5 March 2019
SECTOR UPDATE
INDIA | INFRASTRUCTURE

JM FINANCIAL

India Road Sector

Road capex - FY19 lull to recover in FY20-21

Initiate on Ashok Buildcon (BUY)

Initiate on KNR Construction (BUY)

JM Financial Institutional Securities Limited

TABLE OF CONTENTS

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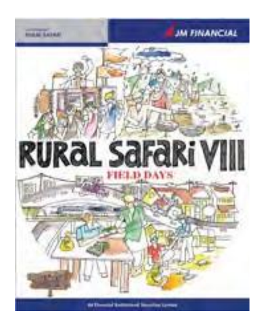


RURAL SAFARI VIII

JM FINANCIAL

Road capex - FY19 lull to recover in FY20-21

We expect a strong a pipeline of road awards by NHAI in FY20-22 based on a basket of 26,000km to be ordered in the next 2-3 years under the Bharatmala plan, of which DPR's are ready or in final stages for c17,000km. We also expect NHAI to continue leading the road sector capex since a majority projects under Bharatmala are large 4-6 large expressways, which normally come within its purview. Also, funding is not a constraint with NHAI's healthy balance sheet (D/E of 0.8x as of Sept'18). However we conservatively estimate **a)** NHAI ordering of 6,000km p.a. (vs. 7,400km in FY18) and **b)** delayed execution for HAM projects already awarded. Even under these conservative estimates we find FY19-21 earnings at a CAGR of 11% for **Ashoka Buildcon** (18% CAGR in our Bull case) but trading at 6x FY21 EPS, while **KNR Constructions** has 15% EPS CAGR in FY19-21 and trades at 10x FY21 EPS) We initiate with a **BUY on both stocks**. We maintain **HOLD on Sadbhav Engineering** despite inexpensive valuations (c.6x P/E FY21), due to sector peak leverage of c.9x D/E and delayed BOT asset sale, all of which hampers its ability to grow.

After peak ordering by NHAI in FY18 there has been a lull in FY19 not due to a shortage of funds or projects but on account of **a)** delayed financial closure (FC) of hybrid annuity (HAM) projects awarded in FY18 and **b)** delays in acquiring 80% land needed for granting appointed dates (AD) for FY18 HAM awards. However with most HAM projects now nearing FC and AD's for projects expected by Mar'19, we expect the large pipeline of active NHAI tenders (c.INR 1trn), to result in project award after the general elections. Additionally, NHAI is expected to award more EPC projects vs HAM in FY20, to avoid further delay in execution. With a healthy D/E of 0.8x (as of Sept'18), NHAI has ample cushion for 2-3 years of EPC / HAM ordering by leveraging its balance sheet, even if budgetary allocation to NHAI remains stagnant.

FY19 ordering slow can see a quick revival in FY20

The ordering on FY19 till Dec18 has been muted (estimated at 600-700Km), due to **a)** delayed / lengthy FC for HAM projects ordered in FY18 and **b)** delayed AD's for the same projects as NHAI faced hurdles in acquiring the required 80% of land for these projects. However FC for most projects is near completion while AD is expected by 4QFY19 end. Also ordering tends to slowdown seasonally prior to general elections in May'19. However, historically NHAI's ordering has consistently revived post elections (Exhibit 1) as road remains one of the key infrastructure needs of India. Additionally, NHAI has a ready basket of 17,000 km of projects with DPR's in advanced stage. This implies that <u>ramp up in ordering can be much faster in FY20 and FY21.</u>

Ashoka Buildcon

With a life time high OB, we believe ABL is at an inflection point, which can trigger at least 20%+ revenue CAGR in FY19-21E (vs. guidance of 40%). Despite assuming slow execution (20% sales growth) and 11% fall in NHAI ordering (vs. FY18) in FY20-21, we find ABL delivering 12% CAGR in earnings (FY18-21) while stock trades **at P/E of 6x FY21** (core EPC business). **Our bull case**, which factors 40% sales growth as per guidance, <u>implies 17% EPS CAGR in FY18-21</u>. We value the stock at EV / EBITDA of 6x (50% discount to L&T) for the EPC business and NPV value of BOT (implied P/BV of 1.1x) for a TP of INR 170 (44% upside). **We initiate with a BUY.**

KNR Construction

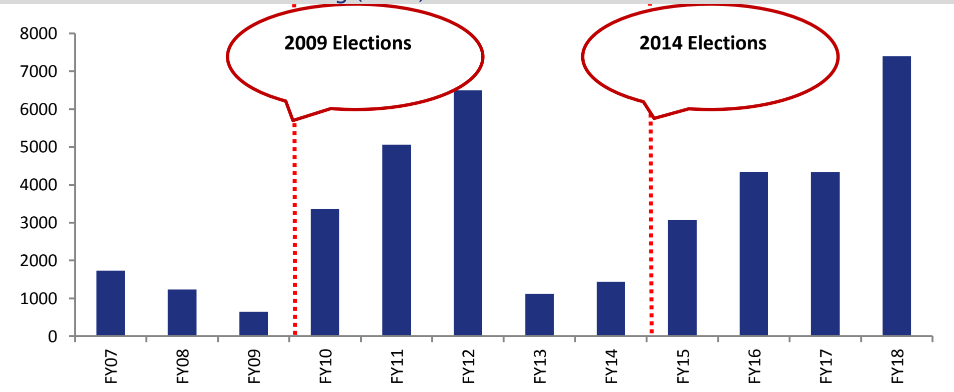
Given the life time high OB and good potential of inflows from NHAI in FY20-21 we find KNR having healthy visibility of revenue growth, though margins may taper off as the lucrative irrigation projects get completed by FY19. Despite factoring lower margins and stable inflows of c.INR 31bn in FY20-21 we find KNR able to deliver <u>earnings CAGR of 14.6% in FY19-21</u> period while stock trades **at P/E of 10x FY21** (core EPC earnings). We value that stock 6.5x EV /EBITDA (c.50% discount to L&T) to get to a TP of INR 255 (17% Upside). **Initiate with a BUY.**

Sadbhav Engineering

While SEL appears optically cheap at c.6x FY21 with an OB of 3.7x FY18 sales, these positives are offset by high D/E of c.9x at a consolidated level. Barring cash inflows from stake sale SEL has a risk of further rise in debt to fund equity in its new HAM projects, which in turn are key for SEL's revenue growth in FY20-21. Additionally without fresh equity SEL will be handicapped in bidding for new HAM projects in FY20-21 given its already heavy debt. Hence despite cheap valuations and a large OB which can potentially lead to 15% EPS CAGR in FY19-21, **we remain cautious on the stock and maintain HOLD.**

Focus Charts

Exhibit 1. NHAI historical ordering (in km) / Red bars show elections



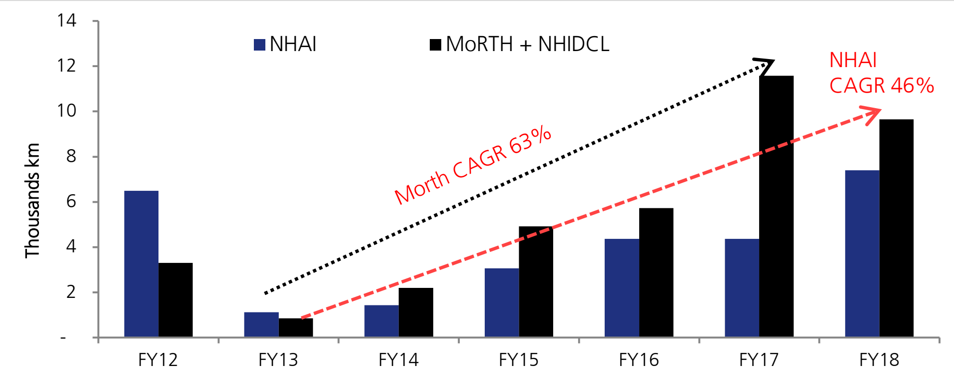
Source: NHAI, JM Financial

Historically NHAI's ordering revived post elections irrespective of the ruling party.

Additionally NHAI has a basket of 17,000km of DPR ready projects

NHAIs budgetary support remains stable while its D/E remains low at 0.82 as of Sep'18.

Exhibit 2. NHAI vs MORTH Awards in Km



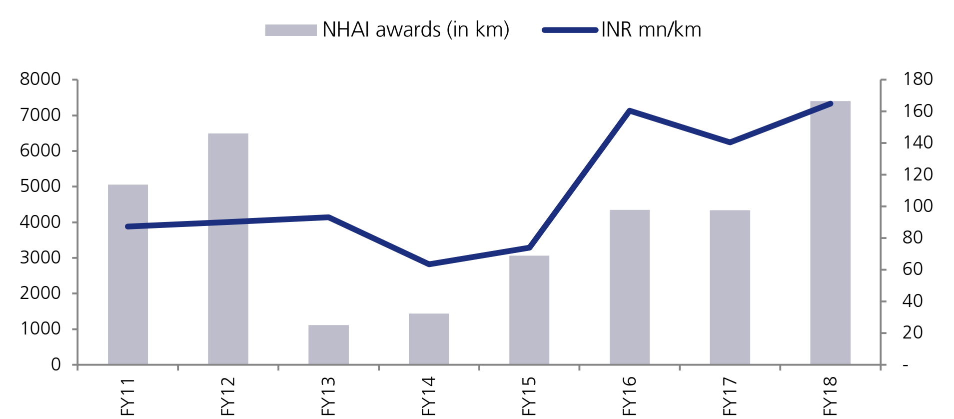
Source: NHAI, MORTH, JM Financial

NHAI to continue leading road capex with majority Bharatmala projects under being large 4-6 large expressways which normally fall in its purview.

NHAI ordering picked up in FY18 just after announcement of Bharatmala plan

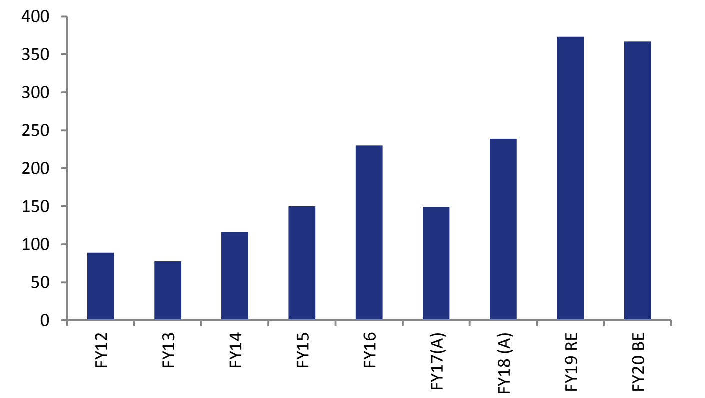
Exhibit-3 clearly shows the rising spend in INR/km for NHAI now at INR 170-180mn/km

Exhibit 3. NHAI awards an spends/km



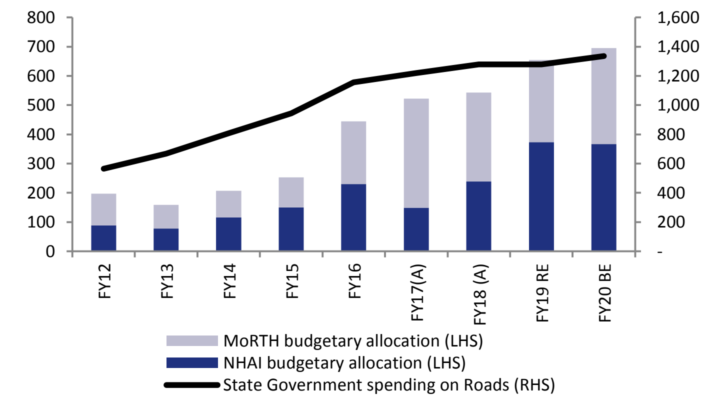
Source: Industry, JM Financial

Exhibit 4. NHAI's Budgetary allocations rising steadily… (INR bn)



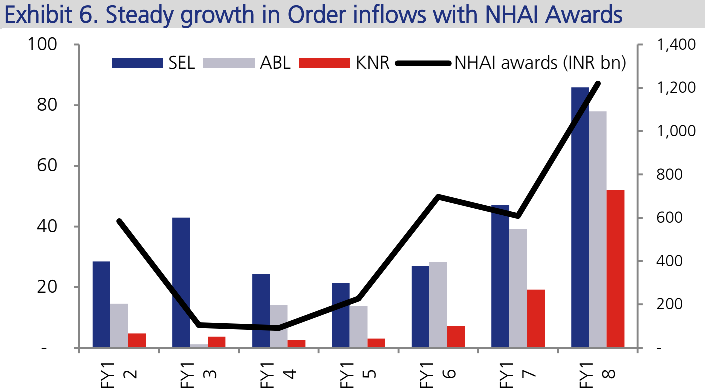
Source: Union Budget, JM Financial

Exhibit 5. …In line with Roads Spending (INR bn)



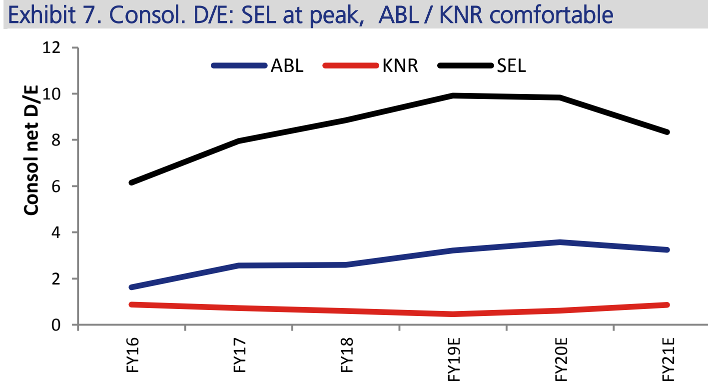
Source: Union Budget, RBI Study of state budgets, JM Financial

Exhibit 6. Steady growth in Order inflows with NHAI Awards



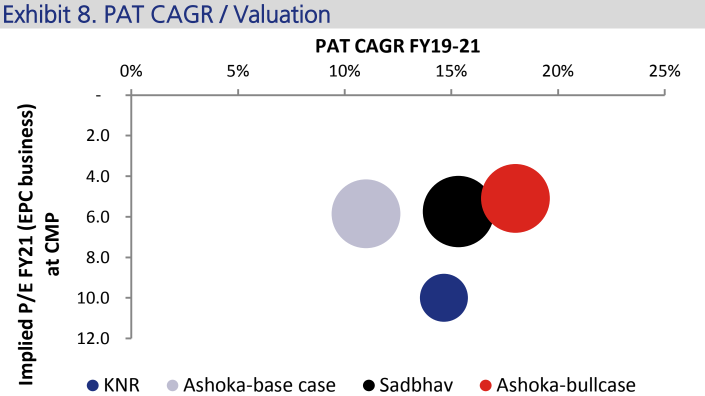
Source: Company, JM Financial

Exhibit 7. Consol. D/E: SEL at peak, ABL / KNR comfortable



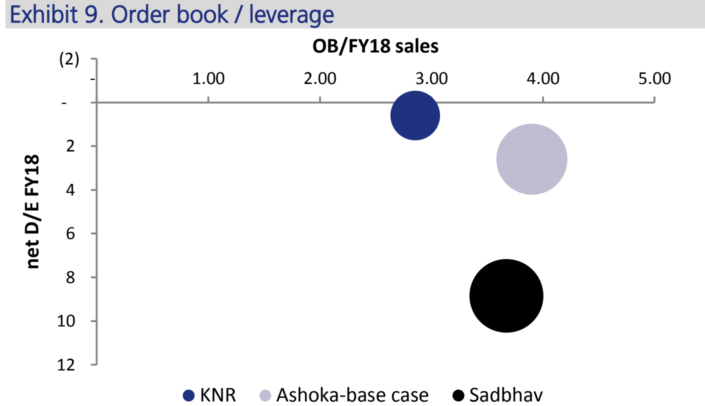
Source: Company, JM Financial

Exhibit 8. PAT CAGR / Valuation



Source: Company, JM Financial

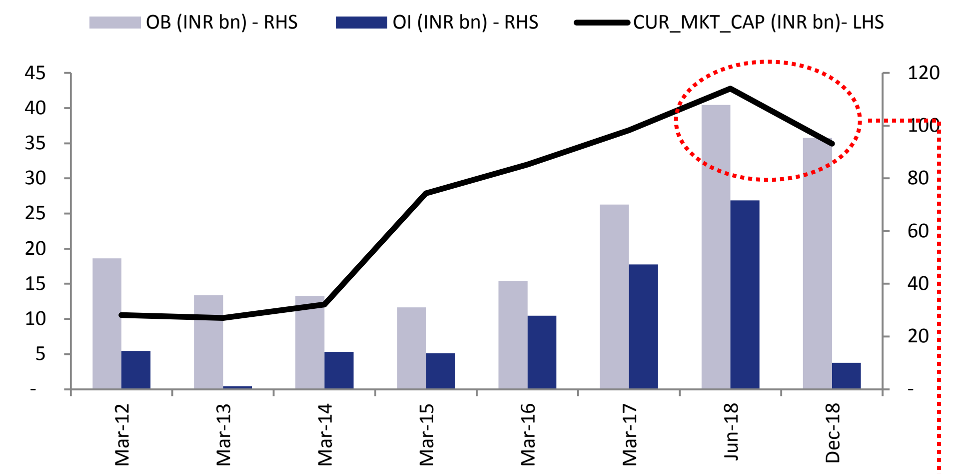
Exhibit 9. Order book / leverage



Source: Company, JM Financial

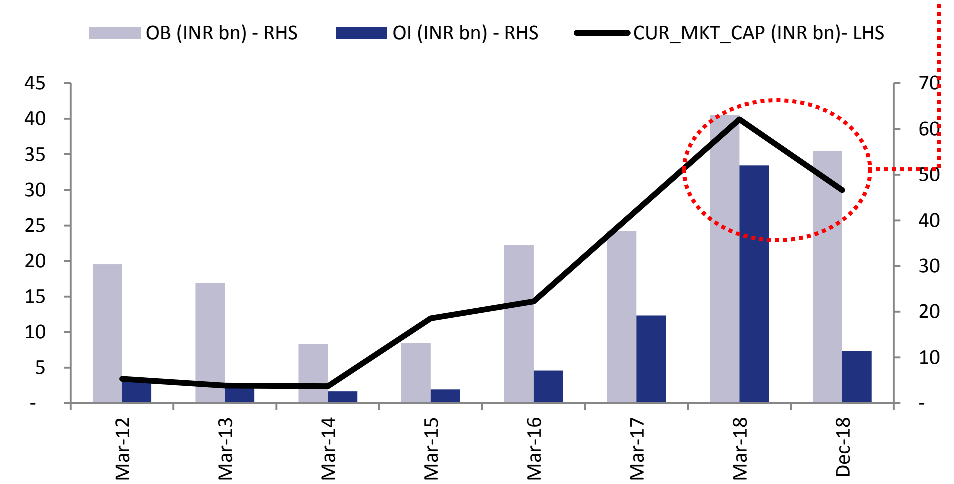
- **ABL** under stress case has 11% EPS CAGR (FY19-21) while **Bull case CAGR is 18%.** While stock trades at 6x FY21 EPS (core EPC).
- **KNR** has EPS CAGR of 15% though at higher valuations of 10x FY21 P/E.
- Although **SEL** has 16% PAT CAGR and is cheap at c.6x FY21 P/E – high leverage / share pledge and delayed BoT asset sale has the company cash strapped which can derail its growth. Also 40% of promoter shareholding is pledged.

Exhibit 10. ABL-Market Cap/OB/OI



Source: Bloomberg, Company, JM Financial

Exhibit 11. KNR- Market Cap/OB/OI



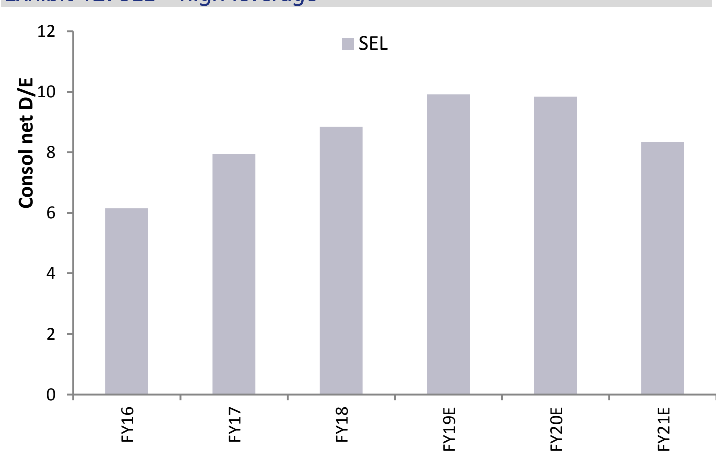
Source: Bloomberg, Company, JM Financial

Historically, Market capitalisation of most Road EPC players mirrors its order Inflows. With robust OIs witnessed in Jan-Apr'18, stock prices rose significantly.

But the muted OIs in 9MFY19 have meant equivalent stock corrections. For SEL the price fall is further steep due to growing debt burden (Exhibit 13) and pending FC for its HAM portfolio (Exhibit-15).

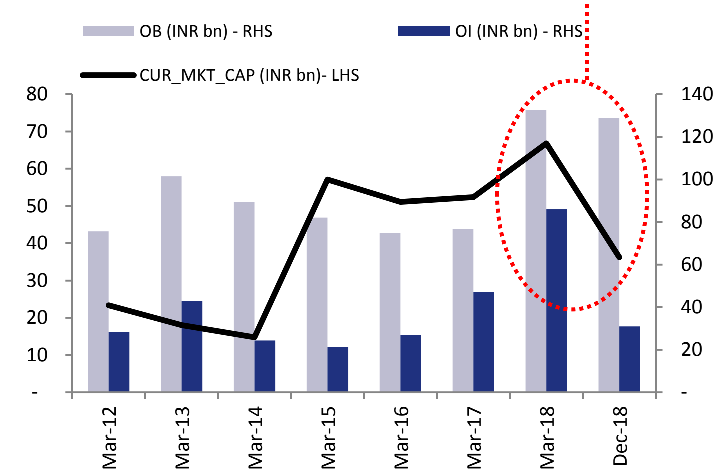
However, given c.26,000km of order basket, with DPRs largely prepared for c.17,000km of projects, we expect NHAI awarding to revive OIs (and hence stock re-rating) for likes of ABL and KNR

Exhibit 12. SEL – high leverage



Source: Company, JM Financial

Exhibit 13. SEL – Market Cap/OB/OI



Source: Bloomberg, Company, JM Financial

Exhibit 14. Key Players: HAM FC status

Firm	HAM Projects Portfolio	FC Complete	Appointed date received	Remarks
Ashoka Buildcon (BUY)	7	7	1	Excluding Bettadahalli-Shivamogga HAM where ACL has emerged as lowest bidder on 21 Feb'19
KNR Constructions (BUY)	5	4	1	Including KSHIP HAM where concession agreement is signed on 18 Jan'19
Sadbhav Engineering (BUY)	13	8	8	
Dilip Buildcon (NR)	12	12	4	Including DBL Sangli Borgaon HAM where FC achievement is notified on 27 Feb'19
PNC Infratech (NR)	7	7	4	Including Chakeri-Allahabad where FC is achievement notified on 14 Feb'19

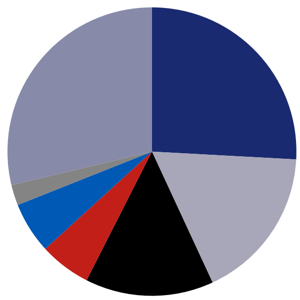
Source: Company, JM Financial

ABL, KNR and PNC has the highest proportion of FC completed projects while appointed dates are excepted in 1-2months

Macros - A Quick recap:

- The Bharatmala announcement:

Exhibit 15. Bharatmala (in km)



Source: PIB, MoRTH, JM Financial

In Oct'17, Union Cabinet approved the Bharatmala plan for

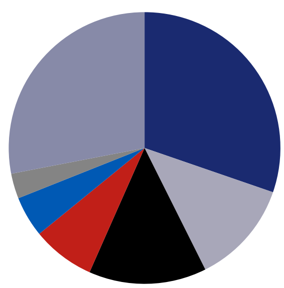
- Developing 34,800km of roads

- Costing INR 5.35trn investments and

- Phase-1 completion by FY21-22.

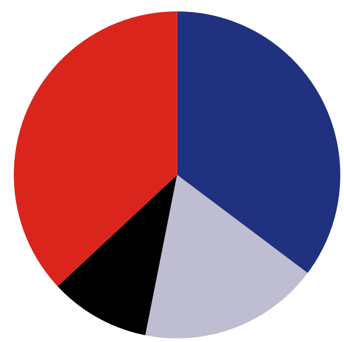
The plan envisages connectivity from factory to market by linking industrial / economic corridors via road connectivity between railway-ports and coastal / border roads

Exhibit 16. Bharatmala-Estimated Cost(INR bn)



Source: PIB, MoRTH, JM Financial

Exhibit 17. Bharatmala-funding (INR bn)



Source: PIB, MoRTH, JM Financial

- Ordering peaks in 4Q18 / HAM take lion's share:

Exhibit 18. FY18-Awards

Mode	Length (in km)	Value (INR bn)	(% of Total Value of Awards)
EPC	3,791	430	35.2%
HAM	3,396	765	62.7%
BOT-Toll	209	25	2.0%
Total	**7,396**	**1220**	**100%**

Source: JM Financial, Industry, PIB

Till Dec'17 NHAI awarded projects costing only INR 221bn covering 1,170km of highways.

However, ordering catapulted in 4QFY18 as NHAI ended FY18 with awards worth

- c.INR 1,220bn +100% YoY

- covering 7,397km, +70% YoY

Notably, Hybrid-Annuity-Model (HAM) orders took lion's share (63% in INR terms) vs EPC model (35% share).

- But pace slackens in FY19 on delayed financial closure (FC)...: The ordering on FY19 till Feb'19 has been muted (estimated at 600-700 km). This is because, most HAM projects have seen delayed / lengthy FC proceedings given **a)** highly leveraged balance sheets of few players resulting from the BOT era, **b)** high concentration of orders with top 5 players (ABL, DBL, SEL, KNR, PNC) who got c.50% of HAM projects, and **c)** Stressed banking sector /NBFC's liquidity crisis, led to delayed FC for most projects while c.15 projects are still awaiting financial closure / sanctions for their projects.

Typically HAM projects have

- NHAI grant for 40% of project cost

- Balance 60% is funded through a mix of debt /equity

- **… and challenges in land acquisition / appointed dates:** NHAI is now strictly following its policy of announcing appointed dates (AD – zero date for start of construction) for projects awarded only when it has acquired majority of the land (80% for HAM / 90% for EPC). This ensures that once a project is under construction it has limited risk of delays due to land non-availability – a major issue faced in the past. However this same policy is delaying receipt of ADs for projects awarded in FY18 as NHAI is yet to acquire the required threshold of land. Hence EPC players are sitting on projects with FC completed /near completion but pending AD. This has also led rising working capital costs as some players (like DBL) have already started initial execution and earth work assuming ADs will come soon but are now facing execution delays. However our interactions with industry participants and NHAI officials suggest that AD's for majority projects are targeted by FY19 (pre-elections).

Why is FC delayed?

PSU banks have stayed out of financing new HAM projects partly due to

a) Past NPA pressures and issues with older BOT projects along with

b) Balance sheet stress. Hence FC has been led by private banks and NBFCs which have been selective in picking projects.

While we hear of FCs being closed at more stringent norms and at cost lower than the bid win costs which would imply higher equity requirement from EPC players.

Exhibit 19. Key Players- HAM Portfolio snapshot

Firm	HAM Projects Portfolio	FC Complete	Appointed date received	Remarks
Ashoka Buildcon (BUY)	7	7	1	Excluding Bettadahalli-Shivamogga HAM where ACL has emerged as lowest bidder on 21 Feb'19
KNR Constructions (BUY)	5	4	1	Including KSHIP HAM where concession agreement is signed on 18 Jan'19
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PNC Infratech (NR)	7	7	4	Including Chakeri-Allahabad where FC achievement is notified to exchanges on 14 Feb'19

Source: Company, JM Financial

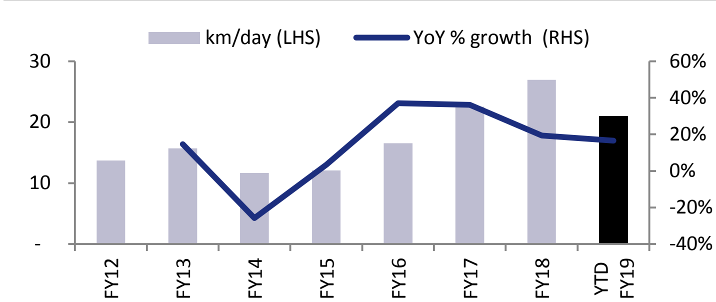
- **Steep targets - execution to catch-up:** FY19 was declared as the "Year of Construction" as the ministry of roads and transport (MoRTH) had set a target of constructing at least 12,000km of highways in FY19 with NHAI accounting for 6000km / 9,700km by MoRTH and 720km by NHIDCL. This translates into c.33km/ day vis-à-vis 27km/ day constructed in FY18, implying a higher focus on execution. However, till date c.61,300km of road projects, costing c.INR 6.48trn are in progress as per MoRTH, while in 9MFY19, c.5,759km of highways were constructed implying 16.5% YoY growth vs. a minimum target of 22% YoY growth. With majority HAM projects still pending AD, much of the execution will now spill over into FY20.

Exhibit 20. FY19 Construction Progress

	FY18	FY19	YoY%
Full Year	9,829	12,000*	22.10%
km/day	27	33	
9-month	4,942	5,759	16.50%
km/day	18	21	

Source: PIB, MoRTH, JM Financial
*MoRTH + NHAI FY19 minimum target

Exhibit 21. Construction YoY

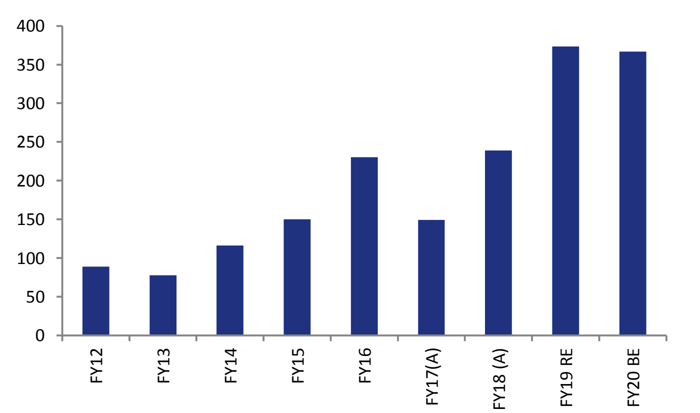


Source: PIB,MoRTH, JM Financial

The Road Ahead?

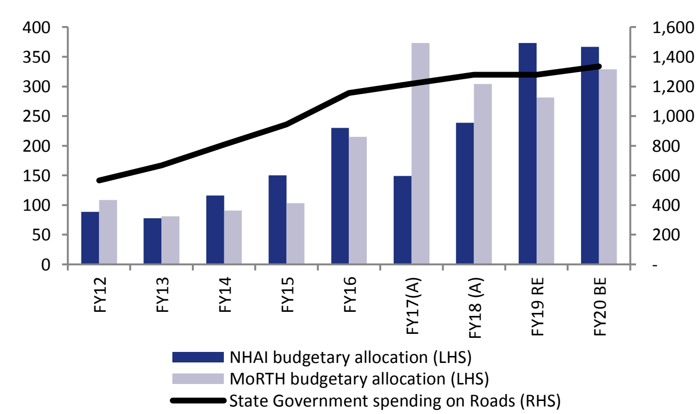
- NHAI Award Basket: Of the 34,000km (phase-I) of Bharatmala (announced in Oct'18), NHAI has already awarded c.4,200 km in FY18 and c.600-700km of projects are estimated to have been awarded in YTD FY19, which may reach 3,000-4,000 km by Mar'19. This would imply a basket of c.26,000 km of projects left for award of which DPR's are ready/in final stages for c17,000 km. Hence we expect that following the elections NHAI awarding will revive in FY20 and can reach 7,000-8,000/annum given backlog of DPR projects.
- Greenfield vs. brownfield: While most of the projects awarded till FY18 were brownfield capex, going ahead focus is largely on greenfield expressways. NHAI has identified 52 greenfield corridors of which c.2,000 km may get ordered in FY19. However greenfield projects typically have a longer life cycle given DPR preparation, approvals land acquisition etc., which delay awarding. However, land acquisition costs for greenfield corridors are expected to be lower vs. brownfield corridors.
- Order mix to shift back to EPC: Given the a) pending FC of HAM projects, b) delay in appointed dates, c) high order concentration in hand of few players - limited competition and d) stressed banking sector / NBFC liquidity crisis, we expect NHAI's order mix to move away from HAM and back to EPC in the near future. Also, most large players participating in HAM already have their plates full of orders, implying fully leveraged balance sheets. Additionally NHAI can borrow debt at much cheaper costs than EPC player which would reduce life cycle cost of constructing projects under EPC mode vs. HAM. However this also implies that NHAI will incur higher upfront costs and stretch its balance sheet as debt rises.
- NHAIs D/E still favourable: NHAI's D/E stood at c.0.82x<1x at 1HFY19 despite the mammoth ordering seen in FY18. While NHAI borrows funds (INR 330bn debt inflow in FY17) at competitive rates, it also receives funds through capital base, cess fund, grants-capital/maintenance and budgetary supports which are as high as INR 370bn (FY20 BE). The budgetary allocations have remained flat even in pro-consumption budgets, while borrowings are expected to rise in future. Given NHAI's low D/E, we believe it has room to leverage its further and can order c.6,000km / year easily.

Exhibit 22. NHAI Budgetary allocations (INR bn)



Source: Union Budget, JM Financial

Exhibit 23. Roads Spending (INR bn)

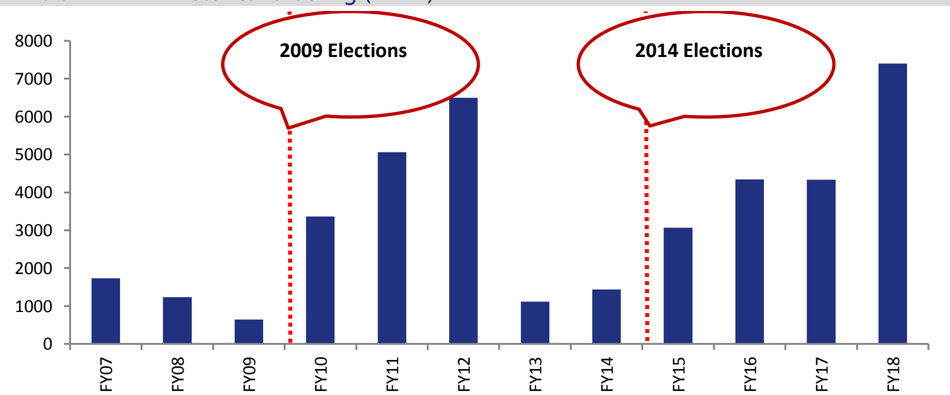


Source: Union Budget, RBI Study of state budgets, JM Financial

Election-impact on ordering?

- Given the upcoming general elections, the model code of conduct is expected to kick-in from Mar'19 implying that there is limited room for NHAI awards in YTDFY19. Hence, we expect only c4,000km of awards in FY19.
- Given the uncertainty of awarding post elections, most stocks have corrected to historical lows. However, historically NHAI's ordering has consistently revived post elections irrespective of the ruling party (see chart) as road remains one of the key infrastructure needs of India. Additionally we now have a ready basket of 17,000km of projects with DPR's in advanced stage. This implies that ramp up ordering can be much faster in FY20 once the over-hang of election passes and the new government focuses on infrastructure development.

Exhibit 24. NHAI historical ordering (in km)



Source: NHAI, JM Financial

Exhibit 25. EPC Concession agreement

	Current	New EPC agreement	Impact
Right of Way (post performance Guarantee)	Within 30 days from date of agreement, >=90% of total length of project (Clause 4.1.3(a))	Within 30 days from date of agreement, >=90% of total length of project, which shall be in **contiguous stretches of length not less than 5 km** (Clause 3.1.(iii).(a))	**Positive:** Larger work front for contractors to execute.
	If works cannot be taken in municipal limits of a town or within any area falling in a reserved forest or wildlife sanctuary or the stretches as requisite clearances/approvals/affected land parcels for commencing construction of works have not been given within **240 days** of appointed date - **affected works to be withdrawn** (Clause 8.3.3)	The window has been reduced to **180 days** in the new EPC agreement. (Clause 8.3.iii(b))	**Positive:** Contractors to have faster access to work front.
Disqualification of Contractor		If a contractor **fails to achieve project completion within 90 days from the scheduled completion** date (unless such failure has occurred due to force majeure or reason attributable to authority), contractor shall be ineligible for bidding any future projects, if the contract value of delayed project is not less than INR 3bn (Clause 10.3. iv)	Higher attention to execution and milestones but this is also positive for contractors with strong execution capability as contractors would be vary while bidding implying less competition for larger players
Deemed termination of contract		Upon signing the agreement and submission of performance security by the contractor, if the appointed date doesn't occur within 90 days, agreement shall be deemed to have terminated wherein authority shall pay damages to the contractor equivalent to 1% of contract price(3% in case of standalone bridges) (Clause-3.4)	**Positive:** Obligation on authority to provide timely appointed dates. Shall ensure that OB is translated into earnings at the earliest.
Maintenance Period	**4 years** from date of completion. Contractor shall be paid 0.5%, 1%, 1.5% and 2% of contract price in 1st, 2nd , 3rd and 4th years respectively (Clause 14.1.1)	• **5 years for flexible pavements** (Bituminous roads) where in contractor shall be paid ○ 0.25% of contract price each in 1st and 2nd year, ○ 0.5% of contract price each in 3rd and 4th year and ○ 1% of contract price in 5th year. • **10 year for rigid pavements** (Concrete roads), including structure where in contractor shall be paid ○ 0.25% of contract price for each of 1st, 2nd and 3rd year, ○ 0.5% of contract price for each of 4th, 5th, 6th and 7th year . ○ 0.75% of contract price for each of 8th, 9th and 10th year (Clause 14.1.1)	Emphasis on O&M with reduced compensation & increased tenure mean contractors are to ensure quality in the construction phase of the pavement. While it is good for the commuters, the norms on stringent on contractors. However, **will benefit contractors with good execution capabilities.** However, an increase in defect liability period would mean that contractors are to submit performance guarantees for longer durations- an increase in non-fund charges.
Mobilisation advance @10% of contract price	Interest bearing at **bank rate** (Clause 19.2.1)	Interest bearing at "**bank rate+3%**" (Clause 19.2.i)	Increase in interest expense for the contractors
Recovery of Mobilisation advance	Deductions to start once all certified payments exceed 20% of contract price (Clause 19.2.7(b))	Deductions to commence in first stage payment statement itself. (Clause 19.2.vi(a))	Increased working capital requirement for the contractor
Performance security		Authority to return additional performance security to contractor within 28 days from Completion certificate. In case of any delays, authority shall pay interest at 9% p.a (Clause 7.4.iii)	
Right of Way (joint inspection)	30 days (Clause- 8.2.1)	10 days (Clause- 8.2.1)	Focus on execution
Change of Scope	"The Authority may, notwithstanding anything to the contrary ……require the Contractor to make modifications/ alterations to the Works **before the issue of completion certificate**" (Clause 13.1.1)	"The Authority may, notwithstanding anything to the contrary ……require the Contractor to make modifications/ alterations to the Works **within a period of six months** counted from the Appointed Date" (Clause 13.1.1)	**Positive:** Emphasis on smoother execution of the project as there are no changes in scope after 6 months of appointed date

Appointment of Authority's engineer	**Within 30 days** of agreement / declaration of appointed date (Clause 18.1.2)	**Within 10 days** of agreement / declaration of appointed date (Clause 18.1.iii)	**Positive:** Fastens OB to execution cycle
Quality testing	The test checks by the Authority's Engineer shall comprise **at least 20%** of the quantity or number of tests prescribed for each category or type of test for quality control by the Contractor. (Clause 11.10.1)	The test checks by the Authority's Engineer shall comprise **at least 50%** of the quantity or number of tests prescribed for each category or type of test for quality control by the Contractor. (Clause 11.10.i)	Emphasis on Quality

Source: NHAI, JM Financial

Ashoka Buildcon | BUY

JM FINANCIAL

Peak OB, trough valuations and robust balance sheet

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Ashoka Buildcon (ABL) is one of India's largest Road EPC companies with an NHAI order market share of 3-5%. ABL's order book (OB) stands at INR 95bn (c.4x FY18 sales) with c.78% mix being from roads. Additionally, ABL has achieved financial closure (FC) for all its HAM projects where the appointed dates (AD) are expected soon culminating to implied EPC revenue growth in FY20. ABL's balance sheet is healthy with standalone / consolidated net D:E of nil / 2.6x in FY18, which peaks at c.0.3x / 3.6x by FY20 when all HAM projects will be commissioned. The equity required for HAM projects will be funded by internal accruals (c. INR 6.5bn needed) coupled with incremental debt (if required) at the standalone level, given the low leverage **(Exhibit 32).** With a life time high OB, we believe ABL is at an inflection point, which can trigger at least 20%+ revenue CAGR in FY19-21E (vs. guidance of 40%). Despite assuming slow execution (20% sales growth and 11% fall in NHAI ordering (vs. FY18) in FY20-21, we find ABL delivering 12% CAGR in earnings (FY18-21) while stock trades at P/E of 6x FY21 (core EPC business). Our bull case, which factors 40% sales growth as per guidance, implies 17% EPS CAGR in FY18-21. We value the stock at EV / EBITDA of 6x (50% discount to L&T) for the EPC business and NPV value of BOT (implied P/BV of 1.1 x) for a TP of INR 170 (44% upside). We initiate with a BUY.

- **Strong OB with HAM financial closure gives earnings visibility:** Roads form a significant part of its OB (78%) which is expected to remain high given robust order basket of NHAI (>17,000km with ready DPRs). As compared to ABLs historic order book levels of c1.7-2.7x sales), it closed 3QFY19 with life time high OB / sales of 4x (FY18 sales). With execution expected to pick up in FY20 as construction starts on financially closed HAM projects, we believe ABL is at an inflection point which can trigger at least 22% revenue CAGR in FY19-21E (vs guidance of 40%). We factor EBITDA margins of c.12-12.6% over FY19-21E (historic trend of c.12-13% and guidance of 13%). **Our macro assumptions** also factor **a)** no incremental OIs in FY19 / c.INR 45bn p.a in FY20-21E- already L1 for INR 13.8bn HAM project and **b)** delayed execution of HAM projects given land acquisition / ROW issues. Despite this we find ABL's revenue CAGR of 28% and PAT CAGR of 12% over FY18-21E. The slower profit growth vs. revenue growth is due to rise in effective tax rate from FY20 as ABL outgrows its minimum alternate tax (MAT) benefit.

- **D/E ratio the best among peers:** ABL's FY18 consolidated net D/E stood at 2.6x in FY18 which we expect to peak out at c.3.6x by FY20, factoring incremental debt for fresh HAM inflows worth c.INR 16bn. The equity required for existing HAM projects (INR 6.5bn) will be funded from internal accruals / current cash, with any shortfall being met through incremental debt at standalone level given low leverage (Exhibit 32).

- **HAM-FC complete:** Currently, many HAM projects still await FC, while ABL has managed to tie up debt for all its HAM projects, given its balance sheet strength and quality of HAM portfolio. ABL has received appointed date for 1 of its HAM projects while the dates for other 4 are expected by 4QFY19 end. Given robust execution capability, we believe land acquisition and AD's remain the key monitorables for earnings growth.

Recommendation and Price Target

Current Reco.	BUY
Previous Reco.	
Current Price Target (12M)	170
Upside/(Downside)	34.5%
Previous Price Target	
Change	NA

Key Data – ASBL IN

Current Market Price	INR126
Market cap (bn)	INR35.5/US$0.5
Free Float	39%
Shares in issue (mn)	280.7
Diluted share (mn)	280.7
3-mon avg daily val (mn)	INR39.5/US$0.6
52-week range	197/93
Sensex/Nifty	36,064/10,864
INR/US$	70.9

Price Performance

%	1M	6M	12M
Absolute	-2.0	-16.8	-24.2
Relative*	-0.8	-17.0	-27.9

* To the BSE Sensex

Exhibit A. ABL-SOTP

Segment	Value per share (INR)	Implied P/E
Road BOTs		
Road BOT assets(Mar-19 NPV)	57	5
Under Construction assets		
	57	5
Construction (6x EV/Ex)	133	
Less: Net Debt (ex BOT)	-18	10
Less: Equity infusion into CGD	-3	
Total Fair value	169	14

Source: JM Financial

Financial Summary (INR mn)

Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Net Sales	19,909	24,369	34,061	42,297	51,111
Sales Growth	3.5%	22.4%	39.8%	24.2%	20.8%
EBITDA	2,427	2,934	4,319	5,237	6,224
EBITDA Margin	12.1%	12.0%	12.6%	12.3%	12.1%
Adjusted Net Profit	1,761	2,370	2,662	2,759	3,299
Diluted EPS (Symbole)	9.4	12.7	9.5	9.8	11.8
Diluted EPS Growth	18.7%	34.6%	-25.1%	3.6%	19.6%
ROIC	25.0%	26.8%	23.9%	20.8%	23.0%
ROE	10.2%	11.9%	12.0%	11.3%	12.1%
P/E (x)	13.4	9.9	13.3	12.8	10.7
P/B (x)	1.3	1.1	1.5	1.4	1.2
EV/EBITDA (x)	15.1	12.1	10.0	8.4	7.2
Dividend Yield	0.6%	1.3%	0.8%	0.8%	0.8%

Source: Company data, JM Financial. Note: Valuations as of 04/Jan/2019

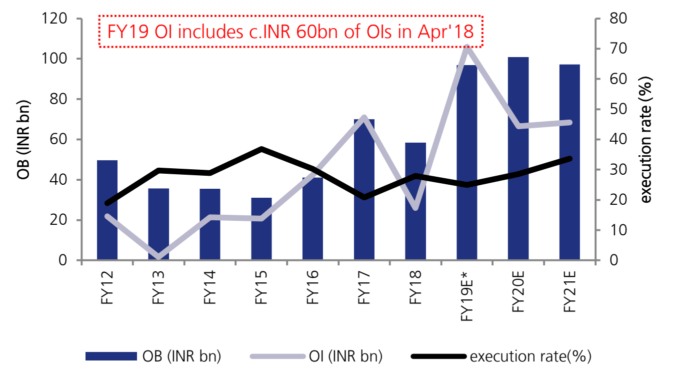
JM Financial Research is also available on: Bloomberg - JMFR <GO>, Thomson Publisher & Reuters S&P Capital IQ and FactSet

Please see Appendix I at the end of this report for Important Disclosures and Disclaimers and Research Analyst Certification.

Investment Rationale

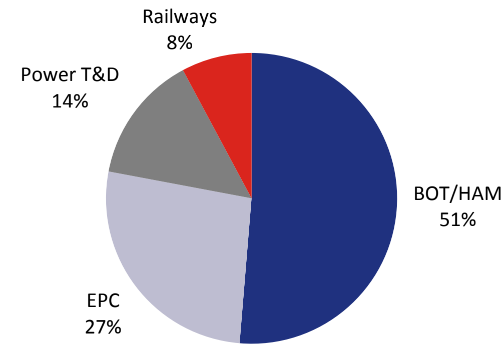
- High earnings visibility/OB: ABL's OB stands at INR 95.4bn (c.3.9x FY18 sales) suggesting high growth visibility. ABL recorded INR 70bn of OIs in FY19 (c. 3x FY18 OI) mainly in Apr'18 due to low base of FY18 and peak awarding activity by NHAI in 4QFY18. Roads form a significant part of its OB (78%) and we expect the share of road projects to remain high given robust order basket with NHAI where road projects of c17,000km have a ready DPR (detailed project reports).

Exhibit 26. OB & OI trends



Source: Company, JM Financial

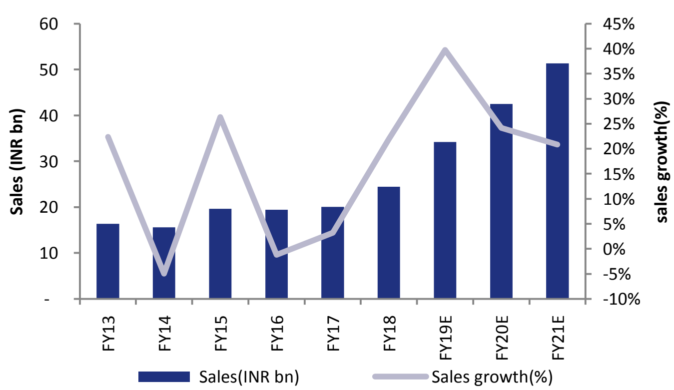
Exhibit 27. OB mix



Source: Company, JM Financial

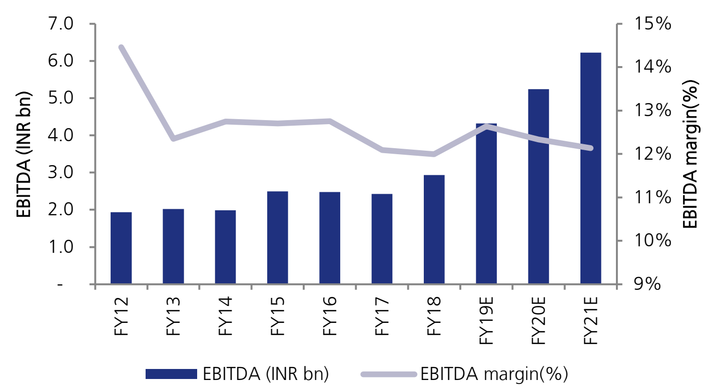
- ABLs revenue growth has been volatile historically, given lower historical OB base of (1.7-2.5x TTM sales). However, with a life-time high OB of 4x FY18 sales, we believe ABL is at an inflection point that can trigger at least 20% revenue CAGR in FY19-21E (vs. guidance of 40%).
- ABL has maintained high EBITDA margins historically at c.12-13%. We factor c.12-12.6% margins over FY19-20E vs. management guidance of 13%.

Exhibit 28. Sales growth



Source: Company, JM Financial

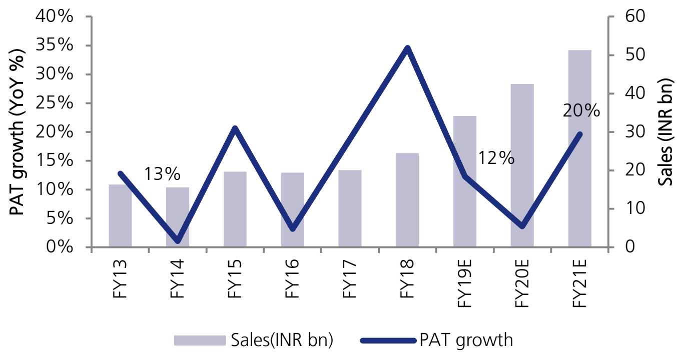
Exhibit 29. EBITDA trend



Source: Company, JM Financial

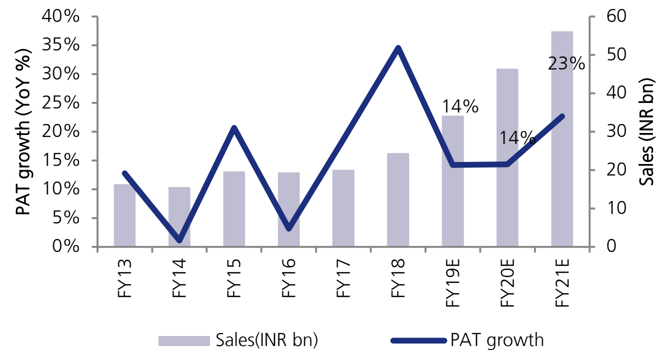
- Despite conservative assumptions of a) Nil / c.45bn in FY19/20/21 and b) delayed execution of HAM projects given land acquisition / ROW issues, we estimate revenue CAGR of 22% and PAT CAGR of 11% over FY19-21E. ABL's effective tax rate is expected to rise in FY20 as the company outgrows its minimum alternate tax (MAT) benefit. However, rising revenue driven by OB execution will more than offset this impact at a net profit level.
- However our bull case which factors 40% revenue growth (as per guidance) implies EPS CAGR of 17% in FY18-21 (Exhibit 30 & 31)

Exhibit 30. Base case: Sales vs. PAT growth



Source: Company, JM Financial

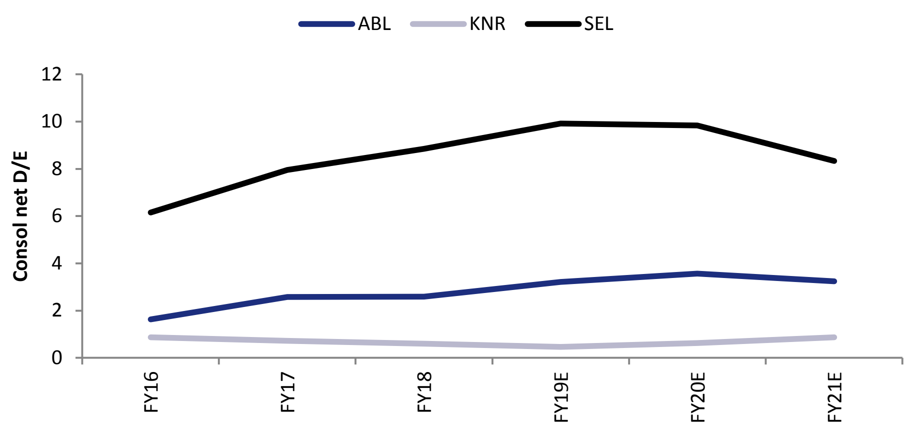
Exhibit 31. Bull case: Sales vs. PAT growth



Source: Company, JM Financial

- D/E ratio the best among peers: ABL's FY18 consol net D/E stood at 2.6x in FY18 which enables it to leverage its balance sheet for future order inflows while standalone debt was nil in FY18. We expect the consol net D/E to reach c.3.6x by FY20, despite assuming c.16bn / c.9bn of HAM OIs over FY20/FY21 which will drive earnings growth.

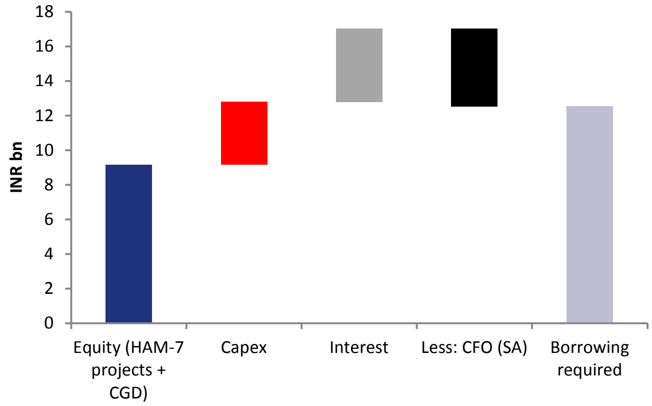
Exhibit 32. Consol net D/E: Peer Comparison



Source: JM Financial, Industry

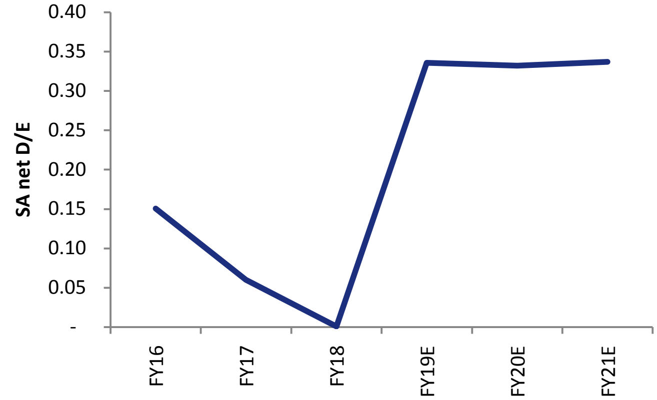
- HAM-FC complete: In the current scenario where many HAM projects awarded by NHAI are still pending FC, ABL has tied up debt for all its HAM projects, given its balance sheet strength and quality of HAM portfolio. ABL has received appointed date for one of its HAM projects while that for 4 other projects is expected in 4QFY19. Given its robust execution capability, we believe that execution will not be a constraint while land acquisition & appointed dates by the authority are the key monitorables. The equity required for HAM projects (c.INR 4.8 bn) will be funded by internal accruals / current cash with any shortfall being met through incremental debt at standalone level given very low leverage.(Exhibit 32)

Exhibit 33. Equity funding: HAM + CGD



Source: Company, JM Financial

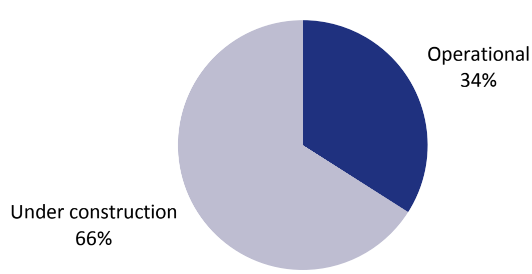
Exhibit 34. Standalone: net D/E



Source: Company, JM Financial

- **BOT/HAM Portfolio:** ABL's BOT/HAM portfolio consists of 17 BOT-Toll/Annuity + HAM projects. While ABL directly holds 3 BOT-annuity projects, 14 projects are held through its subsidiary Ashoka Concessions Ltd (ACL) where in ABL holds c.61% with the rest being held by SBI Macquarie Infrastructure Trust and Macquarie SBI Infrastructure Investments Pte Limited. Of this, 7 new HAM projects and 3 BOT projects are under construction with the rest being operational.
- **SBI Macquarie deal:** ABL entered into a JV with SBI Macquarie whereby the latter's ownership of 31% in subsidiary Ashoka Concessions Ltd (ACL) would increase to 39% over a time subject to **a)** performance of Sambalpur-BOT asset and **b)** 12% return on investment for Macquarie. SBI Macquarie has infused capital through Compulsory Convertible Debentures (CCDs) for 39% stake maturing in Mar'19 (with an option to extend it by another 6 months), with committed returns 12% under the deal. As a result the company has provided for a liability of INR 1.7bn at its SA level, which would be reversed if the returns exceed 12%. ABL management is hopeful of an asset swap with SBI Macquarie which would result in transfer of assets in **a no cash deal**. This would result lowering ABL's consolidated D/E and clear the overhang of the deal with no impact on cash flow. We have conservatively not factored any positive benefit of this deal.

Exhibit 35. ABL SPVs

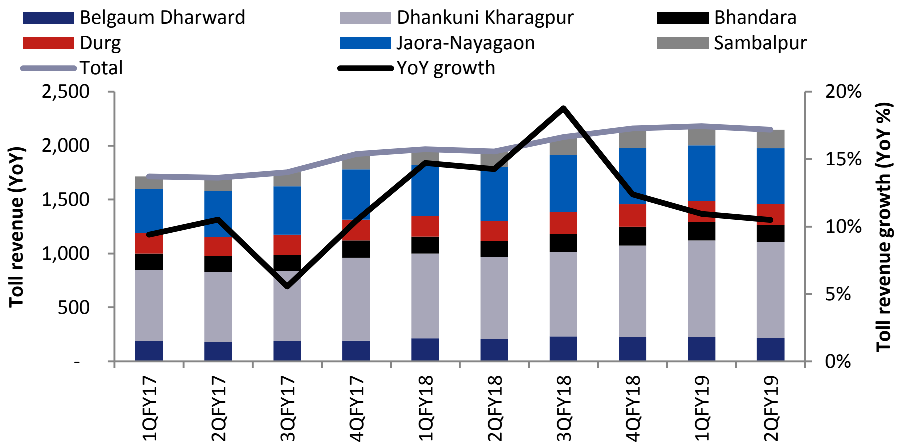


Source: Company, JM Financial

Operational assets

- ABL operates 6 BOT-Toll subsidiaries under its BOT arm-Ashoka Concessions Ltd, where ABL owns c.61% and a 100% owned BOT annuity project (Exhibit-41). Toll revenue grew at average c.12% over last 10 quarters, as the BOT portfolio witnessed double-digit revenue growth (except 3QFY17 due to impact on traffic from demonetisation).
- We factor only **c.10.5%** revenue growth for the BOT portfolio and find that most projects (except Sambalpur), are cash self-sufficient with only MMR support required from parent.

Exhibit 36. ACL BOT-Toll revenue growth



Source: Company, JM Financial

Diversification - Hit or a miss?

- Realty business dropped: While ABL's performance in the road sector and power T&D space is heartening, management has been attempting to diversify its business. After opting out of the realty business (MIAL) for which it had received an LOA in Feb'18, the company is now exploring opportunities in railways construction and gas distribution businesses.
- City Gas Distribution (CGD) business: The company has started a CGD business through its subsidiary-Unison Enviro Private Limited and has bagged 3 orders for Ratnagiri, Chitradurga & Latur areas which require a cumulative capex of c.INR 6.5bn spread over the next 5 years. DBL has roped in Morgan Stanley India Infrastructure (MSII) as the equity partner with 49% stake for a committed investment of c.INR 1.5bn. However, given the non-core and initial stage of investment in this business, we don't factor any value to this business and believe the capital committed here could be at risk until the business matures. We hence do not allot any value to this business while factoring cash outflow in the net debt (INR 825mn).
- Railways: ABL has entered into railways construction business with the receipt of c.INR 8bn order from rail Vikas Nigam Limited (RVNL). Given the company's ability to execute roads / bridges and power T&D projects, we believe this diversification can be a future trigger being closely related to its core competence high growth potential.

Key Risks

- Dependence on NHAI orders: Like all Road EPC players - c.78% of ABL's OB is contributed by roads. Hence ABL's future growth (beyond FY21) is linked to awarding by NHAI. Given a) pending FC of many HAM projects, b) delay in receipt of appointed date for projects with FC, owing to land acquisition/RoW issues and c) political uncertainty in an election year, we foresee slower / nil ordering activity by NHAI in FY19. However this may not impact ABL and also other road EPC players given strong OBs in FY19. However a recovery in NHAI awarding by FY20 is required to have visibility on FY21 growth and beyond.
- Land Acquisition: Although ABL had tied up debt for all of its HAM projects, it is yet to receive appointed dates for 4 of its HAM projects. Any delay in appointed dates owing to land acquisition/RoW issues can defer the earnings growth.
- Diversification: While ABL's performance in the road sector and power T&D space is heartening, management has been on the look-out to diversify its businesses. After opting out of the realty business (MIAL) for which it had received an letter of award (LOA) in Feb'18, the company is exploring opportunities in railways construction and gas distribution businesses. We believe railway construction is largely related to its core competence. However, CGD is not a related business activity for ABL and hence, we believe investment into this business is at high risk.

Valuation

- We factor **a)** Nil / c.INR 45bn of OIs over FY19 / FY20, **b)** EBITDA margins at c.12-12.6% (vs. management guidance of c.13%) and find ABL's EPC business delivering an EPS CAGR of c.11.3% over FY19-21E. We factor only c.10.5% revenue growth for the BOT portfolio and find that most projects (except Sambalpur project), are cash self-sufficient with only MMR support required from parent.

Exhibit 37. Snapshot

CMP	Implied P/E		Implied P/E (adj)		Implied EV/EBITDA		Implied EV/EBITDA (adj)		SA EPS CAGR
	FY20	FY21	FY20	FY21	FY20	FY21	FY20	FY21	FY19-21
Price 126	12.8	10.7	7.0	5.8	8.4	7.2	5.3	4.6	11.3%

Source: Company, JM Financial

- We value ABL at 6x FY21 EV/EBITDA (50% discount to L&T) for the EPC business and BOT at NPV value (implied P/BV of 1.1 x) to arrive at TP of INR 170 (upside of c.34 %). We initiate with a BUY.

Exhibit 38. SOTP

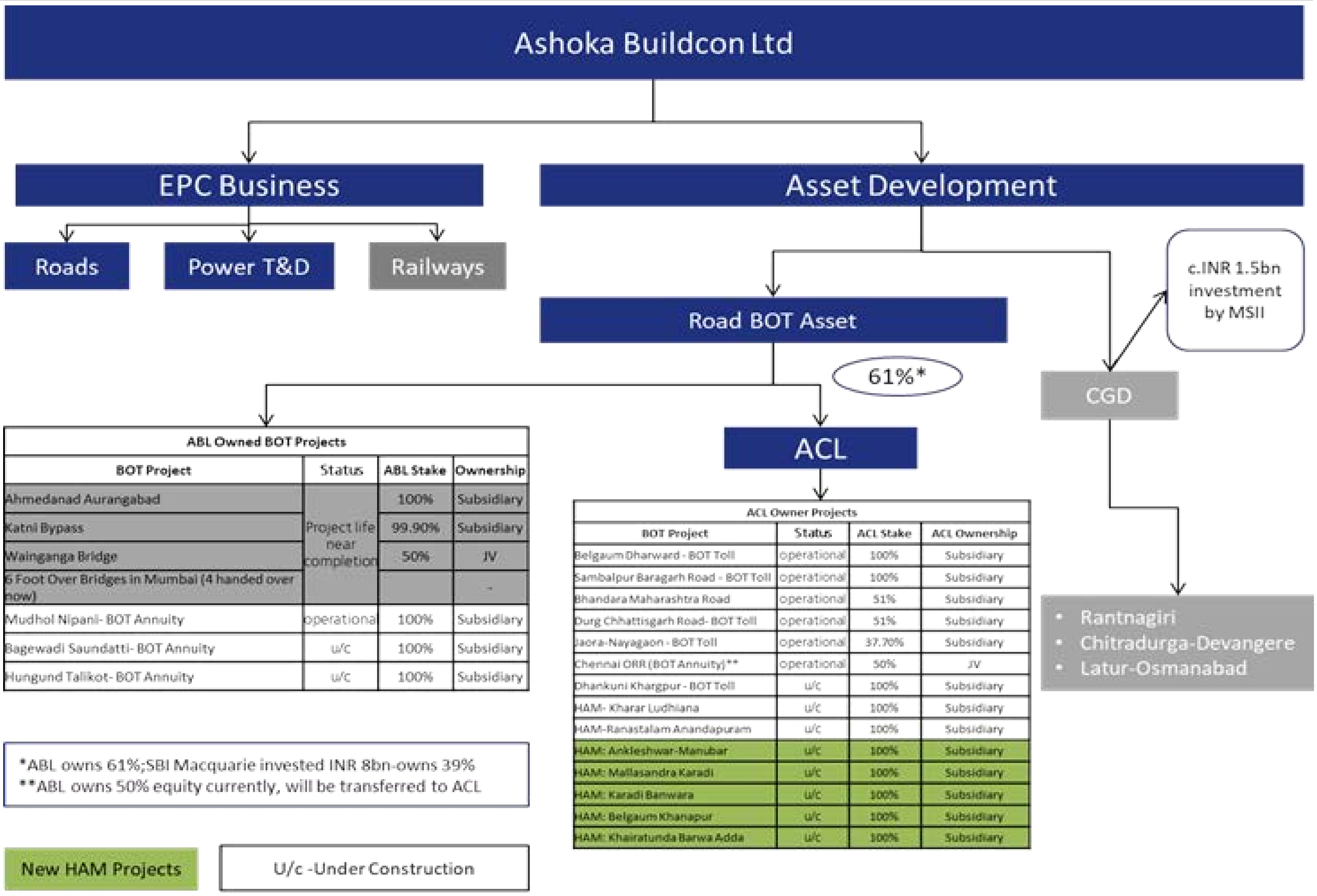
Segment	Basis	Multiple (x)	Value (INR mn)	Value per share (INR)	% of TP	Implied P/E
Road BOTs						
Road BOT assets	Mar-19 NPV		16,082	57	34%	5
Under Construction assets						
			16,082	**57**	**34%**	5
Construction	Mar-21 EV/E (x)	6.0	37,344	133	79%	
Less: Net Debt (ex BOT)			-5,039	-18	-11%	10
Less: Equity infusion into CGD			-829	-3	-2%	
Total Fair value			**47,558**	**169**	**100%**	**14**

Source: Company, JM Financial

Company background and brief history

- ABL started as a civil construction player in 1978, and ventured into development of state road projects in 1996. It won its first BOT project in Maharashtra in 1997. The company ventured into NHAI BOT projects and won its first project in 2006. In 2006, IDFC managed funds invested in ABL and two NH projects of ABL-**the first PE deal**. The company had also ventured into power T&D EPC business in this period. In 2012, SBI Macquarie had invested c.INR 8bn in ACL (ABL's subsidiary) which holds the BOT Toll portfolio-**the second PE deal**. The company had raised c.INR 5bn through QIP in 2015. It had also received its first international EPC contract for USD 38.11mn in 2015. Recently, it has ventured into railways EPC contract and CGD business wherein MSII had agreed to infuse c.INR 1.5bn-**the third PE deal**. The company had successfully handed over a few PPP projects with a few more projects completing their concession period in 2-3 years.
- Share Pledge: Nil

Exhibit 39. ABL Structure



ABL Owned BOT Projects

BOT Project	Status	ABL Stake	Ownership
Ahmedanad Aurangabad	Project life near completion	100%	Subsidiary
Katni Bypass		99.90%	Subsidiary
Wainganga Bridge		50%	JV
6 Foot Over Bridges in Mumbai (4 handed over now)			-
Mudhol Nipani- BOT Annuity	operational	100%	Subsidiary
Bagewadi Saundatti- BOT Annuity	u/c	100%	Subsidiary
Hungund Talikot- BOT Annuity	u/c	100%	Subsidiary

ACL Owner Projects

BOT Project	Status	ACL Stake	ACL Ownership
Belgaum Dharward - BOT Toll	operational	100%	Subsidiary
Sambalpur Baragarh Road - BOT Toll	operational	100%	Subsidiary
Bhandara Maharashtra Road	operational	51%	Subsidiary
Durg Chhattisgarh Road- BOT Toll	operational	51%	Subsidiary
Jaora-Nayagaon - BOT Toll	operational	37.70%	Subsidiary
Chennai ORR (BOT Annuity)**	operational	50%	JV
Dhankuni Khargpur - BOT Toll	u/c	100%	Subsidiary
HAM- Kharar Ludhiana	u/c	100%	Subsidiary
HAM-Ranastalam Anandapuram	u/c	100%	Subsidiary
HAM: Ankleshwar-Manubar	u/c	100%	Subsidiary
HAM: Mallasandra Karadi	u/c	100%	Subsidiary
HAM: Karadi Banwara	u/c	100%	Subsidiary
HAM: Belgaum Khanapur	u/c	100%	Subsidiary
HAM: Khairatunda Barwa Adda	u/c	100%	Subsidiary

Source: Company, JM Financial

Management details

ABL is founded by Mr Ashok Katariya, a gold medallist from College of Engineering in Pune. Mr Satish Parakh is the managing director of the company and he is associated with the company from 1982. The board consists of five non-executive independent directors wherein none of the members have directorship in more than 2 listed entities (including ABL).

Annexure-I

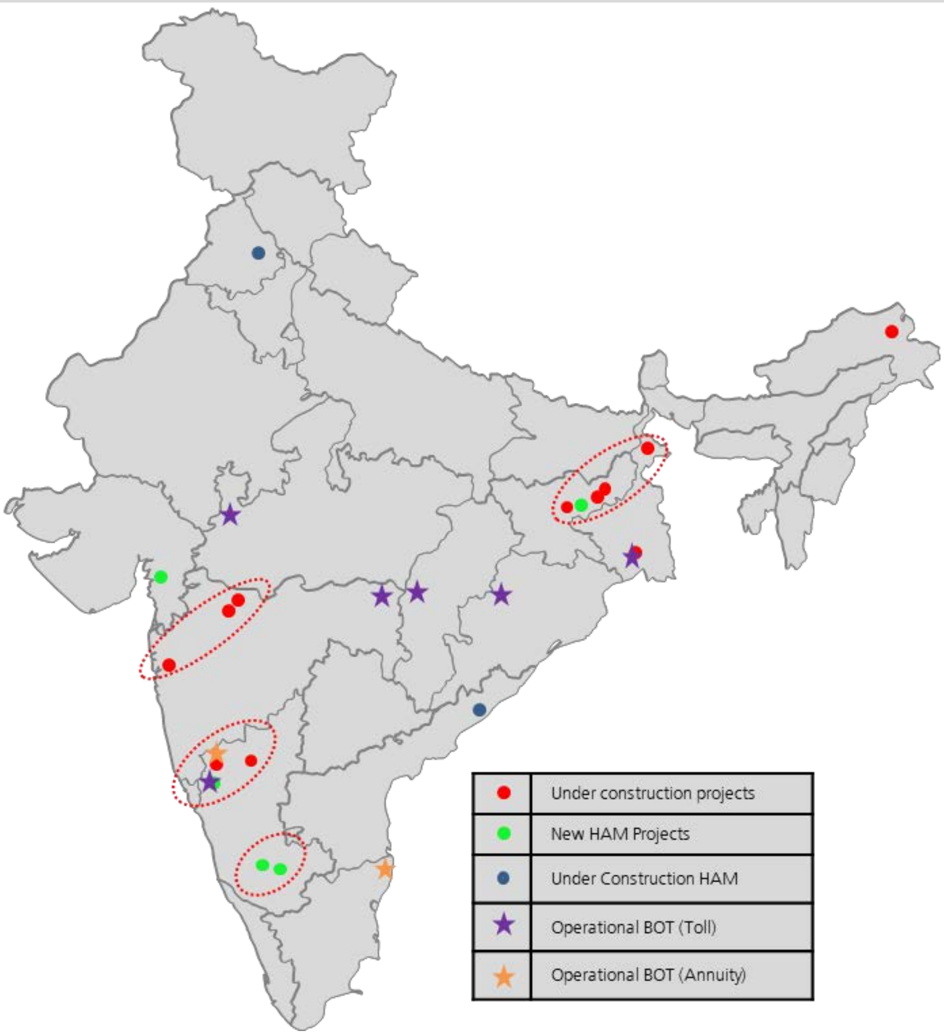
Exhibit 40. New HAM Portfolio

New HAM Portfolio	Bid project cost	Total Project Cost	Debt	Equity	Grant	Financial Closure	Appointed dates	Land Acquisition status	
								3G	3H
Mallasandra Karadi	9,170	7,406	2,750	988	3,668	Debt Tied up for all projects		90%	36%
Karadi banwara	12,185	10,064	3,850	1,340	4,874			70%	36%
Belgaum Khanapur	8,562	7,457	2,950	1,082	3,425			91%	29%
Khairatunda-Barwa adda	8,601	7,117	2,700	976	3,440			89%	68%
Ankleshwar Manubar	16,870	14,831	6,000	2,083	6,748		Received - 10 Dec'18	N/A	
Total	**55,388**	**46,875**	**18,250**	**6,469**	**22,155**				

Source: Company, JM Financial

Annexure-II

Exhibit 41. Ashoka Buildcon: Asset Clusters



Source: Company, JM Financial

Financial Tables (Standalone)

Income Statement					(INR mn)
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Net Sales	19,909	24,369	34,061	42,297	51,111
Sales Growth	3.5%	22.4%	39.8%	24.2%	20.8%
Other Operating Income	156	94	131	162	196
Total Revenue	**20,065**	**24,463**	**34,192**	**42,459**	**51,307**
Cost of Goods Sold/Op. Exp	15,992	19,524	27,409	34,317	41,720
Personnel Cost	901	1,067	1,174	1,291	1,420
Other Expenses	745	938	1,290	1,614	1,943
EBITDA	**2,427**	**2,934**	**4,319**	**5,237**	**6,224**
EBITDA Margin	12.1%	12.0%	12.6%	12.3%	12.1%
EBITDA Growth	-2.1%	20.9%	47.2%	21.2%	18.9%
Depn. & Amort.	507	532	793	981	1,101
EBIT	1,919	2,402	3,526	4,255	5,123
Other Income	719	978	1,075	950	980
Finance Cost	474	485	904	1,088	1,179
PBT before Excep. & Forex	2,164	2,894	3,697	4,117	4,924
Excep. & Forex Inc./Loss(-)	0	0	0	0	0
PBT	2,164	2,894	3,697	4,117	4,924
Taxes	403	524	1,035	1,359	1,625
Extraordinary Inc./Loss(-)	0	0	0	0	0
Assoc. Profit/Min. Int.(-)	0	0	0	0	0
Reported Net Profit	1,761	2,370	2,662	2,759	3,299
Adjusted Net Profit	**1,761**	**2,370**	**2,662**	**2,759**	**3,299**
Net Margin	8.8%	9.7%	7.8%	6.5%	6.4%
Diluted Share Cap. (mn)	187.1	187.1	280.7	280.7	280.7
Diluted EPS (Symbole)	**9.4**	**12.7**	**9.5**	**9.8**	**11.8**
Diluted EPS Growth	18.7%	34.6%	-25.1%	3.6%	19.6%
Total Dividend + Tax	180	360	360	360	360
Dividend Per Share (`)	0.8	1.6	1.1	1.1	1.1

Source: Company, JM Financial

Balance Sheet					(INR mn)
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Shareholders' Fund	18,768	21,003	23,304	25,702	28,641
Share Capital	936	936	1,404	1,404	1,404
Reserves & Surplus	17,832	20,067	21,900	24,298	27,237
Preference Share Capital	0	0	0	0	0
Minority Interest	0	0	0	0	0
Total Loans	1,768	1,251	8,751	9,351	10,651
Def. Tax Liab. / Assets (-)	-304	-349	-349	-349	-349
Total - Equity & Liab.	**20,232**	**21,905**	**31,706**	**34,704**	**38,943**
Net Fixed Assets	1,847	2,324	3,730	2,771	3,062
Gross Fixed Assets	2,500	3,495	5,695	5,717	7,109
Intangible Assets	114	162	162	162	162
Less: Depn. & Amort.	925	1,431	2,225	3,206	4,307
Capital WIP	158	97	97	97	97
Investments	13,065	13,182	17,710	20,280	22,447
Current Assets	19,285	23,414	32,321	38,895	46,227
Inventories	866	1,459	2,039	2,532	3,060
Sundry Debtors	5,875	10,117	14,141	17,560	21,220
Cash & Bank Balances	638	1,235	923	818	1,004
Loans & Advances	1,424	4,035	6,038	6,584	7,168
Other Current Assets	10,482	6,568	9,180	11,399	13,775
Current Liab. & Prov.	13,965	17,015	22,056	27,243	32,794
Current Liabilities	5,693	5,927	8,284	10,288	12,431
Provisions & Others	8,272	11,087	13,771	16,955	20,362
Net Current Assets	5,320	6,399	10,266	11,652	13,433
Total – Assets	**20,232**	**21,905**	**31,705**	**34,704**	**38,942**

Source: Company, JM Financial

Cash Flow Statement					(INR mn)
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Profit before Tax	2,164	2,894	3,697	4,117	4,924
Depn. & Amort.	507	532	793	981	1,101
Net Interest Exp. / Inc. (-)	16	-141	-171	138	199
Inc (-) / Dec in WCap.	2,307	2,415	-4,178	-1,491	-1,596
Others	149	73	0	0	0
Taxes Paid	-722	-789	-1,035	-1,359	-1,625
Operating Cash Flow	**4,421**	**4,985**	**-894**	**2,387**	**3,003**
Capex	-400	-1,417	-2,200	-22	-1,392
Free Cash Flow	4,021	3,568	-3,094	2,365	1,611
Inc (-) / Dec in Investments	-949	-2,397	-4,528	-2,571	-2,167
Others	-107	473	0	0	0
Investing Cash Flow	**-1,456**	**-3,341**	**-6,728**	**-2,593**	**-3,559**
Inc / Dec (-) in Capital	0	0	0	0	0
Dividend + Tax thereon	-150	-181	-360	-360	-360
Inc / Dec (-) in Loans	-1,268	386	7,500	600	1,300
Others	-1,184	-1,253	171	-138	-199
Financing Cash Flow	**-2,602**	**-1,047**	**7,310**	**101**	**741**
Inc / Dec (-) in Cash	**364**	**596**	**-311**	**-104**	**185**
Opening Cash Balance	274	638	1,235	923	818
Closing Cash Balance	638	1,235	923	818	1,004

Source: Company, JM Financial

Dupont Analysis					
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Net Margin	8.8%	9.7%	7.8%	6.5%	6.4%
Asset Turnover (x)	1.0	1.2	1.3	1.3	1.4
Leverage Factor (x)	1.1	1.1	1.2	1.4	1.4
RoE	10.2%	11.9%	12.0%	11.3%	12.1%

Key Ratios					
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
BV/Share (`)	100.3	112.2	83.0	91.6	102.0
ROIC	25.0%	26.8%	23.9%	20.8%	23.0%
ROE	10.2%	11.9%	12.0%	11.3%	12.1%
Net Debt/Equity (x)	0.1	0.0	0.3	0.3	0.3
P/E (x)	13.4	9.9	13.3	12.8	10.7
P/B (x)	1.3	1.1	1.5	1.4	1.2
EV/EBITDA (x)	15.1	12.1	10.0	8.4	7.2
EV/Sales (x)	1.8	1.4	1.3	1.0	0.9
Debtor days	107	151	151	151	151
Inventory days	16	22	22	22	22
Creditor days	118	100	101	101	101

Source: Company, JM Financial

KNR Constructions | BUY

JM FINANCIAL

Winning the race… slow and steady

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KNR Constructions (KNR) is a predominantly southern India based road sector EPC player with a conservative strategy focusing on profitable growth. This is visible in its historic growth of 30% / 55% CAGR in revenues and profits between FY15-18. KNR currently has its lifetime peak OB of INR 55bn (2.9x FY18 revenues) which include 5 HAM projects won in FY19. With 94% of OB from roads we find the mix will continue to be road focused even in future as most of its irrigation projects are near completion. Given the life time high OB and good potential of inflows from NHAI in FY20-21 we find KNR having healthy visibility of revenue growth, though margins may taper off as the lucrative irrigation projects get completed by FY19. Despite factoring lower margins and stable inflows of c.INR 31bn in FY20-21 we find KNR able to deliver earnings CAGR of 14.6% in FY19-21 period. We value that stock 6.5x EV /EBITDA (c.50% discount to L&T) to get to a TP of INR 255 (17% Upside). Initiate with a BUY.

- **Peak OB:** KNR's OB stood at c.INR 15.4bn at the end 9MFY19; excluding the newly won 5 HAM projects where appointed dates are yet to be received. Including these HAM projects OB stands INR 55bn (2.9x FY18 Rev). Roads (94%) form a significant part of the OB as is the case with most other road players while the irrigation projects form c.6% of OB. However, management guides to complete majority of the Irrigation works by FY19.

- **Conservative bidding strategy:** KNR has a conservative strategy of prioritising on profitability over fresh order inflows. The company also bids for smaller ticket size projects to limit its exposure to a single project, which also implies exposure to higher competition. On the other hand the conservative bidding strategy has resulted in its BOT projects not only servicing debt through internal accruals but also being FCFE positive. Recent sale of its 3 HAM projects to Cube Highways at healthy valuations (1.5x-2.1x P/BV) is another feather in its cap (details in Exhibit 60).

- **Execution/EBITDA margins:** KNR owns 100% of its equipment to execute the project, sub-contracting only low margin activities of the projects, which is reflected in its EBITDA margins that have remained at c17%. Although management has been guiding for c.14-15% sustainable margins, its margins have historically fallen to 14% only in FY15 which was period cyclical downturn in road sector capex and execution. In 9MFY18, KNR's EBITDA margins stood at c.17% / c.25% from Roads/Irrigations, resulting in blended margins of c.20%. We conservatively factor c.16.5%/c.20% margins from Roads / Irrigation projects. In current scenario of peak order book execution pick up expected in FY20-21 from HAM execution we find it unlikely that KNR margins will fall to historic lows (Exhibit 54 chart of Rev growth vs margins & OB)

- **Healthy balance sheet:** KNR's FY18 consol net D/E stood at 0.6 x at the end of FY18 leaving ample space for leverage for future HAM inflows. Additionally, c.30% of debt is funded by promoters further limiting the external debt risk. We expect the consol net D/E to reach c.0.9x by FY21, factoring c.9.4bn of annual HAM OIs

Recommendation and Price Target	
Current Reco.	BUY
Previous Reco.	NR
Current Price Target (12M)	255
Upside/(Downside)	16.8%
Previous Price Target	0
Change	NA

Key Data – KNRC IN	
Current Market Price	INR218
Market cap (bn)	INR30.7/US$0.4
Free Float	45%
Shares in issue (mn)	140.6
Diluted share (mn)	140.6
3-mon avg daily val (mn)	INR28.0/US$0.4
52-week range	340/163
Sensex/Nifty	36,064/10,864
INR/US$	70.9

Price Performance

%	1M	6M	12M
Absolute	10.3	-2.5	-30.0
Relative*	11.6	-2.7	-33.4

* To the BSE Sensex

Exhibit B. KNR-SOTP

Particulars	Value (INR /share)	Implied P/E
EPC business (A) (6.5x FY21 EV/EBITDA)	232	12
Less: Net Debt (B)	(9)	(1)
Total (C = A-B)	223	12
BOT Asset Value (D) (FY20 NPV)	32	2
Total (C+D)	255	14

Source: JM Financial

Financial Summary (INR mn)

Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Net Sales	15,411	19,317	19,009	24,746	30,832
Sales Growth (%)	70.7	25.3	-1.6	30.2	24.6
EBITDA	2,296	3,861	3,608	4,024	5,028
EBITDA Margin (%)	14.9	20.0	19.0	16.3	16.3
Adjusted Net Profit	1,681	2,721	1,993	2,207	2,620
Diluted EPS (INR)	12.0	19.3	14.2	15.7	18.6
Diluted EPS Growth (%)	-79.1	61.9	-26.7	10.7	18.7
ROIC (%)	20.2	24.5	13.9	16.6	17.7
ROE (%)	20.6	26.5	15.9	15.2	15.5
P/E (x)	18.2	11.3	15.4	13.9	11.7
P/B (x)	3.4	2.6	2.3	2.0	1.7
EV/EBITDA (x)	13.9	8.4	9.1	7.9	6.4
Dividend Yield (%)	0.0	0.2	0.2	0.2	0.2

Source: Company data, JM Financial. Note: Valuations as of 04/Jan/2019

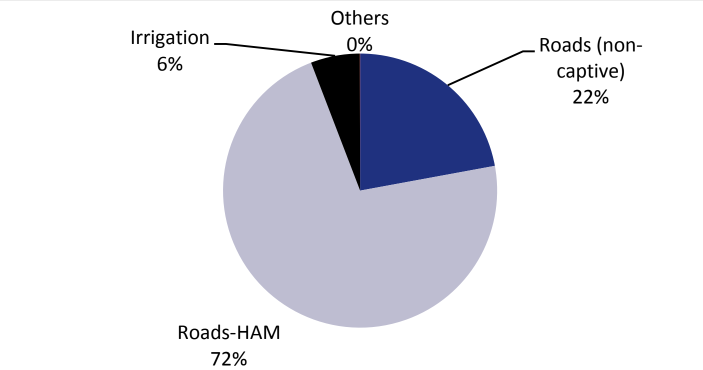
JM Financial Research is also available on: Bloomberg - JMFR <GO>, Thomson Publisher & Reuters S&P Capital IQ and FactSet

Please see Appendix I at the end of this report for Important Disclosures and Disclaimers and Research Analyst Certification.

Investment Rationale

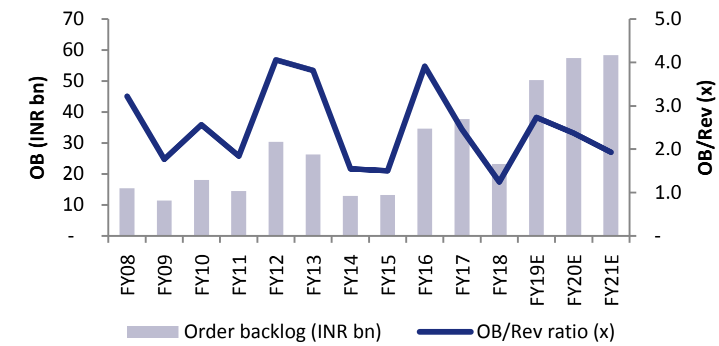
- Peak OB: KNR's OB stood at c.INR 15.4bn at the end 9MFY19; excluding the newly won 5 HAM projects where appointed dates are yet to be received. Including these HAM projects OB stands INR 55bn (2.9x FY18 Rev). Road (94%) form a significant part of the OB as is the case with most other road players while the company also executes irrigation works that form c.6% of OB. However, management guides to complete majority of the irrigation works in FY19.

Exhibit 42. OB mix



Source: Company, JM Financial

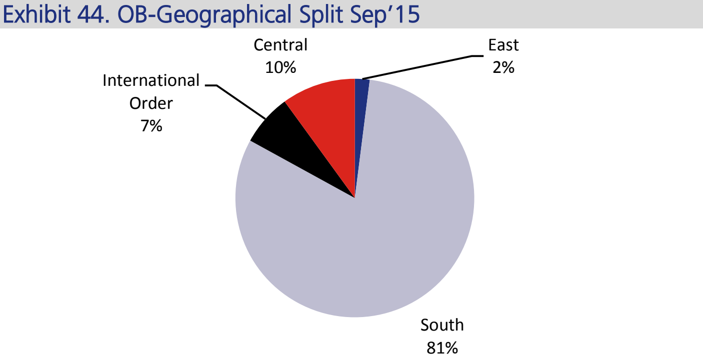
Exhibit 43. OB trends



Source: Company, JM Financial
*FY18 OB doesn't include New HAM projects

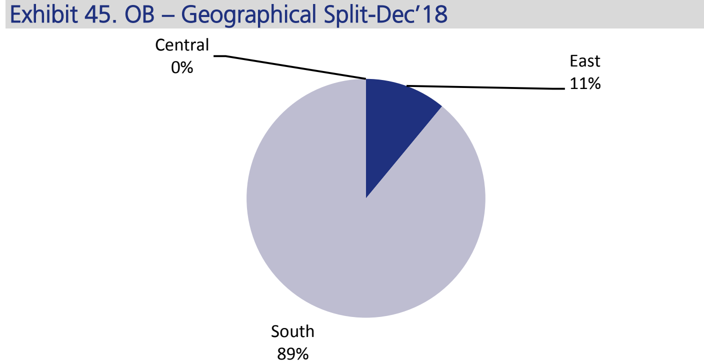
- Focused yet efficient: Predominantly a player focused on southern part of India, KNR has increased its focus on southern states evident from the change in geographical mix of orders from Sep'15 to Dec'18. It focuses on co-locating its projects thereby churning its assets efficiently. The newly won HAM projects are also co-located into 2 clusters (exhibit-46).

Exhibit 44. OB-Geographical Split Sep'15



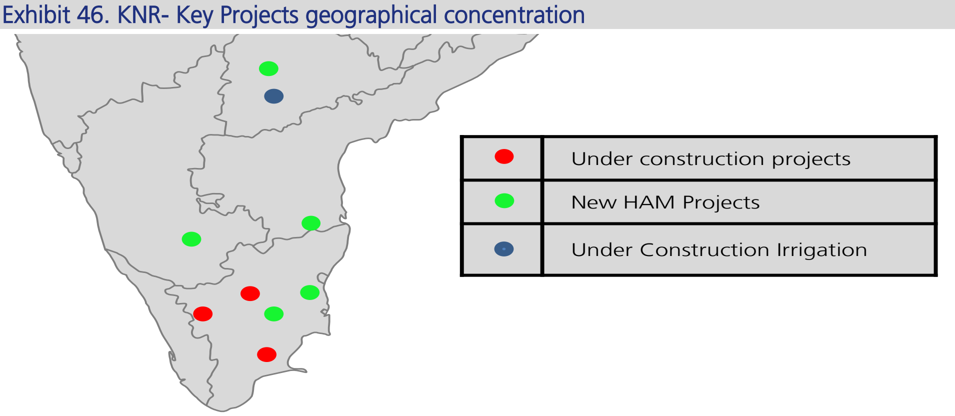
Source: Company, JM Financial

Exhibit 45. OB – Geographical Split-Dec'18



Source: Company, JM Financial

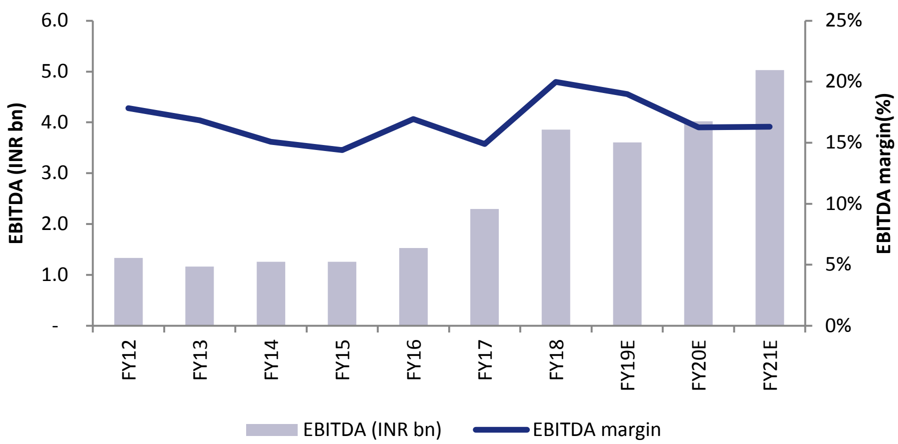
Exhibit 46. KNR- Key Projects geographical concentration



Source: Company, JM Financial

- **Conservative bidding strategy:** KNR has a conservative strategy of prioritising on profitability over fresh order inflows. The company also bids for smaller ticket size projects to limit its exposure to a single project which also implies exposure to higher competition. On the other hand the conservative bidding strategy has resulted in its BOT projects not only servicing debt through internal accruals but also being FCFE positive.
- **Execution/EBITDA margins:** KNR owns 8,880 units of construction equipment and has an in-house team of 1,325 qualified and experienced employees through which it executes most of its works in-house, sub-contracting only low margin activities of the projects, which is reflected in its EBITDA margins that have remained at high teens. Although management has been guiding for c.14-15% sustainable margins, its margins have historically fallen to 14% only in FY15 which was period cyclical downturn in road sector capex and execution. In 9MFY18, KNR's EBITDA margins stood at c.17% / c.25% from Roads/Irrigations, resulting in blended margins of c.20%. We conservatively factor c.16.5%/c.20% margins from roads / irrigation projects.

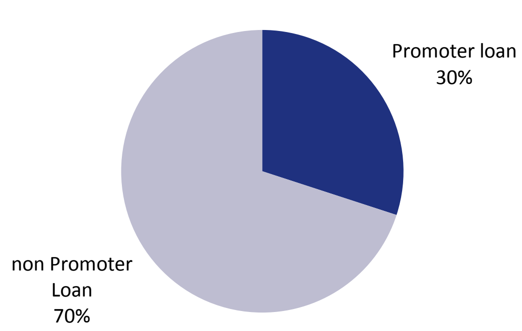
Exhibit 47. EBITDA trend (INR bn)



Source: Company, JM Financial

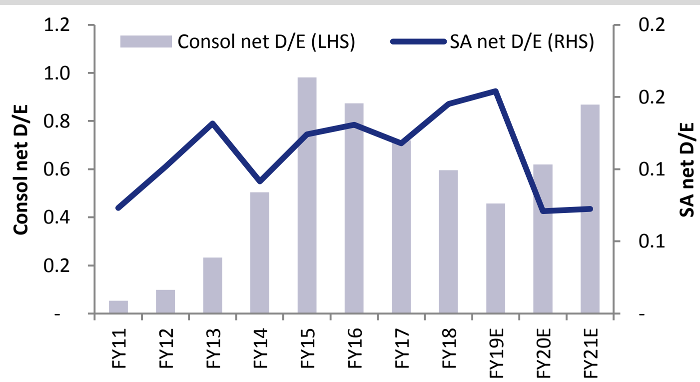
- **Healthy balance sheet**: KNR's FY18 consolidated net D/E stood at 0.6 x which enables it to leverage its balance sheet for future order inflows. Also, c.30% of this is funded by promoters thereby limiting the risk from external debt. We expect the consol net D/E to reach c.0.9x by FY21, factoring c.9.4bn of annual HAM OIs which would drive earnings growth.
- **HAM asset sale:** KNR had signed a share purchase agreement (SPA) with Cube Highways and Infrastructure III Pte Ltd (Cube) to sell stake in 3 HAM, in a phased manner (see New HAM projects in Exhibit 63 for more details). Although, KNR has the ability to infuse equity for its HAM projects given a strong balance sheet, the **SPA would strengthen its balance sheet further**, enabling it to bid for HAM projects going ahead.

Exhibit 48. FY18 Consol debt: Bifurcation



Source: Company, JM Financial, Industry

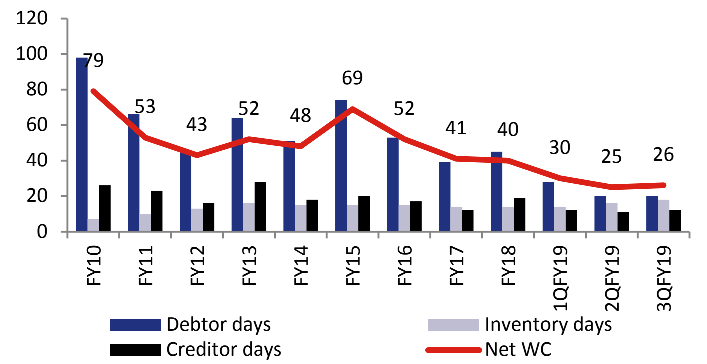
Exhibit 49. KNR SA & Consol net D/E



Source: Company, JM Financial, Industry

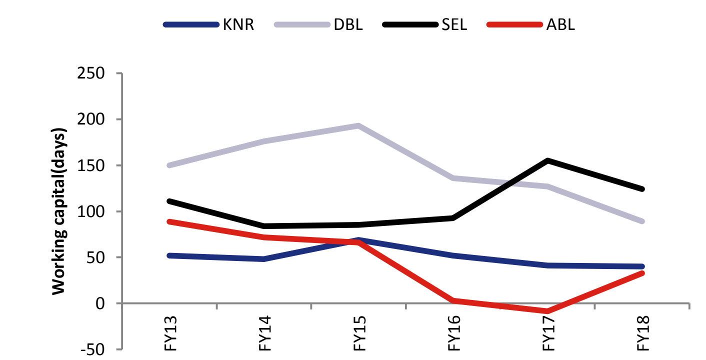
- **Efficient WC Cycle:** KNR's working capital cycle is the best among its peers (Exhibit-50/51) except for ABL, where the working capital cycle is volatile. KNR is able to reduce its working capital cycle with every year. We believe a shift in order inflow mix from third party vendors in the past to NHAI has partially helped the cause. In 9MFY19, it has reduced its working capital days to 26 days from 40 days in FY18, largely driven by reduction in debtor's days to 20 days (vs. 45 days in Mar'18)-partially offset by an increase in inventory days (18 days in Dec'18 vs. 14 days in Mar'18). However, we conservatively do not factor in the benefits of the reduction in the working capital cycle over 9MFY19 in our estimates.

Exhibit 50. KNR-Working capital



Source: Company, Industry, JM Financial

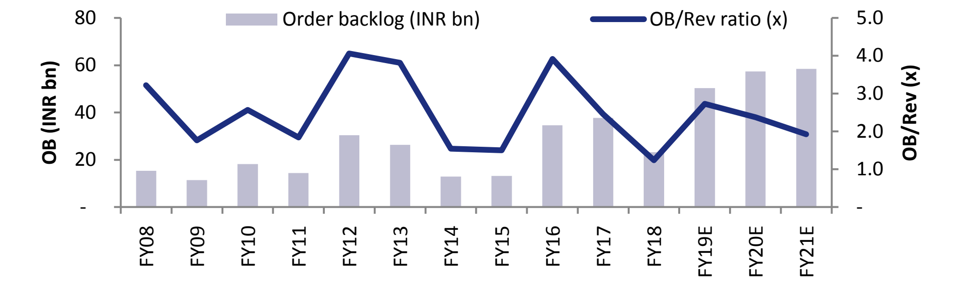
Exhibit 51. Working capital- peer comparison



Source: Company, Industry, JM Financial

Challenges of the past

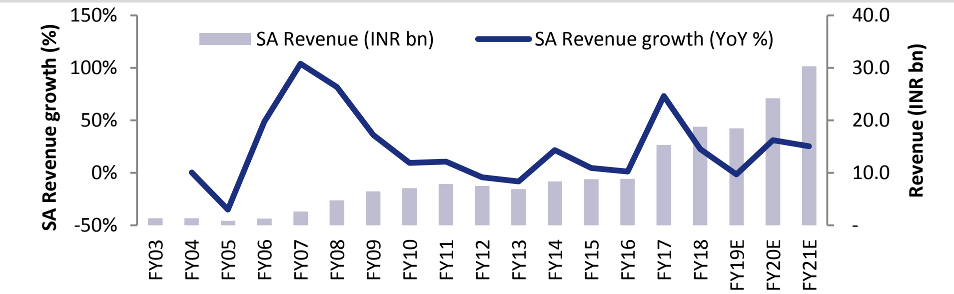
Exhibit 52. OB trends



Source: Company, JM Financial
*FY18 OB doesn't include new HAM OI

KNR's standalone revenue grew at c.24% CAGR over FY03-11 during the previous boom; on the back of strong OB (exhibit-52) in line with NHAI's ordering activity.

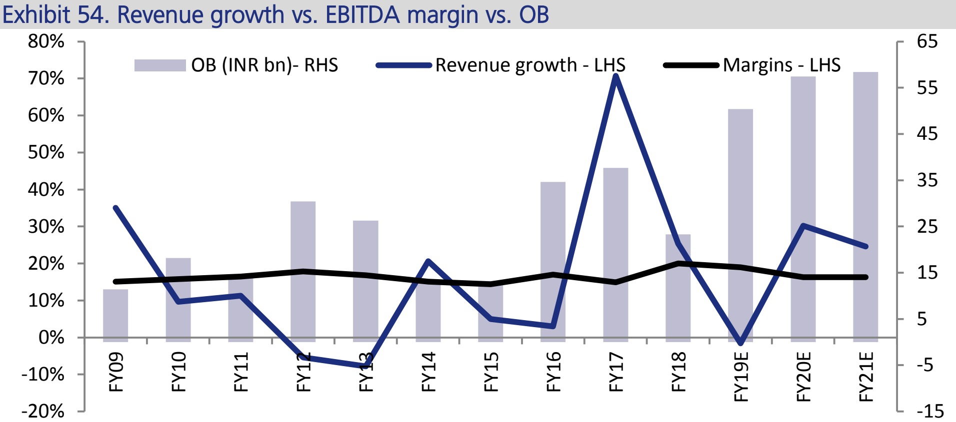
Exhibit 53. Standalone Revenue



Source: Company, JM Financial

Cancellation/de-scoping of orders in FY13 (c.45% of OB) from 3rd party players coupled with muted NHAI awarding in FY14-15 implied muted revenue growth.

Exhibit 54. Revenue growth vs. EBITDA margin vs. OB

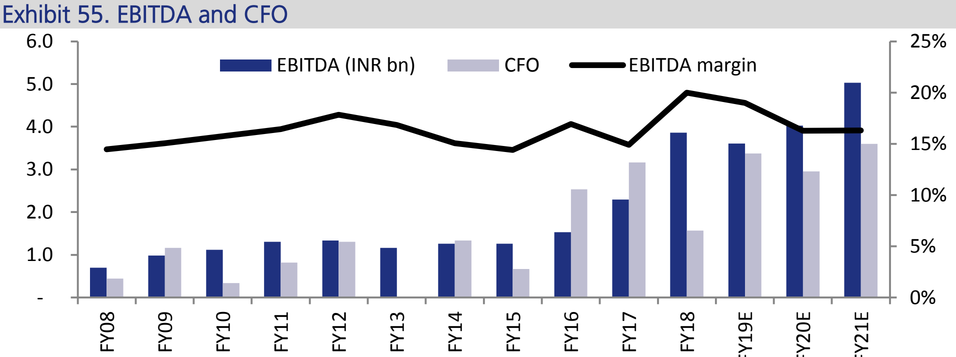


Source: Company, JM Financial

However with growing NHAI awards in FY16-18, KNR's OB and hence revenue grew at c.46% CAGR

Despite Order cancellation / muted OIs, efficient working capital and cost controls helped maintain EBITDA margins and cash flows

Exhibit 55. EBITDA and CFO

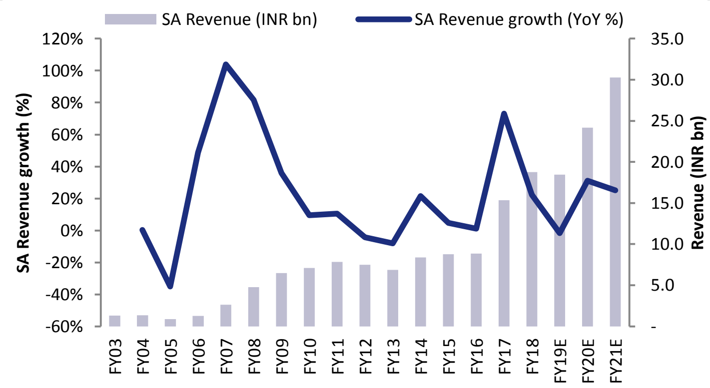


Source: Company, JM Financial

The road ahead is encouraging

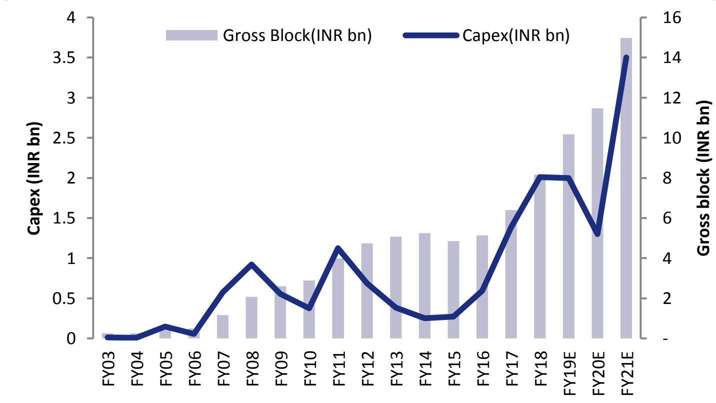
- While in the previous cycle, KNR had to suffer on account of cancellation / de-scoping of a couple of orders from third party players, given that c.100% of OB is now from central / state government authorities the risk is now limited to two players- the government body and KNR. Therefore chances of a de-scoping / cancellation are relatively lower now vis-à-vis the previous cycle. However, the challenges are different going ahead.

Exhibit 56. Standalone Revenue(INR bn)



Source: Company, JM Financial

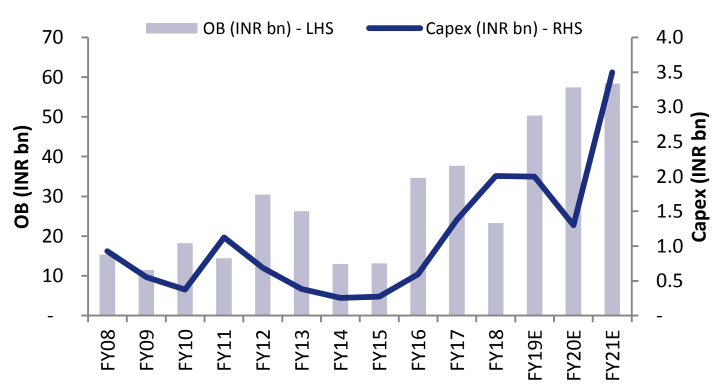
Exhibit 57. Gross Block & Capex (INR bn)



Source: Company, JM Financial

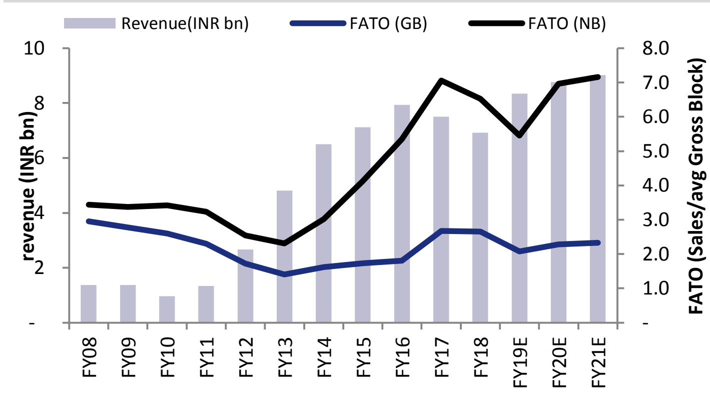
- While revenue grew at c.25% CAGR over FY03-11-the previous boom cycle, KNR had incurred a net capex of INR 3.8bn as gross block grew from INR 262mn in FY03 to INR 4bn in FY11.

Exhibit 58. OB & Capex



Source: Company, JM Financial
*FY18 OB doesn't include new HAM projects
**FY12-13 OB includes cancelled orders

Exhibit 59. Revenue & ATO



Source: Company, JM Financial

- KNR's capex has largely followed OB (naturally), except for FY12-13 period when few orders were cancelled. It had incurred a capex of c.3.4bn over FY17-18 as it had entered into its next orbit with historic high OB/OIs.

- However, asset turnover ratio is expected to reach its historic peak of 2.3x/7.2x at Gross Block/Net Block for KNR by FY21 implying highest utilisation of assets. However, this would also mean that the company will have to incur incremental capex. It has incurred a capex of c.INR 1.6bn in 9MFY19 and expects to incur c.300-400mn in 4QFY19. Additionally, management guides for incremental capex of c.INR 1.3bn in FY20 dependant on new OI.

- Given robust sales growth of 27% over FY19-21E and efficient working capital we believe KNR will be able to meet this through internal accruals alone. However, incremental capex would also make it asset-heavy at standalone level which means **a)** significant financial deleverage in case of a slowdown in awarding activity or **b)** Incremental capex for the next leg of growth given asset turnover ratio is at a historic high implying- **growth will come at a cost**.

New HAM Projects

- As highlighted above, KNR has won 5 HAM projects (4 NHAI + 1 KSHIP) in FY19 with a total bid project cost of c.INR 56bn (estimated EPC cost c.INR 39bn). The company has achieved financial closure for all its NHAI projects while the KSHIP project is pending as of 9MFY19. Given a) strong balance sheet, and b) higher grant amount (c. 65%) from the authority, we believe that KNR should be to tie up debt for this project. Also, it had received appointed date for its Chittor-Mallavaram project, which can contribute to revenues from 4QFY19.
- Management guides for a total equity requirement of INR 4.4bn in its 5 HAM projects to be funded by internal accruals. However KNR has already its HAM portfolio having signed a share purchase agreement (SPA) with Cube highways and Infrastructure III Pte Ltd (Cube) to sell stake in 3 HAM projects. As per the SPA, KNR and Cube shall infuse c.51% and c.49% of equity requirement during the construction phase. KNR shall handover the HAM projects in two stages-post CoD and after the expiry of mandatory lock-in period.

Exhibit 60. Details of HAM SPA (INR mn)

HAM Project	Total Equity Requirement	Equity investment by KNR	Equity investment by Cube	Consideration for KNR's 51% share at exit	Implied P/B
KNR Srirangam Infra Pvt Ltd (Trichy-Kallagam)	962	491	472	736	1.50
KNR Chidambaram Infra Pvt Ltd (Meensurutti-Chidambaram)	455	232	223	365	1.57
KNR Tirumala Infra Pvt Ltd (Chittoor - Mallavaram)	1,432	731	702	1,521	2.08

Source: Company, JM Financial

Key Risks

- Dependence on road orders: Like all Road EPC players - c.94% mix OB contributed by roads. As the management targets to complete the existing irrigation projects largely in FY19, KNR's revenue future growth is linked to awarding by NHAI. Given a) pending financial closure of c.15-20% of awarded HAM projects, b) delay in appointed date of projects that have achieved FC, owing to land acquisition/RoW issues and c) political uncertainty in an election year, we foresee slower ordering activity by NHAI in FY19 which may not impact KNR or other road EPC players given strong OBs. However a recovery in NHAI awarding by FY20 is required to have visibility on FY21 growth and beyond.
- Land acquisition / appointed dates: Although KNR had achieved financial closure for 4 of its HAM projects, it is appointed in only one project while appointed dates are pending for the other three projects where FC is complete. Any delay in appointed dates owing to land acquisition/RoW issues would defer the earnings growth
- Geographical concentration: c.90% of KNR's OB is concentrated in the four southern states of India. While this helps in better churning of assets, the marginal cost of construction it would need for new projects in new geographies would be higher when compared with its peers thereby resulting in a competitive disadvantage.
- Ownership of all equipment: The company has a policy of high equipment ownership which on one hand benefits from higher margins, quality control and on time project completion but on the hand exposes KNR to risk of operating de-leverage in a down turn. However this risk is offset by its conservative strategy of focussing on profitable order rather than aggressive order inflows.

Valuation

- Given a muted awarding activity by NHAI in YTDFY19, we do not factor any incremental OIs in FY19 and c.31bn of OI's over FY20-21E, with c.22bn annual road OIs (c.30% from HAM projects). However, given a strong OB (c.2.9x FY18 Rev), we find KNR's EPS to grow at c.14.6% over FY19-21E vs. EPS CAGR of c.29% over FY15-19E, witnessed after cancellation of third party orders.
- We factor c.10% revenue growth and find its BOT are not only able to service debt through internal accruals but also FCFE positive.

Exhibit 61. Snapshot

CMP	Implied P/E		Implied P/E (adj)		Implied EV/EBITDA		Implied EV/EBITDA (adj)		SA EPS CAGR
	FY20	FY21	FY20	FY21	FY20	FY21	FY20	FY21	FY19-21
Price 218	13.9	11.7	11.9	10.0	7.9	6.4	6.8	5.5	14.6%

Source: Company, JM Financial

- We value KNR at 6.5x FY21 EV / EBITDA (c.50% discount to L&T) for the EPC business and BOT at NPV to arrive at SOTP based TP of INR 255 (17% upside). We initiate with a BUY.

Exhibit 62. SOTP Valuation

Particulars	Basis	Multiple (x)	Value (INR mn)	Value (INR /share)	% of TP	Implied P/E
EPC business (A)	FY21 EV /EBITDA	6.5	32,680	232	91%	12
Less: Net Debt (B)			(1,316)	(9)	-4%	(1)
Total (C = A-B)			**31,364**	**223**	**88%**	**12**
BOT Asset Value (D)			**4,473**	**32**	**12%**	**2**
Walayar-vadakkancherry	FY20-NPV	1.0	3,268	23	9%	
Muzaffarpur	FY20-NPV	1.0	1,205	9	3%	
Total (C+D)			**35,837**	**255**	**100%**	**14**

Source: Company, JM Financial

Company background and brief history

- With an expertise in executing road EPC and irrigation contracts, KNR commenced its EPC business in 1995, Started as a subcontractor, executing projects for Sadbhav Engineering, GVK, GMR, and the company grew into a full size contractor winning 5 HAM projects in 2018-19. The company got listed in 2008 on the bourses and had delivered returns of c.20% CAGR to shareholders since listing.
- Share Pledge: Nil

Management details

- KNR is founded by Mr K.Narasimha Reddy, who is also the managing director. Mr. Reddy had started his career in 1968 and has c. 50 years of experience in highway sector. He is responsible for project planning, scheduling and cost controls. Mr K Jalandhar Reddy, also from the promoter group is an executive director and has c.25 years of experience in highway and infrastructure sector. Mr Jalandhar Reddy is responsible for tendering and bidding activities. The board consists of five members, with two non-executive independent directors and a non-executive, non-independent director in addition to the promoters-Mr K Narasimha Reddy and Mr. K Jalandhar Reddy. Independent directors do not chair any other board of listed entities other than KNR.

Annexure

Exhibit 63. HAM Project status (INR mn)

HAM Status	Project Cost	Total Project Cost	Debt	Equity	Grant	Financial Closure	Appointed date	Stake sale	KNR's equity commitment	Receipt at deal closure
Trichy-kallagam (KNR Srirangam Infra Pvt Ltd)	10,206	9,100	3,820	962	4,318	04-Jan-19	Pending	Share purchase agreement signed	491	736.1
Meensurutti-Chidambaram (KNR Chidambaram Infra Pvt Ltd)	4,820	4,316	1,820	455	2,041	04-Jan-19	Pending		232.1	364.6
Chittoor-Mallavaram (KNR Thirumala Infra Pvt Ltd)	17,301	14,555	5,730	1,433	7,393	04-Jan-19	Received - 04 Jan'19		730.6	1520.6
Ramsanpalle-Mangloor (KNR Shankarampet Projects Pvt Ltd)	12,340	10,456	4,169	1,042	5,245	04-Jan-19	Pending	N/A		
Magadi-Somwarpeth	11,445	10,153	2,134	534	7,485	Pending	Pending			
Total	**56,112**	**48,580**	**17,673**	**4,426**	**26,481**					

Source: Company, JM Financial

Financial Tables (Standalone)

Income Statement					(INR mn)
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Net Sales	15,411	19,317	19,009	24,746	30,832
Sales Growth	70.7%	25.3%	-1.6%	30.2%	24.6%
Other Operating Income	0	0	0	0	0
Total Revenue	**15,411**	**19,317**	**19,009**	**24,746**	**30,832**
Cost of Goods Sold/Op. Exp	13,115	15,455	15,401	20,722	25,804
Personnel Cost	0	0	0	0	0
Other Expenses	0	0	0	0	0
EBITDA	**2,296**	**3,861**	**3,608**	**4,024**	**5,028**
EBITDA Margin	14.9%	20.0%	19.0%	16.3%	16.3%
EBITDA Growth	50.1%	68.2%	-6.6%	11.5%	24.9%
Depn. & Amort.	639	1,341	1,660	1,500	1,793
EBIT	1,657	2,520	1,948	2,524	3,235
Other Income	303	393	620	400	400
Finance Cost	219	231	303	297	276
PBT before Excep. & Forex	1,741	2,682	2,265	2,627	3,359
Excep. & Forex Inc./Loss(-)	0	0	0	0	0
PBT	1,741	2,682	2,265	2,627	3,359
Taxes	60	-39	272	420	739
Extraordinary Inc./Loss(-)	-109	0	0	0	0
Assoc. Profit/Min. Int.(-)	0	0	0	0	0
Reported Net Profit	1,572	2,721	1,993	2,207	2,620
Adjusted Net Profit	**1,681**	**2,721**	**1,993**	**2,207**	**2,620**
Net Margin	10.9%	14.1%	10.5%	8.9%	8.5%
Diluted Share Cap. (mn)	140.6	140.6	140.6	140.6	140.6
Diluted EPS (INR)	**12.0**	**19.3**	**14.2**	**15.7**	**18.6**
Diluted EPS Growth	-79.1%	61.9%	-26.7%	10.7%	18.7%
Total Dividend + Tax	0	85	85	85	85
Dividend Per Share (INR)	0.0	0.5	0.5	0.5	0.5

Source: Company, JM Financial

Balance Sheet					(INR mn)
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Shareholders' Fund	8,955	11,578	13,487	15,609	18,144
Share Capital	281	281	281	281	281
Reserves & Surplus	8,674	11,297	13,206	15,328	17,863
Preference Share Capital	0	0	0	0	0
Minority Interest	0	0	0	0	0
Total Loans	1,303	2,118	2,618	1,618	1,818
Def. Tax Liab. / Assets (-)	-863	-1,497	-1,497	-1,497	-1,497
Total - Equity & Liab.	**9,395**	**12,200**	**14,608**	**15,731**	**18,466**
Net Fixed Assets	2,622	3,314	3,654	3,454	5,161
Gross Fixed Assets	6,402	8,173	10,173	11,473	14,973
Intangible Assets	0	0	0	0	0
Less: Depn. & Amort.	3,795	4,859	6,519	8,019	9,812
Capital WIP	15	0	0	0	0
Investments	1,425	1,122	3,114	3,814	4,020
Current Assets	11,269	13,725	13,707	16,100	18,800
Inventories	574	712	701	912	1,136
Sundry Debtors	1,640	2,320	2,283	2,972	3,703
Cash & Bank Balances	164	371	473	444	435
Loans & Advances	4,972	5,203	5,212	5,213	5,354
Other Current Assets	3,920	5,120	5,039	6,559	8,173
Current Liab. & Prov.	5,922	5,962	5,867	7,637	9,516
Current Liabilities	1,427	2,184	2,150	2,798	3,487
Provisions & Others	4,495	3,777	3,717	4,839	6,029
Net Current Assets	5,348	7,764	7,840	8,462	9,284
Total – Assets	**9,395**	**12,200**	**14,608**	**15,730**	**18,466**

Source: Company, JM Financial

Cash Flow Statement					(INR mn)
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Profit before Tax	1,632	2,682	2,265	2,627	3,359
Depn. & Amort.	639	1,341	1,660	1,500	1,793
Net Interest Exp. / Inc. (-)	165	128	-317	-103	-124
Inc (-) / Dec in WCap.	730	-2,329	35	-650	-690
Others	74	-17	0	0	0
Taxes Paid	-75	-237	-272	-420	-739
Operating Cash Flow	**3,165**	**1,568**	**3,371**	**2,953**	**3,599**
Capex	-1,383	-2,009	-2,000	-1,300	-3,500
Free Cash Flow	1,782	-440	1,371	1,653	99
Inc (-) / Dec in Investments	-1,568	-9	-1,991	-700	-206
Others	-144	166	611	399	259
Investing Cash Flow	**-3,095**	**-1,851**	**-3,380**	**-1,601**	**-3,447**
Inc / Dec (-) in Capital	0	0	0	0	0
Dividend + Tax thereon	0	-85	-85	-85	-85
Inc / Dec (-) in Loans	273	763	500	-1,000	200
Others	-220	-189	-303	-297	-276
Financing Cash Flow	**53**	**490**	**112**	**-1,381**	**-161**
Inc / Dec (-) in Cash	**123**	**206**	**103**	**-29**	**-9**
Opening Cash Balance	41	164	370	473	444
Closing Cash Balance	164	370	473	444	435

Source: Company, JM Financial

Dupont Analysis					
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Net Margin	10.9%	14.1%	10.5%	8.9%	8.5%
Asset Turnover (x)	1.8	1.8	1.4	1.6	1.8
Leverage Factor (x)	1.0	1.1	1.1	1.0	1.0
RoE	20.6%	26.5%	15.9%	15.2%	15.5%

Key Ratios					
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
BV/Share (INR)	63.7	82.3	95.9	111.0	129.0
ROIC	20.2%	24.5%	13.9%	16.6%	17.7%
ROE	20.6%	26.5%	15.9%	15.2%	15.5%
Net Debt/Equity (x)	0.1	0.2	0.2	0.1	0.1
P/E (x)	18.2	11.3	15.4	13.9	11.7
P/B (x)	3.4	2.6	2.3	2.0	1.7
EV/EBITDA (x)	13.9	8.4	9.1	7.9	6.4
EV/Sales (x)	2.1	1.7	1.7	1.3	1.0
Debtor days	39	44	44	44	44
Inventory days	14	13	13	13	13
Creditor days	40	52	51	49	49

Source: Company, JM Financial

JM FINANCIAL

Sadbhav Engineering | HOLD

EPC strength burdened by ballooning debt / delayed BoT sale

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While Sadbhav engineering (SEL) appears optically cheap at c.6x FY21 with an OB of 3.8x FY18 sales, these positives are offset by high D/E of c.9x at a consolidated level. The high leverage is led by heavy debt burden in its BoT subsidiary Sadhbhav Infrastructure (SIPL) which has over-leveraged to invest equity into its BoT SPVs. While stake sale at SIPL /SPV level have been in talks for a while, the deal remains elusive. Barring cash inflows from stake sale SEL has a risk of further rise in debt to fund equity in its new HAM projects, which in turn are key for revenue growth at SEL (EPC parent) level in FY20-21. Additionally without fresh equity SEL will be handicapped in bidding for new HAM projects in FY20-21 given its already heavy debt. The promoter share pledge at SEL level has also increased to 44% of promoter holding clearly underlining SEL's liquidity crunch. Hence despite cheap valuations and a large OB which can potentially lead to 15% EPS CAGR in FY19-21, we remain cautious on the stock and maintain HOLD. Finalisation of stake sale in BoT SPVs and its implied cash inflow can lead to a re-rating for SEL stock.

- **Strong OB:** SEL's OB stands at c.INR 128bn (c.3.7x FY18 sales), largely driven by robust OI's of c.INR 86bn in FY18. Roads form 78% of its OB of which c.50% is contributed by HAM projects (received from SIPL). Of total OB, SEL had secured c.INR31bn of OIs in 9MFY19 but given a slowdown in NHAI's pace of awards and SEL's own debt related challenges (details below), incremental OI (especially HAM) is challenging.

- **Delay in FC/Appointed dates:** As per management's 3QFY19 concall, appointed dates for 3 HAM projects constituting c.24% of OB are expected only beyond 4QFY19. Also, project execution for another 22% of OB is expected to start in 4QFY19 (details on page 35). Therefore, execution of c.46% of OB is pending as evident in the muted performance (2% YoY sales growth) in 9MFY19.

- **Equity Shortfall:** For the 12 new HAM projects, SIPL, the BOT arm of Sadbhav Engineering needs to infuse c.INR 13bn of gross equity in its HAM projects of which, c.INR 3.4bn is already infused as of 9MFY18. We estimate a shortfall of c.INR 5bn after accounting for internal accruals (SIPL SA& BOT subsidiaries). While the company has **a)** c.INR5bn of proceeds from securitisation of Maharashtra border check post (of which c.INR 1.5bn is drawdown in 2QFY19) and **b)** c.INR 6bn of debt raised recently (as per media reports), that can bridge the gap, going ahead we believe it's a tightrope walk

- **D/E at c9x in FY18:** SEL has reduced its FY18 D/E to c.0.7x in FY18 (vs. c.1.1x in FY17), however the borrowing increased by c.INR 1.27bn in 9MFY19 as it had raised c.INR 1.9bn through NCD's. While at consolidated level FY18 D/E stood at 8.8x in FY18 which despite internal accruals will remain high at c.8.3x even till FY21 due to debt obligation for new HAM projects. We believe this high leverage will inhibit SEL's ability to bid for more PPP projects as obtaining financial closure for these projects will be difficult, particularly now given the stress in banking/NBFC

Recommendation and Price Target

Current Reco.	HOLD
Previous Reco.	HOLD
Current Price Target (12M)	205
Upside/(Downside)	-0.9%
Previous Price Target	310
Change	-34%

Key Data – SADE IN

Current Market Price	INR207
Market cap (bn)	INR35.5/US$0.5
Free Float	48%
Shares in issue (mn)	171.5
Diluted share (mn)	171.5
3-mon avg daily val (mn)	INR44.6/US$0.6
52-week range	408/162
Sensex/Nifty	36,064/10,864
INR/US$	70.9

Price Performance

%	1M	6M	12M
Absolute	5.5	-27.5	-48.0
Relative*	7.0	-23.3	-50.9

* To the BSE Sensex

Exhibit C. SEL-SOTP

Particulars	Value/share
Road BOTs	
Total BOT Value	94
Total BOT Value at 50% discount (A)	47
Construction(6xEV/EBITDA)	214
Less: Net Debt (ex SIPL L&A)	-56
Total EPC Value (B)	158
Total Fair Value (A + B)	205

Source: JM Financial

Financial Summary (INR mn)

Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Net Sales	33,203	35,051	38,666	44,240	51,485
Sales Growth (%)	4.2	5.6	10.3	14.4	16.4
EBITDA	3,556	4,151	4,601	5,265	6,127
EBITDA Margin (%)	10.7	11.8	11.9	11.9	11.9
Adjusted Net Profit	1,878	2,207	2,544	3,106	3,384
Diluted EPS (INR)	11.0	12.9	14.8	18.1	19.7
Diluted EPS Growth (%)	24.0	17.5	15.3	22.1	8.9
ROIC (%)	10.1	11.8	11.2	12.0	12.6
ROE (%)	11.9	12.5	12.9	14.0	13.5
P/E (x)	18.9	16.1	14.0	11.4	10.5
P/B (x)	2.1	1.9	1.7	1.5	1.3
EV/EBITDA (x)	15.0	11.8	10.8	9.4	8.2
Dividend Yield (%)	0.3	0.8	0.8	0.8	0.8

Source: Company data, JM Financial. Note: Valuations as of 01/Mar/2019

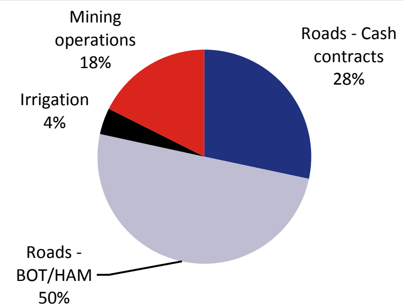
JM Financial Research is also available on: Bloomberg - JMFR <GO>, Thomson Publisher & Reuters S&P Capital IQ and FactSet

Please see Appendix I at the end of this report for Important Disclosures and Disclaimers and Research Analyst Certification.

Investment Rationale - EPC strength outweighed by high leverage

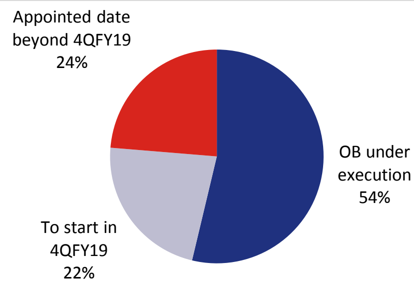
- Strong OB: SEL's OB stands at c.INR 128bn (c.3.7x FY18 sales), largely driven by robust OI's of c.INR 86bn in FY18. Roads form 78% of its OB of which c.50% is contributed by HAM projects (received from SIPL). Of total OB, SEL had secured c.INR31bn of OIs in 9MFY19 but given a slowdown in NHAI's pace of awards and SEL's own debt related challenges (details below), incremental OI (especially HAM) is challenging.

Exhibit 64. OB mix



Source: Company, JM Financial

Exhibit 65. OB-execution status



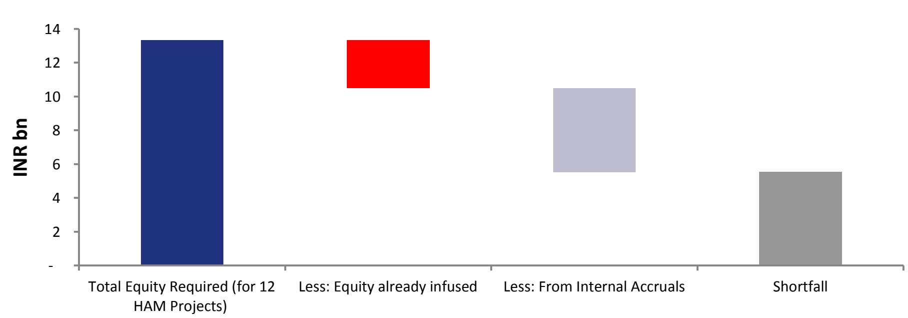
Source: Company, JM Financial

- HAM-Portfolio: SIPL has recently won 5 new HAM projects taking its total HAM portfolio to 12. Of the older 7 HAM projects execution has been steady barring 2 projects (Una-Kodinar and Rampur-II) which witnessed de-scoping on land acquisition issues. Among 5 new HAM projects, 2 projects (Bhimasur-Bhuj & Jodhpur ring road) have achieved FC but only Jodhpur Ring Road has received AD. For 2 of the balance 3 projects (Vadodara-Kim and Tumkur-Shivmoga) SEL has received loan sanctions while its Vizag Port Road project has received in-principal approval for debt. Given the recent stress in banking/NBFC's there could be a risk of delay in disbursements and hence in execution.

- Delay in FC/Appointed dates: As per management's 3QFY19 concall, appointed dates for 3 HAM projects (Bhimasur-Bhuj, Tumkur-Shivmoga, Vizag Port road) and the Gadag Honnali (KSHIP) project which constitute c.24% of OB are expected only beyond 4QFY19. Further another 22% of OB comprising **a)** Kim-Ankleshwar (subject to FC), **b)** Mumbai Nagpur expressway and **c)** Chitradurga branch are also expected to start by 4QFY19. Therefore, execution is yet to start in c.46% of SEL's OB which explains the muted performance (2% YoY sales growth) in 9MFY19. While the start of execution in its 3 new projects would help SEL register earnings growth. Financial closure/appointed dates are key monitorables going ahead as a quarter of OB is dependent on these.

- Equity Shortfall: With the receipt of 12 new HAM projects, SIPL needs to infuse c.INR 13bn of gross equity in its HAM projects of which, c.INR 3.4bn is already infused as of 9MFY18. We estimate a shortfall of c.INR 5bn even after accounting for internal accruals which will be funded through **a)** c.INR5bn of proceeds from securitisation of Maharashtra border check post (c.INR 1.5bn drawn in 2QFY19) and **b)** c.INR 6bn of debt sanctions (as per media reports).

Exhibit 66. Equity Shortfall



Source: Company, JM Financial

- **Consol D/E remains- a constraint:** SEL has reduced its FY18 D/E to c.0.7x in FY18 (vs c.1.1 in FY17), however the borrowing increased by c.INR 1.27bn 9MFY19 as it had raised c.INR 1.9bn through NCD's. Burdened by the high leverage of BOT assets, SEL's Consol net D/E stood at c.8.8x in FY18 (Exhibit- 67). With incremental funding requirement of the HAM projects, we find Consol D/E to remain high at c.8.3x even in FY21. We believe this high leverage will inhibit SEL's ability to bid for more HAM projects.

Exhibit 67. Consol Snapshot

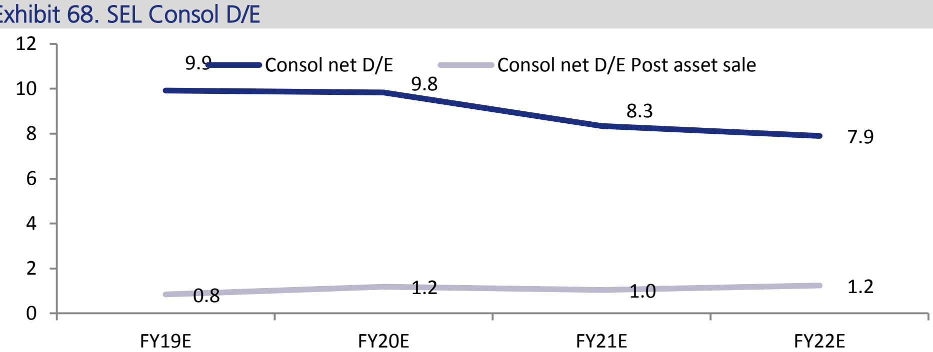
INR mn	FY17	FY18	FY19E	FY20E	FY21E
EBITDA	11,899	14,767	15,222	17,048	19,159
Net Worth (incl. Minority Interest)	12,544	11,218	11,753	13,154	16,131
Net Debt	99,681	99,229	1,16,572	1,29,374	1,34,505
Net D/E (x)	7.9	8.8	9.9	9.8	8.3
Net Debt/EBITDA (x)	8.38	6.72	7.66	7.59	7.02
EBITDA/Interest (x)	1.00	1.12	1.39	1.43	1.53

Source: Company, JM Financial

Asset monetisation – the key trigger

- As per the management's 3QFY19 concall and media articles (see link), Sadbhav Infrastructure Projects Ltd (SIPL) - the BOT arm of SEL is in the process of monetising its BOT-toll / annuity projects.
- A high Consol D/E at c.8.8x and constraints on growth capital would mean that the asset sale is of crucial importance. Assuming the BoT sale results in cash inflow of INR 28bn (implied SIPL value of INR80/share at par with CMP), we find SEL's Consol D/E falls to c.1x before inching up again as new debt flows in for HAM projects. A fall in D/E would increase SEL's ability to bid for PPP mode of projects and hence, OI's which would warrant a re-rating.

Exhibit 68. SEL Consol D/E



Source: Company, JM Financial

- **BOT Portfolio:** After the revival seen in traffic flows into its BOT projects in 2HFY18 to 1HFY19, traffic growth has again slowed down to c.4.5% in 3QFY19 mainly in Dec'18. We factor c.9% revenue growth for the BOT portfolio and find the portfolio generating positive cash PAT except for 2 projects burdened with high debt. This is also evident from SIPL reporting a cash PAT>INR 1bn for the third successive quarter. However, debt levels are particularly high in 2 BOT projects, resulting in a loss at consolidated PAT level. A slower than expected tariff growth significantly impacts SIPL and hence SEL SOTP valuations.

Key Risks

- **Delay in FC / Appointed dates:** Appointed dates for 3 HAM projects (Bhimasur-Bhuj, Tumkur-Shivmoga, Vizag Port road) and the Gadag Honnali (KSHIP) project which constitute **c.24% of OB are expected beyond 4QFY19 only**. Also, SIPL's Kim-Ankleshwar (FC documents submitted) project execution is expected to start in 4QFY19 along with the Mumbai-Nagpur expressway and Chitradurga branch canal. Together these projects constitute c.22% of OB. Therefore, execution is yet to start in c.46% of SEL's which explains the muted performance (2% YoY sales growth) in 9MFY19. While start of execution in its three new projects would help SEL register earnings growth, financial closure / appointed dates are monitorable going ahead as a quarter of OB is yet to start contributing to earnings.

- **Consol D/E remains- a constraint:** Burdened by the high leverage of BOT assets, SEL's Consol net D/E stood at c.8.8x in FY18. With incremental funding requirement of the HAM projects, we find Consol D/E to be c.8.3x by FY21. We believe this high leverage will inhibit SEL's ability to bid for more PPP projects as obtaining financial closure for these projects will be difficult, particularly now given the stress in banking/NBFC.

Valuation

- We factor **a)** Nil / c.54bn of OIs in 4QFY19/FY20, **b)** EBITDA margins at c.11.9% (vs. guidance of c.12%) to account for increased competition for EPC orders which is the potential opportunity for SEL in near term and find SEL's EPC business delivering EPS CAGR of c.18.5% and c.15.7% over FY18-20E and FY19-21E respectively. We factor c.9% revenue growth for the BOT portfolio and find the portfolio generating positive cash PAT except for a couple of projects burdened with high debt.

Exhibit 69. Earnings snapshot

CMP	Implied P/E		Implied P/E (adj)		Implied EV/EBITDA		Implied EV/EBITDA (adj)		SA EPS CAGR
	FY20	FY21	FY20	FY21	FY20	FY21	FY20	FY21	FY19-21
Price 207	11.4	10.4	6.3	5.7	9.3	8.2	6.3	5.7	16%

Source: Company, JM Financial

- We value SEL at 6x FY21 EV/EBITDA (50% discount to L&T) for the EPC business and the BOT at 50% discount to NPV Value to arrive at TP of INR 205 (CMP INR 207/share), factoring c.9% toll revenue growth.
- At 6xFY21 EV/EBITDA, we find the EPC business' value at of c.INR 158/share. At CMP of c.INR 173/share, this would imply only c.INR49/share to its BOT assets .This discount is driven by **a)** net losses at SIPL consolidated level, **b)** delay in the BOT sale and **c)** a muted operational performance of BOT portfolio in 3QFY19 registering (c.4.5% /c.6.2% growth in traffic / toll revenue).

Exhibit 70. SOTP

Particulars	Basis	Multiple	Value/share	% of TP
Road BOTs				
Operational	Mar-20 NPV	68.64% stake	123	
Under construction	Mar-20 NPV	68.64% stake	24	
Less: Net Debt (ex- projects specific)			-53	
Total BOT Value			**94**	
Total BOT Value at 50% discount (A)			**47**	23%
EPC				
Construction	Mar-21 EV/E (x)	6.0	214	
Less: Net Debt (ex SIPL L&A)			-56	
Total EPC Value (B)			**158**	**77%**
Total Fair Value (A + B)			**205**	**100%**

Source: JM Financial

Exhibit 71. SOTP sensitivity

		Traffic growth rate (YoY %)					
	205	0.5%	2.0%	3.5%	5.0%	6.5%	8.0%
Toll rate growth rate (YoY%)	2.0%	157	168	179	192	207	223
	3.0%	162	173	185	199	214	231
	4.0%	166	178	191	205	221	239
	5.0%	171	184	197	212	229	249
	6.0%	177	190	204	220	238	259

Source: JM Financial

Company Background and brief history

SEL was established in 1988 and today has an OB of c.90bn EPC contracts spread across transport (roads), irrigation and mining industries. c.46% of the company's shares is held by its Promoters, 22% by Mutual Funds and 16% by FPIs. The company also holds a 69% stake in SIPL, which holds its BOT-toll portfolio. SEL's portfolio is spread across 14 states.

Management Details

- SEL is promoted by the late Mr Vishnubhai Patel. His son Mr Shashin V Patel is the current chairman and managing director. Mr Shashin Patel holds a master's degree in business administration and has worked at the company since May 2000. The Board consists of four executive directors and five independent directors, who have vast experience in project execution, consulting and related fields.
- Share Pledge

Exhibit 72. Share Pledge at the end of 3QFY19

Promoter Holding	Shares pledged	
	As a percentage of promoter holding	As a percentage of Total no of shares
46.5%	43.6%	20.3%

Source: Company, JM Financial

Annexure-A: HAM Portfolio snapshot

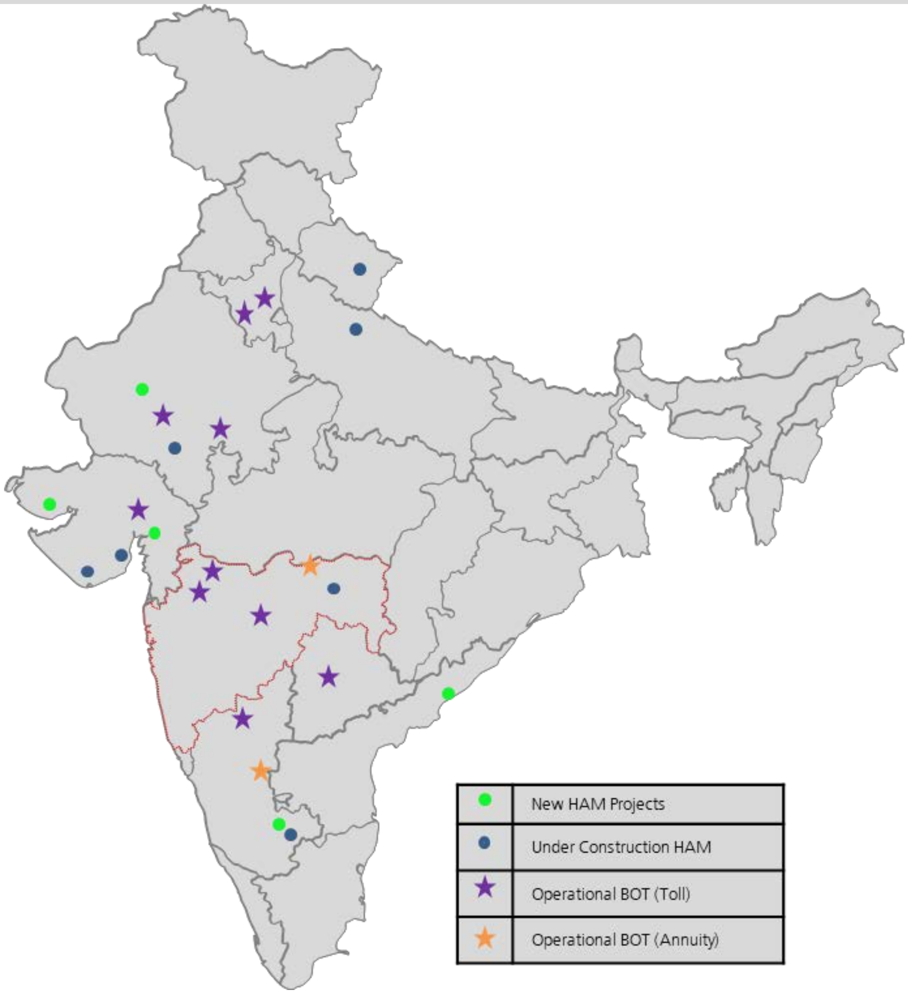
Exhibit 73. HAM Portfolio snapshot (INR bn)

Project	Bid Project Cost	Capital Grant-NHAI	Equity	Debt	Financial Closure	Appointed Date	Scheduled COD	Construction Progress as on Dec'18	Other Remarks
Bhavnagar - Talaja	8.2	3.6	1.1	4.3	Dec-16	Feb-17	Aug-19	62%	• 2nd grant received as of 2QFY19
BRT Tiger	10.1	4.4	1.2	4.8	May-17	Aug-17	Aug-19	64%	• 2nd grant received as of 2QFY19
Rampur - Kathgodam (Package-1)	7.4	3.3	0.9	3.5	Nov-16	Mar-17	Mar-19	60%	• 2nd grant received as of 2QFY19
Rampur - Kathgodam (Package-2)	6.6	3.0	0.8	3.2	Nov-16	Oct-17	Oct-19	25%	• 6.25km - de-scoping (Total length 49km; Reduction in EPC work-c. INR 730mn)
Una - Kodinar	6.2	2.8	0.8	3.4	Dec-16	Feb-17	Aug-19	40%	• 1st Grant Received as of 2QFY19. • 6.5km de-scoping. (Total project length 40km)
Udaipur Bypass	8.9	3.8	1.1	4.3	Oct-17	Nov-17	Nov-19	55%	• 2nd grant received as of 2QFY19
Waranga-Mahagaon	10.7	4.7	1.3	5.2	Nov-17	May-18	Mar-20	32%	• 1st Grant Received as of 2QFY19
Bhimasur-Bhuj	10.5	4.6	1.3	5.1	Oct-18*		Apr-21		• Draft financing documents submitted
Jodhpur Ring Road	11.1	4.8	1.3	5.3	Jul-18	Dec-18	Jul-20	8%	
Tumkur III	10.1	4.4	1.2	4.9			Oct-20		• Received sanctions
Vadodara	14.0	6.1	1.7	6.8			Oct-20		• Received sanctions
Vishakhapatnam	5.3	2.3	0.6	2.5			Apr-20		• In-principal approval received as per management
Total	**109.0**	**47.7**	**13.4**	**53.3**					

Source: Company, JM Financial

Annexure-B: Asset Portfolio

Exhibit 74. BOT/HAM Asset Portfolio



Source: Company, JM Financial

Financial Tables (Standalone)

Income Statement					(INR mn)
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Net Sales	33,203	35,051	38,666	44,240	51,485
Sales Growth	4.2%	5.6%	10.3%	14.4%	16.4%
Other Operating Income	0	0	0	0	0
Total Revenue	**33,203**	**35,051**	**38,666**	**44,240**	**51,485**
Cost of Goods Sold/Op. Exp	29,647	30,899	34,065	38,976	45,358
Personnel Cost	0	0	0	0	0
Other Expenses	0	0	0	0	0
EBITDA	**3,556**	**4,151**	**4,601**	**5,265**	**6,127**
EBITDA Margin	10.7%	11.8%	11.9%	11.9%	11.9%
EBITDA Growth	6.2%	16.7%	10.8%	14.4%	16.4%
Depn. & Amort.	1,000	979	992	1,083	1,259
EBIT	2,556	3,172	3,609	4,181	4,868
Other Income	875	897	500	550	268
Finance Cost	1,534	1,907	1,137	1,158	1,243
PBT before Excep. & Forex	1,897	2,163	2,972	3,573	3,893
Excep. & Forex Inc./Loss(-)	0	0	0	0	0
PBT	1,897	2,163	2,972	3,573	3,893
Taxes	18	-44	428	467	509
Extraordinary Inc./Loss(-)	0	0	0	0	0
Assoc. Profit/Min. Int.(-)	0	0	0	0	0
Reported Net Profit	1,878	2,207	2,544	3,106	3,384
Adjusted Net Profit	**1,878**	**2,207**	**2,544**	**3,106**	**3,384**
Net Margin	5.7%	6.3%	6.6%	7.0%	6.6%
Diluted Share Cap. (mn)	171.5	171.5	171.5	171.5	171.5
Diluted EPS (INR)	**11.0**	**12.9**	**14.8**	**18.1**	**19.7**
Diluted EPS Growth	24.0%	17.5%	15.3%	22.1%	8.9%
Total Dividend + Tax	140	350	350	350	350
Dividend Per Share (INR)	0.7	1.8	1.8	1.8	1.8

Source: Company, JM Financial

Balance Sheet					(INR mn)
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Shareholders' Fund	16,609	18,668	20,862	23,618	26,653
Share Capital	172	172	172	172	172
Reserves & Surplus	16,437	18,496	20,690	23,447	26,481
Preference Share Capital	0	0	0	0	0
Minority Interest	0	0	0	0	0
Total Loans	17,771	13,326	14,316	13,778	14,900
Def. Tax Liab. / Assets (-)	-477	-994	-1,238	-1,238	-1,238
Total - Equity & Liab.	**33,904**	**31,000**	**33,941**	**36,159**	**40,315**
Net Fixed Assets	5,229	5,028	4,736	4,352	5,094
Gross Fixed Assets	6,689	7,282	7,982	8,682	10,682
Intangible Assets	0	0	0	0	0
Less: Depn. & Amort.	1,530	2,278	3,270	4,353	5,612
Capital WIP	69	23	23	23	23
Investments	5,694	5,775	5,775	5,775	5,775
Current Assets	28,804	31,910	36,348	40,808	46,638
Inventories	1,234	1,643	1,993	2,280	2,654
Sundry Debtors	17,010	16,280	20,654	23,631	27,501
Cash & Bank Balances	25	127	141	116	116
Loans & Advances	5,381	6,882	5,092	5,092	5,092
Other Current Assets	5,155	6,978	8,468	9,689	11,275
Current Liab. & Prov.	5,823	11,713	12,918	14,776	17,192
Current Liabilities	5,803	5,990	6,608	7,561	8,799
Provisions & Others	20	5,722	6,310	7,216	8,393
Net Current Assets	22,981	20,197	23,430	26,032	29,447
Total – Assets	**33,904**	**31,000**	**33,941**	**36,159**	**40,315**

Source: Company, JM Financial

Cash Flow Statement					(INR mn)
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Profit before Tax	1,878	2,207	2,972	3,573	3,893
Depn. & Amort.	1,000	979	992	1,083	1,259
Net Interest Exp. / Inc. (-)	788	1,097	1,137	1,158	1,243
Inc (-) / Dec in WCap.	-4,417	3,107	-3,219	-2,627	-3,415
Others	7	-35	-743	-550	-268
Taxes Paid	235	-822	-428	-467	-509
Operating Cash Flow	**-508**	**6,532**	**711**	**2,170**	**2,203**
Capex	-322	-780	-700	-700	-2,000
Free Cash Flow	-830	5,753	11	1,470	203
Inc (-) / Dec in Investments	386	-1,582	0	0	0
Others	747	809	500	550	268
Investing Cash Flow	**811**	**-1,552**	**-200**	**-150**	**-1,732**
Inc / Dec (-) in Capital	2	0	0	0	0
Dividend + Tax thereon	-145	-155	-350	-350	-350
Inc / Dec (-) in Loans	1,324	-2,924	990	-538	1,122
Others	-1,534	-1,799	-1,137	-1,158	-1,243
Financing Cash Flow	**-353**	**-4,879**	**-497**	**-2,046**	**-471**
Inc / Dec (-) in Cash	**-50**	**102**	**14**	**-25**	**0**
Opening Cash Balance	75	25	127	141	116
Closing Cash Balance	25	127	141	116	116

Source: Company, JM Financial

Dupont Analysis					
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
Net Margin	5.7%	6.3%	6.6%	7.0%	6.6%
Asset Turnover (x)	1.1	1.1	1.2	1.3	1.3
Leverage Factor (x)	1.9	1.8	1.6	1.6	1.5
RoE	11.9%	12.5%	12.9%	14.0%	13.5%

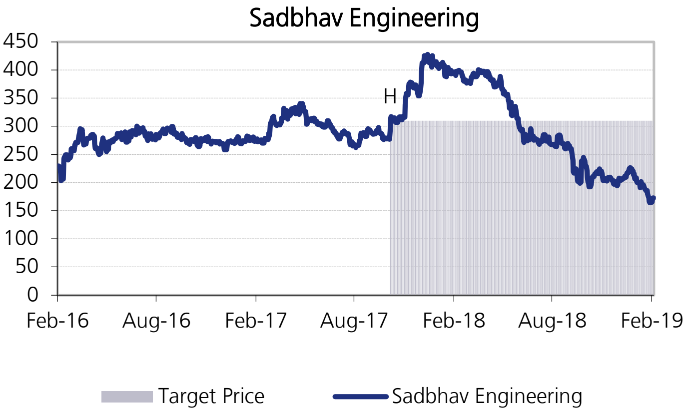
Key Ratios					
Y/E March	FY17A	FY18A	FY19E	FY20E	FY21E
BV/Share (INR)	96.8	108.8	121.6	137.7	155.4
ROIC	10.1%	11.8%	11.2%	12.0%	12.6%
ROE	11.9%	12.5%	12.9%	14.0%	13.5%
Net Debt/Equity (x)	1.1	0.7	0.7	0.6	0.6
P/E (x)	18.9	16.1	14.0	11.4	10.5
P/B (x)	2.1	1.9	1.7	1.5	1.3
EV/EBITDA (x)	15.0	11.8	10.8	9.4	8.2
EV/Sales (x)	1.6	1.4	1.3	1.1	1.0
Debtor days	187	170	195	195	195
Inventory days	14	17	19	19	19
Creditor days	71	71	71	71	71

Source: Company, JM Financial

History of Earnings Estimate and Target Price

Date	Recommendation	Target Price	% Chg.
24-Oct-17	Hold	310	

Recommendation History



APPENDIX I

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