

# KNR Constructions

CMP : ₹169

Target price: ₹275

HP\* : Upto 3 years

Our first pick for Vriddhi is KNR Constructions. This is a company which has an order book running into 5 years and stands to benefit the most from the expected infrastructure boost.

We see KNR benefitting from the below mentioned key drivers:

- 1) Strong execution capabilities :** We see that the company has demonstrated strong execution and has been earning early completion bonus. This attracts confidence in the company and reduces execution risks. Also, the company's current portfolio of projects are running on time and furthers our belief in its execution capabilities. This has been possible due to the company's proper procurement planning and machinery back up.
- 2) Geographical exposure :** The company has exposure to high potential states of Telengana and Tamil Nadu. We expect to see high growth in infrastructure projects and South India will command a sizeable portion of this.
- 3) Irrigation projects :** We expect irrigation projects to contribute substantially to the revenues in FY18 as against 2% in FY16. With the government combining all irrigation schemes under a single head of the PM scheme, it will lead to better coordination and sanction of projects.
- 4) Road orders :** KNR continues to focus on EPC projects and has seen substantial growth in the same on a quarterly basis. We see that HAM based model can impact margins and will also squeeze the projects awarded under EPC. However, seeing the current pipeline of NHAI awards, we feel that EPC orders will still continue to be awarded. KNR, with its strong execution track record, stands to benefit from the same during FY18-19.
- 5) Valuation and Risks :** We see that the company is trading at FY19 P/E of 15.4x on FY19 EPS of 11, leading to 54% upside from the current levels. The company has delivered ROE of 24.9 in FY16, up from 13.4 in FY15. We expect ROE to dip in FY17 and to pick up over FY18-19. Risk to our thesis include – higher HAM project awards and rise in cost of materials.

## Company Details

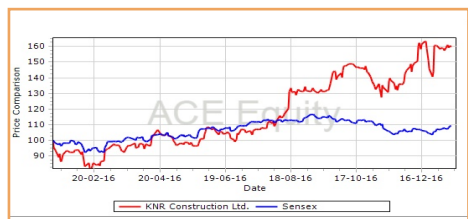
|                   |                            |
|-------------------|----------------------------|
| Industry          | Engineering - Construction |
| Chairman          | B V Rama Rao               |
| Managing Director | K Narasimha Reddy          |
| Company Secretary | M V Venkata Rao            |
| BSE Code          | 532942                     |

## Key Market Indicators (Standalone)

|                                  |             |
|----------------------------------|-------------|
| Latest Date                      | 13-Jan-2017 |
| Latest Price (Rs)                | 169.00      |
| Previous Close (Rs)              | 170.90      |
| 1 Day Price Var%                 | -0.53       |
| 1 Year Price Var%                | 57.26       |
| 52 Week High (Rs)                | 187.80      |
| 52 Week Low (Rs)                 | 81.60       |
| Beta                             | 0.96        |
| Face Value (Rs)                  | 2.00        |
| Industry PE                      | 20.03       |
| TTM Period                       | 201609      |
| TTM EPS(Rs)                      | 11.73       |
| TTM PE (x)                       | 14.50       |
| Price/BV(x)                      | 2.97        |
| EV/TTM EBIDTA(x)                 | 10.95       |
| EV/TTM Sales(x)                  | 2.14        |
| Dividend Yield%                  | 0.12        |
| MCap/TTM Sales(x)                | 2.05        |
| Latest Book Value (Rs)           | 57.16       |
| Market Cap (Rs. In Crores)       | 2390.49     |
| EV (Rs. In Crores)               | 2491.10     |
| Latest no. of shares (In Crores) | 14.06       |

## Share Holding Pattern as on 201609

|                                   |       |
|-----------------------------------|-------|
| Promoter No of shares (In Crores) | 1.63  |
| Promoter %                        | 58.09 |
| FII No of Shares (In Crores)      |       |
| FII %                             |       |
| Total No of Shares (In Crores)    | 2.81  |
| Free Float %                      | 41.91 |



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## Geographic exposure

The company derived 88% of its order book from South India as of Sep 2016. Within this, Tamil Nadu contributes ~60% and Kerala 18%.

We believe the exposure to this geography bodes well for the company. We see that the company has nine projects in Tamil Nadu worth Rs 1997 cr., while it has 10 projects in Telangana and Karnataka worth Rs 750 cr. each. The company has been focusing on targeting EPC (Engineering, procurement and construction) projects.

We expect traction in these geographies to continue as NHAI plans to invest Rs 3900 bn over the next five years. However, we see that with NHAI moving more towards the Hybrid & Annuity model (HAM), it might be a dampener over the short term. However, FY18 might bode well given the expectations that the amount garnered through demonetisation will be used to finance the stalled infrastructure projects. We expect EPC infrastructure investments to treble and provide for lower projects in FY17.

## Irrigation portfolio is set to grow

Irrigation, which contributed around 2% of the order book in FY16, has now grown and contributed 15% of the order book by Sep 2016. There has been a need to improve the irrigation system in core agrarian belts to support agricultural activities. With the government taking up major work in improving the irrigation, we see that this diversification will help the company.

Major impetus can come from Pradhan Mantri Krishi Sinchayee Yojana (PMKSY) which can lead to investments worth Rs 500 bn over the next three years. The four schemes that have been merged in this scheme are Accelerated Irrigation Benefit Programme (AIBP), Har Khet Ko Pani, Per Drop More Crop and Integrated Water Shed Management Programme. In the year 2017-18 and 2018-19, the expected investments under these will be to the tune of Rs 93 bn and Rs 122 bn.

Given this overall spend, the south Indian states have historically taken a sizeable pie from this expenditure. Telangana boasts of Rs 250 bn budgeted expenditure for FY17.

## Road orders - continued growth

KNR's boasts of the best order book of Rs 4579.1 cr. translating into book/bill ratio of 4.6x on FY16 sales. It has also bagged few important projects in FY17 which account for 35% of the order book. The key project - four-laning of Hubli-Hospet section NH-63 in Karnataka - has an estimated value of Rs 1,334 cr. This project is a 50% JV with BSCPL Infrastructure.

As per CRISIL, going forward, we will see 10% and 14% growth in NHAI road length awards. Also, there can be a major infrastructure investment in state roads which can see a boost from Rs 1,700 bn in 2011-16 to Rs 4,500 bn in 2016-20E.



***High growth in infrastructure projects and South India will command a sizeable portion of this in revenue.***



***Irrigation projects by Government to contribute substantially to the revenues in FY18 as against 2% in FY16.***



***Healthy order book gives long term revenue visibility.***

## Financial Performance

The company recorded growth of 7% in FY16 to Rs 995 cr on yearly basis. PBIDT of the company grew by 55 per cent to Rs 216 cr in FY16. PBIDT expanded by 700bps to 22% in FY16 as compare to FY15. PAT surged by 13% to Rs 133 cr in FY16 against FY15. PAT margin ballooned by 600bps to 13% in FY16 as compare to FY15.

KNR has PBIDT and PAT margin of 22%/13% which is better a compare to peers. It has low standalone debt/equity ratio of 0.2x in FY16. On consolidate basis debt/equity ratio rise from 0.3x in FY15 to 0.9x in FY16 due to debt drawn for BOT projects. Currently KNR delivers consolidate ROE and ROCE of 17.96%/ 11.42% in FY16 which is healthier than peers. Currently Company also enjoys lower tax rate due to Minimum Alternate Tax (MAT).

In Q2FY17- The company registered growth in revenue by 71% YoY to Rs 363 cr in Q2FY17 owing to gain from the execution of orders. As orders were added in in H1FY17 giving high book to bill ratio of ~5x as of now. PBIDT and PAT margin contracted due to higher operational expenses. PAT also shown de-growth on rise in tax rate.

Going forward, we see standalone revenue to grow at CAGR of 27 per cent over next three years on account of orderbook building up and execution from order wins. We see PAT to grow moderately at three year CAGR of 12% over FY17-19E on expectation of rise in tax rate over next few years.

## About the company:

It was established in 1995, as a multi-domain infrastructure project development company. It is among the leading providers of integrated engineering, procurement and construction (EPC) services for the construction and maintenance of road and highway networks of the nation. It has diversified into sectors of irrigation and urban water infrastructure. It derived 60% of the order book from Tamil Nadu followed by 19% from Kerala as of FY16. Its two verticals - roads contribute 83%, while irrigation projects contribute 17% to the order book as of 1HFY17.

| Inc/Exp Statement(Consolidated) (Rs in Crore) |         |        |        |        |        |
|---|---------|--------|--------|--------|--------|
| Description                                   | Mar-16  | Mar-15 | Mar-14 | Mar-13 | Mar-12 |
| Net Sales                                     | 995.12  | 931.19 | 895.03 | 764.97 | 892.23 |
| Total Income                                  | 1038.15 | 944.86 | 912.74 | 783.82 | 905.83 |
| Total Expenditure                             | 821.83  | 805.35 | 764.55 | 649.50 | 760.82 |
| PBIDT   | 216.32  | 139.51 | 148.19 | 134.32 | 145.01 |
| PAT   | 133.16  | 71.75  | 65.54  | 51.35  | 49.15  |
| Dividend %                                    | 10.00   | 10.00  | 10.00  | 10.00  | 10.00  |
| Adj. EPS(Rs)                                  | 8.99    | 4.96   | 4.30   | 3.49   | 3.33   |

| Quarter On Quarter (Standalone) (Rs in Crore) |         |        |             |         |             |
|---|---------|--------|-------------|---------|-------------|
| Particulars                                   | Spet-16 | Mar-16 | Q on Q Var% | Spet-15 | Y on Y Var% |
| Net Sales                                     | 363.24  | 303.64 | 19.63       | 212.67  | 70.80       |
| Total Expenditure                             | 317.52  | 259.48 | 22.37       | 177.72  | 78.66       |
| PBIDT (Excl OI)                               | 55.98   | 43.69  | 28.13       | 39.22   | 42.72       |
| PAT   | 43.93   | 30.22  | 45.39       | 56.50   | -22.25      |
| PBIDTM% (Excl OI)                             | 14.99   | 14.41  | 4.02        | 18.08   | -17.09      |
| PBIDTM%                                       | 18.53   | 16.34  | 13.40       | 22.52   | -17.72      |
| PATM%   | 11.76   | 9.97   | 17.95       | 26.04   | -54.84      |
| Adj. EPS(Rs)                                  | 3.12    | 2.15   | 45.12       | 4.02    | -22.39      |

