Morning Insight

JUNE 3, 2019

	30-May	% Chg 1 Day	1 Mth	3 Mths
Indian Indices				
SENSEX Index	39,714	(0.3)	1.7	10.7
NIFTY Index	11,923	(0.2)	1.5	10.5
NSEBANK Index	31,375	(0.5)	5.4	17.1
NIFTY 500 Index	9,805	(0.1)	1.5	9.5
CNXMcap Index	17,959	(0.2)	2.2	7.4
BSESMCAP Index	14,867	(0.6)	1.7	8.6
World Indices				
Dow Jones	24,815	(1.4)	(6.4)	(4.7)
Nasdaq	7,453	(1.5)	(8.7)	(1.9)
FTSE	7,162	(0.8)	(3.0)	0.8
NIKKEI	20,601	(1.6)	(8.5)	(5.7)
Hangseng	26,901	(0.8)	(11.1)	(7.2)
Shanghai	2,899	(0.2)	(6.5)	(3.9)

Value traded (Rs cr)	30-May	% Chg Day
Cash BSE	2,796	26.9
Cash NSE	42,197	13.2
Derivatives	868,179	(63.4)

Net inflows (Rs cr)	29-May	MTD	YTD
FII	2,073	6,759	74,981
Mutual Fund	(1,405)	5,133	2,471

Nifty Gainers & Losers 30-May	Price (Rs)	Chg (%)	Vol (mn)
Gainers			
Tech Mahindra	760	3.5	5.5
Asian Paints	1,407	2.4	2.6
TCS	2,197	2.3	4.3
Losers			
Yes Bank	148	(4.7)	63.4
ITC	279	(3.5)	26.3
Grasim Ind	886	(2.8)	3.0

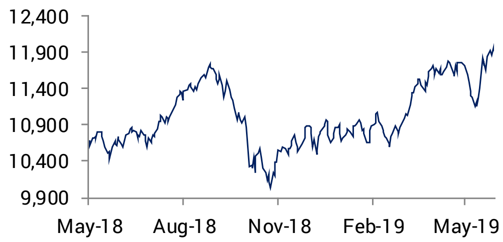
Advances / Declines (BSE)

30-May	A	B	T	Total	% total
Advances	188	306	55	549	100
Declines	268	657	62	987	180
Unchanged	3	22	14	39	7

Commodity	30-May	% Chg 1 Day	1 Mth	3 Mths
Crude (US$/BBL)	61.2	(1.3)	(13.6)	(6.0)
Gold (US$/OZ)	1,305.5	1.3	2.6	1.4
Silver (US$/OZ)	14.6	0.3	(1.8)	(3.6)

Debt / Forex Market	30-May	1 Day	1 Mth	3 Mths
10 yr G-Sec yield %	7.0	7.1	7.4	7.4
Re/US$	69.7	69.9	69.6	70.7

Nifty



Source: Bloomberg

News Highlights

- India's economic growth fell to 5.8 per cent in the January-March period of 2018-19, the lowest in 20 quarters, due to a sharp slowdown in investment and manufacturing growth as well as a contraction in agricultural production. This pulled down the gross domestic product (GDP) expansion to 6.8 per cent in FY19, the slowest in the first stint of the Modi government. (BS)
- Goods and services tax (GST) collection crossed Rs 1 trillion for a third straight month in May, posting over 6 per cent growth year-on-year. (BS)
- The Department of Telecommunications (DoT) may auction 4G and 5G spectrum as early as September-October, likely at prices recommended by the regulator. (ET)
- **Coal India (CIL)** said its production declined by 1.1 per cent to 46.59 million tonnes in May of the current financial year compared with 47.12 million tonnes in the year-ago month. (BS)
- Power discom Tata Power Delhi Distribution Limited (TPDDL) has claimed dues worth Rs 70mn from **NMDC** and DSIIDC for the maintenance of around 50,000 street lights in unauthorised areas under its jurisdiction. (BS)
- The Chandigarh bench of the National Company Law Tribunal has approved the merger of Indus Towers with **Bharti Infratel**, which will create one of the largest telecom tower companies globally. (BS)
- State-owned **Bank of Baroda** (BoB) plans to raise Rs.119bn during the current fiscal through share sale, including Employee Share Purchase Scheme to shore up capital for meeting business expansion requirement. (Business today)
- **Tata Steel** announced it had completed the acquisition of debt-ridden Bhushan Energy Ltd. The announcement came after the National Company Law Tribunal (NCLT) approved the resolution plan of Tata Steel to acquire Bhushan Energy for around Rs.8bn. (Mint)
- The **GSK Consumers Healthcare Ltd** has received 99.99 per cent votes in favour of the scheme of amalgamation among the company and **Hindustan Unilever Ltd (HUL)** in the National Company Law Tribunal-convened meeting of the equity shareholders. (Business Today)
- Indian corporate giant **Reliance Industries Ltd** has resumed lobbying among US lawmakers through a new lobbyist for advocating its position on the "US economic trade sanctions policies" (Business today)
- **Dilip Buildcon** executed an EPC agreement with the National Highways Authority of India for Saoner-Dhapewada-Kalmeshwar-Gondkhairi, NH-547E, Package -II on EPC mode in Maharashtra. (Moneycontrol)
- IN **NTPC**, Unit-1 of 800 MW of Gadarwara Super Thermal Power Station (2 x 800 MW) has started its commercial operation. With this, the commercial capacity of Gadarwara Super Thermal Power Station, NTPC and NTPC group has become 800 MW, 46,525 MW and 54,326 MW, respectively. (Moneycontrol)

What's Inside

- **Event Update**: Nagarjuna Construction Co Ltd
- **Result Update**: KNR Construction, NBCC (India) Ltd
- **Market Strategy**: Market Outlook for June 2019

Source: ET = Economic Times, BS = Business Standard, FE = Financial Express, IE = Indian Express, BL = Business Line, BQ = BloombergQuint, ToI: Times of India, BSE = Bombay Stock Exchange, MC = Moneycontrol kotak Securities

Event Update

NAGARJUNA CONSTRUCTION CO LTD (NCC)

PRICE RS.98 **TARGET RS.132** **BUY**

Stock Details

Market cap (Rs mn)	:	58713
52-wk Hi/Lo (Rs)	:	126 / 63
Face Value (Rs)	:	2
3M Avg. daily vol (Nos)	:	10,572,750
Shares o/s (mn)	:	601

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY19	FY20E	FY21E
Sales	120,798	127,827	141,756
Growth (%)	59.8	5.8	10.9
EBITDA	14,230	14,061	15,593
EBITDA margin (%)	11.8	11.0	11.0
Net profit	5,639	5,009	5,784
EPS (Rs)	9.4	8.3	9.6
Growth (%)	96.6	-11.2	15.5
BVPS (Rs)	79.2	86.0	94.2
DPS (Rs)	1.5	1.5	1.5
ROE (%)	12.5	10.1	10.7
ROCE (%)	21.6	18.6	19.6
P/E (x)	10.4	11.8	10.2
EV/EBITDA (x)	5.4	5.3	4.8
P/BV (x)	1.2	1.1	1.0

Source: Company, Kotak Securities - PCG

Shareholding Pattern (%)

(%)	Mar 19	Dec-18	Sep-18
Promoters	18.1	18.1	18.1
FII	15.9	15.9	16.0
DII	31.8	31.8	30.5
Others	34.2	34.2	35.3

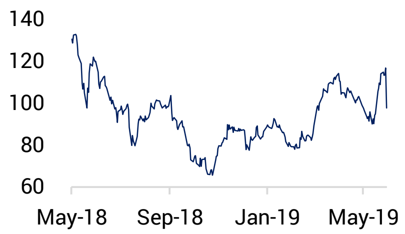
Source: Bloomberg

Price Performance (%)

(%)	1M	3M	6M
Nagarjuna Cons	(1.5)	14.2	12.4
Nifty	1.5	10.5	9.6

Source: Bloomberg

Price chart (Rs)



Source: Bloomberg

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Key highlights

- The new government led by Mr Y S Jaganmohan Reddy government in Andhra Pradesh decided to cancel all projects sanctioned prior to April 1, 2019 by the previous government but work on which was yet to take-off.
- NCC has projects worth Rs 50-60 bn which stand at the risk of cancellation post this. However, company has not received any communication regarding this so far.
- We tweak our estimates to factor in the political risks associated with the order book. We continue to maintain BUY on NCC. However, these events are likely to have an impact on the stock performance in near term.

Order book details

NCC's total order book at the end of FY19 stood at Rs 412 bn and after de-scoping, it stood at Rs 392 bn. Order inflow has been very robust in FY19 at Rs 256 bn and this was the second consecutive year when order inflow stood more than Rs 250 bn.

Based on the recent news flows that new government in AP has decided to cancel all the projects sanctioned prior to 1st April, 2019 by the previous government where work has not yet commenced, NCC management mentioned that order cancellation could be to the tune of Rs 50-60 bn for the company. Thus, it results in an effective order book of Rs 332 bn (taking de-scoped order book of Rs 392 bn). Out of the order book of Rs 332 bn, AP region contributes nearly Rs 80-100 bn worth of projects where work is already going on and are related to affordable housing segment which are funded by central government.

We believe that these cancelled projects would once again come for rebidding and NCC would re-bid based on the pricing. However, we are currently not factoring in significant order inflows for FY20 as the order book is fairly robust and focus of the company would be on execution.

AP exposure

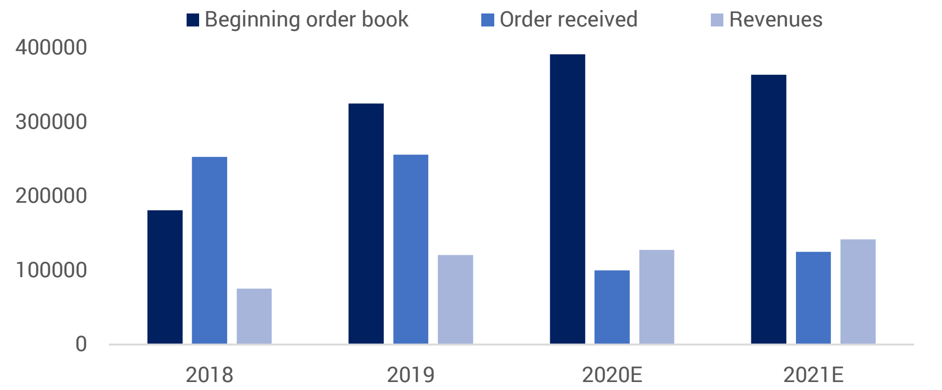
NCC would have an order book Rs 80-100 bn from AP which is currently under execution. Significant proportion of this order book is from APTIDCO and Amravati city development project. These projects have good margins but working capital funding was not significant in these projects. Hence any delays or issues in these projects may have an impact of working capital. Based on the current assessment, only projects where work has not commenced are likely to be cancelled by the new government.

APTIDCO - NCC is executing affordable housing projects from APTIDCO worth Rs 61 bn at seven locations in Andhra. With funding coming from central and state governments along with banks, payment is not an issue and hence work is progressing smoothly.

Amravati city development project - NCC is executing six projects for Amravati Development Corp worth INR30bn. Execution on these projects was initially impacted but then gathered pace.

We believe execution on these projects will continue at normal pace and is not likely to get impacted. We would however keep a close watch on the payment cycle from these projects and overall working capital cycle.

Order book and order inflow assumptions (Rs mn)



Source: Company, Kotak Securities – Private Client Research

Financial outlook

We take into account the cancellation of projects worth Rs 50-60 bn from the order book and assume the starting order book of Rs 332 bn for FY20. We have been conservative in our estimates for order inflow and expect an inflow of Rs 100 bn/125 bn for FY20/21 respectively. We downgrade our execution estimates and expect revenues to grow at a CAGR of 8.3% between FY19-21. (as against our earlier assumption of 12% growth in FY20).

We maintain our estimates for operating margins and expects margins to remain strong at 11% going forward.

We currently do not foresee any impact on the working capital cycle as the cancelled projects had not yet commenced and company had not deployed any funds. We thus expect net profits of Rs 5bn/Rs 5.8 bn for FY20/21 respectively.

Valuation and recommendation

At Rs 98, stock is trading at 11.8x and 10.2x P/E and 5.3x and 4.8x EV/EBITDA on FY20 and FY21 estimates respectively. Post revising our estimates, we arrive at a revised price target of Rs 132 on NCC. (Rs 146 earlier). We continue to maintain BUY on NCC based on strong order book, balance sheet as well as efficient working capital cycle. However, due to political risks associated with the order book, stock is likely to underperform in near term. Key risk to our estimates and recommendation would come from slower than expected execution and adverse ruling on power project cases where arbitration is going on or delays in receivables.

Sum of the parts valuation

(FY21)	Rs per share	Rationale
Core business valuation	120	Based on 12.5x one year forward P/E multiple
Road BOT	2	Based on NPV and P/BV methodology
Real estate and other inv	4	Based on P/BV of 1x of investments
International	6	Based on P/BV of 1x of investments
Total value per share	**132**	

Source: Kotak Securities – Private Client Research

About the company

Nagarjuna Construction Company Limited (NCC), a construction and infrastructure company has evolved to a full-fledged infrastructure solutions provider. The Company's business divisions are categorized as Building & Housing, Transportation, Electrical, Water & Environment, Irrigation, International, Power, Metals and Oil & Gas Division.

Financials: Standalone

Profit and Loss Statement (Rs mn)

(Year-end Mar)	FY18	FY19	FY20E	FY21E
Revenues	**75,593**	**120,798**	**127,827**	**141,756**
% change YoY	(4.2)	59.8	5.8	10.9
EBITDA	**8,549**	**14,230**	**14,061**	**15,593**
% change YoY	24.8	66.5	(1.2)	10.9
Other Income	93	593	500	500
Depreciation	1,175	1,494	1,726	1,942
EBIT	**7,467**	**13,330**	**12,835**	**14,151**
Net interest	3,789	4,513	5,008	5,113
Profit before tax	3,678	8,817	7,827	9,038
% change YoY	37.6	139.7	(11.2)	15.5
Tax	809	3,178	2,818	3,254
as % of PBT	22.0	36.0	36.0	36.0
PAT	**2,868**	**5,639**	**5,009**	**5,784**
% change YoY	27.2	96.6	(11.2)	15.5
Net profit	**2,868**	**5,639**	**5,009**	**5,784**
Shares outstanding (m)	600.7	600.7	600.7	600.7
EPS (reported) (Rs)	**4.8**	**9.4**	**8.3**	**9.6**
CEPS (Rs)	6.7	11.9	11.2	12.9
DPS (Rs)	1.00	1.50	1.50	1.50

Source: Company, Kotak Securities – Private Client Research

Balance sheet (Rs mn)

(Year-end Mar)	FY18	FY19	FY20E	FY21E
Cash and cash equivalents	659	2,990	2,342	2,737
Accounts receivable	46,889	31,542	38,523	42,721
Inventories	16,956	5,129	27,316	30,293
Others	22,253	61,460	39,753	44,027
Current assets	86,757	101,121	107,935	119,779
Other non current assets	2,701	4,336	4,336	4,336
LT investmnts, on a/c of BOT	10,237	14,535	14,535	14,535
Net fixed assets	8,294	11,086	12,860	13,418
Total assets	**108,006**	**131,586**	**140,174**	**152,576**
Payables	51,487	62,512	68,992	76,510
Others	532	629	629	629
Current liabilities	52,019	63,140	69,620	77,138
LT debt	13,131	20,261	18,261	18,261
Other liabilities	439	617	617	617
Equity	1,201	1,201	1,201	1,201
Reserves	41,215	46,367	50,475	55,358
Total liabilities	**108,006**	**131,586**	**140,174**	**152,576**
BVPS (Rs)	70.6	79.2	86.0	94.2

Source: Company, Kotak Securities – Private Client Research

Cash flow Statement (Rs mn)

(Year-end Mar)	FY18	FY19	FY20E	FY21E
EBIT	7,467	13,330	12,835	14,151
Depreciation	1,175	1,494	1,726	1,942
Change in working capital	(3,437)	(911)	(982)	(3,931)
Chgs in other net curnt assets	(420)	(1,457)	-	-
Operating cash flow	4,785	12,455	13,579	12,162
Interest	(3,789)	(4,513)	(5,008)	(5,113)
Tax	(809)	(3,178)	(2,818)	(3,254)
Cash flow from operations	**186**	**4,765**	**5,754**	**3,796**
Capex	(3,069)	(4,779)	(3,500)	(2,500)
(Inc)/dec in investments	49	(4,297)	-	-
Cash flow from investments	**(3,020)**	**(9,076)**	**(3,500)**	**(2,500)**
Proceeds from issue of equity	89	-	-	-
Inc/(dec) in debt	(2,729)	7,131	(2,000)	-
Proceeds from share premium	5,637	-	-	-
Dividends	(601)	(901)	(901)	(901)
Cash flow from financing	**2,397**	**6,230**	**(2,901)**	**(901)**
Opening cash	1,095	659	2,990	2,342
Closing cash	658	2,577	2,342	2,737

Source: Company, Kotak Securities – Private Client Research

Ratio Analysis

(Year-end Mar)	FY18	FY19	FY20E	FY21E
EBITDA margin (%)	11.3	11.8	11.0	11.0
EBIT margin (%)	9.9	11.0	10.0	10.0
Net profit margin (%)	3.8	4.7	3.9	4.1
EPS growth (%)	17.7	96.6	-11.2	15.5
Receivables (days)	202.6	118.5	110.0	110.0
Inventory (days)	77.8	33.4	78.0	78.0
Payable (days)	154	121	135	135
Sales/net assets (x)	9.1	10.9	9.9	10.6
Debt/equity ratio (x)	0.38	0.37	0.39	0.34
ROE (%)	7.5	12.5	10.1	10.7
ROCE (%)	14.1	21.6	18.6	19.6
EV/ Sales (x)	0.9	0.6	0.6	0.5
EV/EBITDA (x)	8.3	5.4	5.3	4.8
Price to earnings (x)	20.5	10.4	11.8	10.2
Price to book value (x)	1.4	1.2	1.1	1.0
Price to Cash Earnings (x)	14.6	8.3	8.7	7.6

Source: Company, Kotak Securities – Private Client Research

Result Update

KNR CONSTRUCTIONS LTD

PRICE RS.280 **TARGET RS.312** **ADD**

KNR Q4FY19 results were way ahead of our estimates led by better than estimated execution of projects and strong margins. The company has beaten its FY19 revenue and margin guidance.

Key Highlights

- Revenue for the quarter grew by 14.6% yoy to Rs 7.2 bn (Vs estimates of Rs 4.3 bn) led by better than estimated execution in its older road and irrigation projects which has boosted revenue for the quarter.
- EBITDA margin at 20.1% was ahead of our estimates on account of lower subcontracting and increased contribution from high margin irrigation project where it had deployed its own equipment and had higher depreciation.
- KNR has an order book of Rs 59 bn (including estimated EPC component of HAM projects). The company targets to add Rs 25 bn of new orders in FY20E of which it is already L1 in Rs 7 bn of work and balance is expected to be added in the rest of the year.

Outlook and Valuation

The company has guided for standalone revenue growth of 10-15% yoy in FY20E, with larger contribution expected in H2FY20 and also expects higher growth in FY21E. H1FY20E is expected to be slower largely on account of delay in appointed date in NHAI HAM projects, which the company expects to receive in the next two to three months. We have upgraded our EPS estimates for FY20E and FY21E by 7-10% based on strong pace of execution and robust order book and pipeline. The EPC business (adjusted for BOT/HAM value Rs 42/share) is available at a PE of 13.1x/11.5x based on FY20E/FY21E revised EPS of Rs 18.1/Rs 20.8, respectively. We maintain ADD on the stock with revised SOTP based target price of Rs 312 (Vs Rs 282 earlier), as we roll forward our valuations to FY21E.

Quarterly results (standalone)

Year to March (INR mn)	Q4FY19	Q4FY18	% Chg	Q3FY19	% Chg
Net Revenues	**7,157**	**6,244**	**14.6**	**4,489**	**59.4**
Raw Materials & Construction Cost	4,862	4,120	18.0	2,804	73.4
Gross Profit	2,295	2,123	8.1	1,685	36.2
Employee Expenses	248	200	24.0	236	5.1
Other Expenses	606	716	(15.4)	549	10.5
Operating Expenses	5,716	5,036	13.5	3,588	59.3
EBITDA	**1,441**	**1,207**	**19.4**	**901**	**59.9**
EBITDA margin (%)	20.1	19.3		20.1	
Depreciation	478	491	(2.6)	450	6.3
Other income	126	183	(31.1)	217	(41.9)
Net finance expense	75	88	(14.9)	73	3.1
Profit before tax	**1,014**	**811**	**25.0**	**595**	**70.3**
Provision for taxes	92	14	573.9	74	-
Net profit	**922**	**797**	**15.6**	**521**	**76.9**
Net profit	12.9	12.8		11.6	
Tax rate (% of PBT)	9.1	1.7		12.5	

Source: Company

Stock Details

Market cap (Rs mn)	:	39408
52-wk Hi/Lo (Rs)	:	315 / 163
Face Value (Rs)	:	2
3M Avg. daily vol (Nos)	:	132,100
Shares o/s (mn)	:	141

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY19	FY20E	FY21E
Revenue	21,373	25,205	32,313
Growth (%)	10.6	17.9	28.2
EBITDA	4,270	4,343	5,252
EBITDA margin (%)	20.0	17.2	16.3
PAT	2,658	2,546	2,921
EPS	18.7	18.1	20.8
EPS Growth (%)	3.2	-3.3	14.7
BV (Rs/share)	101	118	138
Dividend/share (Rs)	0.4	0.5	0.6
ROE (%)	20.5	16.6	16.2
ROCE (%)	18.9	16.1	18.3
P/E (x)	15.0	15.5	13.5
EV/EBITDA (x)	9.5	9.2	7.4
P/BV (x)	2.8	2.4	2.0

Source: Company, Kotak Securities - PCG

Shareholding Pattern (%)

(%)	Mar 19	Dec-18	Sep-18
Promoters	55.4	55.4	55.4
FII	3.0	3.0	3.4
DII	28.8	28.8	28.0
Others	12.9	12.9	13.3

Source: Bloomberg

Price Performance (%)

(%)	1M	3M	6M
KNR Constructions	16.7	40.3	43.8
Nifty	1.5	10.5	9.6

Source: Bloomberg

Price chart (Rs)

Source: Bloomberg

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Q4FY19 revenue way ahead of estimates

The standalone net revenue for the quarter was ahead of our estimates and grew by 14.6% yoy to Rs 7.2 bn as against our estimate of Rs 4.3 bn. The growth in revenue for the quarter was driven by better than estimated execution in its older road and irrigation projects which boost revenue for the quarter. On annual basis, the company has achieved standalone revenue of Rs 21.3 bn up 10.6% as against guidance of Rs 18 bn and our estimate of Rs 19 bn. Based on execution timeline of its order book and delay in appointed date received in HAM projects, the company expects standalone revenue growth of 10-15% yoy in FY20E, with larger contribution expected in H2FY20 and expects higher growth in FY21E.

EBITDA above estimates due to lower subcontracting and contribution from high margin projects

EBITDA margin at 20.1% was ahead of our estimates of 17.1% on account of lower subcontracting and increased contribution from high margin irrigation projects where it had deployed own equipment and had higher depreciation. EBITDA for the quarter stood at Rs 1.4 bn, grew by 19.4% yoy. The company expects EBITDA margins to come to normal range of 15-16% in FY20E as high margin irrigation projects are near their completion and had low contribution of 4% in Q4FY19 closing order book, as against 21% on qoq. PAT for the quarter grew by 34.1% yoy to Rs 922 mn (vs our estimates of Rs 341 mn). The company expects lower effective tax rate of 15% in FY20E, as it has outstanding MAT credit of Rs 750 bn which would be accounted in FY20E and FY21E.

Order book of Rs 59.1 bn gives strong revenue growth visibility for the next two years

KNR has robust order book of Rs 59.1 bn which is 2.8x FY19 revenue and includes Rs 18.9 bn of EPC component of 3 HAM projects where appointed date/FC are awaited. The present order book is largely concentrated in southern region comprising 96% of order book where the company has strong foothold. Besides this, the company is targeting to add Rs 25 bn of fresh road projects in FY20E of which the company has already been declared L1 in Rs 7 bn of projects in Tamil Nadu. The company expects balance work to be added in the rest of the year with large focus on EPC/HAM work. The company is also negotiating subcontract work related to irrigation in the state of Telangana. Since, there are large number of projects expected to come in from NHAI and other state government, we do not see any challenge in meeting its order inflows guidance.

Expect appointed date in all NHAI HAM projects in H1FY20E

KNR has strong portfolio of 6 HAM projects with bid project cost (BPC) of Rs 65.3 bn, out of which two are in construction stage and two have achieved financial closure (awaiting appointed date), while balance two are in process of financial closure. KNR has received appointed date in Rs 17.3 bn Chittor to Mallavaram HAM project in Hyderabad and has completed 12% of the construction work. The company has also received appointed date in Rs 12.3 bn Ramsanpalle to Mangloor (Telangana) project on 2nd May 2019. The company is at final stage of receiving appointed date in Rs 10.2 bn Trichy to Kallagam (TN) project and expects to get it in the near future. In Rs 4.8 bn Meensurutti to Chidambaram (TN), the appointed date is delayed by 2-3 month (vs earlier expected in March 2019) due to land acquisition issues related to some difference over land price payment to the land owner. In Rs 11.4 bn Magadi to Somwarpeth HAM project (KHSIP), the company has signed concession agreement in Jan 2019 and land acquisition is underway. The company expects the process to be completed within next 2 months. In Rs 9.2

bn Oddanchatram to Madathukulam HAM project, the company has received LOA on 7th March 2019.

HAM projects details

HAM Projects	LoA Date	Authority	State	BPC (Rs mn)	Equity (Rs mn)
Trichy to Kallagam	01-Mar-18	NHAI	Tamil Nadu	10,206	962
Meensurutti to Chidambaram	08-Mar-18	NHAI	Tamil Nadu	4,820	455
Chittor to Mallavaram	26-Mar-18	NHAI	Andhra Pradesh	17,301	1,433
Ramsanpalle to Mangloor	26-Mar-18	NHAI	Telangana	12,340	1,042
Magadi to Somwarpet	18-Jan-19	KSHIP	Karnataka	11,445	533.5*
Oddanchatram to Madathukulam	Mar-19	NHAI	Tamil Nadu	9,200	750*
Total				**65,312**	**5176**

*Source: Company, * Estimated amount*

Agreement with Cube to reduce upfront equity commitment in HAM project

KNR has entered into a share purchase agreement with Cube Highways and Infrastructure III Pte. Ltd for three HAM projects, Trichi Kallagm (TN), Meensurutti to Chidambaram (TN) and Chittor to Mallavaram (AP) with total BPC of Rs 32.3 bn and estimated equity requirement of Rs 2.85 bn. The deal will be completed in two phase. In first phase, Cube Highways will acquire 49% stake till COD and it will acquire balance 51% stake later based on NHAI rule related to lock in period of investment. Cube Highways will buy 49% stake in these projects at approximate valuation of 1.5x to 2x P/BV. Further, Cube Highways will buy stake in 4th NHAI HAM project Ramsanpalle to Mangloor (Telangana) later after completing due diligence. This is expected to free equity capital investment for KNR in these projects and would improve cash flows of the company in the longer run to bid for new projects. Based on its strong balance sheet (standalone net debt equity at 0.1x) and cash flows, KNR can meet its equity commitment in these projects easily.

The company has already infused Rs 1.05 bn equity in HAM projects and further require Rs 850 mn of its portion of equity commitment in 4 four HAM projects where FC have been achieved. Further, the company has an option to monetize its BOT assets and land bank at appropriate time which would help its future growth. The company is looking to monetize Walayar Tollays project in Kerala which will free equity infused in the project and will also reduce Rs 2 bn of standalone debt infused by the promoters via standalone entity.

Other Highlights

- The company has Rs 2.6 bn of standalone debt at the end of the quarter which includes Rs 2.1 bn of promoter debt. It has consolidated debt of Rs 7.3 bn.
- The net working capital cycle at the end of the quarter was 36 days and is expected to be in the range of 26-45 days in the coming quarters.
- The company is working on financial closure of KSHIP HAM project. This is 75: 25 project (75% grant) hence achieving financial closure is not an issue.
- KNR continued to report decent toll revenue in BOT projects and would exit the same at right time.
- The company has targeted Rs 1.8-2 bn capex in FY20E based on addition of irrigation projects.
- Based on current gross block of Rs 10.8 bn, the company can execute Rs 25-30 bn of work in a year.

- As per the management, KNR has no exposure to AP state government developmental projects and is executing only central government/NHAI projects in the state.

Outlook and valuation

KNR has a track record of generating positive operating cash flows which would help it in meeting capital for the future growth. Deal with Cube Highways will help in meeting upfront equity commitment in HAM projects. Further, the company has track record of beating its revenue guidance and margin guidance, and we believe that the trend will continue.

The company has guided for standalone revenue growth of 10-15% yoy in FY20, with larger contribution expected in H2FY20 and expects higher growth in FY21E. This is largely on account of delay in appointed date in NHAI HAM projects which the company expects to receive in the next two to three months. We have upgraded our EPS estimates for FY20E and FY21E by 7-10% based on strong pace of execution and robust order book and pipeline. The EPC business (adjusted for BOT/HAM value Rs 42/share) is available at a PE of 13.1x/11.5x based on FY20E/FY21E revised EPS of Rs 18.1/Rs 20.8, respectively. We maintain ADD on the stock with revised SOTP based target price of Rs 312 (Vs Rs 282 earlier), as we roll forward our valuation to FY21E for standalone business.

Revision in Estimates

Particulars	Previous			Revised			Change %		
Rs Mn	FY19E	FY20E	FY21E	FY19A	FY20E	FY21E	FY19A	FY20E	FY21E
Revenue	19069	25360	30605	21373	25205	32313	12.1	(0.6)	5.6
EBITDA	3690	4132	4994	4270	4343	5252	15.7	5.1	5.2
EBITDA Margin%	19.4	16.3	16.3	20.0	17.2	16.3	60 bps	90 bps	0 bps
Adj PAT	2137	2320	2722	2658	2546	2921	24.4	9.8	7.3
Adj EPS (Rs)	15.2	16.5	19.4	18.7	18.1	20.8	24.4	9.8	7.3

Source: Kotak Securities Private Client Research

Valuation Table

Segment	Parameter	Multiple (x)	Per Share (Rs)
Standalone Construction Business	FY21E PE	13	270
Road BOT/HAM	BV of equity	1	42
Consol KNR	**Value**		**312**

Source: Kotak Securities Private Client Research

Company Background

KNR Constructions Ltd (KNR), incorporated in 1995, is Hyderabad based construction company promoted by Mr. K. Narasimha Reddy. The company is broadly present in construction of roads and highways with small presence in irrigation space. Over 90% of its order book is located in South India. The company has a track record of executing 6000 lane km of projects across 12 states in India with top management is actively involved at all stages of project execution. It has portfolio of four BOT projects of 778 lane Kms projects in the state of Telangana, Karnataka, Kerala and Bihar of this two are BOT toll based and two are annuity based. The company has securitized its annuity based projects. Further, it has also won five HAM projects in south India. The company executes its road projects through in-house construction equipment.

Financials: Standalone

Profit and Loss Statement (Rs mn)

(Year-end Mar)	FY18	FY19	FY20E	FY21E
Revenues	**19,317**	**21,373**	**25,205**	**32,313**
% change yoy	25.3	10.6	17.9	28.2
Direct Cost	12,854	13,881	17,088	22,585
Employee Cost	721	929	1,068	1,228
Other Expenses	1,880	2,293	2,706	3,247
Total Expenses	15,455	17,103	20,862	27,060
EBITDA	**3,861**	**4,270**	**4,343**	**5,252**
% change yoy	68.2	10.6	1.7	20.9
Depreciation	1,344	1,681	1,727	1,838
EBIT	**2,517**	**2,589**	**2,616**	**3,415**
Other Income	393	634	697	767
Interest	231	291	318	288
Profit Before Tax	**2,679**	**2,931**	**2,996**	**3,894**
% change yoy	54	9	2	30
Tax	(39)	273	449	974
as % of EBT	(1.5)	9.3	15.0	25.0
PAT	**2,718**	**2,658**	**2,546**	**2,921**
% change yoy	61.7	(2.2)	(4.2)	14.7
Shares outstanding (mn)	141	141	141	141
EPS (Rs)	**18.1**	**18.7**	**18.1**	**20.8**
DPS (Rs)	0.5	0.4	0.5	0.6
CEPS (Rs)	27.7	30.7	30.4	33.8
BVPS (Rs)	82.3	100.6	118.1	138.1

Source: Company, Kotak Securities – Private Client Research

Balance sheet (Rs mn)

(Year-end Mar)	FY18	FY19	FY20E	FY21E
Paid - Up Equity Capital	281	281	281	281
Reserves	11,297	13,862	16,319	19,137
Net worth	11,578	14,143	16,600	19,418
Borrowings	2,200	2,642	2,642	2,142
Total Liabilities	**13,778**	**16,785**	**19,242**	**21,560**
Gross Block	9,076	10,536	12,336	14,136
Accumulated Depreciation	5,140	6,821	8,548	10,386
Net block	3,936	3,715	3,788	3,750
Capital work in progress	0	0	0	0
Total fixed assets	3,936	3,715	3,788	3,750
Investments	5,356	5,884	6,734	7,734
Inventories	712	951	1,726	2,213
Sundry debtors	2,320	2,344	2,764	3,544
Cash and equivalents	439	1,324	1,937	2,412
Loans and advances & Others	4,499	5,430	5,973	6,570
Total current assets	7,969	10,049	12,401	14,740
Sundry creditors and others	5,696	5,754	6,560	7,525
Provisions	184	164	181	199
Total CL & provisions	5,880	5,918	6,741	7,724
Net current assets	2,089	4,130	5,660	7,016
Other assets	990	1,317	1,321	1,321
Net Deferred tax	1,408	1,739	1,739	1,739
Total Assets	**13,778**	**16,785**	**19,242**	**21,560**

Source: Company, Kotak Securities – Private Client Research

Cash flow Statement (Rs mn)

(Year-end Mar)	FY18	FY19	FY20E	FY21E
Pre-Tax Profit	2,511	2,906	2,996	3,894
Depreciation	1,344	1,681	1,727	1,838
Change in WC	(1,511)	(1,488)	(916)	(881)
Other operating activities	(1,005)	(936)	(449)	(974)
Operating Cash Flow	**1,338**	**2,163**	**3,357**	**3,877**
Capex	(2,658)	(1,456)	(1,804)	(1,800)
Free Cash Flow	**(1,319)**	**708**	**1,553**	**2,077**
Change in Investments	610	(528)	(850)	(1,000)
Investment cash flow	**(2,048)**	**(1,983)**	**(2,654)**	**(2,800)**
Equity Raised	-	-	-	-
Debt Raised/Repaid	759	442	-	(500)
Dividend	(82)	(66)	(89)	(103)
Other Financing activity	226	(2)	-	-
CF from Financing	**903**	**374**	**(89)**	**(603)**
Change in Cash	193	554	614	475
Opening Cash	246	438	1,324	1,937
Closing Cash	439	992	1,937	2,412

Source: Company, Kotak Securities – Private Client Research

Ratio Analysis

(Year-end Mar)	FY18	FY19	FY20E	FY21E
EBITDA margin (%)	20.0	20.0	17.2	16.3
EBIT margin (%)	13.0	12.1	10.4	10.6
Net profit margin (%)	14.1	12.4	10.1	9.0
Adjusted EPS growth (%)	51.7	3.2	(3.3)	14.7
Receivables (days)	44	40	40	40
Inventory (days)	13	16	25	25
Loans & Advances (days)	85	93	86	74
Payable (days)	108	98	95	85
Net Working Capital (days)	35	51	57	54
Asset Turnover	1.6	1.4	1.4	1.6
Net Debt/ Equity	0.2	0.1	0.0	(0.0)
RoCE (%)	22.5	18.9	16.1	18.3
RoE (%)	24.8	20.5	16.6	16.2
P/E (x)	15.4	15.0	15.5	13.5
P/BV (x)	3.4	2.8	2.4	2.0
EV/EBITDA (x)	10.7	9.5	9.2	7.4
EV/Sales (x)	2.1	1.9	1.6	1.2

Source: Company, Kotak Securities – Private Client Research

Result Update

NBCC (INDIA) LTD (NBCC)

PRICE RS.62 **TARGET RS.61** **REDUCE**

NBCC Q4FY19 results was below estimates at operating level. Revenue was below estimates on slower growth in PMC segment, while real estate business reported strong revenue in the quarter.

Key Highlights

- The standalone net revenue for the quarter grew by 8.9% yoy to Rs 23.8 bn on strong revenue contribution from real estate, as the company sold inventory in completed projects. PMC segment disappointed in the quarter with 3.6% yoy growth in revenue (Vs 23.5% yoy growth estimates).
- EBITDA for the quarter was Rs 1.8 bn, declined by 1.5% yoy, due to decline in EBIT margin in PMC segment and segmental loss in EPC segment. PAT for the quarter grew by 7.8% yoy to Rs 1.5 bn due to higher other income.
- NBCC has a strong order book of Rs 750-800 bn which gives strong revenue visibility for the next five years. But the company has awarded work on only Rs 300-320 bn of orders and a large portion of order book has not yet been awarded yet, due to delay in approvals, litigation issues, etc.

Valuation & outlook

The company targets revenue growth of 25-30% yoy growth in standalone basis with standalone EBITDA margins expected at 5-5.5% in FY20E. We have marginally revised our earnings estimates upwards for FY20E and FY21E. We maintain our Reduce rating on the stock with revised target price of Rs 61 (Vs Rs 60 earlier), valuing the stock at 19x FY21E EPS. We have factored in the near term risk related to project clearance, any risk on balance sheet due to shift towards asset heavy model, etc.

Quarterly performance

Year to March (INR mn)	Q4FY19	Q4FY18	% Chg	Q3FY19	% Chg
Net Revenues	**23,776**	**21,842**	**8.9**	**16,516**	**44.0**
Materials/Work consultancy Cost	21,007	18,874	11.3	14,690	43.0
Gross Profit	2,769	2,968	(6.7)	1,826	51.6
Employee Expenses	597	605	(1.3)	634	(5.8)
Other Expenses	384	548	(29.9)	458	(16.2)
Operating Expenses	21,988	20,027	9.8	15,782	39.3
EBITDA	**1,788**	**1,815**	**(1.5)**	**734**	**143.5**
EBITDA margin	7.5%	8.3%		4.4%	
Depreciation	8	6	18.5	6	30.6
Other income	465	391	18.9	387	20.1
Net finance expense	4	-1		2	
Profit before tax	**2,241**	**2,201**	**1.8**	**1,114**	**101.2**
Provision for taxes	714	784	(9.0)	336	112.2
Reported net profit	**1,528**	**1,417**	**7.8**	**777**	**96.5**
NPM (%)	6.4	6.5		4.7	

Source: Company

Stock Details

Market cap (Rs mn)	:	111420
52-wk Hi/Lo (Rs)	:	95 / 47
Face Value (Rs)	:	1
3M Avg. daily vol (Nos)	:	10,924,170
Shares o/s (mn)	:	1800

Source: Bloomberg

Financial Summary

Y/E Mar (Rs mn)	FY19	FY20E	FY21E
Revenue	72,448	91,835	1,24,174
Growth (%)	22.7	26.8	35.2
EBITDA	3,742	4,843	6,600
EBITDA margin (%)	5.2	5.3	5.3
PAT	3,841	4,597	5,805
EPS	2.1	2.6	3.2
EPS Growth (%)	15.1	19.7	26.3
Book value (Rs/share)	8.7	10.3	12.4
Dividend per share (Rs)	0.7	0.8	1.0
ROE (%)	22.7	26.8	28.4
ROCE (%)	25.9	36.7	39.9
P/E (x)	29.1	24.3	19.2
EV/EBITDA (x)	25.6	20.6	14.4
P/BV (x)	7.1	6.0	5.0

Source: Company, Kotak Securities - PCG

Shareholding Pattern (%)

(%)	Mar 19	Dec-18	Sep-18
Promoters	70.6	70.6	70.6
FII	4.1	4.1	4.1
DII	11.5	11.5	11.5
Others	13.9	13.9	13.9

Source: Bloomberg

Price Performance (%)

(%)	1M	3M	6M
NBCC India Ltd	6.8	17.1	17.0
Nifty	1.5	10.5	9.6

Source: Bloomberg

Price chart (Rs)

Source: Bloomberg

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Revenue growth slowed down due to weak PMC and EPC segment

The standalone net revenue for the quarter grew by 8.9% yoy to Rs 23.8 bn (Vs our estimates of Rs 26.2 bn) on strong revenue booking in real estate on a low base, while execution in PMC and EPC segments witnessed weakness. PMC segment which contributes the largest pie, disappointed in the quarter with 3.6% yoy growth in revenue as against our estimates of 23.5% yoy growth. This is on account of quarterly deviation as well as challenges related to approvals and litigation in large size PMC redevelopment projects. Real estate business reported strong revenue in the quarter at Rs 740 mn driven by sale of commercial inventory at Okhla industrial estate. EPC segment witnessed 65% yoy decline in revenue in the quarter and was below our estimates. The company targets revenue growth of 25-30% yoy on standalone basis and 20-25% on consolidated basis in FY20E.

EBITDA margins below estimates

Standalone EBITDA for the quarter was Rs 1.8 bn, declined by 1.5% yoy due to decline in EBIT margin in PMC segment and segmental loss in EPC segment. The margins in PMC division was below our estimates at 5.8% (Vs 7.8% estimates) due to adoption of new accounting standards, quarterly variations and delay in execution of large size redevelopment projects in the quarter. The company targets to maintain EBITDA margin in the range of 5-5.5% in FY20E. PAT for the quarter grew by 7.8% yoy to Rs 1.5 bn due to higher other income.

Segmental Performance

Year to March (INR mn)	Q4FY19	Q4FY18	% Change	Q3FY19	% Change
Segmental Sales					
Real Estate	2235	0	NA	740	202
EPC	607	1739	-65	707	-14
PMC	20689	19963	3.6	14775	40
Total Sales	23530	21701	8	16223	45
Segmental EBIT					
Real Estate	901.9	-52.8	-1807	384	135
EPC	-58.4	148.6	-139	35	-267
PMC	1200	1287	-7	884	36
Unallocated	202	817		-188	
Total EBIT	2245	2199	2	1115	
Segmental Margins (%)					
Real Estate	40.4	NA		51.9	
EPC	-9.6	8.5	-18.2	4.9	
PMC	5.8	6.4		6.0	

Source: Company

Order book of Rs 750-800 bn gives strong revenue growth visibility

NBCC has strong order book of Rs 750-800 bn which includes Rs 410 bn of self-revenue generating project (Redevelopment project). The present order book gives very strong revenue growth visibility for the next five years. The company management has targeted for over 25-30% revenue growth in FY20E on standalone basis and 20-25% on consolidated basis. Its large size project of redevelopment of government colonies stuck due to NGT raising issue related to tree cutting. The Delhi High court has cleared two colonies Netaji Nagar and Sarojini Nagar and the management is optimistic on positive outcome on Nauroji Nagar project where the final hearing is awaited. NBCC has added Rs 125 bn of new orders in FY19 and targets to add similar value of new orders in FY20E.

Status of projects

NBCC has awarded Rs 125 bn of contracts in FY19 and targets to award Rs 150 bn of work in FY20E. The company is expected to finalize Rs 6.5-7 bn of work in the near term and balance is expected to be awarded in the rest of the year. The company has awarded Rs 45-50 bn of work related to Nauroji Nagar project and expects to award fresh order post clearance from the court. As per the management the final hearing on the project is expected on 11th July 2019 and the company expects favourable judgement on the project. In Sarojini Nagar project, the new design has been finalized and has been sent for government's approval. The company would award total Rs 150 bn of work in Netaji Nagar and Sarojini Nagar with Rs 60 bn would be awarded in the first phase in FY20E. As per the management, AIIMS project is delayed due to an environmental issue and expect clearance in the next three months. In railways station redevelopment project, NBCC is currently doing work on two station and other station redevelopment projects would go for renegotiation of terms and conditions.

In terms of new project pipeline, the company is awaiting final term from the court related to Amrapali project which has ~Rs 80 bn of construction work to be executed. The company would be doing this project on PMC basis and does not require to invest any amount in the same.

Stress asset buyout to increase risk near term cashflows

NBCC has submitted revised proposal to acquire Jaypee Infratech which is presently undergoing through voting procedure. The bid would be declared successful if it receives required votes from its stakeholders, which include lenders and home buyers. As per the management, NBCC would be required to invest only Rs 2 bn of equity upfront. It would be required to complete the construction of 21,000 flats of buyers with balance expenditure of ~Rs 70 bn. The resources would be raised through monetization of Jaypee Infratech assets, land parcels, etc, estimated at Rs 150-170 bn. The company believes that there is huge real estate development potential associated with Jaypee Infratech which will make the deal profitable in the longer run. As per management, NBCC is expected to receive 2500 acre of land with FSI area of 10 mn sqft. We believe that foray towards stressed assets will increase risk related to cashflow mismatch and may strain NBCC's balance sheet due to upfront investment and back ended cash flows. This increases risk of leveraged balance sheet with negative free cash flows in the near to medium term.

Other highlights

- In FY19, NBCC's subsidiary HSCL and HSCC reported revenue of Rs 6.6 bn and Rs 20.6 bn and PAT of Rs 249 mn and Rs 490 mn, respectively.
- The company has cleaned up balance sheets of these companies. As per the management, these companies have achieved normalcy.
- NBCC had consolidated cash and bank balance of Rs 51 bn at the end of FY19, which largely included client advances and deposits. NBCC's own cash was stood at ~Rs 1 bn and its subsidiary's cash was at Rs 5.5 bn (Rs 2.5 bn for HSCC and Rs 3 bn of HSCL).

Outlook and valuation

Based on strong order book of Rs 750-800 bn and pipeline of future projects, we expect high growth in NBCC's revenue in the next five years. But its large size project related to redevelopment of government colonies in Delhi is still under litigation. The company is targeting over 25-30% yoy growth in standalone revenue in FY20E despite delay in clearance of redevelopment project at Nauroji Nagar and other redevelopment projects in Delhi.

We have marginally revised our earnings estimates for upwards FY20E and FY21E. We believe that any shift in strategy towards asset heavy model increases risk on company's future cash flows and returns ratios. The stock is presently trading at PE of 24.3x and 19.2x based on FY20E and FY21E revised EPS of Rs 2.6 and Rs 3.2 respectively. We maintain Reduce rating on the stock, with revised target price of Rs 61 (Vs Rs 60 earlier) valuing the stock at 19x FY21E EPS.

Change in Estimates

Particulars	Previous			Revised/Actual			% Chg in estimates		
	FY19E	FY20E	FY21E	FY19A	FY20E	FY21E	FY19A	FY20E	FY21E
Revenue	74,863	91,871	1,24,835	72,448	91,835	1,24,174	(3.2)	(0.0)	(0.5)
EBITDA	4,063	5,114	7,091	3,742	4,843	6,600	(7.9)	(5.3)	(6.9)
EBITDA margin (%)	5.4	5.6	5.7	5.2	5.3	5.3	(30) bps	(30) bps	(40) bps
PAT	3,841	4,344	5,669	3,841	4,597	5,805	0.0	5.8	2.4
EPS	2.1	2.4	3.1	2.1	2.6	3.2	0.0	5.8	2.4

Source: Kotak Securities PCG Research

Company Background

NBCC (India) Ltd is a Navratna PSU company engaged in the business of project management consultancy (PMC), EPC contract and Real Estate development. The PMC business involves concept to commissioning of civil construction projects from various government departments. The company gets PMC contracts mostly on nomination basis as it has been notified as Public Work Organization under revised Rule 126 (2) of General Financial Rules (GFR). The real estate business involves development of residential and commercial projects on government or PSUs land through Joint Development or Land bank based development model. The company has 150 acres land parcels spread across cities such as Delhi, Gurgaon, Kolkata, Kochi, Alwar, Meerut, Ghaziabad, Faridabad, Lucknow, Patna, etc. The company has a very small presence in EPC business where it undertakes EPC contracts involving civil structural work in power BOP space. The company is not much focused on this division. NBCC is designated as the implementing agency for executing projects under various government program such as Jawaharlal Nehru National Urban Renewal Mission (JNNURM), Pradhan Mantri Gram Sadak Yojna (PMGSY), Solid Waste Management (SWM) and developmental work in North Eastern Region.

Financials: Standalone

Profit and Loss Statement (Rs mn)

(Year-end Mar)	FY18	FY19	FY20E	FY21E
Revenues	**59,050**	**72,448**	**91,835**	**124,174**
% change yoy	(6.0)	22.7	26.8	35.2
EBITDA	**3,994**	**3,742**	**4,843**	**6,600**
% change yoy	(0.7)	(6.3)	29.4	36.3
Depreciation	27	26	26	26
EBIT	**3,967**	**3,716**	**4,816**	**6,573**
Other Income	1,061	1,875	1,875	1,875
Interest	2	6	7	7
Profit Before Tax	**5,026**	**5,585**	**6,684**	**8,441**
% change yoy	3.1	11.1	19.7	26.3
Tax	1,690	1,744	2,087	2,635
as % of EBT	33.6	31.2	31.2	31.2
PAT	**3,336**	**3,841**	**4,597**	**5,805**
% change yoy	(5.0)	15.1	19.7	26.3
Shares outstanding (mn)	1,800	1,800	1,800	1,800
EPS (Rs)	**1.9**	**2.1**	**2.6**	**3.2**
DPS (Rs)	0.8	0.7	0.8	1.0
CEPS (Rs)	1.9	2.1	2.6	3.2
BVPS (Rs)	10.1	8.7	10.3	12.4

Source: Company, Kotak Securities – Private Client Research

Balance sheet (Rs mn)

(Year-end Mar)	FY18	FY19	FY20E	FY21E
Paid - Up Equity Capital	1,800	1,800	1,800	1,800
Reserves	16,414	13,848	16,807	20,544
Net worth	18,214	15,648	18,607	22,344
Borrowings	-	-	-	-
Total Liabilities	**18,214**	**15,648**	**18,607**	**22,344**
Net block	635	736	782	856
Capital work in progress	-	-	-	-
Total fixed assets	635	736	782	856
Investments	586	3,586	7,586	11,586
Inventories	16,575	18,323	25,778	34,855
Sundry debtors	22,585	21,076	35,124	47,492
Cash and equivalents	17,135	15,806	11,925	16,651
Loans and advances & Others	17,400	19,453	23,344	28,013
Total current assets	73,695	74,660	96,171	1,27,011
Sundry creditors and others	56,781	65,787	88,307	1,19,403
Provisions	1,505	1,559	1,637	1,719
Total CL & provisions	58,287	67,346	89,944	1,21,122
Net current assets	15,408	7,313	6,227	5,889
Net Deferred tax	1,157	4,012	4,012	4,012
Total Assets	**18,214**	**15,648**	**18,607**	**22,344**

Source: Company, Kotak Securities – Private Client Research

Cash flow Statement (Rs mn)

(Year-end Mar)	FY18	FY19	FY20E	FY21E
Pre-Tax Profit	5,026	5,585	6,684	8,441
Depreciation	27	26	26	26
Change in WC	(157)	6766	(2794)	5063
Other operating activities	(1882)	(4171)	(2087)	(2635)
Operating Cash Flow	**3,014**	**8,206**	**1,829**	**10,895**
Capex	(12)	(128)	(72)	(100)
Free Cash Flow	**3,002**	**8,078**	**1,757**	**10,795**
Change in Investments	462	(3000)	(4000)	(4000)
Investment cash flow	**450**	**(3128)**	**(4072)**	**(4100)**
Equity Raised/others	0	(5038)	0	0
Debt Raised/Repaid	0	0	0	0
Dividend & Others	(1858)	(6407)	(1638)	(2069)
CF from Financing	**(1858)**	**(6407)**	**(1638)**	**(2069)**
Change in Cash	1,606	(1329)	(3881)	4,726
Opening Cash	15,530	17,135	15,806	11,925
Closing Cash	**17,135**	**15,806**	**11,925**	**16,651**

Source: Company, Kotak Securities – Private Client Research

Ratio Analysis

(Year-end Mar)	FY18	FY19	FY20E	FY21E
Profitability Ratios				
EBITDA margin (%)	6.8	5.2	5.3	5.3
EBIT margin (%)	6.7	5.1	5.2	5.3
Net profit margin (%)	5.6	5.3	5.0	4.7
EPS growth (%)	(5.0)	15.1	19.7	26.3
Balance Sheet Ratios:				
Receivables (days)	140	140	140	140
Inventory (days)	102	102	102	102
Payable (days)	351	351	351	351
Cash Conversion Cycle (days)	(109)	(109)	(109)	(109)
Asset Turnover (x)	3.5	6.2	6.3	6.8
Net Debt/ Equity (x)	(0.9)	(1.0)	(0.6)	(0.7)
Return Ratios:				
RoCE (%)	24.2	25.9	36.7	39.9
RoE (%)	19.1	22.7	26.8	28.4
Valuation Ratios:				
P/E (x)	33.5	29.1	24.3	19.2
P/BV (x)	6.1	7.1	6.0	5.0
EV/EBITDA (x)	23.7	25.6	20.6	14.4
EV/Sales (x)	1.6	1.3	1.1	0.8

Source: Company, Kotak Securities – Private Client Research

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MARKET OUTLOOK FOR JUNE 2019

Global markets ended in the red in May as concerns related to the trade war continued to weigh on investor sentiments. However, the Indian equities outperformed global peers as political risk receded after the ruling NDA dispensation came to power with a thumping majority.

The mid and small cap indices outperformed the Nifty/Sensex on account of relative underperformance in the past eighteen months. Among sectoral indices, bank Nifty was a major gainer. FIIs were the major buyers in March and April 2019, but turned net sellers in May on profit taking. However, domestic fund flows supported the markets with strong inflows.

The NDA II has won with a huge mandate. Naturally, this has fuelled expectations of bold reforms and path breaking measures that can have positive long term benefit on the economy. Considering this, we believe that in the near term, market is looking for more visibility as it is anticipating measures/plans to be announced by the government in its first 100 days of functioning. The likely news flows coming from the government side, coupled with fall in crude prices and softening of bond yields can keep market at elevated levels. We also have two key events which would be keenly watched by the market (RBI meet in June and the Union Budget sometime in July). Post Budget markets could again go back to factors like 1) Trade War 2) Consumption related slowdown 3) Quarterly earnings and 4) Valuations.

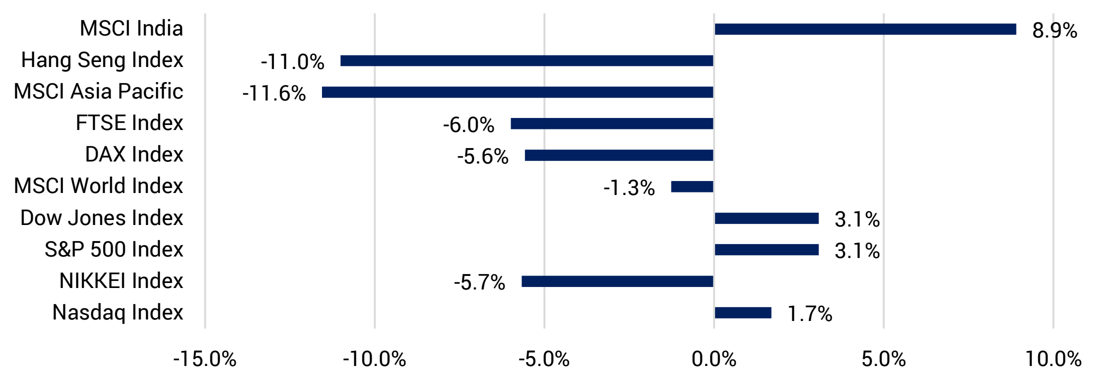
Portfolio strategy – In terms of market cap orientation we see more value in Mid & Small Caps rather than Large Caps at this stage. Accordingly, we would recommend a relatively higher weightage on mid/small caps. Stocks in Industrials, Construction, Private sector banks, Select PSU stocks and Mid caps look interesting. Also, PSU as a space is looking good in view of the limited risk of share sale in the initial phase of FY20, attractive valuations and good dividend yields. Key risks to Indian equities include weak monsoons, rising trade war and potential profit taking by FIIs.

Valuation

We note that the Indian market (Nifty-50 Index) is trading at 19.3x FY2020E 'EPS' assuming a 24% increase in net profits in FY20 and at 16.3X FY2021E 'EPS' assuming 18% increase in net profits in FY21 (based on inhouse estimates). We also note that Fw valuations of Nifty is trading at a 17% premium to the long term average valuation of 16.5x.

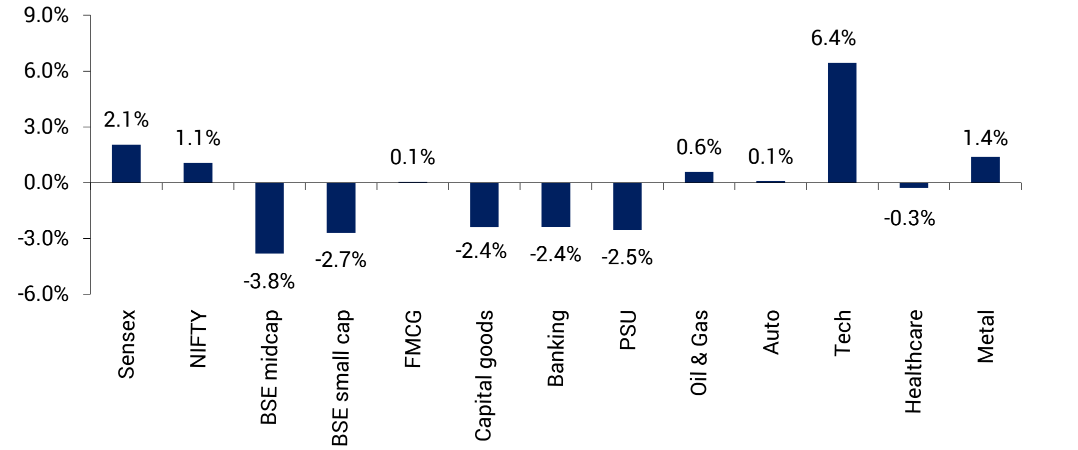
Based on Bloomberg estimates, the Mid Cap Index is now at trading at 15.5x Fw PE Vs 18.5x Fw PE of Nifty-50. The Mid Cap Fw PE now trades at 16.1% discount to Nifty Fw PE. We expect Nifty to trade between range of 12,500-13,000 by Mar 20 (average 12750), based on 17-18x Fw target multiple.

1-year performance of benchmark global indices (%)



Source: Bloomberg

Market performance – sector wise (May 2019)



Source: Bloomberg

TOP INVESTMENT IDEAS

Recommended Stocks

Company	CMP* (Rs)	Target Price (Rs)	Potential Upside (%)	52 Week H/L (Rs)	Market Cap (Rs bn)
GAIL	361	455	26.0	399/296	814.0
Powergrid	189	235	24.1	212/173	990.3
SBI	353	410	16.3	364/247	3,145.9
Surya Roshni	252	328	30.0	381/185	13.7
Welspun Corp	142	171	20.8	187/87	37.5
Phoenix Mills	651	754	15.8	715/489	99.8

*Source: Kotak Institutional Equities; Kotak Securities – Private Client Research; *CMP as on 31 May 2019.*

GLOBAL MARKETS

Global markets were weak in May as concerns related to the trade war continued to weigh on investor sentiments. Apart from this, there were also signs of global economic slowdown which led to pressure on US 10 year bond yield which dropped to 2.26%. A positive fallout of this was on the crude oil prices, which weakened despite supply cuts by OPEC and sanctions on Iranian crude exports.

Trade war intensifies

US stocks as also other developed markets posted one of the sharpest declines in the month in recent times. Apart from signs of slowdown, it was the failure to reach an amicable middle path on the trade talks that led to the correction in global markets.

On May 10, the U.S. took tariff rates on $250 billion of Chinese exports to 25%. The Chinese retaliated by raising tariffs on certain U.S. goods in a range from 5% to 25%. These moves have the potential to pull down global economic growth. Bloomberg Economics' modelling suggest that two years hence, output in China and U.S. would be lower by 0.5% and 0.2% respectively, relative to a no-trade-war scenario. Global output would also come down a notch.

With few signs of a trade deal, investors are watching for the G-20 summit in June wherein Presidents Donald Trump and Xi Jinping are set to meet. But at this point, it looks more likely that the trade war will be long.

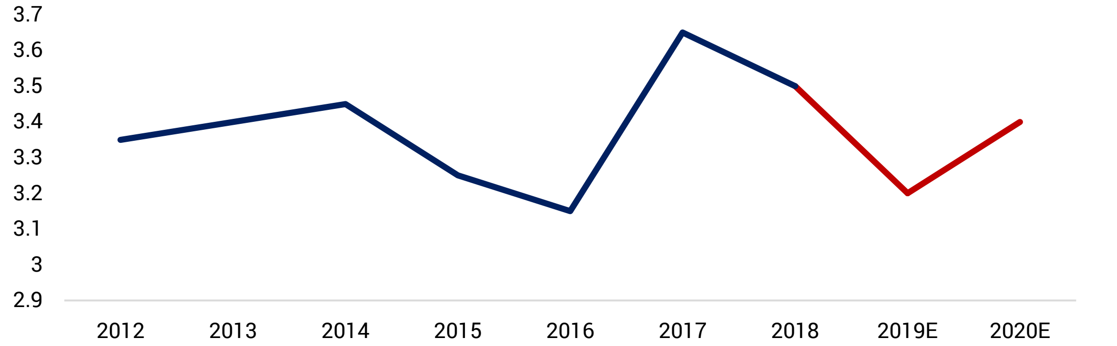
OECD sees heightened risk of a decelerating economic growth in CY2019

Trade tensions are seen weighing on the global growth, which is projected to slow to only 3.2% this year before edging up to 3.4% in 2020, well below the growth rates seen over the past three decades, or even in 2017-18. GDP growth in Germany and Japan is projected to be well below 1% in 2019. Secondly, while services growth has held up better than the manufacturing, given the direct and indirect linkages between manufacturing and services activity, the OECD expects the services sector growth to also slow down.

China remains a source of concern, as the deployment of monetary, fiscal and quasi-fiscal tools not only has uncertain effects on activity, but might continue to fuel non-financial corporate debt, already at a record high level. We estimate that a 2-percentage point reduction in domestic demand growth in China, sustained for two years and combined with heightened uncertainty, could hurt global GDP meaningfully by the second year.

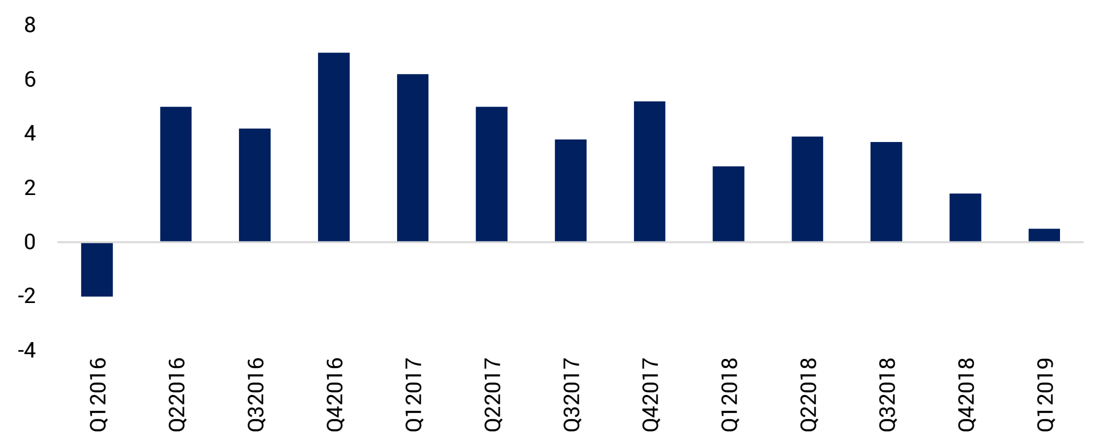
Finally, private sector debt is growing fast in major economies. The global stock of non-financial corporate bonds has almost doubled in real terms compared with 2008, at close to USD 13 trillion, and the quality of debt has been deteriorating, including a heightened stock of leveraged loans. As a result, a new wave of financial stress could erupt.

Global Economic Growth (%)



Source: OECD

QoQ growth in global trade (%)

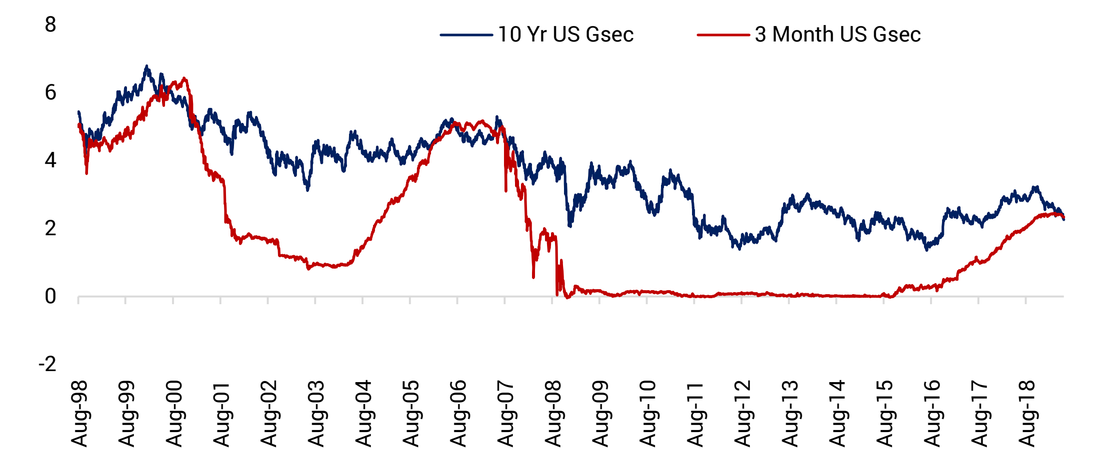


Source: OECD

Inverted Yield Curve – precursor to economic slowdown

In May, the 3-month US government T-bill yield rose above the 10-year government bond yield (commonly known as yield curve inversion). While the Central Bank anchors short-term rates with its monetary policy, economic conditions influence the long-term rates. An inverted yield curve occurs when the policy rates are raised, thereby forcing up the short-term yields and economic conditions deteriorate, thereby forcing down the long-term yields. Historically, every recession since the 1960s has been preceded by an inverted yield curve and therefore it is not surprising that investors have become a little nervous about the recent inversion.

US Yield curve



Source: Bloomberg

With US bond yields at 19 month low, expectations are raised of a Fed rate cut

With diminishing prospects of near term resolution in Trade war, the benchmark 10-year Treasury yield has continued to weaken and is now hovering around 2.21%, well below the fed funds rate that banks charge each other for overnight lending. Markets now expect the Federal Reserve to cut interest rates as economic signs continue to weaken and Wall Street stumbles through another rough patch.

Crude Oil prices cooled off.

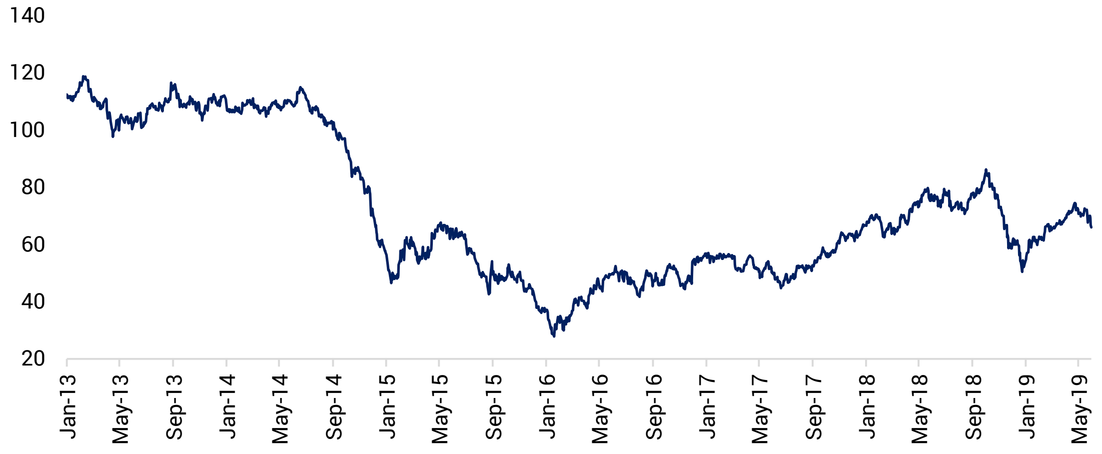
Crude oil is expected to remain under pressure on back of escalating US-China trade war and rising US oil inventories. The oil markets continued to hit hard by the increased tension in the US-China trade war, which has made investors increasingly worried about the state of the global economy and, by extension, the outlook for global oil demand growth for the rest of the year. Recently, the IEA has reduced its forecast demand for global crude. Anticipated risk of slowdown in demand, OPEC and some allies including Russia are due to meet in late June or early July to discuss output policy going forward.

Table – Demand Supply for Crude

Particulars	2015	2016	2017	2018	2019E	2020E
Demand (mn b/d)	95.3	96.4	98.0	99.2	100.6	102.0
Supply (mn b/d)						
- Non OPEC	59.8	59.1	59.9	62.7	64.6	66.3
- OPEC	36.6	37.8	37.5	37.4	36.0	36.0
Total Supply	96.4	96.9	97.4	100.1	100.6	102.3
OPEC Crude capacity	35.2	35.9	34.9	34.9	32.5	33.0
Implied spare capacity	4.9	4.0	2.3	3.9	2.1	2.9

Source: Kotak Institutional Equities, Bloomberg

Brent crude (US$/barrel)



Source: Bloomberg

Domestic Markets

The Indian markets outperformed global markets as the focus shifted to the outcome of the general elections. Markets started rallying post the exit poll results which showed clear majority for the ruling NDA dispensation. The actual results were even better as the NDA cruised way above the comfortable majority. With this, the political risk has receded and the markets can again start focusing on economic reforms and global events.

Domestic events to watch out in near term

Consumption trends – slowdown accelerates. GDP growth to slow in FY20

March IIP growth contracted by (-)0.1% as against a growth of 0.1% in February led largely by slowdown in the manufacturing segment. Consumption growth has slowed down recently, especially on the back of NBFC-related liquidity crunch and farm sector concerns. Private sector investment is unlikely to see a sharp recovery given the still-weak balance sheets and limited scope for the private sector to invest in the basic infrastructure sectors. We thus see limited impetus to economic growth and expect GDP growth to weaken to 6.8% in FY20 from 6.9% in FY19.

Table – High frequency data is signaling deepening slowdown

YoY (%)	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19
Cement Production	11.8	18.4	8.8	11.6	11	8	15.7	na
Air traffic	19	13.3	11	12.9	8.9	5.6	0.1	-2
CV sales	24.1	24.8	5.7	-7.8	2.2	-0.4	0.3	-6
Passenger car	-5.6	1.6	-3.4	-0.4	-1.9	-1.1	-3	-17

Source: KIE and Kotak PCG

Hopes of a rate cut has increased in the 6th June Monetary Policy meet

CPI inflation inched marginally higher to 2.92% in April. While CPI inflation hardened for the third consecutive month but remains well within the RBI's target of 4%. Growth in the economy, which had been supported primarily by consumption and the government's expenditure, has slowed considerably in 4QFY19 as pointed out by high frequency indicators. Going ahead, the fiscal space to support capex in FY20 will be constrained given the higher revenue expenditure. Against this backdrop, the demand from economic observers for a rate cut has risen and we believe that the MPC would cut the repo rate by another 25-50 bps in the rest of CY19, although for rate cuts to be effective, structural liquidity concerns will need to be addressed.

Normal monsoons are critical for rural spending

IMD has forecast that the monsoon may enter Kerala 'slightly delayed' on 6th June with a model error of +/- four days. It sees a 'near normal' season this year , with its second long-range forecast update due in early June. However, there is very less chance for the monsoon rainfall to be above normal or excess. Overall, the country is expected to have well distributed rainfall scenario during the 2019 monsoon season, which will be beneficial to farmers in the country during the ensuing Kharif season.

Corporate earnings growth for Q4FY19 failed to meet estimates

Our analysis of Q4FY19 results of the Nifty-50 Index suggests that reported profits are well below our expectations. As against estimated aggregate profits for Nifty stocks of Rs 740 bn in Q4FY19, the reported profits have come at Rs 651 bn, a miss of 12%. However, if we exclude SBI and Yes Bank (both reported oversized provisions for credit losses), then the aggregate reported profits are very much in line with estimates.

Further, only sixteen or just 32% of Nifty companies managed to meet or exceed our estimates. And so, as a result of the earnings misses in Q4FY19 results, we now project the FY19 net profits of the Nifty-50 Index to grow 13% versus 22% at the beginning of FY19. We do not rule out earnings downgrades in a whole host of sectors in case the current economic slowdown was to be more prolonged versus our expectations.

Table – Q4FY19 Nifty Earnings

	Net income Rs bn			Change (%)	
	Mar 2019 (Act)	Mar 2019E	Mar 2018 (Act)	Act versus Est	YoY
Nifty 50	651	740	549	-12.0%	18.6%
State Bank of India	8.4	68	-77.2	-	-
Yes Bank	-15	8.5	11.8	-	-
Adjusted for SBI and Yes Bank	657.6	663.5	614.4	-0.9%	7.0%

Source: Kotak Institutional Equities

Table - Nifty-50 Index EPS estimates trend. Reported EPS has lagged forecast meaningfully in last three fiscals

Nifty 50 EPS

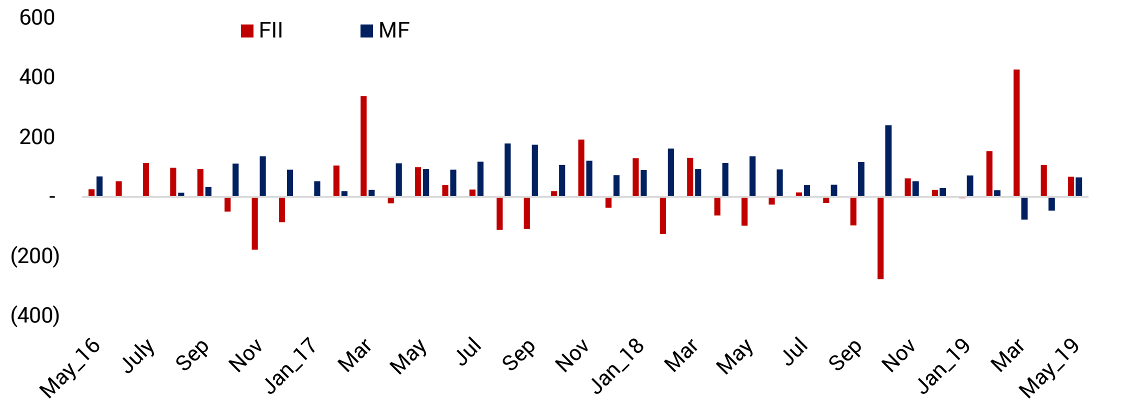
(Rs)	2Y Forecast	Reported	% change
FY17	560	439	-21.6%
FY18	628	449	-28.5%
FY19	622	481	-22.7%
FY20	618	na	na
FY21	731	na	na

Source: Kotak Institutional Equities

DIIs turned net buyers

After subdued January, FII flows picked up in February and March but started to decelerate from April onwards. In May, FII flows have been negative Rs 25.1 bn. On the other hand, MF flows have bounced back strongly in May at Rs 653 bn.

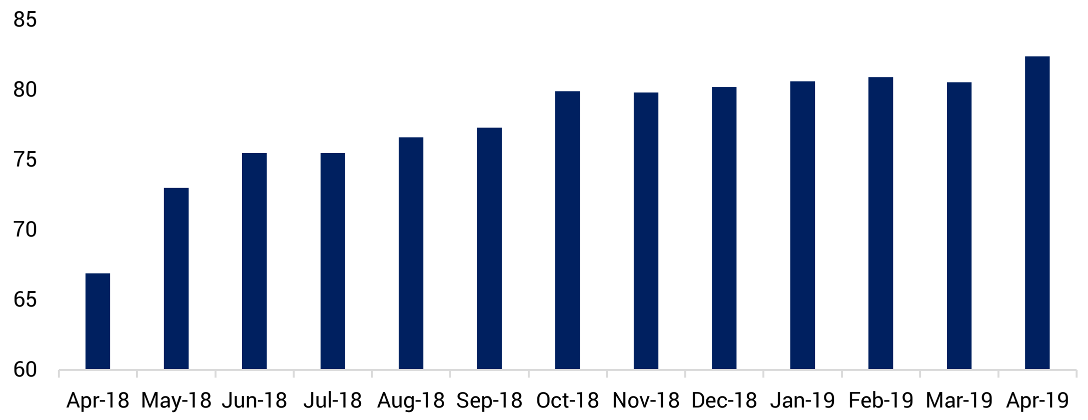
MF/FII flows (Rs bn)



Source: Bloomberg

While overall equity flows have been erratic, investment in equity funds through SIPs came as a silver lining, with a tally of Rs 82.4 bn in April, an all-time high. If the current monthly SIP run-rate at Rs 80 bn is maintained, the MF industry is expected to see equity inflows of nearly Rs 1.0 trn in FY20, which can help provide support to the markets in times of FII selling.

Monthly SIP flows Rs bn



Source: AMFI

NDA II – Focus areas for 2019-24

In our report dated 24th May 2019, we had shared our market outlook post the massive Election mandate received by NDA II. Given its relevance in the near term, we include some of the highlights of the report.

Key measures proposed in the BJP Manifesto that could have impact on Equities

- By 2024, make capital investment of Rs.100 Trillion in the infrastructure sector (build gas grids, i-ways, regional airports, metros etc.).
- Making India a global manufacturing hub (Take country's ranking in Ease of Doing business Index into the Top50; Strengthening Companies Act; New Industrial Policy and creating clusters/networks for growth).
- Recognise the need of cheaper cost of capital.
- Plan to build 60,000 km of National Highways, connect 100% of villages with rural roads, operationalize 100 new airports, modernize 400 railway stations, and cover 50 cities with metro networks.
- Doubling farmer's income by 2022. Plan to spend Rs.25 Trillion in Agri-rural sector to improve the productivity of the farm sector
- To ensure 100% disposal of liquid waste water and reuse of waste water.

Based on our reading we feel following sectors could benefit the most in the next one year: capital goods, construction, building materials, corporate banks, power equipment, housing finance companies and rural focused companies. Consumption stocks could take a back seat because of the slowdown in demand and rich valuations.

In our view priority of the government will be to revive economic growth and investment although the macro-economic situation is quite challenging. There is a need of strong fiscal stimulus but scope of doing so seems limited given high crude prices leading to higher current account deficit and higher fiscal deficit. However, there is scope for monetary stimulus in the form of rate cuts, higher FPI limits for government bonds and infusion of liquidity in the banking system. Government would need to implement further reforms to attract more FDI in various sectors of the economy. Revival of capex cycle and investment of private sector in infrastructure building will be crucial to achieve the desired GDP growth and job creation.

Our Sector Preferences

Mid sized Industrials

As capacity utilization climbs, signs of a nascent capex cycle should emerge in the next few quarters. Already industrials are showing improved order books. Prefer L&T, KEC, Kalpaturu Power, Sadbhav Engineering, Voltamp Transformers and Cochin Shipyard.

Infrastructure

As per the election manifesto, by 2024, the government plans to make capital investment of Rs.100 Trillion in the infrastructure sector (build gas grids, i-ways, regional airports, metros etc). Plan to build 60,000 km of National Highways, connect 100% of villages with rural roads, operationalize 100 new airports, modernize 400 railway stations, and cover 50 cities with metro networks. Road building has been one of the success stories of the NDA II and we believe with plans like Bharat Mala, the focus on highway construction will continue. Accordingly, we expect significant growth opportunities for construction companies like L&T, PNC Construction, KNR Constructions, NCC etc.

Water and Waste Water: The election manifesto intends to ensure 100% disposal of liquid waste water and reuse of waste water. Improving Urban Infrastructure is one of the focus areas for NDA III. Towards this, we expect to see greater investments dedicated to river cleaning (Namami Gange) and waste water treatment. Accordingly, we see improved prospects for companies like VA Tech Wabag.

Select Midcaps

In terms of market cap orientation we see more value in Mid & Small Caps rather than Large Caps at this stage. From the peak of Jan'18, the Nifty is up ~7.5% as of 30th May'19 whereas the NSE Mid Cap 100 Index and BSE Small Cap Index are still down by 17% and 25%, respectively. We continue to be positive on Himatsingka Seide, Welspun Corp, Cyient Ltd, Mahindra Holidays etc.

Select PSUs

The S&P BSE PSU Index has been flat over the past year even as the Sensex has risen 13.5%. Post this sharp underperformance, we have begun to see pockets of value that more than discounts the risks and concerns that come with PSUs.

MARKET OUTLOOK

The market has rallied strongly post the announcement of the Exit Polls. With the ruling NDA set for another five-year term, political risks have reduced and market expectations of government's continuity have been addressed. There would be renewed expectations for a more reforms-oriented policy agenda in disinvestment, Goods & Services Tax (GST) simplification, labor reforms, the ease of doing business and land acquisition.

The NDA II has won with a huge mandate. Naturally, this has fuelled expectations of bold reforms and path breaking measures that can have positive long term benefit on the economy. Considering this, we believe that in the near term, market is looking for more visibility as it is anticipating measures/plans to be announced by the government in its first 100 days of functioning. The likely news flows coming from the government side, coupled with fall in crude prices and softening of bond yields can keep market at elevated levels. We also have two key events which would be keenly watched by the market (RBI meet in June and the Union Budget sometime in July). Post Budget markets could again go back to factors like 1) Trade War 2) Consumption related slowdown, 3) Quarterly earnings and 4) Valuations.

Post Pulwama attack lot of smart money from FIIs has already come into the market and higher proportion of that has come in the form of passive investment (i.e. ETFs). Hence, we cannot rule out profit booking from these smart investors in the very near future. However, long only money which has been waiting on the side lines by both active FIIs and local investors can come into the market (as there is visibility in terms of government stability for another five years and possibility of bolder reforms)

Beyond Elections/Budget, we believe that the market is likely to focus on the growth cycle as we move in to the 2H of 2019. Their key concerns include:

- A fresh wave of NPLs emanating from the weakness in non-bank financials creating systemic problems along with it.
- Further slowdown in consumption and lack of private capex hurting earnings growth prospects.
- Fiscal slippage leading to currency woes.
- Domestic flows turn negative.

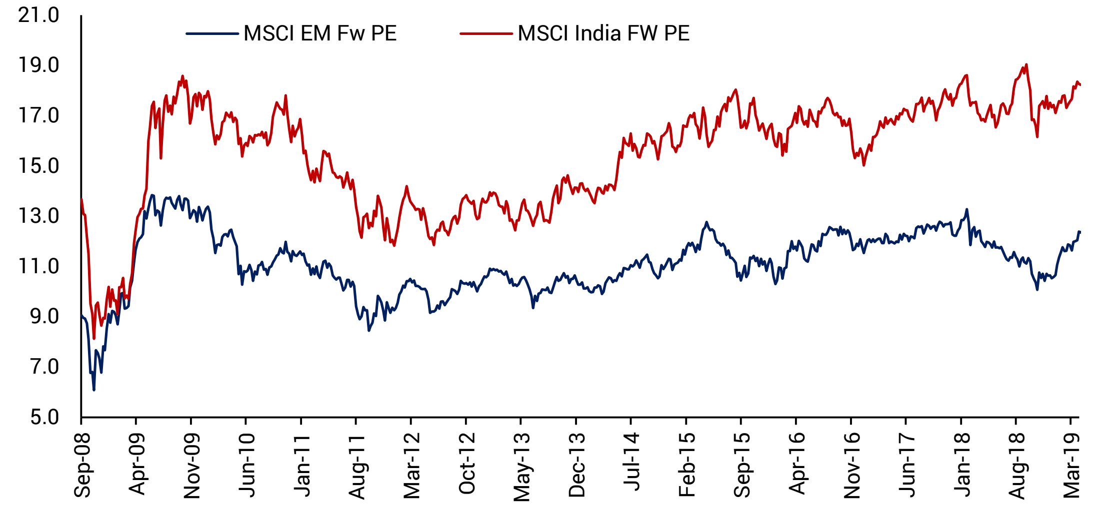
VALUATION

We note that the Indian market (Nifty-50 Index) is trading at 19.3x FY2020E 'EPS' assuming a 24% increase in net profits in FY20 and at 16.3X FY2021E 'EPS' assuming 18% increase in net profits in FY21 (based on inhouse estimates). We also note that Fw valuations of Nifty is trading at a 17% premium to the long term average valuation of 16.5x.

Based on Bloomberg estimates, the Mid Cap Index is now at trading at 15.5x Fw PE Vs 18.5x Fw PE of Nifty-50. The Mid Cap Fw PE now trades at 16.1% discount to Nifty Fw PE. We expect Nifty to trade between range of 12,500-13,000 by Mar 20 (average 12750), based on 17-18x Fw target multiple.

MSCI India trades at Fw PE of 18.2x as compared to the MSCI EM Fw PE of 11.7x. The Premium of MSCI India Fw PE over MSCI EM Fw PE has gone up to 56% as compared to the 10-year average of 40%.

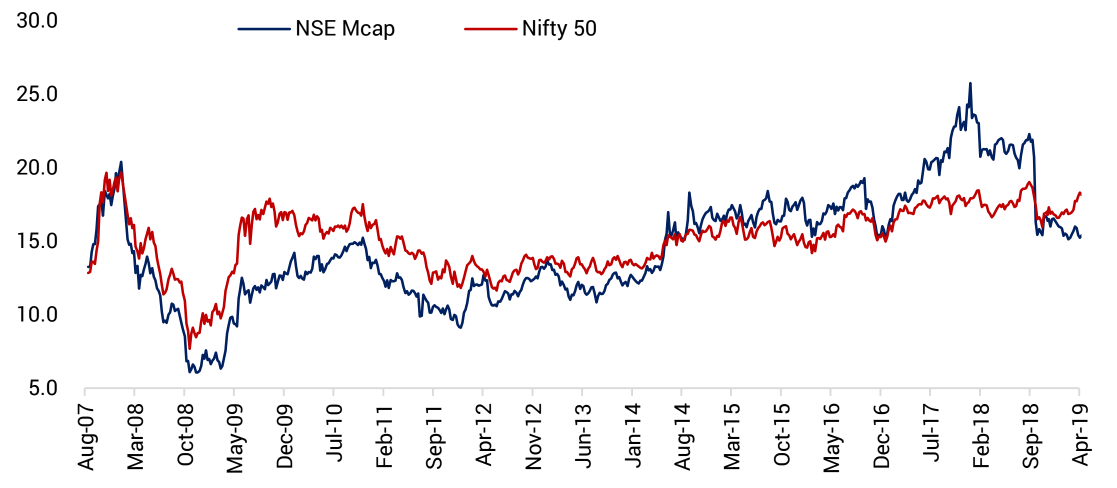
MSCI Emerging Market Vs MSCI India 1 Yr rolling FW PE



Source: Bloomberg

Based on Bloomberg estimates, the NSE Mid Cap Index trades at Fw PE of 15.5x Vs 18.5x of Nifty-50. The Mid Cap Fw PE now trades at 16% discount to the Nifty Fw PE.

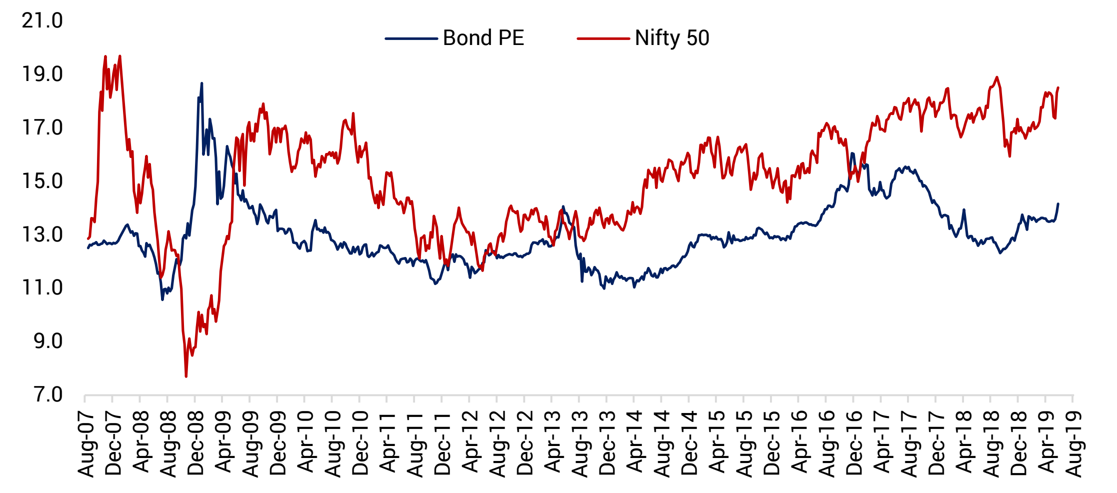
One Yr Fw PE chart: Nifty-50 Vs Mid Cap 100 Index



Source: Bloomberg

The Recent fall in Indian 10 YR GSec Yield to 7.06% has increased the Bond PE to 14.2x. Still the difference of Nifty PE over Bond PE is on the higher side at 430 bps.

Bond PE Vs Fw Equity PE of Nifty



Source: Bloomberg

Rating Scale (Kotak Securities – Private Client Research) / Kotak Institutional Equities

Definitions of ratings

BUY	–	We expect the stock to deliver more than 15% returns over the next 12 months
ADD	–	We expect the stock to deliver 5% - 15% returns over the next 12 months
REDUCE	–	We expect the stock to deliver -5% - +5% returns over the next 12 months
SELL	–	We expect the stock to deliver < -5% returns over the next 12 months
NR	–	**Not Rated.** Kotak Securities is not assigning any rating or price target to the stock. The report has been prepared for information purposes only.
SUBSCRIBE	–	We advise investor to subscribe to the IPO.
RS	–	**Rating Suspended.** Kotak Securities has suspended the investment rating and price target for this stock, either because there is not a Sufficient fundamental basis for determining, or there are legal, regulatory or policy constraints around publishing, an investment rating or target. The previous investment rating and price target, if any, are no longer in effect for this stock and should not be relied upon.
NA	–	**Not Available or Not Applicable.** The information is not available for display or is not applicable
NM	–	**Not Meaningful.** The information is not meaningful and is therefore excluded.
NOTE	–	Our target prices are with a 12-month perspective. Returns stated in the rating scale are our internal benchmark.

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