COMPANY UPDATE

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KNR CONSTRUCTIONS

PRICE: RS.297 RECOMMENDATION: BUY
TARGET PRICE: RS.348 FY20E PE: 17.0X

KNR Constructions, a strong player in road construction in south is focusing on growing its order book by adding new projects in road sector. The company has been awarded first Hybrid Annuity project (HAM) from NHAI of value Rs 10.2 bn in the state of Tamil Nadu. This is the first major road project bagged by the company in FY18E and would strengthen its order book to ~Rs 43 bn from Rs 33.3 bn at the end of Q3FY18. The company is also lowest bidder (L1) in another HAM project of Rs 11.7 bn in Karnataka where awarding is expected in near future. The company has strong bid pipeline of road projects in south India particularly in HAM segment and targets to add Rs 25-30 bn of new orders in FY18E. The company has net cash balance sheet at standalone level and hence it is confident to achieve financial closure of HAM projects. The company has maintained its guidance to achieve over Rs 18 bn revenue in FY18E and Rs 21 bn in FY19E. KNR has track record of beating its guidance and we expect the trend to continue looking at its order pipeline. We have maintained our earnings estimates and recommend Buy on the stock (Vs Accumulate) with target price of Rs 348.

Summary table - Standalone

(Rs mn)	FY18E	FY19E	FY20E
Revenue	18114	21883	26042
Growth (%)	17.5	20.8	19.0
EBITDA	3432	3579	4259
EBITDA margin (%)	18.9	16.4	16.4
PBT	2357	2486	3230
PAT	2121	2113	2455
EPS	15.1	15.0	17.5
EPS Growth (%)	26.2	(0.4)	16.2
CEPS (Rs)	23	23	25
Book value (Rs/share)	77	92	108
Dividend per share (Rs)	0.8	0.8	0.9
ROE (%)	21.5	17.8	17.5
ROCE (%)	20.7	18.6	20.8
Net cash (debt)	(617)	1244	3173
NW Capital (Days)	89	78	73
P/E (x)	19.7	19.8	17.0
P/BV (x)	3.8	3.2	2.7
EV/EBITDA (x)	12.3	11.3	9.1
EV/Sales (x)	2.3	1.9	1.5

Source: Company, Kotak Securities – Private Client Research

Bagged first HAM project

KNR has bagged its first HAM with bid project cost of Rs 10.2 bn from NHAI for four laning of Trichy to Kallagam section of NH-227 under Bhartmala Pariyojana in Tamil Nadu. The project has a concession period of 17 years including construction period of 2 years from the appointed date. The company is required to achieve financial closure in the next six months, post that it will be starting the construction work. We believe that achieving financial closure in the project would not be difficult for the company as it has net cash balance sheet at standalone level. Hence, the company is expected to achieve the same before 6 months. In addition, the project is located in Tamil Nadu where KNR has strong foothold and is already executing project. Hence it can arrange resources very easily with low capex for executing the same.

Road projects awarding to pick up

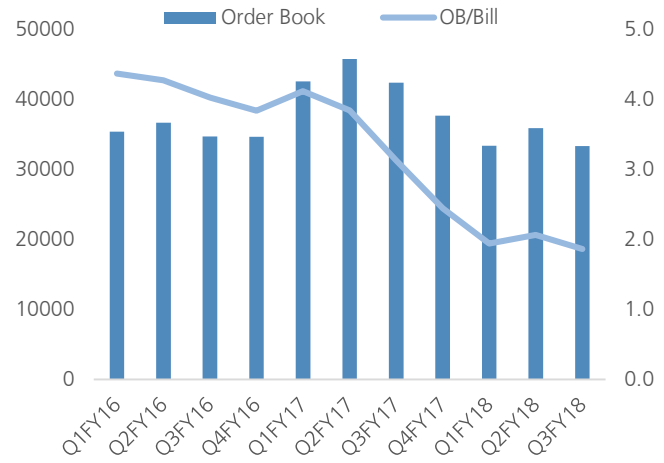
The government has set target to award 50000 km of road projects of value Rs 5 trn in the next 2 years. The awarding activity has been subdued in FY18 YTD due to stricter land acquisition criteria, GST, etc. NHAI is not awarding the projects unless 90% of the land is available for construction for EPC and 80% for HAM project. The slower awarding in projects was also due to rollout of the GST which impacted preparation of detailed project reports due to new tax structure and its impact on project cost. Earlier, NHAI targeted to award over 10,000 km of road projects in FY18, but has awarded ~2700 km till YTD FY18 (till January 2018). Similarly, MoRTH and NHIDCL together targeted award of 15,000 km of road projects, but could award ~3100 km (based on industry reports) during the period. The pace of award is expected to improve in Q4FY18, particularly in last two months of FY18 with over 6000km – 8000 km of projects are expected to come for bidding.

Positive on growing its order book

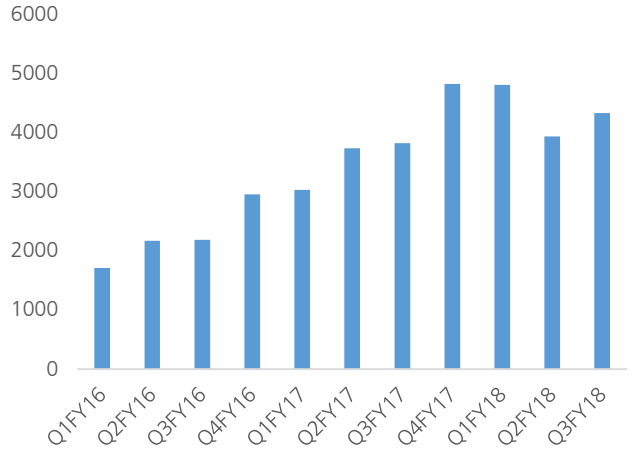
KNR had witnessed a stable order book in the past 2-3 quarters in the range of Rs 33-35 bn with a low TTM OB/bill of 1.9x at the end of Q3FY18. This is led by strong execution of existing orders, slower awarding by NHAI and selective approach by the company towards HAM projects. The company is positive on pickup in order inflows based on its pipeline. It has added Rs 5 bn of new project in 9MFY18 which is from irrigation space. The recent addition of Rs 10.2 bn NHAI HAM project takes its order book to ~Rs 43 bn. Further, the company has strong bid pipeline in roads space. It is L1 in Rs 11.7 bn Karnataka government HAM project which is expected to be finalized soon. In addition, the company has submitted bids in other two packages of Trichy-Kallagam road project (of cost ~Rs 11 bn) and is positive on

adding these projects. Based on this, KNR is well placed to achieve its guidance of Rs 25-30 bn of order inflows in FY18E. The company does not see any challenges in meeting equity in these projects as it has net cash balance sheet at standalone.

Order Book (Rs mn) and TTM OB/bill (x)



Quarterly Standalone Revenue (Rs mn)



Source: Company

On track to exceed revenue guidance in FY18E

Based on execution timeline of current order book and future pipeline, the company maintained its guidance to achieve over Rs 18 bn and Rs 21 bn of revenue in FY18E and FY19E respectively. In FY18E, the company is targeting ~20% EBITDA margins while it is expected to normalize in FY19E to ~14-15%. The higher margin in FY18 was due to higher contribution from project near completion. The company targets for lower tax rate of 10% and 15% in FY18E and FY19E respectively, as it would continue to claim 80IA tax benefits on its current order book. We believe that KNR would be able to exceed its guidance.

Update on BOT projects: KNR has reported Rs 1.4 mn toll per day in Kerala project (Walayar –Vadakkancherry) and Rs 1.3 mn per day in Bihar project (Muzaffarpur Barauni) project where it has got 100% COD. The company would be refinancing the term loan in Bihar project as a result the cost of debt would reduce to 8.75%. The company intends to exit from these BOT projects in future at right valuation.

Outlook and valuation

We recommend BUY on KNR Constructions with a price target of Rs.348

KNR has track record of generating positive operating cash flows and net cash balance sheet, which would help it in funding HAM projects. Based on current order book of ~Rs 43 bn (including new HAM projects), L1 HAM project of Rs 11.7 and robust pipeline for future projects, we expect KNR's revenue growth to remain strong for next 2-3 years. We maintain our earnings estimates factoring in strong order pipeline, robust execution and positive outlook of the sector. The construction business of the company is available at PE of 17.6x and 15.1x, based on FY19E and FY20E revised EPS of Rs 15 and Rs 17.5 respectively, after adjusting for BOT value of Rs 33 per share. We upgrade our rating on the stock to **Buy** (from Accumulate) due to recent correction and maintain target price of Rs 348 based on SOTP valuation.

Valuation Table

Segment	Parameter	FY20 Multiple (x)	Per Share (Rs)
Construction Business	PE	18	315
Road BOT	BV of equity	1	33
Consol KNR	Value		348

Source: Kotak Securities - Private Client Research

RATING SCALE

Definitions of ratings

BUY	–	We expect the stock to deliver more than 12% returns over the next 12 months
ACCUMULATE	–	We expect the stock to deliver 5% - 12% returns over the next 12 months
REDUCE	–	We expect the stock to deliver 0% - 5% returns over the next 12 months
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NOTE	–	Our target prices are with a 9-month perspective. Returns stated in the rating scale are our internal benchmark.

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