

BUY
 TP: Rs 350 | ▲ 50%

KNR CONSTRUCTIONS | Infrastructure

| 17 August 2019

Revenue disappoints but beat on margins; growth visibility intact

KNR Constructions’ (KNRC) Q1FY20 revenue dropped 17% YoY to Rs 4.6bn, >20% under estimates due to deferred AD award. EBITDA margin at 19.4% (-40bps YoY) beat our 15.5% forecast due to lower subcontracting cost and a better project mix. PAT fell 36% YoY on higher tax and interest cost. KNRC’s Jun’19 order backlog stood at Rs 65bn (incl. L1 projects) or 3.2x TTM revenues. We trim FY20 EPS 6% and roll over to a new Jun’20 TP of Rs 350 (vs. Rs 365).

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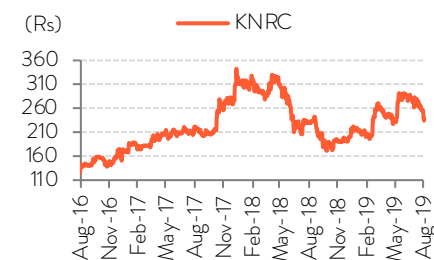
Non-receipt of AD hinders execution; expect better H2: Q1 revenue declined 17% YoY to Rs 4.6bn (Rs 5.9bn est.) as the expected appointed dates (AD) did not materialise, pushing back the execution of HAM projects. KNRC also saw a drag from unbilled revenue of Rs 400mn-500mn (booked in Q2). The order backlog as on Jun’19 stood at Rs 65.2bn (incl. L1 projects of Rs 18.9bn), with visibility of 3.2x TTM revenues.

Ticker/Price	KNRC IN/Rs 233
Market cap	US\$ 461.7mn
Shares o/s	141mn
3M ADV	US\$ 0.4mn
52wk high/low	Rs 303/Rs 165
Promoter/FPI/DII	55%/3%/30%

Source: NSE

The company expects to bag a ~Rs 8.5bn irrigation subcontracting project from Mega Engineering in Telangana. We model for a revenue CAGR of 20% over FY19-FY22 led by likely AD award in the KSHIP HAM project by end-Sep’19 and start of irrigation works (EPC value of ~Rs 17bn) post monsoon.

STOCK PERFORMANCE



Source: NSE

Receivable days elongated but leverage under control: KNRC executed ~Rs 2bn of work on its three NHAI HAM projects in Q1. But payments were delayed, resulting in high receivable days of 58 days (40 as on Mar’19). Net D/E remained under control at 0.2x as on Jun’19 (unchanged QoQ).

Maintain BUY: We adjust FY20/FY21 earnings by -5.8%/+1.1% to build in the Q1 performance and roll forward to a revised Jun’20 TP of Rs 350 (from Rs 365).

KEY FINANCIALS (STANDALONE)

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Adj. net profit (Rs mn)	2,721	2,468	1,999	2,800	2,577
Adj. EPS (Rs)	19.3	17.6	14.2	19.9	18.3
Adj. EPS growth (%)	61.8	(9.3)	(19.0)	40.1	(8.0)
Adj. ROAE (%)	26.5	19.2	13.1	15.8	12.7
Adj. P/E (x)	12.1	13.3	16.4	11.7	12.7
EV/EBITDA (x)	8.8	8.1	8.3	5.9	5.8

Source: Company, BOBCAPS Research



FIG 1 – STANDALONE QUARTERLY PERFORMANCE

(Rs mn)	Q1FY20	Q1FY19	YoY (%)	Q4FY19	QoQ (%)
Revenue	4,646	5,564	(16.5)	7,157	(35.1)
Total Expenditure	3,746	4,465	(16.1)	5,716	(34.5)
EBITDA	900	1,099	(18.1)	1,441	(37.5)
EBITDA margins (%)	19.4	19.7	(37bps)	20.1	(76bps)
Other income	168	178	(5.6)	71	134.9
Interest	90	72	25.6	75	20.7
Depreciation	389	360	8.0	478	(18.7)
PBT	589	844	(30.3)	959	(38.6)
PBT margin (%)	12.7	15.2	(250bps)	13.4	(73bps)
Current tax	140	158	(11.3)	167	(16.2)
Deferred tax	(28)	(54)	(47.0)	(75)	na
Total tax provision	112	104	7.1	92	21.1
Effective tax rate (%)	19.0	12.4	661bps	9.6	935bps
Adjusted PAT	477	740	(35.5)	867	(45.0)
Extraordinary items	-	-	-	55	na
Reported PAT	477	740	(35.5)	922	(48.2)
Adjusted PAT margin (%)	10.3	13.3	(303bps)	12.1	(184bps)
EPS (Rs)	3.4	5.3	(35.5)	6.2	(45.0)
% growth YoY					
Revenue	(16.5)	15.7	-	14.6	-
EBITDA	(18.1)	30.0	-	19.3	-
Other income	(5.6)	44.9	-	(60.9)	-
Interest	25.6	38.5	-	(14.9)	-
Depreciation	8.0	47.7	-	(2.6)	-
PBT	(30.3)	25.6	-	18.2	-
Adjusted PAT	(35.5)	9.5	-	8.7	-
Reported PAT	(35.5)	9.5	-	15.5	-
EPS	(35.5)	9.5	-	8.7	-

Source: Company, BOBCAPS Research

Earnings call highlights

- Order inflows:** Order inflows remained healthy at ~Rs 8.5bn in FY20 YTD. So far, KNRC has won one irrigation subcontracting contract from Navayuga Engineering in the state of Telangana.
- FY20 guidance:** Management expects revenue at ~Rs 25bn, EBITDA margin at 17-18%, effective tax rate at 15-20%, capex at Rs 1.8bn-2bn (factoring in order inflows from irrigation segment; Q1 capex at Rs 900mn), order inflows at ~Rs 25bn (incl. recently won irrigation project), and quarterly depreciation run-rate at Rs 450mn-500mn.
- Unbilled revenue:** Unbilled revenue of Rs 400mn-500mn from the execution of two HAM projects in Q1FY20 (Trichiraopalli-Kallagam and Ramsanpalle-Mangloor) will be booked in Q2.

- **Pending receivables of ~Rs 2bn are as under:**
 - Chittor-Mallavaram at ~Rs 1bn
 - Trichiraopalli-Kallagam at Rs 430mn-450mn
 - Ramsanpalle-Mangloor at Rs 550mn-570mn
- **Arbitration awards:** The company has received a claim of Rs 530mn in Q2FY20 which will be booked in Q2 revenue (net positive impact of Rs 300mn on PAT). Additionally, it expects Rs 250mn-300mn of claims to be recognised in H2.
- **Toll collection:** Gross toll collection at the Muzaffarpur/Walayar BOT projects stood at Rs 2.8mn/Rs 1.9mn day in Q1FY20. The company plans to monetise the Walayar project (100% stake) by end-Mar'20 which will free up capital of ~Rs 4bn. However, the sale of its 51% stake in the Muzaffarpur BOT (toll) project is unlikely due to NHAI's interest in lane expansion on the stretch.
- **Stake sale in Ramsanpalle-Mangloor:** KNRC has signed a definitive SPA to sell its stake in NHAI HAM project Ramsanpalle-Mangloor to Cube Highways (already has SPAs for stake sale in three other NHAI HAM works). For its equity investment share of Rs 532mn, the company shall receive a consideration of Rs 958mn (1.8x P/BV). It will sell its entire shareholding in the project SPV to Cube in a phased manner as under:
 - **First stage during construction period:** Cube will invest 49% of the equity requirement during the construction period, subject to availability of 90% of right of way (ROW).
 - **Second stage on achievement of COD:** On achieving commercial operation date (COD), Cube will acquire 25% of the balance 51% stake from KNRC; it will buy the remaining 26% stake two years after COD.
- **Leverage:** Of the standalone gross debt of Rs 3.4bn as on Jun'19 (Rs 2.6bn as on Mar'19), promoter debt stood at Rs 2.1bn. Net D/E remained under control at 0.2x as on Jun'19 (unchanged QoQ).

FIG 2 – STAKE SALE TO CUBE HIGHWAYS

HAM project (Rs mn)	Total equity requirement	Equity investment – KNRC's share at 51%	Equity investment – Cube's share at 49%	Consideration for KNRC's 51% stake	Implied P/BV
Trichiraopalli-Kallagam	962	491	472	736	1.5x
Meensurutti-Chidambaram	455	232	223	365	1.6x
Chittor-Mallavaram	1,433	731	702	1,521	2.1x
Ramsanpalle-Mangloor	1,042	532	511	958	1.8x
Total	3,892	1,985	1,907	3,579	1.8x

Source: Company, BOBCAPS Research

FIG 3 – STATUS OF HAM PROJECTS

HAM project (Rs mn)	Length (km)	BPC	EPC cost (net of GST)	TPC	Equity	Grant	Debt	Equity invested up to Jun'19	AD	Land status/Work completion
Trichiraopalli-Kallagam, Tamil Nadu (NHAI)	39	10,206	7,464	9,100	962	4,318	3,820	481	01-Mar-19	83%/started
Meensurutti-Chidambaram, Tamil Nadu (NHAI)	32	4,820	3,518	4,316	455	2,041	1,820	84	Delayed; 6-7km of land disputed	63%
Ramsanpalle-Mangloor, Telangana (NHAI)	47	12,340	8,438	10,456	1,042	5,245	4,169	521	02-May-19	80%/ 13%
Chittor-Mallavaram, Andhra Pradesh (NHAI)	61	17,301	11,607	14,555	1,433	7,393	5,730	725	04-Jan-19	94%/19%
Magadi-Somwarpath, Karnataka (KSHIP)	166	11,445	8,723	11,276	1,221	7,485	2,570	26	FC documents submitted; AD by end of Sep'19	63%
Oddanchatram - Madathukulam (Pkg -2), Tamil Nadu (NHAI)	45	9,200	6,300	8,790	800	3,680	4,310	1	LOA received on 7-Mar-19	CA signing in two months
Total		65,312	46,050	58,493	5,913	30,161	22,419	1,838		

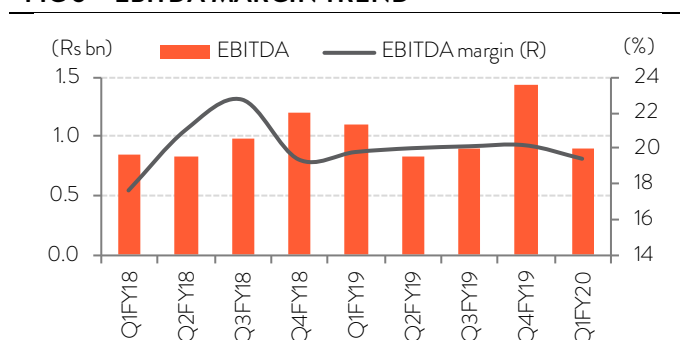
Source: Company, BOBCAPS Research | Note: AD – Appointed Date, BPC – Bid Project Cost, CA – Concession Agreement, FC – Financial Closure, LOA – Letter of Award, TPC – Total Project Cost

FIG 4 – ORDER BACKLOG AT RS 65.2BN INCL. L1 OF RS 18.9BN; EXECUTABLE SHARE AT 63%

Particulars (Rs mn)	Q1FY18	Q2FY18	Q3FY18	Q4FY18	Q1FY19	Q2FY19	Q3FY19	Q4FY19	Q1FY20	
Order inflows	-	-	5,607	39,830	-	-	-	-	8,473	
Order backlog	33,388	35,872	33,326	23,266	19,800	18,315	15,408	40,156	46,338	
Book-to-bill (x)	1.9	2.1	1.9	1.2	1.0	0.9	0.8	1.9	2.3	
Order backlog break-up										
Roads	28,380	27,283	24,328	16,519	15,446	13,685	12,194	38,421	36,596	
Irrigation	5,008	8,562	8,998	6,747	4,337	4,613	3,199	1,721	9,728	
Others	-	27	-	-	17	17	15	14	14	
Total order backlog	33,388	35,872	33,326	23,266	19,800	18,315	15,408	40,156	46,338	
% share										
Roads	85.0	76.1	73.0	71.0	78.0	74.7	79.1	95.7	79.0	
Irrigation	15.0	23.9	27.0	29.0	21.9	25.2	20.8	4.3	21.0	
Others	-	0.1	-	-	0.1	0.1	0.1	0.0	0.0	
Total order backlog	100	100	100	100	100	100	100	100	100	
Order backlog incl. L1	33,388	35,872	44,771	63,016	59,550	58,065	55,158	59,006	65,188	
Book-to-bill (x)	1.9	2.1	2.5	3.3	3.0	2.9	2.7	2.8	3.2	

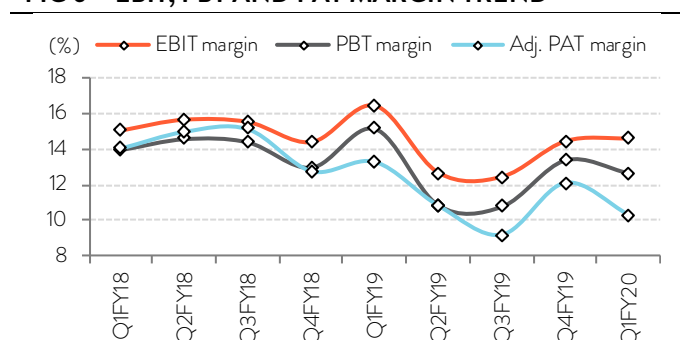
Source: Company, BOBCAPS Research

FIG 5 – EBITDA MARGIN TREND



Source: Company, BOBCAPS Research

FIG 6 – EBIT, PBT AND PAT MARGIN TREND



Source: Company, BOBCAPS Research

Valuation methodology

Improved contract wins (strong inflows in Q4FY19 and YTD FY20) and a stronger order backlog substantially raise KNRC's EPC revenue visibility over the next two years. Moreover, the company's positive operating cash flows, lean working capital and low net D/E (0.2x as on Jun'19) will help it fund new HAM projects. Equity requirements for existing HAM contracts are unlikely to be a concern due to its recent deal with Cube (49% stake to be monetised during the construction period). We have not considered this stake sale in our valuation as Cube will begin investing only once 90% of ROW is available.

We model for a revenue CAGR of 20% over FY19-FY22 led by likely AD award in the KSHIP HAM project by end-Sep'19 and start of irrigation works (EPC value of ~Rs 17bn) post monsoon. The stock is trading at 12.4x/8.8x FY20E/FY21E standalone earnings after adjusting Rs 58/sh for the value of its assets. These valuations are fairly attractive considering KNRC's impressive execution track record, strong balance sheet, superior margins and favorable return ratios. We adjust FY20/FY21 earnings by -5.8%/+1.1% to build in the Q1 performance and roll forward to a revised Jun'20 TP of Rs 350 (from Rs 365). Maintain BUY.

FIG 7 – REVISED ESTIMATES

(Rs mn)	FY20E			FY21E		
	Old	New	Change (%)	Old	New	Change (%)
Revenue	25,026	25,236	0.8	32,402	34,524	6.5
EBITDA	4,098	4,280	4.4	5,737	5,999	4.6
EBITDA margin (%)	16.4	17.0	59bps	17.7	17.4	(33bps)
Adjusted PAT	2,122	1,999	(5.8)	2,771	2,800	1.1
PAT margin (%)	8.5	7.9	(56bps)	8.6	8.1	(44bps)

Source: Company, BOBCAPS Research

For our SOTP model, we value:

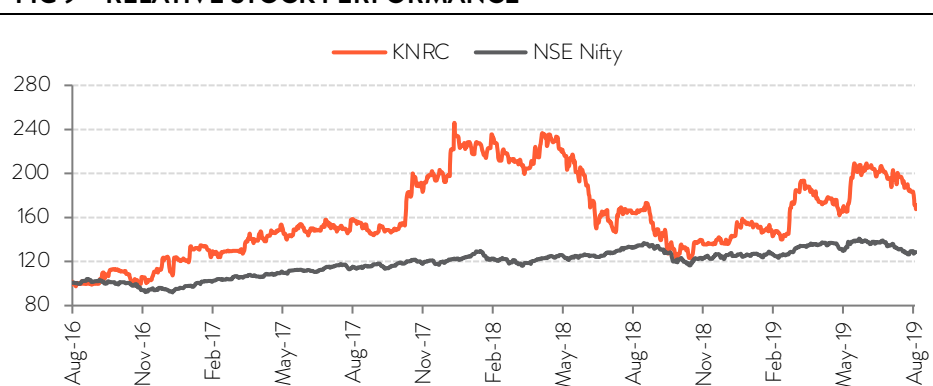
- (i) the EPC business at Rs 293/sh based on 15x Jun'21E earnings;
- (ii) BOT assets at Rs 35/sh on P/BV basis (implied P/BV of 1x for invested equity in the two assets as on Mar'20);
- (iii) HAM projects at Rs 18/sh on P/BV (implied P/BV of 1-1.2x for equity investment in six projects as on Mar'20); and
- (iv) land at Rs 5/sh on P/BV (of 1x for investment made as per balance sheet).

FIG 8 – JUN'20 SOTP-BASED TARGET PRICE OF RS 350

Business	Basis of valuation	Value (Rs mn)	Multiple (x)	Valuation (Rs mn)	Value per share (Rs)
Standalone business (EPC)	P/E (x) on Jun'21E earnings	2,745	15.0	41,170	293
Equity investment in BOT/HAM road assets and real estate	Equity investment as on Mar'20	6,933		8,094	58
Equity investment in BOT projects	P/BV	4,878		4,878	35
- Walayar		3,974	1.0	3,974	28
- Muzaffarpur		903	1.0	903	6
Equity investment in HAM projects	P/BV	2,055		2,479	18
- Trichiraopalli - Kallagam		481	1.2	594	4
- Meensurutti - Chidambaram		84	1.2	103	1
- Ramsanpalle - Mangloor		521	1.2	643	5
- Chittor - Mallavaram		725	1.2	895	6
- Magadi - Somwarpeth		244	1.0	244	2
- Oddanchatram - Madathukulam		-	1.0	-	-
Land	P/BV	738	1.0	738	5
Target price (Rs)				49,264	350
O/s shares (mn)					141

Source: Company, BOBCAPS Research

FIG 9 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- **Slowdown in road sector capex:** Capex in the road sector has witnessed some revival over the last two years. Any slowdown in project awarding would impact the company's growth and our estimates.
- **Delay in execution of projects in hand:** Execution delays due to land acquisition hurdles or delay in appointed dates or other regulatory bottlenecks could adversely affect KNRC's revenue prospects.
- **Execution risk:** While KNRC has excellent execution skills, a potential entry into new segments and geographies exposes it to execution risks. Also, with the average size and complexity of projects increasing, the company faces the challenge of completing large projects within the stipulated time and cost.

- **Profitability risks:** Historically, KNRC's operating profitability has been higher than peers due to its backward integration model and concentration in the roads space in South India. If the company enters new geographies, it may not always have access to cheaper raw material sources/quarries and may face other challenges to sustaining profitability.
- **Unpredictable traffic:** KNRC's presence in the toll road segment exposes it to risks associated with unpredictability in traffic growth.

FINANCIALS (STANDALONE)

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue	19,317	21,373	25,236	34,524	36,643
EBITDA	3,861	4,270	4,280	5,999	6,038
EBIT	2,520	2,589	2,480	3,939	3,900
Net interest income/(expenses)	(231)	(291)	(364)	(413)	(424)
Other income/(expenses)	393	444	383	391	399
Exceptional items	0	0	0	0	0
EBT	2,682	2,741	2,499	3,917	3,875
Income taxes	39	(273)	(500)	(1,116)	(1,298)
Extraordinary items	0	165	300	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	2,721	2,633	2,299	2,800	2,577
Adjustments	0	0	0	0	0
Adjusted net profit	2,721	2,468	1,999	2,800	2,577

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	2,184	2,236	2,420	3,263	3,464
Other current liabilities	0	0	0	0	0
Provisions	184	165	195	267	283
Debt funds	2,204	2,641	2,650	2,650	2,350
Other liabilities	3,508	3,519	5,073	6,931	7,354
Equity capital	281	281	281	281	281
Reserves & surplus	11,297	13,862	16,094	18,826	21,336
Shareholders' fund	11,578	14,143	16,375	19,108	21,617
Total liabilities and equities	19,658	22,704	26,712	32,218	35,068
Cash and cash eq.	438	130	274	316	364
Accounts receivables	3,560	3,785	4,950	6,333	6,954
Inventories	712	951	1,383	1,892	2,008
Other current assets	0	0	0	0	0
Investments	5,976	7,078	9,081	11,319	13,391
Net fixed assets	3,315	3,710	3,910	3,100	2,463
CWIP	0	0	0	0	0
Intangible assets	0	0	0	0	0
Deferred tax assets, net	1,408	1,739	1,864	2,060	2,254
Other assets	4,248	5,311	5,251	7,197	7,635
Total assets	19,658	22,704	26,712	32,218	35,068

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	4,062	4,314	4,099	4,861	4,715
Interest expenses	231	291	364	413	424
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(2,134)	(1,760)	106	(1,261)	(728)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	2,160	2,845	4,569	4,013	4,410
Capital expenditures	(2,035)	(2,076)	(2,000)	(1,250)	(1,500)
Change in investments	(11)	(1,101)	(2,003)	(2,239)	(2,072)
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(2,045)	(3,177)	(4,003)	(3,489)	(3,572)
Equities issued/Others	0	0	0	0	0
Debt raised/repaid	763	437	9	0	(300)
Interest expenses	(231)	(291)	(364)	(413)	(424)
Dividends paid	(66)	(68)	(68)	(68)	(68)
Other financing cash flows	(389)	(54)	0	0	0
Cash flow from financing	77	24	(422)	(481)	(791)
Changes in cash and cash eq.	192	(308)	143	43	47
Closing cash and cash eq.	438	130	274	316	364

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	19.3	18.7	16.4	19.9	18.3
Adjusted EPS	19.3	17.6	14.2	19.9	18.3
Dividend per share	0.4	0.4	0.4	0.4	0.4
Book value per share	82.3	100.6	116.4	135.9	153.7

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	1.8	1.6	1.4	1.0	1.0
EV/EBITDA	8.8	8.1	8.3	5.9	5.8
Adjusted P/E	12.1	13.3	16.4	11.7	12.7
P/BV	2.8	2.3	2.0	1.7	1.5

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	101.5	90.0	80.0	71.5	66.5
Interest burden (PBT/EBIT)	106.4	105.9	100.8	99.4	99.4
EBIT margin (EBIT/Revenue)	13.0	12.1	9.8	11.4	10.6
Asset turnover (Revenue/Avg TA)	107.8	100.9	102.1	117.2	108.9
Leverage (Avg TA/Avg Equity)	1.7	1.6	1.6	1.7	1.7
Adjusted ROAE	26.5	19.2	13.1	15.8	12.7

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	25.3	10.6	18.1	36.8	6.1
EBITDA	68.2	10.6	0.2	40.2	0.6
Adjusted EPS	61.8	(9.3)	(19.0)	40.1	(8.0)
Profitability & Return ratios (%)					
EBITDA margin	20.0	20.0	17.0	17.4	16.5
EBIT margin	13.0	12.1	9.8	11.4	10.6
Adjusted profit margin	14.1	11.5	7.9	8.1	7.0
Adjusted ROAE	26.5	19.2	13.1	15.8	12.7
ROCE	23.0	18.9	15.4	21.4	18.8
Working capital days (days)					
Receivables	67	65	72	67	69
Inventory	13	16	20	20	20
Payables	41	38	35	35	35
Ratios (x)					
Gross asset turnover	2.6	2.3	2.2	2.7	2.6
Current ratio	1.5	1.7	1.5	1.5	1.5
Net interest coverage ratio	10.9	8.9	6.8	9.5	9.2
Adjusted debt/equity	0.2	0.2	0.1	0.1	0.1

Source: Company, BOBCAPS Research

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Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: KNR CONSTRUCTIONS (KNRC IN)



B – Buy, A – Add, R – Reduce, S – Sell

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