

16 November 2020

KNR Construction

*Asset monetisation brightens prospects; raising to a Buy*Rating: **Buy**

Target Price: Rs320

Share Price: Rs256

With monetisation proceeds from its Walayar-Vadakancherry BOT-toll, KNR's balance sheet is at its strongest in many years. It could have been sturdier were it not for the protracted receivables cycle for Telengana irrigation orders. With these payments already started to flow in and the swifter-than-expected return of execution efficiency, KNR appears set to continue its industry-leading performance. On its sturdier balance sheet, ample assurance and proven execution capabilities, we raise our rating to a Buy, with a TP of Rs320 (from Rs293).

Walayar-Vadakancherry monetised, balance sheet strengthened. The much-awaited deal was consummated with an enterprise value of ~Rs5.1bn. Immediate receipt of ~Rs3.1bn (of ~Rs3.8bn total equity value) helped clear the entire ~Rs2.1bn promoter loans, and bring net debt down ~Rs2.9bn q/q (to ~Rs0.2bn). The balance would be realised by FY23, based on milestones.

OB at life-high, aided by a new order. Two irrigation orders (of ~Rs23bn) in Q1 were followed by a ~Rs10.3bn (excl. GST) road EPC order in Q2. Besides, its fifth hybrid annuity project of EPC value ~Rs6.4bn formed part of the OB on attaining the appointed date. Consequently, the OB rose ~Rs13.5bn q/q to its life high of ~Rs85.5bn (book-to-bill at ~3.7x). ~Rs20-30bn more is targeted in the short term to cover for three hybrid annuity projects due for completion in the next six months.

Revenue guidance firmed. Based on the recovery in execution efficiency and recent orders added, FY21 revenues are now expected at ~Rs23.5bn-24bn. This is against the earlier guidance of flat revenues y/y but with potential. Margin guidance re-iterated at 17-18%, but with potential based on the project mix.

Valuation. On a mix of raised revenue estimates, lowered depreciation charge, and the Walayar-Vadakancherry monetisation, FY21e earnings have been raised ~45% (and ~22% for FY22). At the CMP, the stock (excl. investments) trades at 10.4x FY22e EPS. The TP assumes 13x PE, but scope exists for a better PE if the irrigation receivables cycle is checked. **Risk.** Delays in irrigation receivables.

Key financials (YE Mar)	FY18	FY19	FY20	FY21e	FY22e
Sales (Rs m)	19,317	21,373	22,442	24,268	30,404
Net profit (Rs m)	2,721	2,658	2,359	2,219	3,026
EPS (Rs)	19.4	18.9	16.8	15.8	21.5
Growth (%)	61.8	-2.3	-11.2	-6.0	36.4
PE (x)	14.7	13.8	11.7	16.2	11.9
EV / EBITDA (x)	10.8	9.2	6.1	7.7	6.0
PBV (x)	3.4	2.6	1.7	2.0	1.7
RoE (%)	24.4	20.6	15.5	12.9	15.3
RoCE (%)	26.3	23.5	22.0	20.5	23.1
Net debt / equity (x)	0.2	0.2	0.1	0.0	0.0

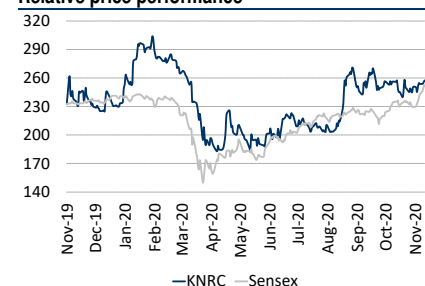
Source: Company, Anand Rathi Research

Key data	KNRC IN / KNRL.BO
52-week high / low	Rs312 / 171
Sensex / Nifty	43443 / 12720
3-m average volume	\$0.7m
Market cap	Rs36bn / \$483m
Shares outstanding	141m

Shareholding pattern (%)	Sep'20	Jun'20	Mar'20
Promoters	55.0	55.0	55.2
- of which, Pledged	-	-	-
Free float	45.0	45.0	44.8
- Foreign institutions	1.5	1.6	1.9
- Domestic institutions	34.3	34.0	34.0
- Public	9.1	9.3	8.9

Estimates revision (%)	FY21e	FY22e
Sales	7.2	0.6
EBITDA	8.8	0.3
EPS (Rs)	44.6	21.7

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations (standalone)

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
Order backlog	23,266	40,156	52,297	76,445	82,526
Order inflows	4,723	37,919	34,092	48,295	36,485
Net revenues	19,317	21,373	22,442	24,268	30,404
Growth (%)	25.3	10.6	5.0	8.1	25.3
Direct costs	14,297	15,725	15,648	17,554	22,195
SG&A	1,180	1,378	1,924	1,977	2,209
EBITDA	3,839	4,270	4,871	4,737	6,000
EBITDA margins (%)	19.9	20.0	21.7	19.5	19.7
Depreciation	1,341	1,681	1,918	1,470	1,883
Other income	393	634	566	263	247
Interest expenses	209	291	474	472	320
PBT	2,682	2,931	3,044	3,058	4,044
Effective tax rate (%)	-1.5	9.3	22.5	27.5	25.2
+ Associates / (Minorities)	-	-	-	-	-
Net income	2,721	2,633	2,252	2,106	3,026
Adjusted income	2,721	2,658	2,359	2,219	3,026
WANS	141	141	141	141	141
FDEPS (Rs / sh)	19.4	18.9	16.8	15.8	21.5

Fig 3 – Cash-flow statement (Rs m)

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
PBT + Net interest expense	2,498	2,589	2,952	3,267	4,117
+ Non-cash items	1,341	1,681	1,918	1,470	1,883
Oper. prof. before WC	3,839	4,270	4,871	4,737	6,000
- Incr. / (decr.) in WC	2,182	-2,180	838	1,254	1,565
Others incl. taxes	194	551	978	840	1,018
Operating cash-flow	1,463	5,899	3,055	2,643	3,417
- Capex (tang. + intang.)	2,040	2,086	2,144	1,225	2,071
Free cash-flow	-577	3,813	911	1,418	1,346
Acquisitions	-	-	-	-	-
- Div. (incl. buyback & taxes)	85	68	153	85	84
+ Equity raised	-	-0	-	-	-
+ Debt raised	171	106	-215	-1,481	-127
- Fin investments	-278	4,754	617	-577	1,000
-Net interest expense + Misc.	-404	-594	-274	321	73
Net cash-flow	192	-308	200	108	62

Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
Share capital	281	281	281	281	281
Net worth	11,578	14,143	16,239	18,260	21,202
Debt	2,204	2,641	2,297	676	550
Minority interest	0	0	0	0	0
DTL / (Assets)	-1,408	-1,739	-1,610	-1,470	-1,470
Capital employed	12,375	15,045	16,926	17,466	20,282
Net tangible assets	3,934	4,339	4,462	4,320	4,508
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	5,149	5,768	5,191	6,191
Investments (financial)	0	1	0	0	0
Current assets (ex cash)	13,444	11,336	14,904	15,199	17,700
Cash	438	130	330	439	501
Current liabilities	5,839	5,911	8,642	7,682	8,618
Working capital	7,604	5,425	6,262	7,517	9,082
Capital deployed	12,375	15,045	16,926	17,466	20,282
Contingent liabilities	555	1,315	1,381	-	-

Fig 4 – Ratio analysis

Year-end: Mar	FY18	FY19	FY20	FY21e	FY22e
P/E (x)	14.7	13.8	11.7	16.2	11.9
EV / EBITDA (x)	10.8	9.2	6.1	7.7	6.0
EV / Sales (x)	2.2	1.8	1.3	1.5	1.2
P/B (x)	3.4	2.6	1.7	2.0	1.7
RoE (%)	24.4	20.6	15.5	12.9	15.3
RoCE (%)	26.3	23.5	22.0	20.5	23.1
Sales / FA (x)	4.9	4.9	4.9	5.6	6.7
DPS (Rs / sh)	0.5	0.4	0.9	0.5	0.5
Dividend yield (%)	0.2	0.2	0.5	0.2	0.2
Dividend payout (%) - incl. DDT	3.1	2.6	6.5	3.8	2.8
Net debt / equity (x)	0.2	0.2	0.1	0.0	0.0
Receivables (days)	44	40	77	75	70
Inventory (days)	13	16	20	15	17
Payables (days)	41	38	41	42	45
CFO : PAT %	53.8	221.9	129.5	119.1	112.9

Source: Company, Anand Rathi Research

Fig 6 – EV / EBITDA band



Source: Company

Concall highlights

Income statement

- **Q2 reaffirms faith in its execution capabilities.** KNR's superior execution capabilities were yet again at display with its Q2 FY21 revenue growing ~10% y/y (to Rs6bn), notwithstanding a challenging milieu (workforce not yet normal). Sequential revenue growth of ~25% demonstrates its execution capabilities even better (as a monsoon-impacted quarter).
 - Like last many quarters, irrigation and captive hybrid annuities held the key to the healthy revenue performance, and comprised ~76% of Q2 revenue (up from ~71% in the preceding two quarters).
 - A markedly augmented order backlog helped to ~45% y/y growth in irrigation revenues (from ~Rs1bn to ~Rs1.4bn). Consequently, the division's share rose to ~23%, from ~17% a year ago.
 - Captive hybrid annuities, too, saw a healthy pace of execution. Thus, the division's share was ~53% during the quarter.
 - A large part of the balance Q2 revenue came from its third-party road EPC orders (incl. ~Rs0.5bn from Hubli-Hospet, ~8% of the total).
 - The quarter also includes KNR's share of a favourable arbitration claim of ~Rs120m for a JV entity.

Fig 7 – Financial highlights

Particulars (Rs m)	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	Q1 FY21	Q2 FY21	% Y/Y	% Q/Q
Sales	5,564	4,163	4,489	7,157	4,646	5,462	5,579	6,756	4,794	6,012	10.1	25.4
EBITDA	1,098	831	899	1,441	900	1,258	1,244	1,469	943	1,240	-1.4	31.5
EBITDA margin (%)	19.7	20.0	20.0	20.1	19.4	23.0	22.3	21.7	19.7	20.6	-239bps	95bps
Interest	72	74	70	75	90	98	142	145	102	158	61.8	54.6
Depreciation	360	393	450	478	389	475	517	538	331	352	-26.0	6.3
Other income	178	88	217	151	168	256	70	73	61	76	-70.3	24.4
Exceptional	-	-	-	25	-	40	67	-	-	112	180.7	-
PBT	844	453	595	1,014	589	901	588	859	571	694	-22.9	21.5
Tax	104	3	74	92	112	200	186	187	173	196	-1.9	13.0
PAT	740	450	521	922	477	701	402	672	398	498	-28.9	25.2
Adjusted PAT	740	450	521	947	477	741	469	672	398	611	-17.6	53.5

Source: Company

- **Healthy EBITDA margin, further boosted by an arbitration claim.** Besides the lion's share of revenues emanating from the higher-margin hybrid annuity and irrigation orders, an EBITDA contribution of ~Rs79m from the favourable arbitration claim helped to a ~20.6% EBITDA margin.
 - On a reported basis, the EBITDA margin compressed ~239bps y/y as the base quarter too had a favourable arbitration claim.
 - Adjusted for arbitration claims, the Q2 margin contracted from ~20.6% to ~19.7%.
- **Earnings decline.** Higher reported finance costs (up ~62% y/y) and

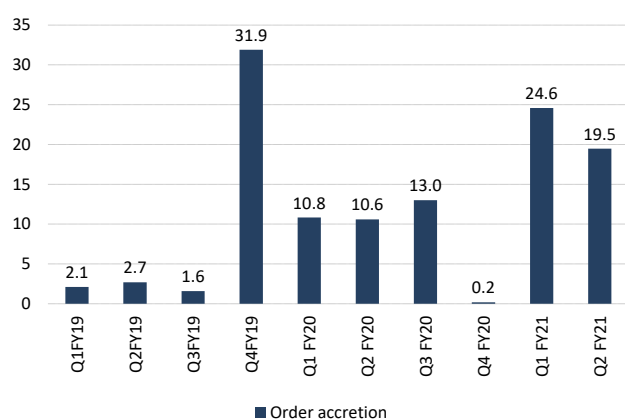
lower other income (down ~70% y/y) led to reported earnings declining ~29% y/y to ~Rs0.5bn. An exceptional loss from the recently concluded Walayar-Vadakancherry BOT-toll monetisation too was responsible for lower earnings. Adjusted for the exceptional losses (in Q2 FY21 as well as Q2 FY20), earnings was down ~18% y/y to ~Rs0.6bn.

- A fair value impact of ~Rs59m for the balance receipts (milestone linked) from the Walayar-Vadakancherry BOT-toll monetisation was the key to a sharp y/y rise in finance costs. Adjusted, finance costs would have been flat.
- Reported lower other income was mostly on account of interest income of ~Rs218m on favourable arbitration claims in the base quarter.
- Exceptional loss in Q2 FY21 was on account of deal equity value for the monetised BOT-toll lagging that of equity invested. Besides, management also made a prudent provision of ~Rs52m toward milestone-based payments (~Rs767m) from the deal. For Q2 FY20, the exceptional loss pertains to management providing for equity invested in a hybrid annuity project terminated for RoW-related issues.
- The effective tax rate was higher y/y on waning 80-IA benefits.

Order backlog and scope

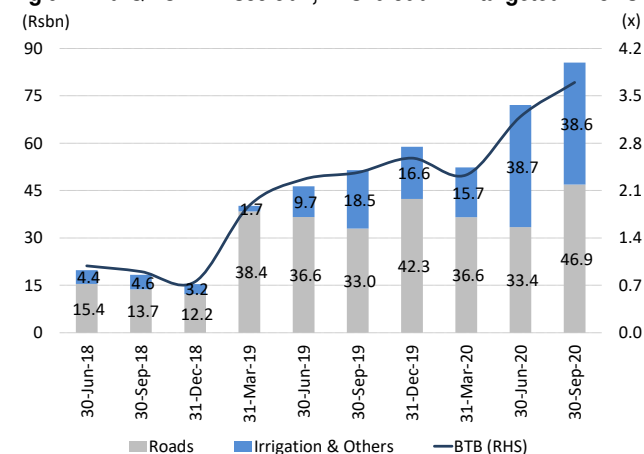
- The two irrigation orders of a combined value of ~Rs23bn were followed by ~Rs10.3bn (excl. GST value) of an elevated highway EPC order from the Tamil Nadu state government. Besides, KNR attained appointed date for its fifth hybrid annuity project (of EPC value ~Rs6.4bn) during Q2, paving the way for its inclusion in the order backlog.
- The Sep'20 order backlog of ~Rs85.5bn (at life-high) was ~Rs13.5bn higher q/q as orders added during Q2 exceeded revenues recognised. The q/q change in the OB also had some contribution from the change in scope of works.
- Based on TTM core EPC revenues, the end-Sep'20 OB implied healthy revenue assurance of ~3.7x TTM revenues

Fig 8 – One a new EPC order, and HAM appointed in Q2
(Rsbn)



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

Fig 9 – End-Q2 OB: ~Rs85.5bn; ~Rs20-30bn H2 targeted inflows



Source: Company

- With the recent two irrigation orders in Telengana, the share of the division has risen significantly, to ~45%. Consequently, new orders are mostly targeted in the roads segments. Besides, management highlights that limited lucrative irrigation orders are in the offing at this juncture.
- With three of its hybrid annuity projects progressed 50-70%, management looks to add more in the segment such that, by the time the old projects are completed, the new projects are in position to start contributing.
 - Given the scale of operations and execution timelines in place, management looks to add orders of ~Rs20bn-30bn in the short term to keep the momentum going.
 - To this effect, a bid has already been placed for a hybrid annuity project in Telengana. Besides, management plans to bid for 10-15 already identified projects. These include four projects in Kerala, three in Tamil Nadu and three in Telengana.
 - Some of the identified projects were to come up for bidding in the recent past, but bidding was postponed.
- On irrigation, management had earlier identified that it does not see any significant opportunities unless the government makes some progress on the river-inter-linking projects.

Hybrid annuity projects and equity infusion updates

- **Chittoor-Mallavaram.** Physical progress at end-Q2 touched ~63.8%, up from ~57.6% a quarter ago. Cumulative equity infusion was flat q/q, at ~Rs0.95bn. Project execution is tracking expectations and management hopes it to be completed by Feb'20.
 - With further drawdowns of ~Rs1.6bn, total debt drawn was ~Rs1.98bn from the total available debt limit of ~Rs5.7bn.
 - Based on a milestone completed, the SPV received one more instalment of a grant during the quarter. The cumulative amount received on the grant was ~Rs4.7bn, up from ~Rs4.15bn.

Fig 10 – Hybrid annuities @ a glance, All appointed

Particulars	Trichy-Kallagam	Chittoor-Mallavaram	Ramsanpalle-Mangloor	Magadi-Somwarpet	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	Achieved
Appointed dates	1 st Mar'19	4 th Jan'19	2 nd May'19	12 th Feb'20	05 th Oct'20
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 (Rsm)	10,206	17,301	12,340	11,445	9,200
EPC value (Rsm)	7,230	12,256	8,742	9,000	6,400
Means of finance					
Grant (Rsm)	4,318	6,920	4,936	7,485	3,945
Debt (Rsm)	3,820	5,730	4,169	2,570	3,170
Equity (Rsm)	962	1,905	1,351	1,221	805
Equity Invested (Rsm)	497	952	686	82	50
Debt drawn (Rsm)	1,060	1,980	1,400	-	-
Grant received (Rsm)	2,259	4,711	3,196	-	-

Source: Company

- **Ramsanpalle-Mangloor.** This project has already attained ~55.9% physical progress, up from ~51.5% a quarter ago. Cumulative equity infusion on 30th Sep'20 was ~Rs 0.7bn. The SPV, cumulatively, has received grants of ~Rs3.2bn, incl. ~Rs0.2bn in Q2 FY21. The project SPV did not draw any further finances from the project lenders
 - Management expects to complete the project by Mar'20, and sees the possibility of an early completion bonus for two months.
- **Trichy-Kallagam.** The project has already made ~49.9% progress, up from ~43% a quarter back. Management has already infused ~Rs0.5bn equity, of ~Rs0.96bn of the total required. Milestone-linked grants of ~Rs2.3bn have already been received (incl. ~Rs0.5bn in Q2).
 - Based on land available and Covid-led disruptions, management expects the completion timeline to extend beyond that scheduled (by 2-3 months).
 - The project SPV awaits ~5km RoW. Per management, the RoW not yet available could impact opening of ~14km of the bye-pass; effectively making ~50% of the project length inaccessible.
- **Magadi-Somwarpeth (KSHIP).** Physical progress at end-Q2 was ~13.9% at this project, up from ~9.3% a quarter ago. Of the required equity infusion of ~Rs1.2bn, only ~Rs82m has been infused including ~Rs5m during the quarter.
- **Oddanchatram-Madathukulam.** The appointed date for KNR's most recent hybrid annuity project was 05th Oct'20. This paves the way for this project (~Rs9.2bn BPC, ~Rs6.4bn EPC value) to start contributing. Though management plans to monetise this asset as well (on the lines of agreement entered into for the first three NHAI projects with Cube), it prefers to make some progress first.
- **Equity commitment, infusion schedule.** For the five hybrid annuity projects, equity required is ~Rs6.2bn, including Cube's share of 49% equity for the committed three hybrid annuity projects.
 - Having already infused ~Rs2.3bn equity (~Rs33m in Q2 FY21), management looks to infuse another ~Rs2.4bn during the rest of FY21 (~Rs0.5bn already infused in Q3).
 - Of the balance ~Rs1.6bn, FY22 is expected to see infusion of ~Rs1bn, with the rest due in FY23.
 - While RoW, per Cube's requirement, is largely in place for the projects already agreed to be monetised, KNR intends 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 the construction period would carry an interest rate higher than the company's blended cost of funding.

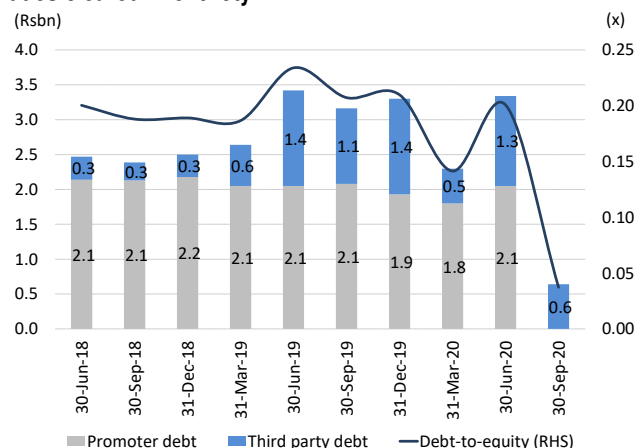
Balance sheet

- Largely led by monetisation proceeds, net debt during Q2 was down ~Rs2.9bn q/q to ~Rs0.2bn on 30th Sep'20.
 - A large part of the monetisation proceeds of ~Rs3.1bn was utilised to clear promoter dues of ~Rs2.1bn.
 - Consequently, the gross debt at 30th Sep'20 was ~Rs0.6bn, down from ~Rs3.3bn the quarter prior. With the promoter's loan entirely repaid, the Sep'20 gross debt was entirely from third parties, and

mostly comprises working capital utilisation.

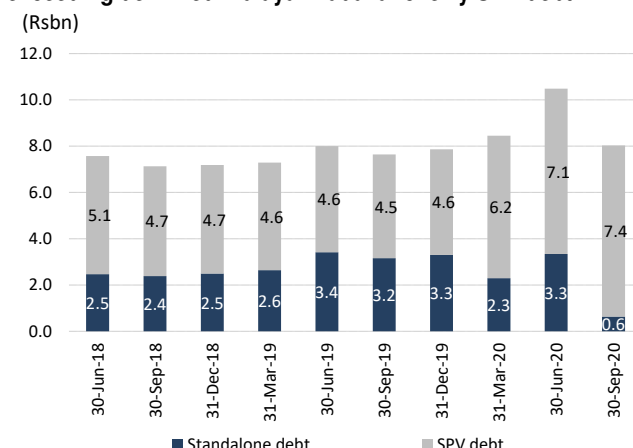
- Q/q reduction in net debt lagging gross monetisation receipts was attributed to greater working capital needs.

Fig 11 – De-levered, on BOT-toll monetisation; promoter dues cleared in entirety



Source: Company

Fig 12 – SPV debt up ~Rs0.3bn (net), on HAM drawdowns exceeding de-linked Walayar-Vadakancherry SPV debt



Source: Company

- With the monetisation proceeds, huge reduction in net debt led to net debt-to-equity compressing to its many-year lows of ~0.01x, down from ~0.19x q/q.
- At end-Q2 FY21, consolidated gross debt (~Rs8bn) was down ~Rs2.5bn q/q.
 - Reduction in gross debt was on account of de-linking of ~Rs1.3bn SPV debt for the monetised asset. Besides, the balance reduction is a result of q/q lower standalone gross debt (on repayment of the promoter loan in entirety, and also a part of third-party debt).
 - The reduction is despite ~Rs1.6bn of fresh drawdowns by one of the SPVs for under construction hybrid annuity assets.
 - Gross debt for the two annuity SPVs (not consolidated line-by-line as it has a 40% stake in each) declined ~Rs0.2bn q/q to ~Rs5.5bn.
- The end-Sep'20 billed receivables of ~Rs3.5bn comprised ~Rs1.3bn for irrigation (similar to a quarter ago), ~Rs1.8bn due from hybrid annuity SPVs, and other EPC road projects explain the balance.
- On 30th Sep'20, gross exposure to its Telengana irrigation orders (billed & unbilled receivables and WIP combined) was ~Rs7.4bn. With NABARD already on-boarded by the state government (for KNR's one of the two sub-contracted orders), management expects to see this exposure come down substantially by the year end.
 - Management hopes to realise a large part of the dues as the Telengana state government has roped in NABARD to fund the Mallana Sagar project. Whereas the Palamuru Rangareddy project still depends on budget finances, management expects to recover these dues as well.
 - The payments have already started flowing in with ~Rs0.7bn of dues cleared already in Q3 for the Palamuru Rangareddy project, and ~Rs1bn in the process of being credited toward Mallana Sagar.
 - Management expects to realise ~Rs5.7bn by the year-end, with

~Rs3bn expected shortly.

- Driven by a partial recovery from billed receivables (down ~Rs1.3bn q/q) and a better scale of operations, the cash-conversion cycle was down 22 days q/q to 44. The reduction was partly contained by a contracted creditor's cycle (down 10 days).

BOT-toll projects

- **Operational performance.** With the monetisation of the Walayar-Vadakancherry, KNR is left with only one operational BOT-toll asset, Muzaffarpur-Barauni.
 - Though toll collection at the project recovered from the Q1 low of ~Rs103m (toll suspended for 19 days) to ~Rs120m, it still was down 24% y/y. This is because of the yet recovering traffic.
 - The SPV has invoked force majeure. Management is discussing with the NHAI suitable compensation for the Covid-disrupted toll collection.
- **Walayar-Vadakkancherry monetisation.** The much-awaited asset monetisation was consummated during Q2. It was sold for an enterprise value of ~Rs5.1bn. The transaction entailed an equity value of ~Rs3.8bn.
 - The ascribed equity value of ~Rs3.8bn compares to ~Rs3.97bn of gross sponsor support (equity and sub-debt combined).
 - Since a part of the total equity proceeds was linked to certain milestones, KNR realised ~Rs3.1bn immediately on consummation of the transaction; the balance is expected by FY23 (subject to milestones achieved).
 - Of the milestone linked payments of ~Rs767m, ~Rs149m is toward working capital pass-through (to be recovered as realised), ~Rs160m is linked to completion of pending Income Tax assessments, ~Rs160m to achievement of agreed traffic/revenue projections for the period up to Jul'21 (~Rs60m received from this), ~Rs270m to achievement of agreed traffic/revenue projections for the period from Apr'21 to Mar'23.
 - Equity proceeds slightly lagging the equity invested led to KNR recognising an exceptional loss of ~Rs60m (~Rs67m provided earlier in Q3 FY20 on foreseeable losses) and another ~Rs52m is also reflected as an exceptional loss in Q2 FY21 on the basis of an internal assessment of traffic projections (and, thus, prudent provisioning).
 - Any claims receivable from the NHAI and other government instrumentalities would be passed through to KNR when realised. The SPV has a favourable arbitration award of ~Rs1.7bn from NHAI (challenged in the Court of law).

Guidance

- With two of its hybrid annuity projects due to be completed by the year end, and the third by early next year, management looks to replace these with orders such that there is no gap. Thus, management aim to secure orders of ~Rs20-30bn to take full year inflows to ~Rs50bn-60bn.
 - New orders are mostly targeted in hybrid annuity, and it has already

identified 10-15 projects to bid for.

- Taking into account current labour availability and execution efficiency and the scale-up expected in coming quarters, management now guides to growth over FY20.
 - On the base of current execution efficiency, management is eyeing ~Rs5.7bn-6.3bn revenues in Q3.
 - With its recent irrigation orders likely to get going by end-Q3, and its better scale for the recently added Coimbatore elevated road EPC project, management expects Q4 revenues at ~Rs7bn.
 - Consequently, FY21 revenues are targeted at ~Rs23.5bn-24bn, against the earlier guidance of flat revenues but with potential.
- Having incurred ~Rs350m capex in H1 (incl. ~Rs200m in Q2), it intends to incur ~Rs0.7bn to ~Rs0.8bn in the rest of the year (guidance retained at ~Rs1bn-1.2bn).
- On the tax front, management said that the normalising tax-rate is due to lower contribution from projects enjoying 80-IA benefits. KNR has been paying at marginal corporate tax rate (~34%), but with deferred tax adjustments, the effective rate has been lower (at ~25%). Cash payouts also were lower owing to MAT credit available.

Other highlights

- **Outlook on labour, execution.** Post easing of lockdown restrictions, labour availability has been gradually improving across all its sites. It is currently pegged at ~80%, up from ~60% in late-Aug'20. Management expects to return to normality after the festival season. With execution efficiency set to gain traction (currently in line with labour available), the retreating monsoons and as execution commences at some recently bagged order, H2 is likely to be better than H1.
- **Update on the Telengana irrigation projects.** The two recent orders of ~Rs23bn have yet to be taken up. Of the two sub-contracted works, Mallana Sagar (sub-contracted by Megha Engineering) has seen cumulative progress of ~60%; the Palamuru project (from Navayuga) has made ~30% progress.
 - In terms of completion, Mallana Sagar, per management, is likely to take another 6-8 months whereas Navayuga is likely to take more than a year owing to land-acquisition delays.
 - Management highlights that the land acquisition has mostly been resolved, and land payment distribution is underway.
 - The two recent irrigation orders (of ~Rs23bn) are likely to get the go-ahead by this month-end; thus, management hopes to work on these two for an entire quarter (Q4). The required capex would depend on designs for the pump-house; thus, yet to be firmed up. Capex for this is likely in FY22 only.

Valuation

To account for swifter than expected recovery in order execution, we raise our revenue estimates ~7.2% for FY21e, and rub-off effect takes FY22e revenues are ~0.6% higher. We have also made adjustment for an arbitration claim recognised in Q2 FY21, and depreciation charge has been lowered keeping in mind the H1 reported figures. The earnings revision also takes into account the Walayar-Vadakancherry monetisation. Consequently, FY21e earnings have been raised ~45%, and ~22% for FY22e.

Our sum-of-parts-based target of Rs320 a share (against Rs293 earlier) is derived using 13x FY22e PE multiple for the construction business (Rs280 a share, raised from Rs230 earlier). Scope for a better multiple exists, but the assigned multiple takes into account the elongated working capital cycle for the Telengana irrigation orders. Any significant reduction in this would make us raise the multiple. The asset-ownership business has been assumed at a 20% discount to the invested/liquidation value (Rs40 a share, down from Rs63 earlier on monetisation of Walayar-Vadakancherry BOT-toll).

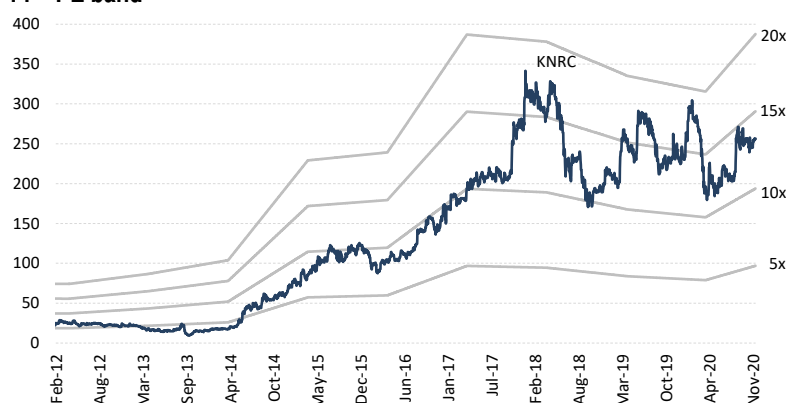
Fig 13 – Estimates revision

(Rs m)	Old Estimates		Revised Estimates		Change (%)	
	FY21e	FY22e	FY21e	FY22e	FY21e	FY22e
Revenue	22,635	30,228	24,268	30,404	7.2	0.6
EBITDA	4,354	5,979	4,737	6,000	8.8	0.3
EPS (Rs)	10.9	17.7	15.8	21.5	44.6	21.7

Source: Anand Rathi Research

At the ruling price, the stock (excl. investments) quotes at 14.2x FY21e and 10.4x FY22e EPS.

Fig 14 – PE band



Source: Company, Bloomberg, Anand Rathi Research

Risks

- Any significant delay in recovery of irrigation receivables.
- Considerable deterioration in working capital.

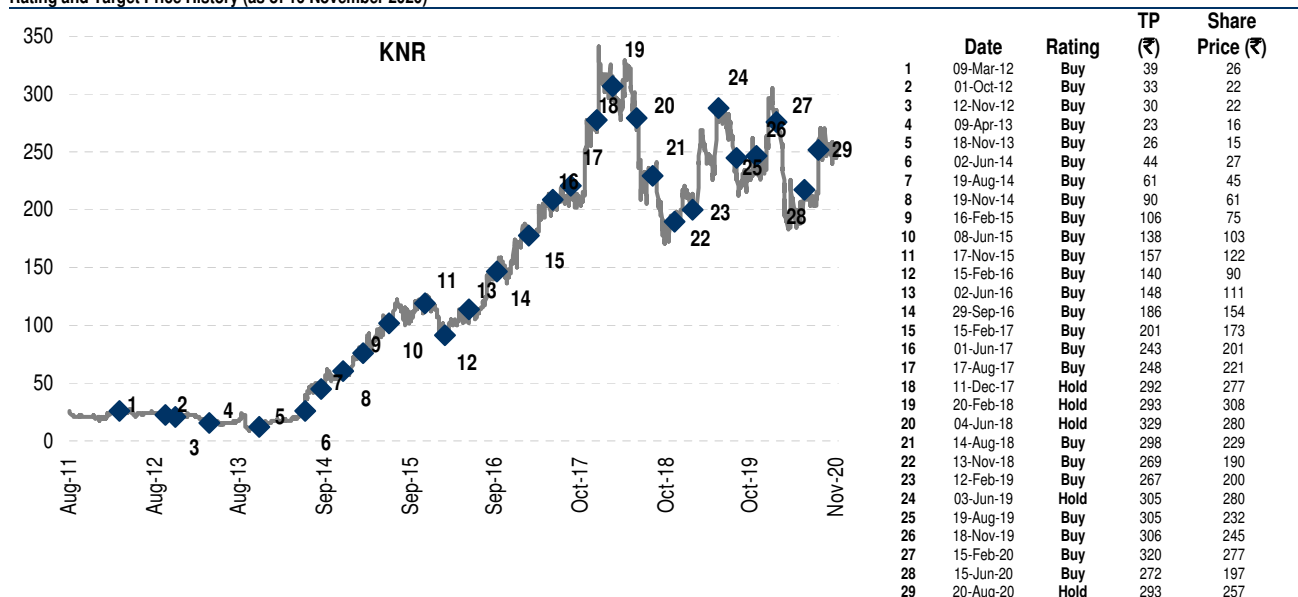
Appendix

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