

Grading Rationale for CRISIL IPO Grading

KNR Constructions Ltd

CRISIL IPO Grade 3.0/5.0

Public issue of 7,734,570 equity shares of face value Rs 10 targeted at an issue size in the range of Rs 1,500-Rs 1,750 million.

Bid/Offer Opens	*
Bid/Offer Closes	*
Shares Offered	7,734,570 (excluding the offer to employees)
Shares Outstanding (Post issue)	28,123,460
Lead Managers	
Axis Bank Ltd	
Registrar to the Issue	
Intime Spectrum Registry Ltd	

Past financial performance		2005-06	2006-07
Total income	Rs Million	1262.00	2591.00
Total expenditure	Rs Million	1183.00	2280.00
Net profit	Rs Million	154.00	199.00
Return on equity	Per cent	36.50	34.60
No. of equity shares	Million	20.20	28.10
Net worth	Rs Million	486.00	661.00
Earnings per share	Rs	7.60	9.80
Book value per share	Rs	24.00	32.70
Gearing	Times	1.20	1.70

Shareholding pattern	Pre issue		Post issue	
	No of shares	%	No of shares	%
Promoter Holding	20,113,890	99.3	20,113,890	71.5
Others	135,000	0.7	135,000	0.5
Employees	-	0.0	140,000	0.5
Public	-	0.0	7,734,570	27.5
Total	20,248,890	100.0	28,123,460	100.0

In order to arrive at the overall grade, CRISIL considers the following broad parameters:

- Business prospects and financial performance
- Management capability
- Corporate governance

Overall assessment

CRISIL has assigned a CRISIL IPO Grade '3/5' (pronounced 'three on five') to the proposed initial public offer of KNR Constructions Ltd (KNRCL). This grade indicates that the fundamentals of the issue are average, in relation to other listed equity securities in India.

The grading reflects KNRCL's strong track record of project execution in both roads construction and operations and maintenance (O&M). The company has executed many projects as part of the NHAI's NHDP program and has had a 7-year relationship with Patel Engineering as a joint venture partner. The KNR-Patel JV has won 10 road construction projects so far, including two BOT Annuity projects as a part of NHDP Phase II, the combined value of which stands at Rs 9.6 billion. As of September 2007, KNRCL's order book stood at Rs 16.2 billion, of which 89 per cent was contributed by the roads sector. The grading is constrained by the relatively underdeveloped state of the company's operating system, which in turn could constrain its ability to expand the size of its operations. The grading also reflects the uncertainties associated with company's plans to diversify into the power generation and real estate sectors.

Sound record in timely and quality execution

KNRCL is backed by the strong operational skills of the promoters, who have been involved in road construction for almost a decade. The promoters themselves are project directors and pay close attention to project management. The company has a good reputation with NHAI for quality and timely execution and has not been fined for delays as yet.

Long standing relationship with Patel Engineering

KNRCL has been working along with Patel Engineering since 2000 for road construction. The joint venture will continue to provide KNRCL with support on the net worth criterion and aid the bidding process for larger projects.

Good prospects for revenue growth in the roads sector

The NHAI has planned an investment of Rs 2.2 trillion for the development of roads and highways through its NHDP programme. This will provide a large opportunity to road developers, which augurs well for the company. However, most of the future awards will be in the form of BOTs, to which KNRCL will gain exposure only over the next 2 years.

High dependence on promoters and rudimentary technology can pose issues with scalability

The company does not have adequate systems in place for a company of its size. Various sites are not interlinked and the software used by the joint venture is not integrated. The rudimentary systems make it necessary for the promoters to monitor projects on-site, making KNRCL highly dependent on promoters for timely and quality completion. This signals a potential problem in terms of bandwidth. However, the company is looking at integrating various software under a single ERP platform.

No clear strategy in place for diversification

The company has articulated its vision of having only 50 per cent of its total revenues from roads in 2010 by diversifying into EPC of power plants and real estate. However, no detailed strategy or plans for execution have been formulated as yet.

Family run business, no clarity on succession plan

So far, the company has been closely run by the Reddy family. Although Mr K Jalandhar Reddy is the most likely successor to Mr K N Reddy, there is no clear plan of succession in place, which may lead to confusion/ conflict in future.

Business profile

KNRCL is engaged in the business of providing engineering, procurement and construction services in the transportation sector, namely, roads and highways, irrigation and urban water infrastructure management. Roads and highways is the key business of operation, forming 89 per cent of the company's order book as on September 30, 2007. The company has been awarded various projects by both NHAI and state governments.

KNR Constructions Ltd (KNRCL) was incorporated as a public limited company on July 11, 1995. It was promoted by Mr K N Reddy who started as a contractor for small works. His son, Mr K Jalandhar Reddy, and son-in law, Mr J V Panindra Reddy, joined the company in 1993 and currently head the execution of projects in different parts of the country. Mr M Rajesh Reddy, the younger son-in-law of Mr K N Reddy, joined the company 5 years ago and looks after Finance, HR and Administration.

KNRCL was primarily a road operation and maintenance company that ventured into road construction 8 years ago and is now diversifying into irrigation and urban sanitation projects. In 1999, it formed a joint venture with NCC to complete the four-laning of a 21 km stretch near the Hapur Bypass in UP. In 2000, KNRCL formed a 50:50 joint venture with Patel Engineering. Since then, the joint venture has bagged several large projects, including two BOT Annuity projects awarded by NHAI in 2006 and 2007. KNRCL diversified into irrigation and water supply in 2005 and secured the first urban water infrastructure management contract in 2006 from Bangalore Mahanagar Palike.

Projects bagged through joint ventures currently form 74 per cent of the company's total order book. The company is heavily dependent on Patel Engineering for bagging larger projects in road construction, as it is not qualified to bid for projects on a standalone basis due to its low net worth. In the irrigation segment, KNRCL operates through joint ventures with Backbone Projects Ltd and Srilaxmi Engineering Company.

The company has been following the strategy of bidding for World Bank/ADB aided O&M projects and has bagged a large number of them. It is more likely to bid and win projects in South India that are located near its quarries. The company also has a strategy of acquiring land near its projects and owns more than 50 acres of land in and around upcoming airports in Hyderabad and Bangalore.

Of the planned IPO proceeds, KNRCL plans to utilise Rs 821.1 million to fund its 40 per cent equity stake in the special purpose vehicles formed in joint venture with Patel Engineering for the two BOT Annuities won under then NSEW corridor of the NHDP on NH-7. The company also plans to invest Rs 214.87 million towards funding the purchase of plant and machinery to meet requirements at various projects. In addition, it will utilise Rs 148.8 million for working capital requirements.

Financial profile

For 2006-07, the company's consolidated total income and net profits were Rs 2,591 million (Rs 1,261 million) and Rs 198.8 million (Rs 153.7 million), respectively. Currently, the company earns revenues from only one segment, that is, engineering, procurement and construction, which is dependent on investments in roads, irrigation and urban water infrastructure management. The return on equity (ROE) and return on capital employed (ROCE) for 2006-07 stood at 34.6 per cent and 24.2 per cent, respectively.

Profile of Management and Board

The company's operations are headed by the promoters. Mr K N Reddy is the managing director. Mr K Jalandhar Reddy (Head - Southern projects and bidding) and Mr JV Panindra Reddy (Head- North and North-Eastern projects) have played an active role in the growth of KNRCL. The execution of projects is closely monitored by the promoters on site. The estimation skills within KNRCL, while bidding for projects, are concentrated and the involvement of promoters is high in execution. This poses a potential problem with regard to bandwidth. As the company expands, the promoters will find it increasingly difficult to personally oversee each site. Though the company has a strong middle level management for execution, most senior level management, other than the promoters, have joined recently.

KNRCL's Board consists of 8 directors, which include four promoter-directors and four non-executive and independent directors. All the four independent directors, including the Chairman, joined the board on

December 26, 2005. Though the directors are from diverse backgrounds, the contribution of some directors to the board functioning is significantly less than others. Also, one of the group companies, KNR infrastructure Projects Private Ltd, which has been floated as a shell company to enable formation of SPVs, has objectives similar to that of KNRCL, which may lead to a potential conflict of interest.

Board of Directors

Names	Designation	Age	Qualification	Work-ex/Past positions held	Offices held
Mr. B.V Rama Rao	Chairman & Independent Director	68	Master in Economics; Masters in Public Administration (Harvard, USA); Overseas Fellow Member of the Economic Development Institute, conferred by World Bank;	Retired as CMD Nizam Sugars Ltd in 1997; Joined IAS in 1973: e Chief Secretary Govt of AP	Dean- ICFAI Shool of Public Policy; Vice Chancellor Institute of Chartered Financial Analysts of India University, Sikkim
Mr. K. Narasimha Reddy	Managing Director	59	B.A from Kakatiya University	associated with KNR since inception	Director in 3 Group companies
Mr. K. Jalandhar Reddy	Executive Director	36	B.E (Computers); Bangalore University	associated with KNR since inception	Director in 3 Group companies
Mr. J.V. Panindra Reddy	Executive Director	41	B.E (Civil); REC, Warrangal	associated with KNR since inception	Director in 3 Group companies
Mr. M. Rajesh Reddy	Executive Director	35	B.E (Electronics); Kuvempu University, Karnataka	- total 12 years work experience ; Free lance consultant in US; with KNR for 5 years	Director in 3 Group companies
Mr. L.B. Reddy	Independent Director	64	B.Com from Sri Ventakeswara University, Tirupathi; Fellow Member ICAI (C.A), Diploma in Information System audit from ICAI	Retired as GM Syndicate Bank : over 30 years experience in planning, accounts, inspection, computer policy and development; Deputation from Syndicate bank as Chairman of Rayalaseema Grameena Bank for 6 yrs	Director: New Era Insurance Broking Services Ltd ; Senior partner- L.B Reddy & Co. (a CA firm)
MR. D. Ramaiah	Independent Director	71	M.A from Osmania University	Retired as Director of Protocol of Govt. of A. P; Joined IAS in 1987: General Manager – A.P Scheduled Castes' Co-op Finance Corporation; Held positions in Anti- Corruption Bureau; Irrigation and CAD; Pay Anomalies Commission	
Mr. JS R Chandra Mouli	Independent Director	74	B.E (Civil); Mysore University	Retired as Chief Engineer PWD in 1992; various positions held in various state Govt agencies	

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