

BSE Code: 532942 NSE Code: KNRCON Reuters Code: KNRCON Bloomberg Code: KNRCON

KNR Construction Ltd (KNRC), a Hyderabad-based company, preliminarily focussed on road infrastructure projects, is well-poised to post exponential growth back by robust book-bill position of over 3.7x of its FY'11 revenues, the company has healthy Margins owing to its backward integration. Its ability to forge joint ventures to foray into large projects provides sufficient revenue visibility over the medium term.

Investor's Rationale

Strong Book-bill position at 3.7x FY'11 sales

KNRC is set to clock impressive growth owing to strong order book of ₹39,000 million, executable over the next two years. We estimate the company to post a CAGR of 19% and 20% in top-line and bottom-line over FY2010-13E, respectively.

Backward integration to sustain margins

The company recorded OPM of 14.1% in FY'11, which is reasonably high compared to industry standards. This was largely due to savings derived from investments in construction equipment and captive quarries. Going ahead, rising inflationary pressures would put pressure on its cost of operations. However, its backward integration initiatives will help sustain Margins.

BOT to ensure stable future cash flows

KNRC's JV with Patel Engineering to execute BOT projects on annuity basis is expected to assure stable cash inflows going ahead. The two projects bagged by the JV are expected to earn annuity of ₹1,875 million. However, based on our DCF to Equity methodology, the BOT projects would result into ₹19 per share. Hence, we have not factored the same in our estimates.

Increasing government focus on Infrastructure sector

Eleventh Plan envisages ₹8,000 billion worth of investments in the Infrastructure sector. Though GDP growth is expected to slow down to 7.6% levels, adequate infrastructure needs to be in place. Hence, the government is laying higher emphasis on the Infra space. With the major drivers contributing to this growth, the Govt has chalked out a massive plan to add over 8,800km of road network during FY'13. We expect KNRC to benefit from this huge infrastructural expenditure as it is present in all the three verticals.

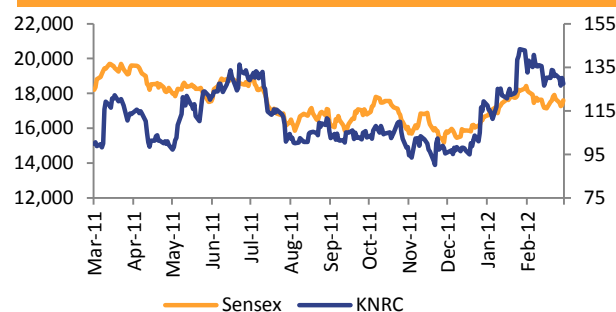
Market Data

Rating	BUY
CMP (₹)	125
Target (₹)	173
Potential Upside	~36%
Duration	Long Term
52 week H/L (₹)	153/85.40
All time High (₹)	215.8
Decline from 52WH (%)	22.4
Rise from 52WL (%)	31.6
Beta	0.75
Mkt. Cap (₹ mn)	3,522.0
Enterprise Val (₹ mn)	4,868.5

Fiscal Year Ended (₹mn)

	FY10A	FY11A	FY12E	FY13E
Revenue	8,991.7	10,517.0	12,725	15,143.4
Net Profit	554.2	629.5	808.5	965.7
Share Capital	281.2	281.2	281.2	281.2
EPS (₹)	19.7	22.4	28.8	34.3
PE (x)	6.4	5.6	4.4	3.6
P/BV (x)	1.1	0.9	0.8	0.7
EV/EBITDA	3.4	3.3	2.4	2.1
ROE (%)	17.2	16.8	18.1	18.0
ROCE (%)	23.2	25.0	26.8	26.8

One year Price Chart



Shareholding Pattern	Dec'11	Sep'11	Diff.
Promoters	74.01	74.01	-
FII	0.02	0.08	(0.06)
DII	7.99	7.99	-
Others	17.98	17.92	0.06

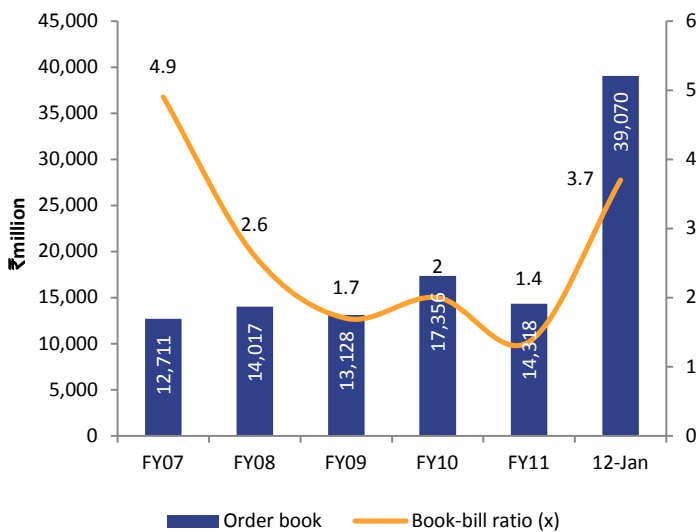


Stellar book-bill ratio @ 3.7x provide earning visibility for next 24-30 months

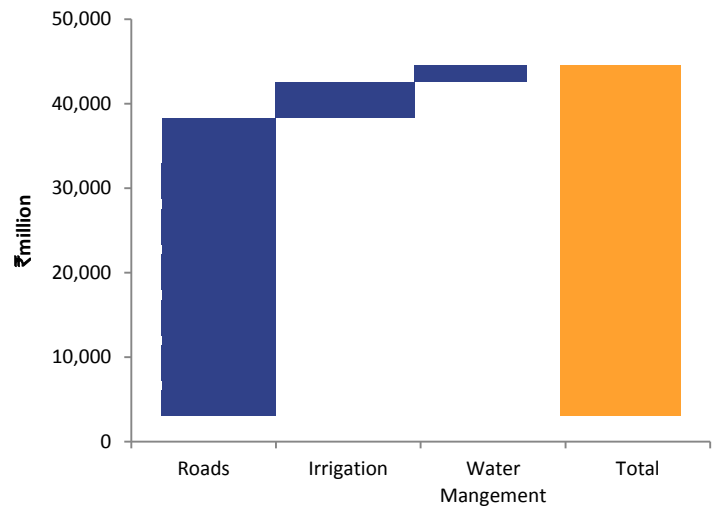
KNRC's current order stood over ₹39,000 million, which translates into robust book-to-bill ratio of over 3.7x of its FY'11 earnings and providing the strong earning visibility for ensuring 24-30 months. When the other players are struggling to bag orders, KNR to its credential has been able to bag large size orders. The order book has been boosted by recent awards worth ₹18,000 million including EPC order for road project worth ₹5,800 million from Sabdhav Engineering Ltd, ₹6,200 million order from GMR projects, 3 projects worth ₹3,910 million from government of Karnataka and ₹2,070 million order from Government of Andhra Pradesh for construction of major bridge in 60:40 joint venture with Sri Lakshmi Metal Industries.

We expect order intake to remain healthy given the recent pick up in order awards from NHAI (awarded ~4,700 km of roads vs. 2,000 km in 1H FY'11) and also traction in project awards from various state governments.

Book-bill ratio ~ 3.7x of its FY'11 earnings



Order book mix

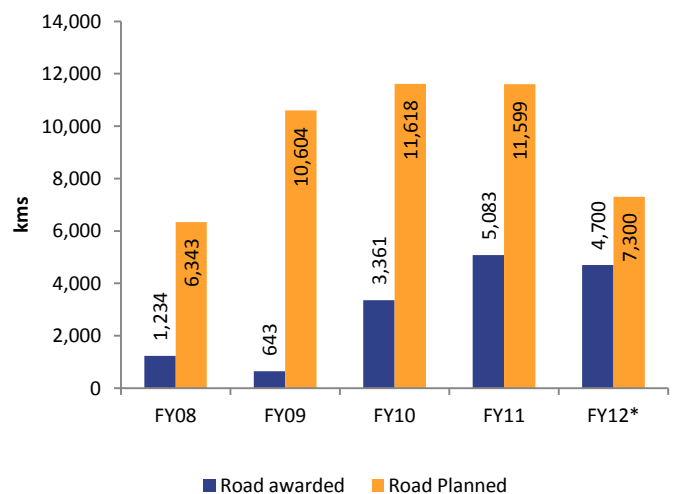


KNRC's order book comprises majority of projects with shorter execution cycle. This helps it enjoy high book to bill conversion ratio. With the improvement in the company's execution capabilities combined with an enhanced Balance Sheet size, it has been able to secure larger ticket size orders.

Order book to remain elevated as NHAI targets to award 7,300 km in FY'12

NHAI has set a target to award 7,300 km of road projects in the current year, which is likely to translate into a more than ₹700 billion opportunity for road contractors. The year has started off on a good note with the NHAI awarding two big-ticket projects - the Ahmadabad-Vadodara and the Beawar-Pali-Pindwara projects. Also recently, NHAI awarded a 555-km long road on Kishangarh-Udaipur-Ahmedabad highway to GMR infrastructure on BOT basis. Moreover, the Public Private Partnership Appraisal Committee has recently approved five highway projects worth ~₹65 billion, which means the financial bids for these projects could be invited.

Pick up in orders awarded by NHAI





Plethora of opportunity in the road network space ~ National Highways

KNRC in road infra space, is well poised to capitalize on the high demand for infrastructure in India, particularly in the road network space. Road network exhibited a 2.4% CAGR during FY'01-10 as against increase in passenger and commercial vehicles by 13.6% and 14% respectively during the same period. India has the second largest road network in the world spread across 3.3 million kms, handling more than 70% of freight and 85% of passenger traffic in the country. However, the country's network of Highways or Expressways, measured over 70,934 km comprises only of 2% of the length of total road network. Considering congested structure of the Indian road network and its growing traffic burden, the Government of India has launched major initiatives to upgrade and strengthen National Highways through various phases of the National Highways Development Project (NHDP). In addition, NHAI plans to add 24,406km over the next 5 years (Mar'17) at a total cost over ₹1.5 trillion. With augmented focus of Government of India on developing national highways, NHAI has targeted to award orders worth ~₹570 billion (~8,000kms) during FY'12 and another 1,000kms on Annuity/EPC basis projects are also expected to be awarded in FY'12. While the balance of 16,406km worth over ₹1 trillion is likely to be awarded by NHAI during FY'13E-15E respectively, to various road developers in order to achieve its target of constructing and delivering 24,406km or national highways by 2017. Given the focus and impetus on the road sector, the magnitude of opportunity for the players cannot be undermined from the escalation prospective available in Indian Road sector. Further, given the large number of projects that are still to be bided in the road sector, the magnitude of opportunity for the players cannot be undermined, as the Udaipur-Ahmedabad project falls in the basket of KNRC, the road ahead becomes easier for the company, as it is well-positioned to win other projects. Recently, the Cabinet Committee, on Infrastructure approved 15 projects totaling 1,184 km at an investment of ₹156.8 billion.

Order inflow in FY'11 remains dull as NHAI awarded ~ just 5000 km of road against an ambitious target of 12,000 km of roads. However, the traction so far in FY'12 has been good as NHAI awarded ~ over 5,000 km of road (including ~ 400 km of L1) against ~2300 km in full year of FY11. Also the traction of project awards from state government has picked up in the past six months.

We believe the government is taking concerted action to meet the target of building 20kms of highways per day. These include appropriate policy changes, increasing ordering activity and making adequate financing available for the sector. India has road network of around 4.2 million kilometers which being second largest road network in the world. The main concern remains the fact that only about seven percent of all roads are relatively well developed. The length of highways (including expressways, National Highways and State Highways) stood merely 5%, which leaves ample opportunity for authority to bank on.

One of the significant developments in road infrastructure in India is the NHDP involving a total investment of US \$ 49 billion upto 2012. The recent cabinet approval for phase NHDP V and NHDP VI are estimated at US \$ 13 billion. Projects are being financed using multiple methods, including tax inflow, foreign aid and private sector participation. Increasing private sector participation and BOT contracts are expected to drive road construction. The Government of India introduced policies aiding public private participation (PPPs) to bridge the gap between demand and supply of urban infrastructure.

India Road Network

Categories	Length (Km)
Expressways	332
National Highways	70,602
State Highways	1,54,522
District Highways	25,77,396
Rural & Other Roads	14,33,577
Total Length	4,236,429



Asset owned Strategy ~ BOT

Apart from taking up EPC work in the road segment, the company has also forayed into asset ownership (BOT). In the BOT segment, KNRC has two operational BOT assets through a 40% stake in the Patel-KNR joint venture. KNRC has adopted a conservative approach towards bidding. Further, the KNRC has entered into strategic partnership with other players (including Ashoka Buildcon, Sadbhav Engineering, Pratibha Industries) so as to have a diversified basket of road assets. In FY'08, KNRC in JV with Patel Engineering – bagged its first BOT road project KNT-1 (annuity) worth ₹4.4 billion, in Karnataka; subsequently, it bagged another BOT road project AP-7 (annuity) in FY'09 totaling over ₹5.9 billion, in Andhra Pradesh. Both these projects have been completed recently and annuity has started flowing in. This has enabled the company not only to earn contracting revenues but also see a stable cash flow stream in the form of fixed annuities - KNT-1 in Karnataka has a fixed annuity of ₹659 million while AP-7 in Andhra Pradesh has a fixed annuity of ₹887 million. To maintain leverage, the company has bid for these projects in 40:60 JV with Patel Engineering, which limits its equity contribution.

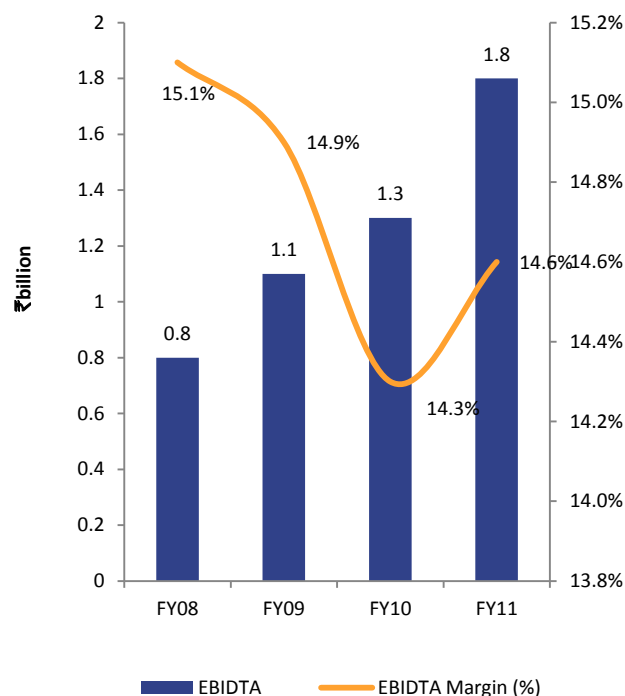
Going forward, the management's strategy would be to have a 100% captive EPC cash contract though being flexible on the equity stake in the SPV's. The core competence of the company is timely execution; this will help service the equity requirement of the SPVs. KNRC focuses on BOT based projects; focuses on projects involving higher degree of engineering skills and leverages its business growth by identifying and forming strategic joint venture relationships for mutual benefit through sharing of resources and business skills. Further, with the NHAI laying greater emphasis on the PPP route to execute larger tracts of the national highway, and the Phase III and Phase V of the NHDP would be entirely awarded on BOT basis, we believe KNRC is well placed to bag more road construction projects under the BOT route. BOT projects will ensure assured cash inflow for the company going ahead. We have valued the BOT projects on DCF basis and arrived at a value of ₹521 million for BOT assets which translates into ₹19 per share.

Backward Integration initiatives to sustain Margins

KNRC has made substantial investments in fixed assets. These investments are expected to help the company become self sufficient in equipment apart from cushioning it against rising operating costs. The company's Operating Margins of 14.8% registered in FY'11, which is reasonably high compared to industry standards, is largely attributable to the savings it has been able to derive out of investing in construction equipment. KNRC has credentials to maintain the operating margins of over 14% for the last five financial years, which is above industry average. The company stands to benefit from its backward integration initiatives in the back drop of rising inflationary pressures, which is likely to put pressure on the cost of operations going ahead.

Further, the company has resorted to backward integration of sourcing aggregates, especially for its road projects. Currently, the company has three captive quarrying mines, 24 crusher units with a crushing capacity of ~700 TPH and 11 batch plants in proximity to its area of operations. This enables the company to reduce its costs and improve margins considerably as raw materials from captive quarrying units are 50% cheaper compared with those purchased from outside. Also, the company has tie-ups with BPCL, HPCL, IOC, and MRPL to source bitumen, which comprises 67% of the project cost. Typically, a road contractor posts 9-10% margins but KNR is able to post over 14% margins for the last five financial years, backed by strong backward integration.

Margins trend



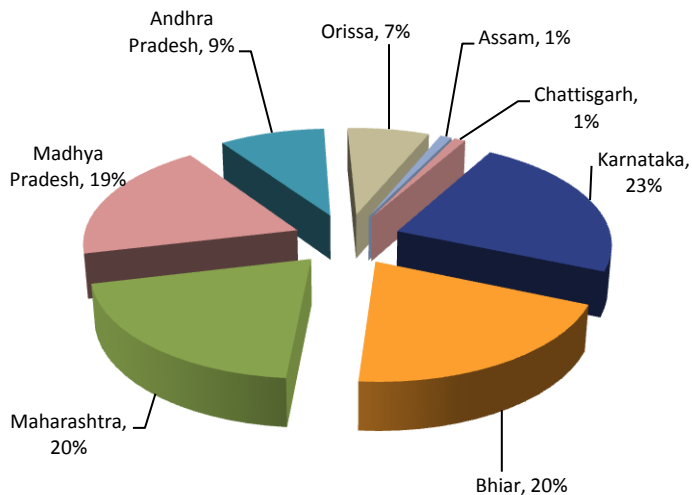


Geographically diversified order book

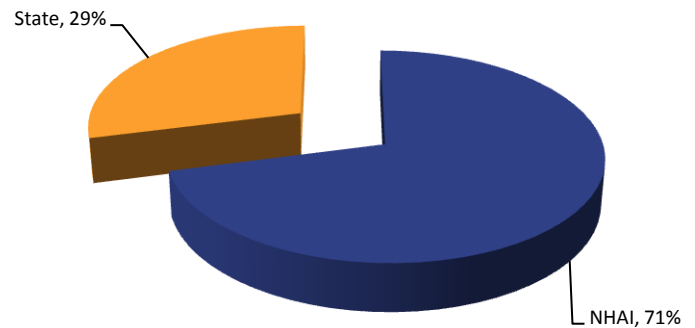
KNRC's project portfolio is geographically well diversified with NHAI/state projects in Andhra Pradesh, Madhya Pradesh, Maharashtra, Orissa, Bihar and Karnataka. Projects in South India account for 40% of the order book (as a result of the large size of BOT orders bagged in the region), predominantly from Andhra Pradesh and Karnataka, the rest of the orders are from the East, North-East and Northern regions. The company, over the years, has received repeat orders on a continuous basis. Going ahead, it proposes to capitalize on the proposed investments to be made by the government in the Infrastructure segment, the Road Construction segment in particular.

Till FY'08, the company was predominantly focused on the southern part of the country with Karnataka and Andhra Pradesh comprising ~nearly 80% of the order backlog. The company, in order to expand its geographic foot print and to diversify its order book has made a strategically shift toward other regions, has started to bid for projects in other markets, in its endeavor to provide the geographical diversification, the company has already bagged projects in Maharashtra, Bihar, Madhya Pradesh and Chhattisgarh. KNRC's order book is spread across multiple states and exposure is largely on Central and state-funded projects.

Region-wise order book



Client distribution (%)



Further, most of the clients of KNRC are governmental agencies like the NHAI and public works department under the State Governments of Andhra Pradesh, Madhya Pradesh, Karnataka, Tamil Nadu and Uttar Pradesh which have the ability to fund KNRC's projects. KNRC has also been executing projects funded by multilateral agencies like 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. Apart from these highway construction projects, KNRC bagged an order from the Government of Bihar, Water Resources Department for extension, renovation and modernization of the Eastern Kosi Canal system in Bihar.

In addition to all this, the company is looking to spread its operation into other fields, it is planning to bid for Hydel power project and Oil & Gas pipeline projects, for Oil & Gas pipeline projects it is planning to enter through the route of Joint Venter, while the company will bid for Hydel Power Projects of its own.



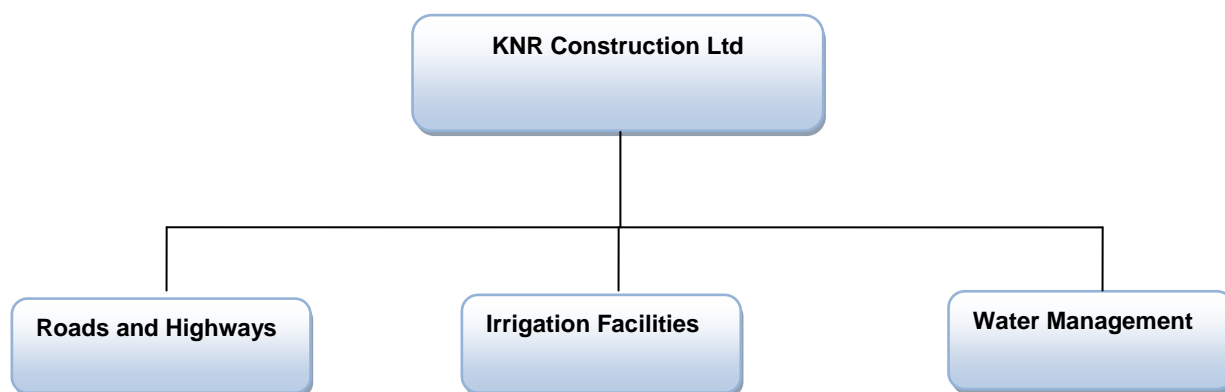
Company Profile

KNR Construction Ltd, promoted by Mr. K. Narasimha Reddy, the company is primarily engaged in the operations of Infrastructure development, providing engineering, procurement and construction services across various sectors namely road and highway development, irrigation and urban water infrastructure management.

The company's core competency lays in road transportation engineering projects namely construction and maintenance of roads, highways, flyovers and bridges wherever integral to the projects undertaken.

KNR Construction Ltd has executed infrastructure projects independently as well as through JVs to leverage on the experience and execution capabilities of both the parties which will help bag orders in diverse areas and of higher value.

Business Segments:



Key Projects Executed

SL.No.	Projects	Segment	Region/State	value (₹ mn)
1	Islam Nagar- Kadthal	Road	Andhra Pradesh	5,030
2	AP/Karnataka Border to Avathi village	Road	karnataka	4,390
3	Surat- Manor section of NH-8	Road	Gujarat	2,550
4	Madurai-Kanyakumari NH-7	Road	Tamil Nadu	1,700
5	42Kms Madurai-Kanyakumari NH-7	Road	Tamil Nadu	1,030
6	Widening of NH-&7, TN- Madurai stretch	Road	Tamil Nadu	1,007
7	Krishnagiri-Vaniyambadi section NH-46	Road	Tamil Nadu	857
8	Morena-Sabalgarh Section SH-2	Road	Madhya Pradesh	848
9	Nagon-Dharamtul National Highway	Road	Assam	828
10	Widening of NH-5- Nellore- kavali	Road	Andhra Pradesh	822
11	Design, estimation and construction of reservoir across Mathadivagu	Irrigation	Andhra Pradesh	378
12	Design, estimation of Budpur balancing reservoir of earthen dam	Irrigation	Andhra Pradesh	370



Balance Sheet (Standalone)

(₹million)	FY10A	FY11A	FY12E	FY13E
Share Capital	281.2	281.2	281.2	281.2
Reserve and surplus	2,945.4	3,459.3	4,197.5	5,092.9
Net Worth	3,226.6	3,740.5	4,478.7	5,374.1
Loan Funds	1,573.0	1,803.9	1,898.9	2,025.2
Net Deferred Tax Liability	69.7	28.1	28.1	28.1
Capital Employed	4,869.3	5,572.5	6,405.7	7,427.4
Gross fixed assets	3,462.4	4,525.9	5,438.3	6,297.1
Less: accumulated depreciation	1,030.7	1,452.8	1,984.5	2,552.9
Capital Work in Progress	110.3	111.8	120.0	120.0
Net Fixed assets	2,542.0	3,184.9	3,573.8	3,864.2
Investment	340.5	353.3	530.1	600.2
Misc. Expense	61.9	53.6	30.0	30.0
Net Current Assets	1,924.9	1,980.7	2,271.8	2,933.0
Capital Deployed	4,869.3	5,572.5	6,405.7	7,427.4

Key Ratios

	FY10A	FY11A	FY12E	FY13E
EBITDA Margin (%)	13.9	14.1	14.4	14.2
NPM (%)	6.2	6.0	6.4	6.4
ROCE (%)	23.2	25.0	26.8	26.8
ROE (%)	17.2	16.8	18.1	18.0
ROA (%)	2.7	3.5	7.7	17.3
EPS (₹)	19.7	22.4	28.8	34.3
P/E (x)	6.4	5.6	4.4	3.6
BVPS (₹)	114.7	133.0	159.3	191.1
P/BVPS (x)	1.1	0.9	0.8	0.7
EV/Operating Income(x)	0.5	0.5	0.3	0.3
EV/EBITDA (x)	3.4	3.3	2.4	2.1

Profit & Loss Account (Standalone)

(₹million)	FY10A	FY11A	FY12E	FY13E
Net Sales	8,991.7	10,517.0	12,725.6	15,143.4
Expenses	7,743.9	9,029.4	10,893.1	12,993.1
EBITDA	1,250.6	1,487.6	1,832.5	2,150.4
EBITDA Margin %	13.9	14.1	14.4	14.2
Depreciation	320.3	461.8	531.7	568.4
EBIT	930.3	1,025.8	1,300.8	1,582.0
Interest	118.7	97.1	113.8	156.8
Other Income	46.6	27.3	38.0	38.0
Profit Before Tax	858.2	956.0	1,225.0	1,463.2
Tax	304.0	326.5	416.5	497.5
Profit after Tax	554.2	629.5	808.5	965.7
NPM %	6.2	6.0	6.4	6.4

Valuation & Views

Overall, investment in road construction is estimated at ₹2,536bn going ahead, with NHAI plan to award project over 7,300km in FY'12 and 8,800km in FY'13. Hence, there exists tremendous growth opportunity for players like KNRC who have a proven track record. Further, the robust bill-book position of over 3.7x of its FY'11 ensures earnings visibility over the medium term. On a comparative basis too, KNRC is trading at a substantial discount to its peers. It is available at 0.7x FY2013E BV. We have valued the company based on the P/E parameter. We recommend the stock with a Buy with 12-month Target Price of ₹173, implying an upside of 36% from current levels.



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