

## IPO Review

## KNR Construction

**Issue Opens**  
 Jan 24, 2007

**Issue Closes**  
 Jan 29, 2007

**Price Band**  
 Rs 170 to Rs 180

## Stiff pricing ...

KNR Construction (KNR) designs, engineers, constructs and maintains roads. The company diversified into construction of irrigation and urban water supply projects in 2005.

- Significant experience, strong track record**

The execution of infrastructure projects requires significant amount of technical expertise and skill. Pre-qualification for bidding of such projects is often based on past experience of execution of similar projects and financial strength of the bidder. KNR's promoters have significant experience of executing various road transportation engineering projects like roads, highways, flyovers, bridges, etc.

- Strong order book**

Currently, the company is executing three irrigation projects, of which one is with joint venture with Backbone Projects Ltd in which it has a 51% stake, and the other two in a joint venture with Srilaxmi Engineering (49% stake). Its share of the irrigation contract with Backbone aggregates to Rs 191 crore. As on November 30, 2007, it had executed projects estimated at Rs 45.34 crore. The balance order book aggregating approximately Rs 145 crore is under execution.

- Good client base**

Most of its clients are governmental agencies like the NHAI, and state PWDs. The company has also been executing projects, funded by multilateral agencies like the World Bank and Asian Development Bank.

### Concerns

The company operations are small-sized and this might be hindrance in bidding for large-scale projects which require minimum net worth criteria.

### Valuations

In view of recent fall in the markets, stock prices of infrastructure contracting companies have corrected sharply and are available at attractive P/E multiples between 12x to 15x, based on FY08 estimates. At the price band of Rs 170-180, the company's P/E works out to 17x to 18x.

**AVOID**

### Analysts' Names

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### Fact sheet

	Pre issue	Post issue
Equity capital (Rs cr)	2.02	2.81
Promoters (%)	95.82	72.3
Others (%)	4.18	4.70
Public (%)	NA	23.0

### Issue details

Issue size (Rs crore)	134-142
No of shares on offer	78.74 lacs
QIB (%)	386
Non institutional (%)	1160185
Retail (%)	77.34 lacs
Minimum Lot Size	
Mkt Cap post issue (Rs cr)	478-506

### Comparative return metrics

Stock return	3 M	6M	12M
Pratibha ind.	23.5%	45.6%	93%
Gayatri Projects	34%	42%	53%
Roaman Tarmat	16%	13%	NA

### Exhibit 1: Key Financials

Year to March	(Rs crore)		
	FY05	FY06	FY07
Total Income	129.30	149.90	324.40
EBITDA	9.87	13.30	44.32
Net Profit	4.19	8.07	20.50
Diluted EPS (Rs)	2.03	3.99	10.14
RoNW (%)	17.27	20.52	35.79

Source: Company RHP, ICICIdirect Research

## Company Background

KNR Construction is an infrastructure project development company providing engineering, procurement and construction services across various fast growing sectors namely roads & highways, irrigation and urban water infrastructure management.

Its project execution strength primarily is in road transportation engineering projects namely construction and maintenance of roads, highways, flyovers and bridges wherever integral to the projects undertaken.

The company has in the past executed infrastructure projects, both independently and through joint ventures. Currently, most of the road projects under execution are with Patel Engineering with whom it has a association for the past 7 years. As on November 30, 2007, it has 25 projects on hand across various states in India covering Uttar Pradesh, Madhya Pradesh, Assam, Andhra Pradesh, Karnataka, and Tamil Nadu. The company has the ability to bid, execute and implement medium and large size projects across various infrastructure segments.

## Objects of the issue

The objective of the issue is to augment the purchase of capital equipments and fund for working capital requirements.

Particulars	Amount (Rs crore)
Purchase of capital requirement	21.48
Investments in BOT projects	58.2
Working capital requirements	25.2

## INVESTMENT RATIONALE

### **Significant experience, strong track record**

The execution of infrastructure development projects requires significant amount of technical expertise and skill. Pre-qualification for bidding of such projects is often based on past experience of execution of similar projects and financial strength of the bidder. KNR's promoters have significant experience of executing various road transportation engineering projects involving construction of roads, highways, flyovers, bridges, etc. This experience together with consistent and successful track record of timely completion of projects provides the company a competitive edge in winning new bids in roads and highways sector.

In addition to, its proven capabilities of executing medium and large road transportation engineering projects, the company has forayed into execution of irrigation and water management projects. Currently, the company is executing three irrigation projects, of which one is with joint venture with Backbone Projects Ltd in which it has a 51% stake, and the other two in a joint venture with Srilaxmi Engineering (49% stake). Its share of the irrigation contract with Backbone aggregates to Rs 191 crore. As on November 30, 2007, it had executed projects estimated at Rs 45.34 crore. The balance order book aggregating approximately Rs 145 crore is under execution.

### **Good client base**

Most of its clients are governmental agencies like the NHAI, and state PWDs. The company has also been executing projects, funded by multilateral agencies like the World Bank and Asian Development Bank. These multilateral agencies regularly monitor the progress of the projects and ensure not only timely completion but also timely payment to the contractors.

### **Expertise in sourcing, maintaining supply chain for raw material**

Some of the key raw materials which are required for its business are bitumen, diesel, cement, steel, and stone aggregates. Its ability to source these key raw materials in proximity to its operating sites enables us to control its operating costs and the project execution period. Procurement of stone aggregate from its captive quarries has also enabled an assured supply on a timely basis at reasonable prices.

### **Ability to execute the project within stipulated time**

The company has executed complex projects prior to the scheduled completion date and earned bonus for early completion.

### **Qualified and experienced technical persons**

KNR Construction's employees are qualified in terms of technical expertise and experience of handling the relevant contracts. They have been able to attract employees from various government departments after their retirement

## BUSINESS STRATEGY

### **Maintain competitiveness in existing business**

The company knows the importance of the infrastructure development in India and the high impetus given by the government. Considering the huge potential in its existing line of business, it intend to maintain competitiveness of its existing business and achieve growth by capitalizing on its strong project execution skills and further improving them to enhance its scale of operations to undertake large sized projects.

### **Focus on BOT-based projects in infrastructure sector**

Both the Central and state governments are pursuing the BOT strategy to encourage development of the infrastructure facilities in India. Toll-based BOT projects offer the possibility of higher revenues to the contractor by virtue of better-than-anticipated use of assets. Its joint venture Patel-KNR (JV) has been awarded two road projects under the annuity model by NHAI. Further, going forward it also intend to simultaneously focus on 77 toll-based projects by leveraging its technical and financial credentials, which the company believe will further improve after the proposed Issue.

A stronger balance sheet should enable the company to bid for more projects, including BOT projects on its own or in alliance with other construction companies. The company intends to maintain an appropriate mix bet annuity and toll-based BOT projects. This is expected to help optimize returns and in keeping the business risk under control by ensuring stable cash flows.

### **Execute irrigation, water supply projects**

The company intends to capitalize on its experience in road construction to build its expertise in executing medium and large irrigation projects, which generally offer higher operating margins due to higher engineering skills required in executing such projects. Currently, the company is executing three irrigation projects.

### **Foray into water infrastructure management projects**

As a part of its long-term strategy of having presence in all infrastructure segments, the company has diversified into urban water infrastructure management projects namely sanitation, sewage management, etc. It is currently executing a project for Bangalore Mahanagara Palike with a contract value of Rs 45.19 crore. The company intends to procure bigger projects in this sector by forming alliances with suitable partners on similar lines as in road and irrigation sector.

### **Leverage its engineering skills**

The projects involving higher level of precision and complex engineering skills and higher mechanization provide better operating margins. The company intends to gradually increase its engineering capabilities by making continuous investments in building a dynamic organisation with competent professionals from reputed institutes and providing them a level playing field to pursue their activities creatively in line with organizational objectives.

## KEY CONCERNS

### **Small size of operations**

The company's operations are small-sized and this might be hindrance in bidding for large-scale projects which require minimum net worth criteria.

### **Presence in Mumbai and adjoining areas only**

The company's operations are currently concentrated only in Maharashtra region which can hamper its future growth if the state government reduces its spending on infrastructure budgets.

### **Execution risks**

Any delay in execution of projects can seriously hurt its cash flows and thereby the profitability.

## FINANCIALS

For FY07, the company clocked a top line of Rs 332 crore, and EBITDA of Rs 52.54 crore, resulting in a margin of 15.83%. PBT was Rs 26.92 crore, while PAT was at Rs 20.40 crore, resulting in an EPS of Rs 10.10.

For H1FY08, the total income was Rs 242 crore with EBITDA of Rs 37.17 crore resulting in a margin of 15.36% with PBT of Rs 20.20 crore and PAT of Rs 13.55 crore. On the post-issue equity of Rs 28.12 crore, EPS in FY08 is likely to surpass Rs 10.

## VALUATIONS

At the upper band of Rs 180, the company will have a market capitalisation of Rs 510 crore. Adding debt of Rs 190 crore, the EV of the company works out to Rs 700 crore. This translates into order-to-market cap of about 2.5x. On an expected EPS of Rs 10 for FY08, the share is valued at a P/E of about 18x at the upper band. Construction equipment, valued at over Rs 185 crore at the gross level, gives an added margin and advantage to the company.

**At this level, all the future growth seems to be priced in. We advise investors to avoid the issue as there are better picks in the secondary market.**

## FINANCIAL SUMMARY

### Profit & Loss

Year to March	FY05	FY06	FY07
Net Sales	86.40	128.55	262.22
Other & Mgmt Income	9.75	5.27	4.76
Total Expenditure	87.20	121.72	32.04
Operating Profit	9.12	12.10	35.14
Interest	0.65	0.40	8.90
Depreciation	2.46	4.78	7.36
Goodwill Amortisation	0.00	0.00	0.00
Profit Befor Tax	6.57	24.59	26.80
Tax	1.92	8.14	6.47
Net Profit	4.63	16.08	20.51
Operating Margin (%)	10.50	9.41	13.40
Profit Margin (%)	5.35	12.50	7.82
Outstanding Shares (crore)	2.02	2.02	2.02
Diluted EPS (Rs)	2.03	3.99	10.14

### Balance Sheet

Year to March	FY05	FY06	FY07
Equity Share Capital	6.75	20.02	20.02
Reserves & Surplus	26.83	19.96	37.26
Secured Loans	84.30	132.63	187.70
Unsecured Loans	0.28	0.39	0.16
Current liability	38.91	61.80	115.18
Deferred Tax Liability	2.50	6.78	6.00
Total Liabilities	97.76	192.63	313.10
Net Block	29.76	68.14	150.48
Capital Work in Progress		1.87	1.50
Investments	0.01	0.00	0.00
Net Current Assets	67.97	122.60	183.25
Misc. Expense w/o	0.00	0.00	0.00
Total Assets	97.76	192.63	313.10

## Cash Flow

Year to March	FY05	FY06	FY07
<b>Cash Flow Summary</b>			
Cash and Cash Equivalents at beginning of year	37.10	112.00	97.80
Net Cash from Operating Activities	81.50	-28.80	327.90
Net Cash Used in Investing Activities	-120.80	-308.30	-579.70
Net Cash Used in Financing Activities	114.20	322.90	277.90
Net Inc/(Dec) in Cash and Cash Equivalent	74.90	-14.20	26.10
Cash and Cash Equivalents at End of the year	112.00	97.80	123.90

## Ratio Analysis

Year to March	FY05	FY06	FY07
<b>Key Ratios</b>			
Debt-Equity Ratio	0.40	0.89	1.47
Long Term Debt-Equity Ratio	0.35	0.85	1.27
Current Ratio	1.51	1.52	1.29
<b>Turnover Ratios</b>			
Fixed Assets	2.82	2.91	3.19
Inventory	7.39	33.97	45.56
Debtors	5.23	4.64	7.54
Interest Cover Ratio	11.12	60.98	4.01
PBIDT margin (%)	10.07	22.25	16.15
PBITM (%)	7.52	18.68	13.39
PBDTM (%)	9.40	21.95	12.81
CPM (%)	7.38	15.86	10.39
APATM (%)	5.35	12.5	7.82
ROCE (%)	16.01	32.15	25.41
RONW (%)	14.37	39.93	35.72



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