

KNR Constructions

Bloomberg: KNRC IN EQUITY

Recommendation: BUY

Reuters: KNRL.BO



INITIATING COVERAGE

Building The Road To Growth

Initiate coverage with BUY: Target price Rs300

We initiate coverage on KNR Constructions (KNRC) with BUY and SOTP TP of Rs300 (valuing standalone business at Rs271/sh based on 9x FY12E earnings and AP-7 BOT at Rs30/sh based on DCF). We have not valued KNT-1 as it has been securitized and KNRC has realized the cash proceeds.

Significant discount versus peers

Our analysis suggests that KNRC is trading at 35% discount to the average peer group multiple, owing to: (i) muted order booking during FY10; and (ii) lull in order awards. During Q1FY11, KNRC has seen Rs8bn worth of order inflows taking the order book to Rs18bn and is currently L1 in orders worth Rs14bn. This robust order intake is expected to result in multiple expansion.

Order book to grow 3x, diversification on anvil

Momentum in Road segment awards is expected to pick up in 2HFY11. Besides Roads, KNRC is evaluating opportunities in Pipeline and Contract mining via MOUs with other players. KNRC has pre-bid MOUs with large players in roads segment. We expect order book to grow 3x over FY12E.

Profitability and growth robust

KNRC has witnessed strong growth in last 5 years having delivered average 13-15% EBIDTA margins and 6-7% net margins. This has been on the back of higher average order drop size, own equipment bank and ownership in aggregate quarries. Ahead, KNRC is focusing on maintaining margins as they intend to enter at the pre-bid stage with key developers.

Balance sheet strong; CFO positive; D/E at 0.3x

Strong cash flow generation and high promoter holding gives comfort on future growth. D/E at low levels versus peer group, strong customer advances and high margins have resulted in strong cash flows. Low D/E gives adequate headroom for funding future growth.

BOT story intact; asset monetization freeing up capital

KNRC owns 40% in two BOTs — KNT-1 and AP-7. KNT-1 is already monetized through securitization and AP-7 is likely to be securitized in 3QFY11. This will free up Rs1bn for investment in other BOTs. Currently KNRC is L1 in a toll project on BOT basis in Kerala worth Rs7.4bn, LOA is expected in 3QFY11.

Exhibit 1: Key financials

Y/E March (Rs mn)	FY08	FY09	FY10	FY11E	FY12E
Operating income	4,812	6,496	7,125	9,931	13,424
EBITDA	697	979	1,121	1,492	1,882
Net profit	295	437	503	635	846
EPS (Rs)	10.5	15.5	17.9	22.6	30.1
RoE (%)	21.1	18.1	17.7	18.9	21.0
RoCE (%)	12.8	12.9	13.1	16.0	17.7
P/E (x)	18.5	12.5	10.9	8.6	6.5

Source: Company, Ambit Capital research

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Recommendation

CMP:	Rs195
Target Price :	Rs300
Upside (%) :	54
EPS (FY11E):	Rs22.6

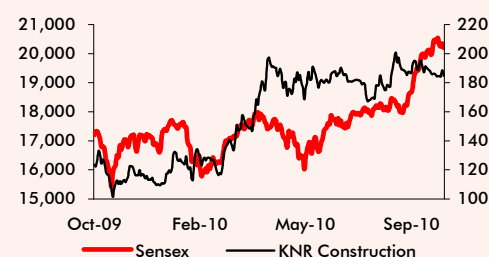
Stock Information

Mkt cap:	Rs5,473mn/US\$124mn
52-wk H/L:	Rs207/98
3M Avg. daily vol. (mn):	0
Beta (x):	1.0
BSE Sensex:	20,125
Nifty:	6,063

Stock Performance (%)

	1M	3M	12M	YTD
Absolute	2.7	6.9	57.4	65.8
Rel. to Sensex	-0.5	-4.9	34.5	43.9

Performance (%)



Source: Bloomberg, Ambit Capital research

Company Financial Snapshot

Profit and Loss (consolidated)

	FY10	FY11E	FY12E
Net sales	7,125	9,931	13,424
Optg. Exp(Adj for Ol.)	6,004	8,439	11,541
EBIDTA	1,121	1,492	1,882
Depreciation	262	404	451
Interest Expense	70	180	227
PBT	827	963	1,281
Tax	323	327	436
Adj. PAT	503	635	846

Profit and Loss Ratios

EBIDTA Margin %	15.7	15.0	14.0
Adj Net Margin %	7.1	6.4	6.3
P/E (X)	10.9	8.6	6.5
EV/EBIDTA (X)	5.0	3.8	2.7
Dividend Yield (%)	1.3	1.3	1.8

Company Background

Incorporated in 1995, KNR Constructions (KNRC) is a leading construction player with focus on National and state highway projects. With a presence across multiple states and partnerships with leading construction players the company has gone long way in building strong execution credentials. With a high promoter holding of ~74%, KNRC is well poised to take advantage of the India Infrastructure story. Other segments expected to drive future growth include Water, Irrigation, Pipelines & Contract mining. KNRC is in advance stages of formalizing MOUs with players in these segments and in turn this would help it get into the Roads vertical.

Balance Sheet (consolidated)

	FY10	FY11E	FY12E
Total Assets	4,183	5,202	6,054
Fixed assets	2,205	2,172	2,171
Current assets	5,186	5,528	7,646
Investments	651	1,105	1,105
Current Liabilities/Prov.	3,859	3,602	4,868
Total Liabilities	4,245	5,202	6,054
Total Networkth	3,070	3,645	4,397
Total debt	1,106	1,486	1,586
Deferred Tax Liability	69	71	71

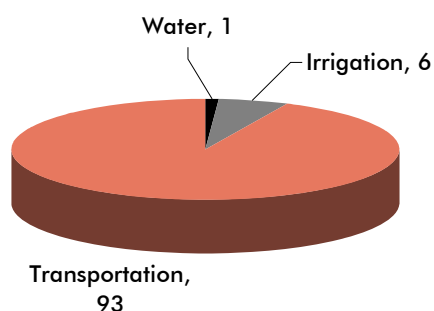
Balance Sheet Ratios

RoE	17.7	18.9	21.0
RoCE	13.1	16.0	17.7
Net Debt/Equity	23.3	34.8	14.5
Total Debt/Equity	36.0	40.8	36.1
P/BV (x)	1.8	1.5	1.2

Cash Flow (consolidated)

	FY10	FY11E	FY12E
EBIT	896	1,143	1,508
Depreciation	262	404	451
Tax	271	327	436
Net working capital	(572)	(772)	(123)
CF from operating activities	315	393	1,323
Capital expenditure	(375)	(371)	(450)
Investments	475	(420)	77
CF from investing activities	101	(791)	(373)
Incr (decr) in borrowings	(254)	380	100
Issuance of equity/DTL adj.	(55)	13	(0)
Net dividends	(66)	(71)	(94)
Interest paid	(72)	(180)	(227)
CF from financing activities	(456)	225	(221)
Net change in cash	(41)	(174)	729
Closing cash balance	391	218	947

Order-book mix



Rating



Valuation and Risks

Target price of Rs300 implies upside of 60%

Valuation methodology: On P/E basis we have valued KNR Constructions at 25% discount to our construction coverage universe and at 18% discount to the peer group mentioned in Exhibit 4. We believe that investment in the roads sector would continue to drive stock performance and, KNR, being a focused player in the segment with strong execution track record will likely benefit.

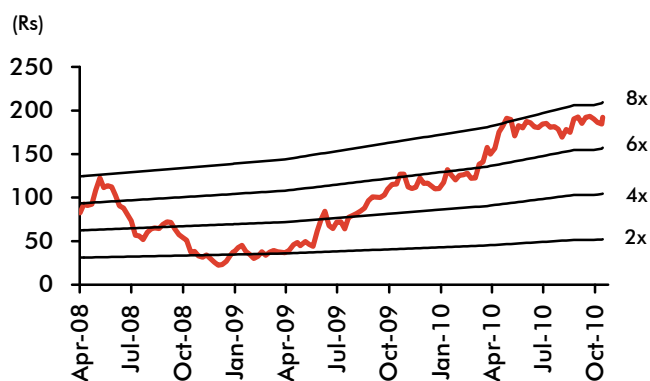
We arrive at a target price of Rs300 for the stock (standalone business at 9x FY12E EPS and AP-7 BOT on DCF basis). We have not valued KNT-1, as it has already been securitized and KNRC has realized the cash proceeds.

Exhibit 2: SOTP valuation

Particulars	Segments	Value (Rsmn)	Value per share(Rs)	Rationale
KNR standalone	Core construction business	7,610	271	At 9x FY12E Earnings
Andhra BOT	Roads Annuity	831	30	DCF Valuation
Total		8,441	300	

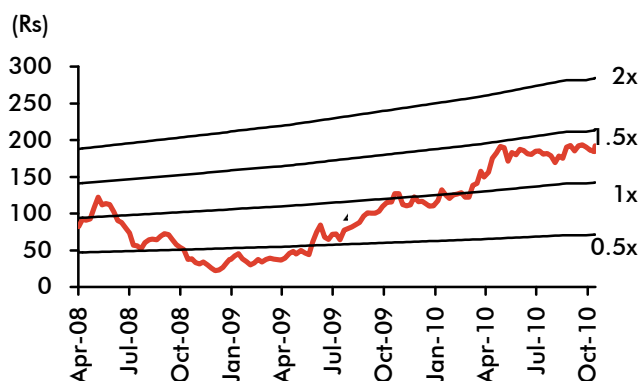
Source: Ambit Capital research

Exhibit 3: One year forward P/E band



Source: Ambit Capital research, Bloomberg

Exhibit 4: One year forward P/BV band



Source: Ambit Capital research, Bloomberg

Investment Rationale

Current valuation at large discount to peers

We have created a peer group for KNR Construction based on similar order book size, balance sheet strength, positive cash flow characteristics and debt/equity ratio. We do not have under coverage any other stock that is listed here (except KNRC) and have referred to consensus estimates to arrive at the company size multiple. On CMP basis KNRC is trading at a 35% discount to the average peer group at 6.2x; removing the BOT valuation of Rs30 (arrived at by the DCF valuation method) from the CMP, the stock is trading at 5x its FY12E EPS, which gives a favorable entry point. Most of the other companies in the peer group have not really diversified into road BOT's hence the current P/E multiple reflects the core cash contracting business.

We estimate that the average target multiple of the peer group ex-KNR is 11x on FY12E EPS basis and our target multiple of 9x FY12E EPS stated above is at an 18% discount to this and provides comfort to our price forecast. We believe that KNRC's growth over FY11-12E will deliver size impact and the resulting multiple re-rating.

Exhibit 5: Peer Group Valuations

Company		Consolidated Construction Ltd	Ahluwalia Contracts Ltd	B. L. Kashyap & Sond Ltd.	Unity Infraprojects Ltd	J.Kumar Infraprojects Ltd	KNR Construction Ltd
Market cap	Mn Rs	15,022	13,491	9,450	8,520	7,256	5,287
Net debt	Mn Rs	1,687	(222)	4,344	5,191	(221)	714
EV	Mn Rs	16,709	13,270	13,796	13,711	7,035	5,656
Sales	FY10	19,760	16,175	10,484	15,255	7,624	7,125
	FY11E	25,011	19,941	12,707	18,484	10,037	9,931
	FY12E	31,057	24,656	14,613	22,211	12,600	13,424
EBIDTA	FY10	1,931	1,799	899	1,970	1,285	1,121
	FY11E	2,273	2,271	1,080	2,398	1,568	1,492
	FY12E	2,834	2,782	1,242	2,879	1,862	1,882
PAT	FY10	916	818	402	856	700	503
	FY11E	1,159	1,102	531	1,058	834	635
	FY12E	1,459	1,357	605	1,272	1,000	846
EPS	FY10	5.0	13.0	2.0	12.5	29.0	17.9
	FY11E	6.3	17.5	2.6	14.1	30.0	22.6
	FY12E	7.9	21.7	2.9	17.2	36.0	30.1
BVPS	FY10	31.9	40.3	25.0	76.4	112.1	109.2
	FY11E	37.4	60.5	27.4	86.0	140.1	129.6
	FY12E	44.3	82.0	30.1	101.3	177.9	156.3
RoE	FY10	16.6	38.0	8.2	17.4	30.3	17.7
	FY11E	18.0	34.6	9.8	17.1	24.2	18.9
	FY12E	19.1	31.2	11.2	17.8	23.9	21.0
Debt:Equity	Ratio	0.6	0.6	0.9	1.2	0.2	0.4
OP mgn%	FY10	9.8	11.1	8.6	12.9	16.8	15.7
PAT mgn%	FY10	4.6	5.1	3.8	5.6	9.2	7.1
FY12E P/E		10.7	9.9	13.3	6.6	7.1	6.2
Target price*		97	264	44	144	260	300
Target P/E		12.3	12.1	15.0	8.4	7.2	11.0

Note: * except for KNR rest of the Companies Target price is consensus Bloomberg estimate

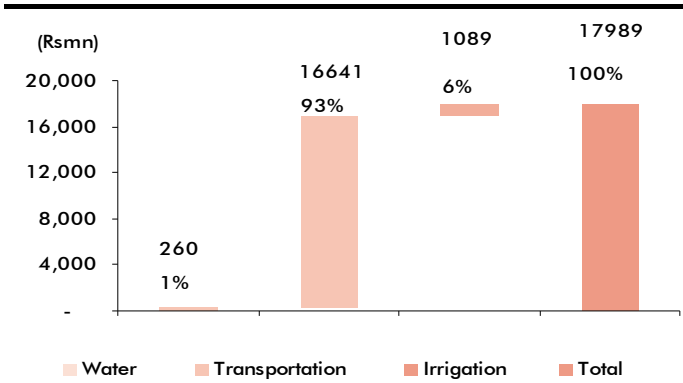
Source: Ambit Capital research, Bloomberg

Order book to grow 3x

127% order book CAGR over FY10-12E

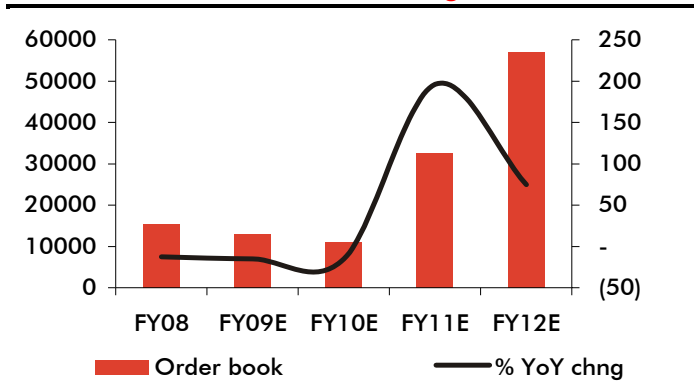
KNRC's key verticals are Transportation, Irrigation and Water. Currently transportation constitutes 93% (Rs16,641mn) of KNRC's 1QFY11 order book while irrigation constitutes 6%, and water, 1%. We expect order book to grow at 127% CAGR over FY10-12E to Rs56.9bn. Revenue growth was impacted during FY10 on account of slowdown in order intake and the company's depleting order book. Order book growth is now back on track with KNR winning the Rs8250mn order for the Bijapur-Hungud Road BOT for which it had submitted its support bid. Currently KNR is L1 in projects worth Rs14bn. We note pending receivables in irrigation is only to the extent of Rs25mn.

Exhibit 6: Order book and Order mix %



Source: Company, Ambit Capital research

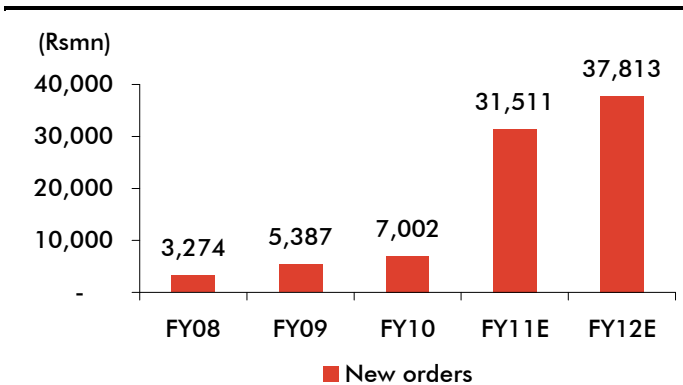
Exhibit 7: Order book forecast and growth %



Source: Company, Ambit Capital research

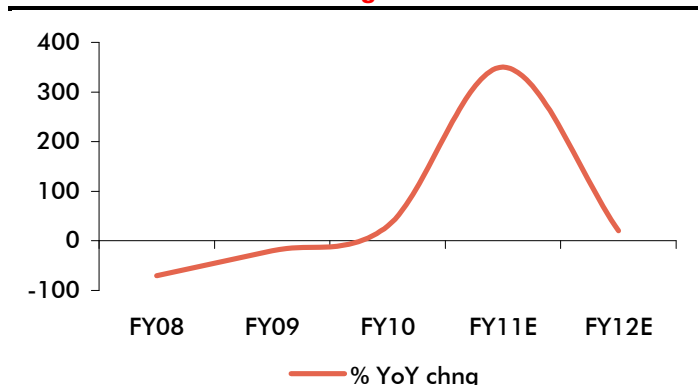
We expect order intake to grow at 127% CAGR over FY10-12E. This will predominantly be led by roads though the company expects to win some orders in the pipeline and Contract mining segments. KNRC is working towards this and is making efforts to reach an arrangement with Pratibha Industries and Sadbhav Engineering respectively.

Exhibit 8: New order intake



Source: Ambit Capital research estimates

Exhibit 9: New order intake growth %

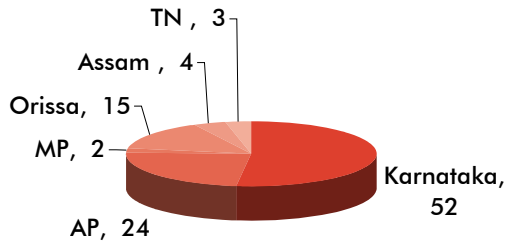


Source: Ambit Capital research estimates

Order book geographical and client distribution

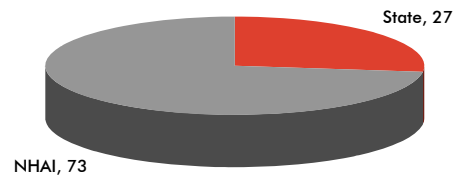
KNRC's order book is spread across multiple states and exposure is largely on Central and state-funded projects.

Exhibit 10: Order book Geographical split (%)



Source: Company, Ambit Capital research

Exhibit 11: Client distribution (%)

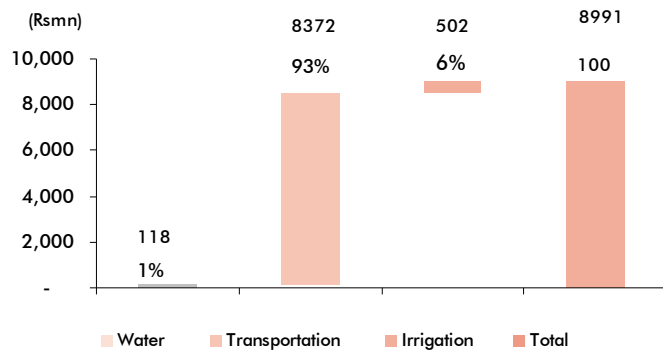


Source: Company, Ambit Capital research

Strong order growth to support 38% revenue CAGR over FY10-12E

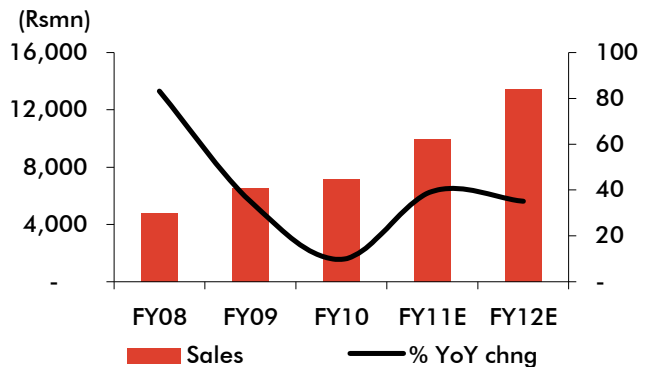
We expect KNRC's revenue to grow at 38% CAGR over FY10-12E to Rs13,424mn. Such robust growth is led by transportation segment. We are not building any contribution from the new segments such as pipelines and coal mining. KNRC has support bid arrangements with larger developers like Tata Realty, Sadbhav Engineering, and is prequalified for jobs upto Rs10bn. We believe KNRC will witness good traction once the National Highways Authority of India (NHAI) awards pick up momentum. In 1HFY11 alone KNRC has been able to win Rs8,250mn of road cash contracts and is L1 in projects worth Rs14bn.

Exhibit 12: Revenue and Revenue mix %



Source: Ambit Capital research estimates

Exhibit 13: Revenue and revenue growth %

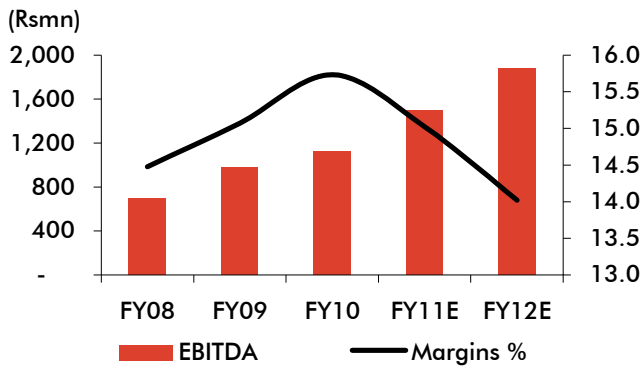


Source: Ambit Capital research estimates

... leading to 30% operating profit CAGR over this period ...

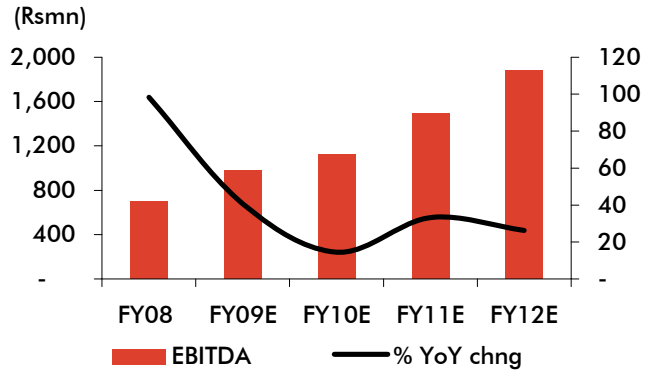
KNRC endeavors to maintain operating margins in the 13-15% band over FY10-12E. Historically over FY07-10, KNRC has been averaging about 14.7% margins. The higher margins relative to larger peers is on account of its ownership of equipment bank, higher order drop size and minimal equipment hiring. Going forward we expect KNRC's operating margins to contract largely on account of high growth in the order book, which could result in increasing its equipment hiring; also, acquiring captive raw material sourcing could pose a challenge. We estimate OPM at around 15% for FY11E and 14% for FY12E. Operating profit is estimated to increase to Rs1,492mn in FY11E (up 33% YoY) and thereafter to Rs1,882mn in FY12E (up 26% YoY), resulting in 30% CAGR over FY10-FY12E.

Exhibit 14: EBITDA and EBITDA margins %



Source: Ambit Capital research estimates

Exhibit 15: EBITDA and EBITDA growth %

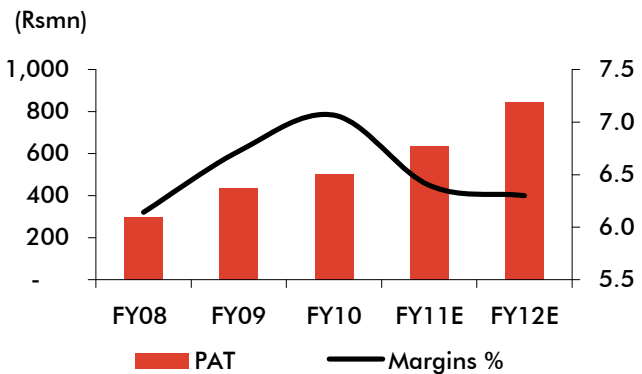


Source: Ambit Capital research estimates

... and net profit CAGR of 29% to FY12E

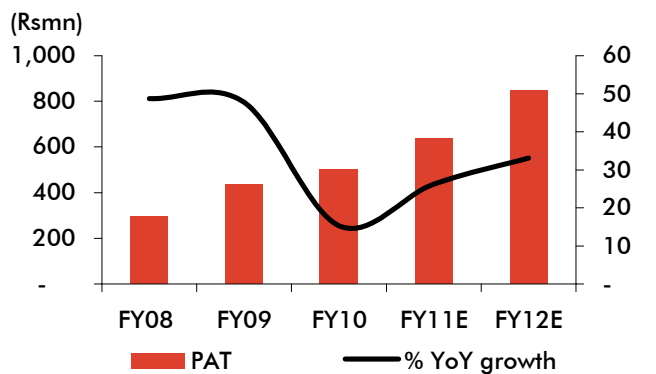
KNRC's net profit grew 15% YoY to Rs503mn in FY10 on the back of muted order intake during FY10. With pick up in order book we expect net profit to grow to Rs635mn in FY11E, registering 26% YoY growth, then to Rs846mn in FY12E with growth of 33% YoY i.e. at 29% CAGR over FY10-FY12E.

Exhibit 16: PAT and PAT margins %



Source: Ambit Capital research estimate

Exhibit 17: PAT and PAT growth %



Source: Ambit Capital research estimate

Profitability and growth analysis

History of delivering strong growth

KNRC has delivered strong revenue and profitability growth in recent years and this momentum is expected to pick up going forward.

Exhibit 18: Growth matrix

Particulars	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11E	FY12E
Growth ratios (% YoY)									
Revenue growth	0.7	(49.1)	89.3	91.1	83.2	35.0	9.7	39.4	35.2
EBITDA growth	(8.3)	(26.9)	32.7	190.3	98.2	40.6	14.5	33.1	26.2
Net Income growth	33.9	(33.6)	253.7	23.9	51.2	43.5	13.8	26.2	33.1
Diluted EPS growth	24.9	(28.8)	17.9	23.9	8.9	43.5	13.8	26.2	33.1
Diluted CEPS growth	9.6	(17.7)	(5.6)	35.2	16.4	55.9	11.4	35.9	24.8

Source: Company, Ambit Capital research estimates

Track record of strong margins

EBIDTA margins have averaged 13-15% and net margins, 6-7%

Exhibit 19: Margins continue to be robust

Particulars	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11E	FY12E
Operating ratios (%)									
EBITDA margins	8.7	12.6	8.8	13.4	14.5	15.1	15.7	15.0	14.0
EBIT margins	7.7	10.0	18.2	13.6	11.8	11.9	12.6	11.5	11.2
PBT margins	5.8	9.0	15.8	9.9	9.7	10.1	11.5	9.6	9.5
Net Income margins	4.9	6.3	10.6	7.5	6.4	6.8	7.0	6.4	6.3
Admin & other expenses/revenue	0.9	2.4	2.7	2.2	2.2	1.7	1.4	1.4	1.4
Operating expenses/revenue	90.4	85.0	88.5	84.4	83.3	83.2	82.9	83.6	84.6
Other Income/pre-tax Income	10.7	8.8	71.9	29.7	3.9	7.0	4.5	5.7	6.0
Effective tax rate	16.8	29.3	34.6	24.6	35.3	33.7	39.1	34.0	34.0

Source: Company, Ambit Capital research estimates

EBIDTA margins continue to be stable in the 13-15% range while net margins have been maintained at 6-7%. Management attributed this largely to ownership of equipment and having aggregate quarries. Also the labour cost/salary and wages appear to be lower on account of the cheap labour available in the state of Andhra Pradesh. Tax for FY10 is higher on account of the tax outgo of Rs62.6mn as prior period tax from JVs which were claiming 80IB benefits and had to reverse it. This also impacted the investments, which reduced YoY, as a negative charge was additional on account of the AS-23 standard.

Strong balance sheet lends visibility to growth

Leverage analysis

Exhibit 20: Solvency ratios

Particulars	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11E	FY12E
Solvency ratios / Liquidity ratios (%)									
Debt equity ratio (D/E)	0.3	0.6	1.3	1.8	0.8	0.5	0.4	0.4	0.4
Long term debt / total debt	0.9	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Net working capital / total assets	0.4	0.2	0.2	0.2	0.4	0.1	0.2	0.3	0.3
Interest coverage ratio	4.2	11.1	61.1	4.0	5.7	6.9	12.8	6.3	6.6
Debt servicing capacity ratio (DSCR)	0.3	0.5	0.7	1.2	1.2	1.8	3.8	6.8	6.7
Current ratio	0.7	1.2	1.1	1.3	1.3	1.2	1.3	1.5	1.6
Cash and cash equivalents / Total assets	9.1	20.8	8.9	6.7	9.2	10.6	9.2	4.2	15.6

Source: Company, Ambit Capital research estimates

Debt/equity ratio is better versus the industry standard, and excluding mobilization advance, it is still lower. The lower D/E is also attributable to the company making net positive cash at the operational level. DSCR is very high so the company can service 4x the annual interest and principal repayments.

Working capital cycle

Exhibit 21: Working Capital Cycle

Particulars	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11E	FY12E
Turnover Ratios									
Inventory turnover ratio (x)	6.0	5.6	34.9	44.8	46.1	37.7	44.2	39.9	31.3
Assets turnover ratio (x)	3.3	1.5	1.9	1.8	1.7	1.6	1.7	2.1	2.4
Adjst. assets turnover ratio (x)	4.4	1.8	2.4	2.3	2.2	2.3	2.2	2.6	3.0
Leverage (assets/equity) B	1.6	1.5	2.0	2.6	2.0	1.6	1.5	1.4	1.4
Working capital cycle (days)	44.7	98.9	74.0	59.6	55.4	49.1	54.4	59.8	63.9
Average collection period (days)	27.9	79.4	69.5	52.3	38.7	52.9	81.6	72.4	67.7
Unbilled revenues (days)	0.1	13.2	18.1	15.8	11.9	9.6	16.2	16.6	14.1
Retention money	9.1	13.9	17.9	22.1	21.1	19.8	17.8	15.0	15.4
Total	37.0	106.5	105.5	90.2	71.8	82.3	115.5	104.0	97.2
Average payment period (days)	84.8	140.6	92.6	93.1	70.8	60.2	126.9	112.3	72.9
Advances received (days)	0.0	0.0	0.0	0.0	27.8	58.7	34.7	29.4	51.2
Total	84.8	140.6	92.6	93.1	98.6	118.9	161.7	141.8	124.1

Source: Company, Ambit Capital research estimates

Net working capital days have been steady at 50-55 days, this is on account of attractive payment terms with the suppliers and advances from the clients. for instance, KNR takes diesel on credit from public sector (PSU) oil companies against bank guarantees.

Balance Sheet - Return Ratios

Exhibit 22: Return ratios

Particulars	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11E	FY12E
Return / profitability ratios (%)									
Return on capital employed (RoCE)- Overall	21.0	10.8	20.4	18.4	12.8	12.9	13.1	16.0	17.7
RoCE -ex L&A, investments	21.0	10.8	20.4	18.4	12.8	12.9	13.2	16.0	17.7
ROCE - ex cash	23.0	12.8	23.5	19.9	14.0	14.3	14.6	16.3	18.7
Return on Invested capital (RoIC) - total cash	31.3	22.9	17.0	25.9	26.2	27.1	29.9	33.8	37.3
Return on net worth (RoNW)	25.9	14.5	40.6	35.9	21.1	18.1	17.7	18.9	21.0
Dividend payout ratio	0.0	15.4	42.1	11.6	14.8	14.9	13.1	11.1	11.1

Source: Company, Ambit Capital research

Return ratios continue to be better than industry standard and appear to be slightly impacted on account of the high investment in BOT assets. After adjusting for the BOT investments, the ratios would be more favourable. Return on net worth continues to be strong, in the 18-20% range.

Cash flow analysis

Operating cash flows are positive on account of good working capital management

Exhibit 23: Strong cash flows

Particulars	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11E	FY12E
Cash flows from operation									
Cash Flow operations - ex working capital change	120	80	248	356	544	804	887	1,164	1,447
Working capital inflow / (outflow)	(17)	47	(150)	(138)	(198)	221	(572)	(772)	(123)
Net cash flow from operating activities	103	127	98	218	346	1,025	315	393	1,323
Cash Inflow/(outflow) from Investing	46	(125)	(472)	(655)	(1744)	(516)	101	(791)	(373)
Cash flow from financing	(150)	73	359	463	1,640	(443)	(456)	225	(221)
Total Increase / (decrease) in cash	(0)	75	(14)	26	242	66	(41)	(174)	729

Source: Company, Ambit Capital research

Cash flows from operations continue to be positive while the investing activity contributed about Rs120.4mn on account of liquidation of IPO proceeds invested in mutual funds to the tune of Rs450mn. Also KNR paid long-term funds to the tune of Rs349mn (though the due was only Rs151mn). At the net level, total change in cash and cash equivalents stood at Rs40mn.

Exhibit 24: AR analysis

Y/E Mar (Rsmn)	FY09	FY10	Reason
Equity share capital	281	281	Remain same as no new shares allotted
Reserves and surplus	2352	2789	Went up on account of profit generation
Shareholders' equity	2633	3070	
Deferred tax liability	71	69	
Secured loans	1360	1103	
Long-term debt (secured)	1360	1103	
Term loans	521	169	Reduced on repayment
Working capital	482	571	
Secured trade advance	357	363	though Mobilization advance dec. as deduction from bills by client, machinery advance led to margins increase
Short-term debt (secured)			
Unsecured loans	0.2	2.4	from promoters
Total debt	1,360	1106	
Total debt & shareholders' equity	4,064	4244.9	
Gross block	2599	2893	Increase on acquiring assets for new contracts
Less: Revaluation reserves	0		
Accumulated depreciation	533	793	
Net fixed assets	2,067	2100	
Capital work in progress	25	105	
Investments	1,105	651	Money was utilized in the investment to BOT's & Tax impact on Patel-KNR JV
Subsidiaries	0	21	
Associates & other long term invest.	243	243	
Marketable securities & JVs & others	862	387	Tax impact in Patel KNR - JV and Liquidation of Mkt Sec as investment in BOT's moved up
Current assets	3,511	5186	
Cash	432	391	
Inventory	185	137	
Sundry debtors (net of provision)*	1284	1901	includes Rs423mn due from Company in which directors are interested
More than six months	135	358	Rs237mn due from directors
Others debtors	1150	1543	Rs186mn due from directors
Retention money	361	332	
Others assets	168	463	increase in other deposits
Loans and advances	1080	1962	increase due to advance to BOT as unsecured loan also increa in advance tax for income tax
Current liabilities	2276	3142	inc on account of increase in sundry creditors
Provisions	439	716	on account of tax
Current liabilities and provisions	2715	3859	
Net working capital	796	1327	
Total assets	4064	4245	

Note: *Dues from the companies where directors have interests - expected to be returned in FY11E

Source: Ambit Capital research

Conservative on the BOTs bidding

In the BOT segment, KNR Constructions has two operational BOT assets through a 40% stake in the Patel-KNR joint venture. KNRC has adopted a conservative approach towards bidding and is currently commanding L1 status in a toll project in Kerala with a total project cost of Rs7,400mn. This was the 65th project the company had bid for as the focus has been on bidding with an IRR in excess of 17-18%. KNRC is also working on strategic partnership with other players (including Ashoka Buildcon, Sadbhav Engineering, Pratibha Industries) so as to have a diversified basket of road assets.

The two Road BOT projects, KNT-1 and AP-7 are operational. While the Patel-KNR JV has already securitized KNT-1 (KNR received its share of Rs400mn), AP-7 has been rated and is in the process of getting securitized with KNRC expected to receive Rs600mn from the transaction. Securitization will help KNRC to reset interest rate at 9.57% v/s the old debt cost of 10.5%-11%. This will help the company invest in new projects at a lower cost of capital.

Going forward the strategy would be to have a 100% captive EPC cash contract though being flexible on the equity stake in the SPV's. The core competence of the company is timely execution; this will help service the equity requirement of the SPVs.

Management discussion analysis

KNR is considering foraying into new businesses. Major orders added during FY10 include (i) the Rs8,250mn road project in Karnataka, to be executed over 910 days; and the Orissa NHA order on NH-5, worth Rs2,310mn, to be completed in 24 months. The company also won a water works order through its JV (to be shared in the ratio 50:25:25) with JKM Infra Projects and Karnala Constructions, worth Rs2,252mn. This project is progressing well. Receivables from AP irrigation projects is worth Rs25mn and, currently, no execution is taking place on the balance order book of Rs650mn.

Karnataka Expressway (KNT-1)

Project details	Rs mn	Scope of the project
Mode	Annuity	KNT-1 is an annuity BOT road project developed by the Patel-KNR JV with KNRC holding 40% equity. The scope of the work included 60km of roadway between Karnataka-AP border to Avathi village on DBFOT basis. (on NH-7).
Semi Annual Annuity	330	
Total Project Cost	4,400	
Capital cost net of NHAI grant	-	
Debt	3,270	
Equity	1130	
Grant (Net)	-	
NHAI grant - number of years	-	
Debt/Equity (excl. NHAI grant)	2.9	
Moratorium period (yrs)	1	
Debt repayment period (yrs)	17.5	
Equity Pending		Concession details
Equity stake (%)	40	The project achieved commercial operations date (COD) on 21 December 2009 and is operational. The project has a concession period of 18 years, that includes a construction period of 2.5 years. The project has been capitalized at Rs4,400mn.
Length (km)	60	
Interest rate (%)	11.25	Current status
Concession Period (yrs)	20.5	KNT-1 has been securitized through an NCD for Rs4,090mn at 9.67% (the cash came in April 2010, old debt was at 10.75%). The proceeds were used to retire original project debt to extent of Rs3,000mn and remaining Rs1,090mn was split between Patel and KNR in the ratio 60:40. KNRC realized about Rs400mn, which was utilized towards reducing the working capital. The NCD will be payable over 17.5 years and the JV will be left with a balance of one annuity in the terminal year.
Assumptions		Valuation methodology
Traffic (Revenue PCU's)	-	- For the purpose of representation we value KNR's stake in KNT-1 at Rs683mn using DCF at a WACC of 12% over the balance life of the project. KNRC holds 40% in the project while Patel Engineering, the remaining 60%. We have not included this project in our price target forecasts, as only residual equity and terminal annuity remains, which will contribute minimally to the SOTP.
Growth in traffic (%)	-	
Initial toll rates (Rs/km)	-	
Growth in toll rates (%)	-	
Toll collection efficiency (%)	-	
Financial closure	Achieved	Risks
WACC (%)	12	No visible risk as the project has the nature of an annuity and is already operational.
COD already achieved	Dec-09	

Source: Company, Ambit Capital research

Exhibit 25: Computation of the ROE (IRR)

	FY11E	FY12E	FY13E	FY14E	FY15E
PBT	401	101	123	145	125
Add: Dep.	242	242	242	242	242
Less: Tax paid	(68)	(17)	(21)	(24)	(21)
Less: Principal payments		(234)	(234)	(234)	(234)
Debt o/s	3,270	3,036	2,803	2,569	2,336
Net cash accruals	576	93	111	129	113
FCFE	576	93	111	129	113
ROE (IRR)	17%				
Discounted cash flows	1,707				
KNR stake	40%				
Value of KNR stake	683				

Source: Company, Ambit Capital research

Andhra Expressway (AP-7)

Project details	Rs mn
Mode	Annuity
Semi Annual Annuity	444
Total Project Cost	6,000
Capital cost net of NHAI grant	-
Debt	4,800
Equity	1200
Grant (Net)	-
NHAI grant - number of years	-
Debt/Equity (excl. NHAI grant)	4.0
Moratorium period (yrs)	1
Debt repayment period (yrs)	17.5
Equity Pending	
Equity stake (%)	40
Length (km)	52
Interest rate (%)	9.6
Concession Period (yrs)	20.5
Assumptions	
Traffic (Revenue PCU's)	-
Growth in traffic (%)	-
Initial toll rates (Rs/km)	-
Growth in toll rates (%)	-
Toll collection efficiency (%)	-
Financial closure	Achieved
WACC (%)	12
Provisional COD already achieved	Jun-10

Source: Company, Ambit Capital research

Scope of the project

AP-7 is an annuity BOT road project developed by the Patel-KNR JV with KNRC holding 40% equity. The work scope included 52km of road between Islamnagar to Nagpur-Hyderabad section on DBFOT basis (on NH-7).

Concession details

The project has achieved provisional commercial operations date (COD) on 11 June 2010 and is operational. The project has a concession period of 18 years that includes a construction period of 2.5 years. The project has been capitalized at Rs6,000mn.

Current status

AP-07 project achieved provisional COD on 11 June 2010 and currently the process is ongoing for securitization, which should occur in the next two months. The NCD issue will be worth Rs5,000-5,200mn and KNR shall receive about Rs600mn from the proceeds post repayment of current debt.

Valuation methodology

We have valued KNRC's stake in AP-7 at Rs831mn using DCF at a WACC of 12% over the balance life of the project. KNRC holds 40% in the project while Patel Engineering holds the remaining 60%.

Risks

No visible risk as project is of the nature of an annuity and is already operational.

Exhibit 26: Computation of the ROE (IRR)

	FY11E	FY12E	FY13E	FY14E	FY15E
PBT	538	98	130	162	154
Add: Dep.	331	331	331	331	331
Less: Tax paid	(91)	(17)	(22)	(27)	(26)
Less: Construction period interest					
Less: Principal payments		(343)	(343)	(343)	(343)
Debt o/s	4,800	4,457	4,114	3,771	3,429
Net cash accruals	778	69	96	123	116
Equity contribution	-	-	-	-	-
FCFE	778	69	96	123	116
ROE (IRR)		19%			
Discounted cash flows		2,076			
KNR stake		40%			
Value of KNR stake		831			

Source: Ambit Capital research, Company

Exhibit 27: Balance sheet

Year to March (Rs mn)	FY08	FY09	FY10	FY11E	FY12E
Cash & equivalents	366	432	391	218	947
Debtors	598	1,284	1,901	2,041	2,942
Inventory	159	185	137	361	496
Loans & advances	1,160	1,080	1,962	1,986	2,014
Investments	1,136	1,105	651	1,105	1,105
Fixed assets	1,795	2,092	2,205	2,172	2,171
Other assets	599	600	857	923	1,247
Current liabilities & provisions	1,851	2,715	3,859	3,602	4,868
Total assets	3,964	4,064	4,245	5,202	6,054
Debt	1,635	1,360	1,106	1,486	1,586
Deferred Tax Liability	66	71	69	71	71
Total liabilities	1,701	1,431	1,175	1,557	1,657
Shareholders' equity	281	281	281	281	281
Reserves & surpluses	1,981	2,352	2,789	3,364	4,115
Total networth	2,263	2,633	3,070	3,645	4,397
Net working capital	(198)	221	(572)	(772)	(123)
Net debt (cash)	1,270	928	714	1,268	639
Total liabilities & equities	3,964	4,064	4,245	5,202	6,054

Source: Company, Ambit Capital research

Exhibit 28: Income statement

Year to March (Rs mn)	FY08	FY09	FY10	FY11E	FY12E
Operating income	4,812	6,496	7,125	9,931	13,424
% growth	83.2%	35.0%	9.7%	39.4%	35.2%
Operating expenditure	4,115	5,517	6,004	8,439	11,541
EBITDA	697	979	1,121	1,492	1,882
% growth	98.2%	40.6%	14.5%	33.1%	26.2%
Depreciation	145	250	262	404	451
EBIT	552	729	859	1,088	1,431
Interest expenditure	100	112	70	180	227
Non-operational income/exp	6	41	37	55	77
PBT	457	658	827	963	1,281
Tax	161	222	323	327	436
PAT / net profit	295	437	503	635	846
% growth	48.7%	47.7%	15.3%	26.2%	33.1%

Source: Company, Ambit Capital research

Exhibit 29: Cashflow statement

Year to March (Rs mn)	FY08	FY09	FY10	FY11E	FY12E
EBIT	557	770	896	1,143	1,508
Depreciation	145	250	262	404	451
Tax	158	216	271	327	436
Others	0	0	0	(55)	(77)
Net working capital	(198)	221	(572)	(772)	(123)
Cash flow from operating activities	346	1,025	315	393	1,323
Capital expenditure	(924)	(547)	(375)	(371)	(450)
Investments	(821)	31	475	(420)	77
Cash flow from investing activities	(1,744)	(516)	101	(791)	(373)
Incr (decr) in borrowings	516	(276)	(254)	380	100
Issuance of equity/DTL adj.	1,339	0	(55)	13	(0)
Net dividends	(33)	(66)	(66)	(71)	(94)
Interest paid	(100)	(112)	(72)	(180)	(227)
Misc	(82)	10	(10)	83	0
Cash flow from financing activities	1,640	(443)	(456)	225	(221)
Net change in cash	242	66	(41)	(174)	729
Closing cash balance	366	432	391	218	947

Source: Company, Ambit Capital research

Exhibit 30: Ratio analysis

Year to March (%)	FY08	FY09	FY10	FY11E	FY12E
EBITDA margin (%)	14.5	15.1	15.7	15.0	14.0
EBIT margin	11.5	11.2	12.1	11.0	10.7
PAT Margin (%)	6.1	6.7	7.1	6.4	6.3
Return on capital employed	12.8	12.9	13.1	16.0	17.7
Return on equity	21.1	18.1	17.7	18.9	21.0
Current ratio (x)	1.3	1.2	1.3	1.5	1.6

Source: Company, Ambit Capital research

Exhibit 31: Valuation parameters

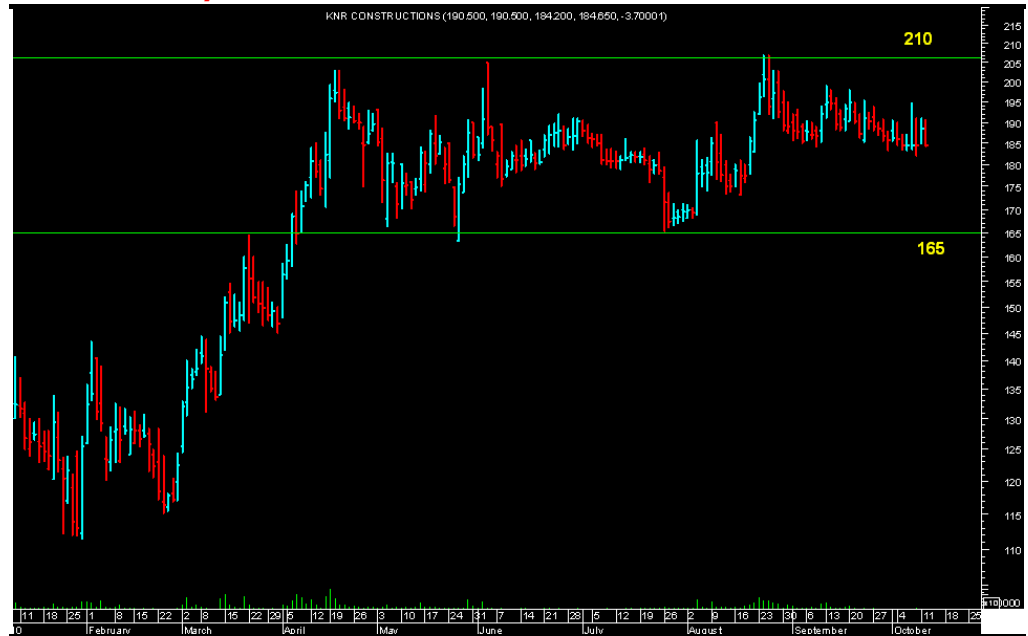
Year to March	FY08	FY09	FY10	FY11E	FY12E
EPS (Rs)	10.5	15.5	17.9	22.6	30.1
Diluted EPS (Rs)	10.5	15.5	17.9	22.6	30.1
Book value per share (Rs)	80.4	93.6	109.2	129.6	156.3
P/E (x)	18.5	12.5	10.9	8.6	6.5
P/BV (x)	2.4	2.1	1.8	1.5	1.2
EV/EBITDA (x)	8.1	5.5	5.0	3.8	2.7
EV/Sales (x)	1.8	1.2	0.8	0.8	0.6

Source: Company, Ambit Capital research

Technical View

KNR Constructions — Remains range-bound

Exhibit 32: Daily chart



Source: MetaStock

- The momentum oscillators of KNR Constructions are in the neutral zone.
- But the stock is languishing in the 20 point trading range for the last couple of weeks.
- For the next three months we expect the stock to continue to be range-bound in the Rs165 to Rs210 trading band.
- On the weekly chart the momentum oscillators are in Buy mode and hence we advise to use any fall till Rs165 as a Buying opportunity.
- On the upside it appears difficult for the stock to breach Rs210, as there is a great deal of selling pressure.
- We advise to **BUY** on declines, as at the current price, risk is high.

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Explanation of Investment Rating

Investment Rating	Expected return (over 12-month period from date of initial rating)
Buy	> 15%
Hold	5% to 15%
Sell	<5%

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