SPVs, and consequently improve return profile.
  - The balance ~₹1.3bn (incl. Cube's ~₹0.8bn share toward the first three projects) would be invested thereafter, in FY22.
  - The partner, Cube Highways, for the three older NHAI projects would invest its share of equity only when ~90% RoW is available.
  - While RoW, per Cube's requirement, is largely in place for the projects already agreed to be monetised, KNR may opt to delay Cube's equity infusion to improve its (KNR's) return profile (by saving on the IDC component), as any investment by Cube during construction period would carry an interest rate higher than the company's blended cost of funding.
  - Management didn't discount a scenario in which it could infuse the ~100% equity required in these projects and recoup the monies from Cube later. It hopes to firm up its decision on this shortly.

Balance sheet

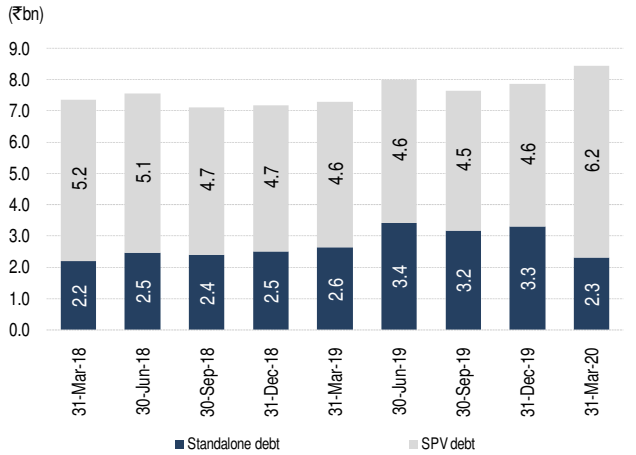
- At 31st Mar'20, gross debt was down ~₹1bn q/q to ~₹2.3bn. The decline in the net debt was more pronounced, ~₹1.3bn lower q/q to ~₹2bn. The standalone net-debt-to-equity is an appealing ~0.1x, against ~0.2x a quarter and a year ago.

Fig 11 – Gross and net debt down ~₹1bn and ~₹1.3bn q/q



Source: Company

Fig 12 – SPV debt up ~₹1.6bn (net), on HAM draw-downs



Source: Company

- Of the gross debt, promoter loans accounted for ~₹1.8bn, against ~₹1.9bn a quarter back. Third-party debt, thus, was a only ~₹0.5bn (down ~₹0.9bn q/q).
- The reduction in absolute debt stemmed from a mix of availing of mobilisation advances (amounting to ~₹0.6bn) at a recently commenced hybrid annuity project (Magadi-Somwarpeth), a drawdown of further debt of ~₹1.7bn by the hybrid annuity SPVs (would have been up-streamed partly), and NHAI grants of ~₹3.6bn in hybrid annuities (partly up-streamed).
- The reduction could have been better were it not for ~₹0.2bn of equity infusion in hybrid annuities and a build-up in receivables on account of the recently executed work at hybrid annuities, and irrigation orders.
- With its comfortable liquidity position, the company did not avail of the moratorium on its loans during the scheme's first round (Mar-May'20); it has no such plans for the second round (Jun-Aug'20).

- At end-FY20, consolidated gross debt (~₹8.5bn) was up ~₹0.6bn q/q. This was due to ~₹1.6bn net debt draw-downs by the SPVs but off-set by ~₹1bn lower standalone gross debt.
  - At ~₹6.2bn, gross debt at the SPVs eligible for consolidation was up ~₹1.6bn q/q. This was largely on account of drawdown of ~₹1.7bn by the SPVs for the under-construction hybrid annuity assets, but partly offset by ~₹71m of repayments by two operational BOT-toll assets.
  - Gross debt for the two annuity SPVs (not consolidated on a line-by-line basis as it has a 40% stake each in both) declined ~₹0.2bn q/q to ~₹5.8bn.
- Year-end standalone receivables of ~₹4.8bn (up from ~₹2.3bn on 31st Mar'19 and ~₹2.9bn on 30th Sep'19) comprise ~₹2bn from irrigation orders (incl. ~₹1.3bn due toward the Mallanna Sagar project from Megha Engineering), and another ~₹2bn due from one of the hybrid annuity projects (pending bank disbursals). Over the last six months, unbilled revenues, too, appear to have come down.
- The cash-conversion cycle was up 17 days y/y, 10 days q/q, to 53. The lengthened receivables cycle (38 days higher y/y, 16 days q/q) was the key contributor to the elongated cash-conversion cycle. Nevertheless, standalone debt (overall) was down on account of the receipt of mobilisation advances.

BOT-toll projects

- **Operational performance.** Performances of the two operational BOT-tolls were a mixed bag during Q4.
  - The Covid-led toll suspension toward end-Mar'20 and a general slowdown earlier muted toll collections at the Walayar-Vadakancherry project to ~2% y/y growth (to ~₹163m), and ~8% q/q decline.
  - For the Muzaffarpur-Barauni project, collections were down ~32% y/y (to ~₹144m) on the combined effect of the Covid-led slowdown and the halting of movement of heavy vehicles on Rajendra Setu (a feeder road), on account of damages to the bridge. Sequentially, the collection was ~6% higher owing to seasonality.

- **Walayar-Vadakanchery monetisation, expected by end-H1 FY21.** Consequent to KNR signing the share-purchase agreement with Cube Highways on 9th Jan'20 to monetise its Walayar-Vadakanchery project, for an enterprise value of ~₹5.3bn, the company has secured approval from the lenders. The proposal has in-principal approval from the NHAI, and expects to have the final accord sooner than later. Consequently, management looks to close the deal by end-H1 FY21.
  - To secure firm approval, the company is required to give certain undertakings to the NHAI. On submission of the undertakings, it would receive the approval in ~45 days.
  - Management said the current state of affairs led to Cube initially approaching the company to discuss again certain aspects of the deal, to which the company agreed that on receipt of all approvals, a dialogue would be held.
  - However, with the government relief measures announced, especially the extension of the concession period, KNR said there shall be no material delays in finalising the deal.
  - Management has not quantified any impact on the final equity value it could receive, but is confident of the deal closure.
  - The company had infused ~₹4bn equity (incl. ~₹2.6bn of quasi-debt instruments) and the project had outstanding debt of ~₹1.4bn on 31st Mar'20. The ~₹5.3bn deal EV implies equity compensation of ~₹3.9bn.
  - Foreseeable losses of ~₹67m were accounted for as an exceptional item in FY20. This loss is likely to be more than made good by the substantial favourable arbitration awards (of ~₹1.7bn). These are currently being challenged by the authority in the higher courts.

Other highlights

- **Execution in the Covid-19 context.** Like most of its peers, KNR too was struck by the Covid-induced lockdown, leading to execution halting at its project sites and suspension of toll-collection at its BOT-toll portfolio. With the gradual easing of the lockdown, management re-commenced execution at all its work sites. Operational efficiency is now 50-65%.
  - Initially, management faced issues of non-availability of raw materials, now to a great extent normalised.
  - Labour has been the key concern till now, with the company having retained only ~30% of its workforce.
  - Management added that migrant workers are willing to return. Stringent conditions pose a key hurdle, though, such as compulsory quarantine and other statutory guidelines. These are tiresome and challenging.
  - Management expects the lockdown conditions to further ease by the month-end, and its manpower to gradually increase.
  - Major execution recovery is likely from Q3, owing to a constrained execution pace in Q1 and monsoon-impacted Q2. Thus, the company has avoided giving any revenue figures for FY21.
  - Against its recent trend of 20%+ EBITDA margins, management sees potential for a ~200bp-300bp contraction in the H1 FY21

margin. This would be on a mix of under-absorbed fixed costs, additional expenses to retain labour and to render worksites compliant with Covid-safety guidelines.

- Management looks to apply for relief measures (as a part of the Atma-nirbhar Bharat package) announced by the government and is currently evaluating them. It expects to receive extension of time and doesn't envisage any penalties arising on delays in execution.
- Also, it hopes for the partial release of bank- and performance-guarantees, in accordance with the relief measures announced by the Finance Minister. Management said that, while this measure by the government is commendable, it has yet to see any progress on this account. At end-FY20, KNR had outstanding retention monies of ~₹1.5bn.

- **Navayuga irrigation project.** Of its ~4km long Navayuga irrigation project (pending EPC value of ~₹8.5bn), it has RoW for ~1km, management said. The balance is expected in 3-4 months and then the contribution from the project is expected to improve. Management highlights that the pace of execution would take into account receipt of payments. It has recently raised its first bill.
- **The newer irrigation projects.** Entailing a combined EPC potential of ~₹20bn, work at these two projects differs from the irrigation projects executed in the past. The projects here involve laying of pipelines and also includes construction of pump house.
  - With available machinery and fleet of vehicles, it seeks to commence execution at these projects by Q3 FY20.
  - Management does not see payments as any issue as the project finances have been tied up with a leading financial institution.
  - Management declared that ~₹0.5bn capex in FY21 would suffice for scope-of-works to be executed in FY21 and sees major capex needs in FY22 on account of this project.
- **Arbitration details.** On the arbitration front, it expects some traction in FY21, more likely in H2.
  - Management said it has claims of ~₹8bn, including the share of its JV partners. Of this, ~₹5.4bn is KNR's share.
  - These are mostly favourably ruled by arbitration panels, and the clients have challenged these favourable rulings in the court of law.

Valuation

Owing to the Covid-brought on situation, the company is likely to lose man-days in FY21. We see a part of the disruption spilling over to FY22; accordingly, we lower our FY21e and FY22e revenue ~22% and ~5% respectively. Notwithstanding the lowered revenue estimates, we raise margin expectations for FY21 and FY22 on account of recent strong inflows in the relatively higher-margin irrigation segment. The lower revenues, partly counter-balanced by the higher margins but weighed down by negative financial leverage, would lead to ~35% lower earnings in FY21. For FY22, earnings would be up ~4% as the anticipated expanded margin would counter-balance the pruned revenue estimates.

Mindful of the altered risk profile, we lower the PE valuation multiple for the EPC business to 12x, from 15x earlier.

On our new estimates, our sum-of-parts-based target of ₹272 a share (against ₹320 earlier) is derived using a relative valuation multiple for the construction business (based on 12x FY22e EPS; ₹209 a share). The asset ownership business has been assumed at a 20% discount to the invested / liquidation value (₹63 a share). The value for the asset ownership assumes KNR to infuse Cube's share of equity investment.

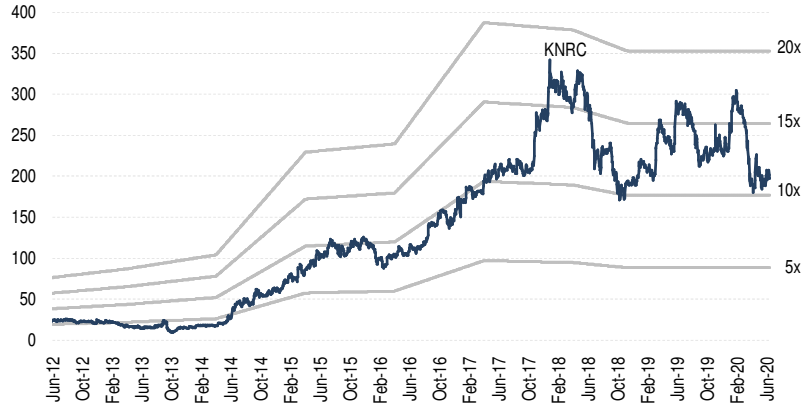
Fig 13 – Estimates revision

(₹ m)	Old Estimates		Revised Estimates		Change (%)	
	FY21e	FY22e	FY21e	FY22e	FY20e	FY21e
Revenue	28,100	31,632	21,790	29,937	-22.5	-5.4
EBITDA	5,374	5,787	4,152	5,966	-22.7	3.1
EPS (₹)	14.6	16.7	9.5	17.4	-35.0	4.3

Source: Anand Rathi Research

At the ruling price, the stock (excl. investments) quotes at 15.9x FY21e and 8.7x FY22e EPS.

Fig 14 – PE band



Source: Company, Bloomberg, Anand Rathi Research

Risks

- Prolonged impact of Covid-19, leading to a slower-than-expected pace of execution.
- A considerable deterioration in working capital.

Appendix

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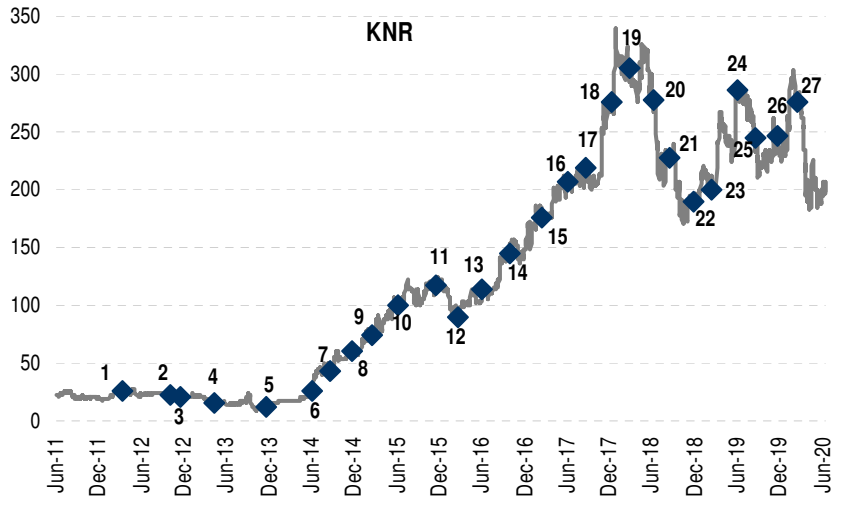
Rating and Target Price History (as of 13 June 2020)



	Date	Rating	TP (₹)	Share Price (₹)
1	09-Mar-12	Buy	39	26
2	01-Oct-12	Buy	33	22
3	12-Nov-12	Buy	30	22
4	09-Apr-13	Buy	23	16
5	18-Nov-13	Buy	26	15
6	02-Jun-14	Buy	44	27
7	19-Aug-14	Buy	61	45
8	19-Nov-14	Buy	90	61
9	16-Feb-15	Buy	106	75
10	08-Jun-15	Buy	138	103
11	17-Nov-15	Buy	157	122
12	15-Feb-16	Buy	140	90
13	02-Jun-16	Buy	148	111
14	29-Sep-16	Buy	186	154
15	15-Feb-17	Buy	201	173
16	01-Jun-17	Buy	243	201
17	17-Aug-17	Buy	248	221
18	11-Dec-17	Hold	292	277
19	20-Feb-18	Hold	293	308
20	04-Jun-18	Hold	329	280
21	14-Aug-18	Buy	298	229
22	13-Nov-18	Buy	269	190
23	12-Feb-19	Buy	267	200
24	03-Jun-19	Hold	305	280
25	19-Aug-19	Buy	305	232
26	18-Nov-19	Buy	306	245
27	15-Feb-20	Buy	320	277

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