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DEMOCRATIZING WEALTH CREATION

UPSTREAM PICK

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Company Name	:	**KNR CONSTRUCTIONS**
BSE Code	:	**532942**
Time Duration	:	**2 years**
CMP	:	**₹219.75 (as on 03 Oct., 2019)**
Target Price	:	**₹310**

Our Upstream Pick for the month of October is KNR Constructions Limited. The company undertakes engineering, procurement and construction (EPC) contracts, as well as build-operate-transfer (BOT) projects across various sectors, such as construction and maintenance of roads, highways, flyovers and bridges. Its range of verticals also includes irrigation projects, water management, agriculture and trading business. The company has successfully completed road projects of around 6,000 km across 12 cities in India.

We have chosen KNR Constructions as our Upstream Pick for this month since its operational performance, which was impacted by higher subcontracting expenses (35% in FY17), has significantly came down to 8% in FY19. This favourable change was supported by higher proportion of the company's own equipments. Going ahead, subcontracting expenses are likely to be around 10% which would drive the operational performance. Also, despite being involved in a capital-intensive industry KNR has been maintaining a healthy balance-sheet and to continue with an asset-light model the company recently has entered into an agreement with Cube Highways to sell stake in its four HAM projects. This deal will be implemented in a phased manner and it is stuck at high valuation of 1.8x P/B. The proceeds from this deal can be used as fuel for running its growth engine going forward.

Rising Contribution from High-Margin Irrigation Projects

The company's irrigation projects order book as on Q1FY20 stood at Rs 972.8 crore and contributes 21% to the total order book. Recently, the company has won two projects under its irrigation business vertical which includes Mallanna Sagar project worth Rs 850 crore and Palamuru Rangareddy Lift Irrigation project of Rs 847.3 crore. Its irrigation business is high-margin business and the management also expects this business to contribute 25-35% to the total revenue by FY21E. So, rising revenue share from its high-margin business would improve the company's operating profitability.

HAM and BOT Projects

The company has six HAM projects in its basket out of which three are under execution and the remaining have achieved financial closure. The projects which are under execution are likely to pick up in H2FY20. It has recently closed a deal for four under-construction HAM projects with Cube Highways to sell its stake. This deal will be implemented in a phased manner and it is stuck at high valuation of 1.8x P/B. The proceeds from this deal can be used to boost its growth engine going forward. The company's BOT projects' portfolio consists of four projects and are mainly spread in Bihar, Karnataka, Telangana and Kerala. By the end of FY20, the company is planning to sell Walayar Tollway which would provide cash flow of around Rs 370 crore.

Strong Order Book

KNR's order book as on June 2019 ended quarter stood strong at Rs 4,633.8 crore which translates to book-to-bill of 2.2x, giving revenue visibility for the next two years. Of these total orders, road-captive (HAM) consist of 54 per cent while road non-captive and irrigation contributes nearly 25 and 21 per cent respectively. In terms of geographies, the southern region remains in a dominating position with 97 per cent share of the total orders. In addition to these orders, the company also holds orders worth Rs 1,885 crore. The company has strong execution capabilities and earlier it has received a bonus for completing projects before the scheduled date. Besides, the company is confident of winning HAM order in FY20E worth Rs 1,000-1,500 crore. We believe that with strong execution capability and large share of high-margin irrigation projects the company will witness traction in topline and profitability going forward.

Other Rationales

- The company has its own large amount of equipment which saves leasing costs that other industry players have to pay. It also has its own quarrying mines at more than 90% of the project sites.

- Lower level of subcontracting expenses and bonus on account of early completion of the projects puts the company in a better position compared with its peers.
- Government's thrust on road connectivity and infrastructure. In the next five years, the government is planning to construct 60,000 km length highways mostly under the Bharatmala Pariyojana Phase 1 and 2. Further, under a recent budget announcement, the government has planned to use Rs 100 lakh crore into infrastructure activities by 2024. Such kind of government initiatives would help companies like KNR to grab several opportunities.

Financials

During FY19, the standalone revenue jumped by 11% to Rs 2,137.26 crore led by higher project executions. EBITDA grew by 11% to 426.97 crore supported by lower subcontracting expenses. Further, the company reported net profit of Rs 263.27 crore, down 3% YoY. Considering the recently concluded quarter Q1FY20, revenue came in at Rs 464.6 crore as against Rs 556.36 crore in the corresponding quarter last year, registering 16.5% YoY decline. The revenue was affected by delay in receiving an appointed date from NHAI for the HAM projects. EBITDA for the quarter fell by 18.1% YoY to Rs 90.01 crore as against Rs 109.86 crore in the corresponding quarter last year, with a corresponding margin contraction of 37 bps. EBITDA margin for the quarter stood at 19.4%. PAT for the quarter came in at Rs 47.72 crore as against Rs 74 crore in the corresponding quarter last year, indicating YoY decline of 35.5%. This was due to higher depreciation for irrigation projects and higher tax expenses.

Valuation and Outlook

Rising contribution from high-margin irrigation projects would likely improve the operating profitability going ahead. Also, subcontracting expenses which have came down significantly would further improve the operating margins going ahead. Besides, the company has the lowest D/E (0.19x) among its peers, which lends financial stability. In term of return ratio, ROE and ROCE stand healthy at 19.90 per cent and 20.35 per cent respectively. At present, the stock is trading at 13.42 P/E on TTM earnings. Considering the above factors coupled with strong order book and government's supportive initiatives, we see a potential upside of 41% with a target price of Rs 310 over a period of two years.

Inc/Exp Statement(Standalone) (Rs in Crore)

Description	201903	201803	201703	201603	201503
Net Sales	2137.26	1931.65	1541.05	902.55	876.13
Total Income	2200.64	1970.97	1571.33	934.27	889.40
Total Expenditure	1709.78	1545.53	1311.47	749.64	750.88
PBIDT	490.86	425.44	259.86	184.62	138.52
PAT	263.26	272.09	157.25	161.07	73.01
Dividend %	20.00	20.00	25.00	10.00	10.00
Adj. EPS(Rs)	18.72	19.35	11.18	11.45	5.19

Quarter On Quarter (Standalone) (Rs in Crore)

Particulars	201906	201903	Q on Q Var%	201806	Y on Y Var%
Net Sales	464.60	715.71	-35.09	556.36	-16.49
Total Expenditure	374.58	571.61	-34.47	446.50	-16.11
PBIDT (Excl OI)	90.02	144.10	-37.53	109.86	-18.06
PAT	47.72	92.15	-48.22	74.00	-35.52
PBIDTM% (Excl OI)	19.38	20.13	-3.73	19.75	-1.87
PBIDTM%	22.99	22.25	3.33	22.94	0.22
PATM%	10.27	12.88	-20.26	13.30	-22.78
Adj. EPS(Rs)	3.39	6.55	-48.24	5.26	-35.55

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