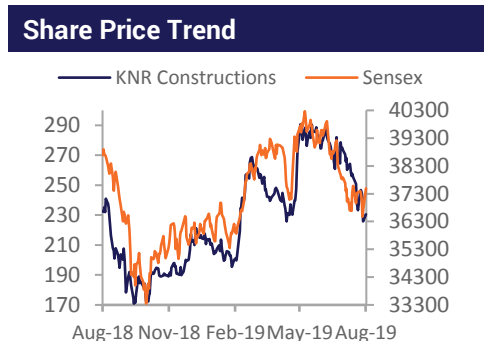


Sector	Road Infra
Recommendation	BUY
Upside	26%

Stock Data	
Sensex	37,494
52 Week h/l (₹)	303/ 163
Market cap (₹Cr)	3,262
BSE code	532942
NSE code	KNRCON
FV (₹)	2
Div yield (%)	0.16

Shareholding Pattern			
	Dec-18	Mar-19	Jun-19
Promoters	55.38	55.17	55.17
DII+FII	31.70	32.70	33.32
Individuals	12.91	12.13	11.50

Source: www.bseindia.com



Prices as on 26/08/2019

Analyst:

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August 27, 2019

KNR Constructions (KNR), an established road contractor, is poised to register 20.4% revenue CAGR over FY19-21E led by (a) robust order book (~2.8x FY19 revenue), (b) strong execution skills, (c) healthy balance sheet (Q1FY20 standalone Debt/Equity ratio of ~0.2x), and (d) likely strong order inflows led by Bharatmala and irrigation projects. The company's earnings will be driven by its proven track record of early execution, better margins and working capital control. KNR's strong balance sheet will support order book expansion given that momentum in road awards from NHAI (25,000km highways shortlisted by government for next 3 years) and state governments continue. Our SOTP of ₹289 is based on 12x FY21E standalone EPS and ₹36/share contribution from stake in 4 BOT assets. We recommend BUY on KNR Constructions.

Strong order book promises revenue growth: KNR's healthy order book of ₹6,519cr (₹4,634cr order book as on Q1FY20 and ₹1,885cr order book for three HAM projects, where KNR is likely to receive appointed date) executable over the next 2.5 years will aid the company to register revenue CAGR of 20.4% to ₹3,101cr over FY19-21E. Strong execution capabilities to aid the timely execution of current projects coupled with two HAM projects (likely to get appointed dates from NHAI soon), will result in healthy revenue growth over next couple of years. Further, order inflow pipeline of ~₹2,500cr from irrigation and road infra projects for FY20E will boost KNR's revenue growth momentum. Given its healthy order book position and balance sheet, KNR is in a sweet spot to secure selective high margin orders. KNR's tax provisioning is likely to increase from FY20E onwards, since the 80-IA benefits are ending, which will lower the net profits to some extent.

Financial Summary

Standalone ₹ cr	FY17	FY18	FY19	FY20E	FY21E
Revenue	1,541	1,932	2,137	2,501	3,101
EBITDA	230	384	427	400	496
PAT	157	272	263	230	297
PAT growth (%)	(2)	73	(3)	(13)	29
P/E (x)	20.6	11.9	12.3	14.1	10.9
Price/BV (x)	3.6	2.8	2.3	2.0	1.7
ROCE (%)	16.1	20.4	17.0	14.6	18.0
EV/EBITDA (x)	14.4	9.0	8.3	8.5	6.5

Source: Company, IIFL Research

Outlook & Valuation

We like KNR as it has light balance sheet (0.2x D/E for Q1FY20), low working capital (Q1FY20 NWC days at 42) and one of the highest RoCE among peers. It has strong execution track record of completing projects before schedule and favorably placed to be the key beneficiary of the government's agenda of road infrastructure spending (25,000km highways shortlisted by government for next 3 years). Further, it has order book position of 2.8x FY19 revenue, that lends comfort in terms of revenue visibility for next 2.5 years. Moreover, healthy order inflow pipeline of ₹2,500cr for FY20E, makes us confident of strong growth momentum going forward.

In our discounted cash flow model, we have assumed 8% revenue growth for the company's both BOT toll projects i.e. Walayar Tollways and Muzaffarpur-Barauni for the balance concession period. We have discounted the cash flows in the range of 11.1-11.3% weighted average cost of capital (WACC) for both the toll projects. For its two annuity projects, we have valued the same on net asset value basis. Our SOTP of ₹289 is based on 12x FY21E standalone EPS and ₹36/share contribution from stake in 4 BOT assets.

SOTP Valuation

SOTP Valuation	Basis	Value ₹ cr	Value ₹/Share
Standalone EPC business	P/E	297	254
KNR Walayar Tollways (100% stake)	NPV	274	20
KNR Muzaffarpur Barauni (51% stake)	NPV	150	11
BOT Annuity projects	NAV	77	5
SOTP target			289
CMP (₹)			230
Upside (%)			26

Source: Company, IIFL Research

Assumption table

Assumptions	FY17	FY18	FY19	FY20E	FY21E
Order Inflow	1,783	871	4,611	2,500	2,500
Revenue Growth	71	25	11	17	24
EBITDA Margin	14.9	19.9	20.0	16.0	16.0

Source: Company, IIFL Research

Profit & Loss Statement

Standalone ₹ cr	FY17	FY18	FY19	FY20E	FY21E
Revenue	1,541	1,932	2,137	2,501	3,101
Growth (%)	71.0	25.3	10.6	17.0	24.0
Total Expenses	1,311	1,548	1,710	2,100	2,605
EBITDA	230	384	427	400	496
Margin (%)	14.9	19.9	20.0	16.0	16.0
Depreciation	64	134	168	140	140
EBIT	166	250	259	260	356
Interest	22	21	29	30	20
Other income	30	39	63	40	40
PBT	163	268	290	270	376
Tax Expense	6	(4)	27	41	79
Tax rate (%)	4	(1)	9	15	21
PAT	157	272	263	230	297

Source: Company, IIFL Research

We estimate that operating margins will likely moderate from FY20E onwards due to lesser irrigation orders, which are of higher margins and increased concentration of road orders, however it is expected to remain healthy in the range of 15-16% over FY19-21E. Depreciation from FY20E onwards will also decline as the irrigation order book remains low. The company's tax expense is estimated to increase from FY20E onwards, however it will remain on the lower side, as it has the MAT credit of ~₹75cr as of FY19 end.

Balance Sheet

Standalone ₹ cr	FY17	FY18	FY19	FY20E	FY21E
Liabilities					
Equity Share capital	28	28	28	28	28
Other equity	867	1,130	1,386	1609	1900
Total Networth	895	1,158	1,414	1637	1928
Borrowings	130	212	221	264	142
Other non-current Liabilities	31	28	18	0	0
Total Liabilities	1,057	1,398	1,654	1,902	2,070
Assets					
Property, plant and equipment	262	331	371	351	361
Investment property	61	62	63	63	63
Investments	480	510	620	620	620
Deferred tax assets (net)	82	141	174	174	174
Other non-current assets	85	94	137	138	153
Net current assets	87	260	288	556	699
Total Assets	1,057	1,398	1,654	1,902	2,070

Source: Company, IIFL Research

Ratio Analysis

Standalone	FY17	FY18	FY19	FY20E	FY21E
Per Share Data					
DPS (₹)	0.5	0.4	0.4	0.4	0.4
EPS (₹)	11.2	19.4	18.7	16.3	21.1
BVPS (₹)	63.7	82.3	100.6	116.4	137.1
Profitability Ratios (%)					
EBITDA margin	14.9	19.9	20.0	16.0	16.0
EBIT margin	10.8	12.9	12.1	10.4	11.5
Tax rate	3.7	(1.5)	9.4	15.0	21.0
Net profit margin	10.2	14.1	12.3	9.2	9.6
Return Ratios (%)					
RoE (%)	17.6	26.5	20.5	15.0	16.7
RoCE (%)	16.1	20.4	17.0	14.6	18.0
Valuation Ratios (x)					
P/E	20.6	11.9	12.3	14.1	10.9
P/BV	3.6	2.8	2.3	2.0	1.7
EV/EBITDA	14.4	9.0	8.3	8.5	6.5
Solvency Ratio (x)					
D/E	0.43	0.21	0.17	0.17	0.08

Source: Company, IIFL Research

Company Overview

Incorporated in 1995 in Hyderabad, KNR Constructions (KNR) is an EPC contractor focused on road & highways, irrigation, and water management sectors. It has successfully executed more than 6,000 lane km of road projects. Most of the company's clients are government agencies, such as the Central government, NHAI and the public works departments of state governments. It has also diversified in the past few years with orders executed in irrigation and flyover & bridge construction segments as well. KNR currently has a portfolio of 10 projects (4 are BOT projects (2 toll & 2 annuity) and 6 are HAM projects) in the roads and highways sector. All BOT projects are operational for over two years now. The company's credit rating has been upgraded from A+ Positive to AA- Stable by CRISIL Rating in February 2019.

Exhibit 1: Order book composition by type (Q1FY20)

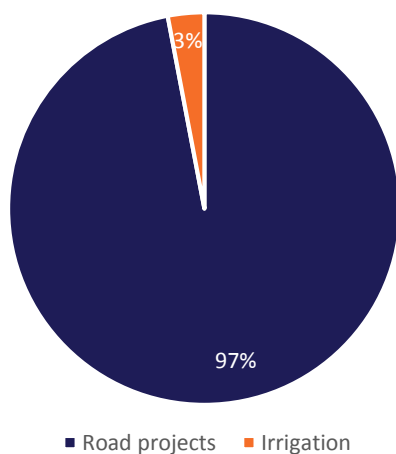


Exhibit 2: Order book composition by clients (Q1FY20)

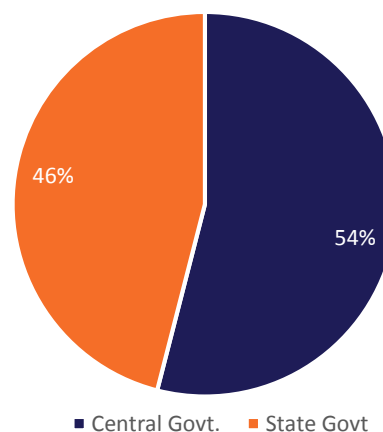


Exhibit 3: Geography wise order book break-up (Q1FY20)

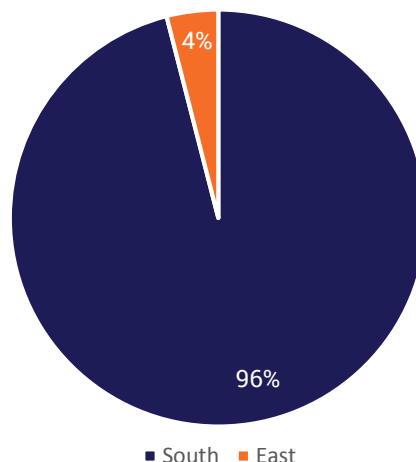
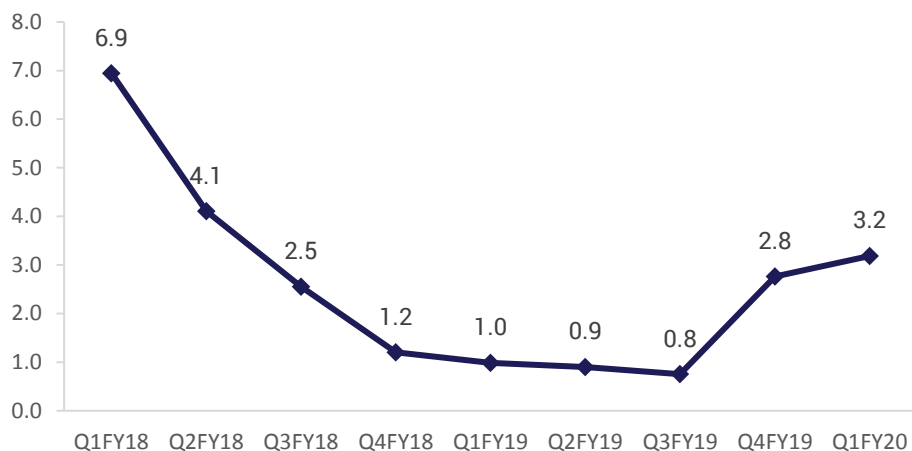


Exhibit 4: Book to Bill ratio



Source: Company IIFL Research

KNR's book to bill ratio has scaled up from 0.8x in Q3FY19 to 3.2x in Q1FY20 as it has received appointed dates for three HAM projects worth ₹3,411cr over the last two quarters, which were included in the order book.

Established track record of execution to aid healthy margins

Over the past 5-6 years, KNR has established a track record of on-time execution (sometimes early execution) on the back of management focus and a captive equipment bank. KNR has consistently recorded industry leading EBITDA margins owing to conservative bidding and by identifying low cost raw material sources before bidding. Management has guided for 15-16% EBITDA margin over next couple of years. We believe that operating margins could moderate from FY20E onwards due to lesser high margin irrigation orders to execute and increased concentration of road orders, however it will still remain healthy in the range of 15-16% over FY19-21E.

Order inflows to be led by irrigation, EPC and HAM projects: KNR's management has guided for getting new orders worth ₹2,500cr during FY20E from both roads infra and irrigation projects. Company is already in negotiation for subcontracting opportunity in irrigation projects in Telangana, it is negotiating a ₹850cr contract. Since it is subcontracting contracts, the margins will be lesser or may be in-line with its road infra segment margins. Besides, KNR is targeting ₹1,200-1,500cr of new road orders. However, if higher margin good projects

come, KNR will try to get the extra orders to the extent of ₹1,000-2,000cr. In terms of project bidding, the company has guided that it will give first preference to EPC projects and second priority will be given to the HAM projects, however for Toll projects, the company is not considering to participate.

Lower debt enhances project bidding prospects: Robust profitability combined with relatively lower working capital cycle (Q1FY20 net working capital days at 42) has enabled KNR to maintain low debt levels (Q1FY20 standalone Debt/Equity ratio of ~0.2x). Its gross debt on standalone basis is at ₹342cr as of Q1FY20, of which promoter debt is ₹205cr, adjusting for it the debt is very minimal, providing comfort on gearing. Lower debt levels improve the prospects for KNR while bidding for projects and enable it to undertake further order book expansion for revenue growth.

BOT asset portfolio of four road projects

Apart from the EPC business, KNR owns four BOT road projects, including two operational annuity projects in a JV with Patel Engineering and two operational BOT (Toll) projects; two small annuity projects where KNR holds 40% stake are operational. The company holds 100% stake in the Walayar-Vadakkancherry BOT (Toll) road project in Kerala. The fourth BOT road project is the Muzaffarpur-Barauni project in Bihar awarded by NHAI.

Exhibit 5: KNR owns four BOT road assets, which are operational

Projects	Type	Length (Km)	Cost (₹ cr)	Concession Ends	Stake (%)
AP- Karnataka Border-Avathi	Annuity	60	442	Mar-27	40
Islamnagar-Kadtai	Annuity	53	592	Mar-28	40
Walayar Tollways	Toll	54	901	May-33	100
Muzaffarpur-Barauni	Toll	108	460	July-33	51

Source: Company

Monetisation of HAM assets lessen debt burden

KNR has six HAM projects in its kitty, which contribute ~77% to its current order book. In Q4FY19, the company had bagged its 6th HAM project worth ₹920cr in the state of Tamil Nadu. KNR has entered into a share purchase agreement (SPA) with Cube Highways for four of its HAM projects, wherein KNR, in a phased manner, will dilute its entire

stake. Further, out of these six HAM projects, four have achieved financial closure and KNR has done an equity investment of ₹198.5cr; the company has received an equity investment of ₹358cr against these projects from Cube Highways. Moreover, KNR has already received appointment date for four projects, while the appointment date for Meensurti-Chidambaram project is expected by 2HFY20E. For the KSHIP project, it expects to get financial closure and appointed date by November 2019 (as of now, land availability for this project stands at ~50%). This would result in limited equity outflows for the company and in turn support financial risk profile of the company.

Details of SPA signed with Cube Highways

	Project cost	Total Equity	Cube (49%)	KNR (51%)	Total Consideration (for KNR 51%)
Trichy Kallagam HAM	910	96	47	49	74
Meensurutti HAM	432	46	22	23	37
Chittor Mallavaram HAM	1,456	143	70	73	152
Ramsanpalle to Mangloor HAM	1,046	104	51	53	96

Source: Company

As per the agreement, its SPVs will sell the entire project to Cube Highways in two stages. The first stage is scheduled to be completed after achievement of COD. The second stage is scheduled to be completed after the expiry of mandatory lock in period as per the concession agreement. The company could also enter into a similar kind of arrangement for two more projects. These HAM projects are expected to drive KNR's execution significantly in FY20E and FY21E. This deal facilitates KNR to remain asset light while churning its equity capital to fund equity requirement of future HAM orders. In addition to this, they are also in the process of evaluating various options to monetize other projects in the coming period. Moreover, the company intends to monetize its KNR Walayar Toll project by FY20-end.

KNR Constructions HAM portfolio

Particulars	Trichy to Kallagam	Meensurutti to Chidambaram	Chittoor to Mallavaram	Ramsanpalle to Mangloor	Magadi to Somwarpeth	Oddanchatram to Madathukulam*
SPV Name	KNR Srirangam Infra Pvt. Ltd	KNR Chidambaram Infra Pvt. Ltd	KNR Tirumala Infra Pvt. Ltd	KNR Shankarampet Projects Pvt. Ltd	KNR Somwarpeth Infra Pvt Ltd	KNR Palani Infra Pvt. Ltd
Stake	100%	100%	100%	100%	100%	100%
Project Type	Hybrid Annuity	Hybrid Annuity	Hybrid Annuity	Hybrid Annuity	Hybrid Annuity	Hybrid Annuity
State	Tamil Nadu	Tamil Nadu	Andhra Pradesh	Telangana	Karnataka	Tamil Nadu
Client	NHAI	NHAI	NHAI	NHAI	KSHIP	NHAI
No of Lanes	Four	Two	Six	Four	Two	Four
Length(KM)	38.7	31.5	61.1	46.8	166	45.4
Concession Period	17 Years	17 Years	17.5 Years	17 Years	9 Years	17 Years
Bid Project Cost (₹ cr)	1,021	482	1,730	1,234	1,145	920
Total Project Cost (₹ cr)	910	432	1,456	1,046	1,128	
Grant (₹ cr)	432	204	739	524	749	
Estimated Equity (₹ cr)	96	46	143	104	122	
Estimated Debt (₹ cr)	382	182	573	417	257	
Status	AD received on 1st Mar 2019	FC Achieved on 7th Sept 2018	AD received on 4th Jan 2019	AD received on 2nd May 2019	Financial Closure Documents have been submitted to the Authority	Received LOA on 7th March 2019
Equity Invested (₹ cr)	48.12	8.35	72.53	52.12	2.6	0.1

Source: Company

Key Risk

Delay in getting the appointment date for remaining HAM projects and execution delay of other EPC projects could affect KNR's revenue and profit.

Recommendation Parameters for Fundamental/Technical Reports:

Buy – Absolute return of over +10%

Accumulate – Absolute return between 0% to +10%

Reduce – Absolute return between 0% to -10%

Sell – Absolute return below -10%

Please refer to <http://www.indiainfoline.com/research/disclaimer> for recommendation parameter, analyst disclaimer and other disclosures.

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