Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

KNR Constructions Limited

Strong Q3; Winning streak to continue

Infrastructure	Sharekhan code: KNRCON	Result Update

Stock Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 222**	
Price Target: **Rs. 270**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 6,245 cr
52-week high/low:	Rs. 242/86
NSE volume: (No of shares)	2.2 lakh
BSE code:	532942
NSE code:	KNRCON
Free float: (No of shares)	12.6 cr

Shareholding (%)

Promoters	55.0
FII	1.5
DII	34.3
Others	9.2

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	18.1	74.4	106.1	58.0
Relative to Sensex	14.0	55.7	71.6	33.7

Sharekhan Research, Bloomberg

Summary

- We retain a Buy on KNR Constructions with a revised price target of Rs. 270 led by upwardly revised earnings estimates for FY2021-FY2023.
- Execution, margins and net profitability outperformed strongly. The company saw significant collection of outstanding receivables in Irrigation space.
- Management retained FY2021 revenue guidance and expects 15-20% y-o-y growth in FY2022 revenues. Order inflows of Rs. 3,000-4,000 crore expected for remainder of FY21.
- KNR in talks to offload three HAM projects which are expected to completed by June 2021. Balance sheet remains sturdy.

KNR Constructions Limited (KNR) reported strong outperformance across execution, margins and net profitability during Q3FY2021. Standalone revenues grew 18.9% y-o-y to Rs. 663 crore, led by ramp-up of project execution, as labour availability reached pre-COVID levels and supply chain issues eased. OPM too beat estimates at 19.7% (-257 bps y-o-y, -91 bps q-o-q). Operating profit grew by 5.2% y-o-y to Rs. 131 crore, higher than expectations. A rise in other income, lower depreciation and a fall in effective tax rate were partly offset by higher interest expenses (as KNR received Rs. 12.6 crore interest income for delayed payments from authority which was passed through to the sub-contractor). Hence, net profit rose 32.4% y-o-y to Rs. 62 crore, significantly exceeding expectations. KNR received strong order inflows of ~Rs. 4000 crore during 9MFY2021. It has bided for Rs. 20,000 crore worth 15 hybrid annuity model (HAM) projects including one EPC project. Hence, it expects to bag another Rs. 3000-4000 crore projects for the rest of FY2021. The management retained its FY2021 standalone revenue guidance of Rs. 2500 crore while expects conservatively to grow revenues in FY2022 by 15-20%. The company also received Rs. 540 crore of outstanding receivables (out of a total of Rs. 680 crore since November 2020). It expects the balance Rs. 140 crore by March 2021. The company has a net cash surplus position in standalone accounts while consolidated net debt/equity stands at just 0.04x. The management is optimistic on strong bidding pipeline in roads, urban infrastructure, irrigation and water infrastructure segments. The company expects ~Rs. 1470 crore revenue booking in four irrigation projects in FY2022 which is expected to keep OPM high. Further, KNR is in talks with Cube Highways to sell three HAM projects, which are expected to be completed by June 2021. The company's order book at Rs. 7,664 crore (3.1x its FY2021E standalone revenues), provides healthy revenue visibility over the next two years. We expect KNR to be one of the key beneficiaries in the roads sector, given the government's investment plans in the next five years. We retain a Buy on the stock with a revised price target of Rs. 270 factoring upwardly revised earnings estimates for FY2021-FY2023.

Key positives

- Healthy outperformance on execution, OPM and net profitability.
- Receipt of outstanding receivables of Rs. 540 crore out of Rs. 680 crore.
- Management retained FY2021 revenue guidance and expects 15-20% revenue growth in FY2022.
- Order inflow target of Rs. 3000-4000 crore for rest of FY2021

Key negatives

- Interest expenses rose on account of receipt of pass-through interest income.

Our Call

Valuation –Retain Buy with a revised price target of Rs. 270: KNR has been able to ramp-up its execution over the past two quarters and also maintain high OPM. The company is further expected to maintain healthy execution run-rate along with higher OPM on account of strong order book, pre-COVID labour levels, normalised supply chain and higher revenue booking from irrigation projects. The company has a strong biding pipeline, which would aid in healthy order intake during Q4FY2021 and FY2022. The company has diversified well into the urban and water infrastructure projects, which are expected to remain buoyant in terms of tendering activities going ahead. We have raised our earnings estimates for FY2021-FY2023, factoring higher execution run-rate and better OPM. We expect KNR to be one of the key beneficiaries in the roads sector, given the government's investment plan over the next five years. We retain a Buy on the stock with a revised price target of Rs. 270 factoring upwardly revised earnings estimates for FY2021-FY2023.

Key risk

Delay in the execution and a weak macroeconomic environment will lead leading to lull in new project awards.

Valuations (Standalone) Rs cr

Particulars	FY20	FY21E	FY22E	FY23E
Revenue	2,244.2	2,456.5	2,945.9	3,507.4
OPM (%)	21.7	19.9	19.8	19.5
Adjusted PAT	248.5	225.5	326.6	397.5
% YoY growth	*(6.5)*	*(9.2)*	*44.8*	*21.7*
Adjusted EPS (Rs.)	8.8	8.0	11.6	14.1
P/E (x)	25.1	27.7	19.1	15.7
P/B (x)	3.7	3.3	2.8	2.4
EV/EBITDA (x)	11.8	11.7	9.9	8.4
RoNW (%)	16.1	12.8	16.2	16.8
RoCE (%)	15.8	13.7	16.9	17.2

Source: Company; Sharekhan estimates

Strong beat on all parameters: KNR Constructions Limited (KNR) reported strong outperformance across execution, margins and net profitability during Q3FY2021. Standalone revenues grew 18.9% y-o-y to Rs. 663 crore, led by ramp-up of project execution, as labour availability reached pre-COVID levels and supply chain issues eased. OPM too beat estimates at 19.7% (-257 bps y-o-y, -91 bps q-o-q). Operating profit grew by 5.2% y-o-y to Rs. 131 crore, higher than expectations. A rise in other income, lower depreciation and a fall in effective tax rate were partly offset by higher interest expenses (as KNR received Rs. 12.6 crore interest income for delayed payments from authority which was passed through to the sub-contractor). Hence, net profit rose 32.4% y-o-y to Rs. 62 crore, significantly exceeding expectations.

Strong growth outlook: KNR received strong order inflows of ~Rs. 4000 crore during 9MFY2021. It has bid for 15 HAM projects worth Rs. 20,000 crore, including one EPC project. Hence, it expects to bag another Rs. 3000-4000 crore projects during the rest of FY2021. The management retained its FY2021 standalone revenue guidance of Rs. 2500 crore while expects conservatively to grow its revenues in FY2022 by 15-20%. The company also received Rs. 540 crore outstanding receivable out of Rs. 680 crore since November 2020 and expects balance Rs. 140 crore by March 2021. The company has a net cash surplus position in standalone accounts while consolidated net debt/equity stands at just 0.04x. The management is optimistic on a strong bidding pipeline in roads, urban infrastructure, irrigation and water infrastructure segments. The company expects to book ~Rs. 1470 crore in revenue from four irrigation projects in FY2022, which is expected to keep OPM high. Further, it is in discussion with Cube Highways to sell three HAM projects, which are expected to be complete by June 2021. The company's order book at Rs. 7664 crore (3.1x its FY2021E standalone revenues), provides healthy revenue visibility over the next two years.

Key Conference call takeaways

- **Industry scenario:** Industry saw strong execution during Q3 led by labour reaching pre-COVID levels and easing of supply chain issues. Measures such as timely disbursals by NHAI, monthly billing by MoRTH versus earlier milestone-based billing and release of retention money as per work done have eased working capital requirements. Budget increased allocation towards MORTH by 8% y-o-y to Rs. 1.98 lakh crore. Budget has offered capital support of 0.45 lakh crore for the roads sector. Awarding activity to gain further traction in roads, urban infrastructure, irrigation, water infrastructure and railways. NHAI aims to award 4800-5200 km of project awards for FY2021. Till December 2020, NHAI has awarded 2423 km versus 3211 km awarded in FY2020.
- **Bidding pipeline:** The company is seeing bidding pipeline of 72,000 crore, of which HAM projects comprise 55%, EPC 38% and two BOT projects. About 60% of the projects are in A.P., Karnataka, Kerala and Punjab. Strong visibility in Irrigation and water projects in A.P., Telangana and Karnataka. Out of 34,800 km projects under Bharatmala Pariyojana, 13,521 are awarded while 16,400 km are in the pipeline.
- **Tolling:** Toll collections for the industry has risen by 13% (8-9% traffic, one-third PVs & two-thirds CVs) from September to November 2020. FY2022 is expected to see toll revenues rise of 14-15%.
- **Equity requirement:** The total equity requirement in all five HAM projects in Rs. 624.28 crore, out of which it has invested Rs. 345.7 crore and balance Rs. 279 crore will be invested over three years (Rs. 90 crore in FY2022, Rs. 139 crore in FY2023 and Rs. 50 crore in FY2024).
- **Order book:** The total order book stands at Rs. 7664 crore of which 55% comprises EPC and HAM projects and balance 45% Irrigation projects. About 70% of the order book is non-captive (54% states, 3% central government and balance private players) and 30% captive HAM projects.
- **Order inflow guidance:** The company received Rs. 4,000 crore of order inflows during 9MFY2021. The company expects to bag Rs. 3000-4000 crore order for balance FY2021. It has bid for 15 HAM projects worth Rs. 20,000 crore including one EPC project.

- **Revenue guidance:** The company maintained revenue guidance of Rs. 2500 crore for FY2021. It expects to achieve 15-20% revenue growth for FY2022. As per management, OPM can be sustained at 17-18%, but with the contribution of irrigation projects, the margins would be higher.
- **Receivables:** The company received Rs. 540 crore out of Rs. 680 crore outstanding towards irrigation projects from November 2020. The balance Rs. 140 crore is expected in the near term.
- **Debt:** Standalone gross debt is at Rs. 16 crore and cash at Rs. 43 crore. Consolidated debt is at Rs. 750 crore and cash at Rs. 75 crore.
- **Capex:** The company undertook a capex of Rs. 60 crore during 9MFY2021. The capex for FY2021 is expected to be Rs. 100 crore. It would incur Rs. 100-120 crore capex in FY2022.
- **Project completion and monetization:** The company would be completing three HAM projects by June 2022. It is currently in discussion to sell the projects to Cube Highways.
- **Higher other income and interest expense:** The company received Rs. 12.6 crore interest income for a ten year old sub-contracted project which was booked in other income. The funds were passed to the sub-contractor leading to higher interest expenses.
- **Commodity price impact:** There is expected to be some impact of rise in commodity price in HAM projects and partly in the EPC segment.
- **Irrigation revenues in FY2022:** The company expects to complete the Navayuga irrigation project of Rs. 775 crore, Malanasagar project of Rs. 195 crore, Rs. 400 crore work in a large irrigation project and Rs. 100 crore in smaller one in FY2022.

Financials (Standalone) Rs cr

Result table	Q3FY2021	Q3FY2020	y-o-y%	Q2FY2021	q-o-q%
Net sales	**663.3**	**557.9**	**18.9%**	**601.2**	**10.3%**
Other income	10.0	7.0	43.4%	7.6	31.7%
Total income	673.3	564.9	19.2%	608.8	10.6%
Total expenses	532.4	433.5	22.8%	477.2	11.6%
Operating profit	**130.8**	**124.4**	**5.2%**	**124.0**	**5.5%**
Depreciation	40.0	51.7	-22.6%	35.2	13.7%
Interest	18.0	14.2	27.2%	15.8	14.0%
Exceptional items	0.0	-6.7		-11.2	
Profit Before Tax	82.8	58.8	40.8%	69.4	19.3%
Taxes	20.7	18.6	11.3%	19.6	5.7%
PAT	62.1	40.2	54.5%	49.8	24.6%
Adjusted PAT	**62.1**	**46.9**	**32.4%**	**61.1**	**1.7%**
EPS (Rs.)	2.2	1.7	32.4%	2.2	1.7%
OPM(%)	19.7%	22.3%	-257 bps	20.6%	-91 bps
NPM(%)	9.4%	8.4%	95 bps	10.2%	-80 bps
Tax rate (%)	25.0%	31.6%	-662 bps	28.2%	-321 bps
Tax rate (%)	28.2%	22.2%	605	30.3%	-214

Source: Company; Sharekhan Research

Outlook and Valuation

Sector View – Roads to remain one of key focus areas in government's infrastructure spending

The government's infrastructure investment is pegged at Rs. 111 lakh crore over FY2020-FY2025. The road sector is expected to witness Rs. 20 lakh crore investments during the same period. Huge investments and favourable government policies are expected to provide strong growth opportunities for players. The roads sector is recovering with near pre-COVID level man-power strength and availability of materials post easing of restrictions post COVID-19 led lockdowns. The industry is expected to see strong order inflows and an improvement in execution run-rate from Q3FY2021 onwards. Working capital issues of the companies have been handled by proactive payments from the NHAI.

Company Outlook – Expect execution and order intake to improve

The management retained its FY2021 standalone revenue guidance of Rs. 2500 crore while expects conservatively to grow its revenues in FY2022 by 15-20%. It has bid for 15 HAM projects worth Rs. 20,000 crore, including one EPC project. Hence, it expects to bag another Rs. 3,000-4,000 crore worth of projects for the rest of FY2021. The management is optimistic on strong bidding pipeline in roads, urban infrastructure, irrigation and water infrastructure segments. The company expects to book revenue of ~Rs. 1,470 crore from four irrigation projects in FY2022 which is expected to keep OPM high. Further, it is in discussion with Cube Highways to sell three HAM projects, which are expected to completed by June 2021. The company's order book at Rs. 7,664 crore (3.1x its FY2021E standalone revenues), provides healthy revenue visibility over the next two years.

Valuation – Retain Buy with a revised price target of Rs. 270

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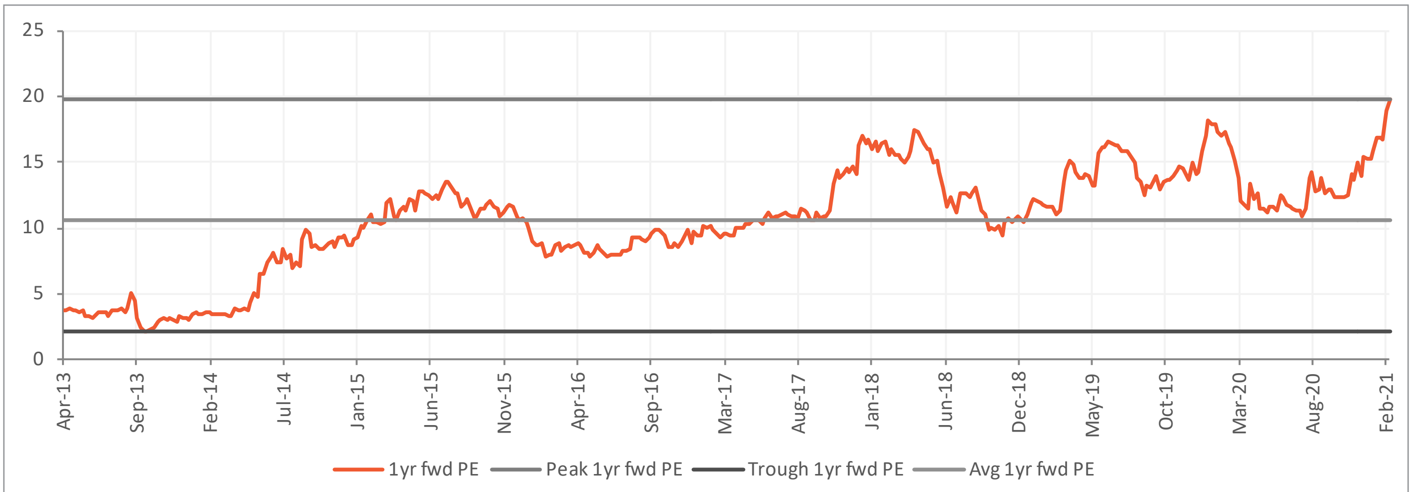
One-year forward P/E (x) band



Source: Sharekhan Research

Peer Valuation

Particulars	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
PNC Infratech	16.5	13.6	8.9	7.6	2.1	1.9	14.0	14.8
KNR Constructions	19.1	15.7	9.9	8.4	2.8	2.4	16.2	16.8

Source: Sharekhan Research, Standalone financials

About company

Incorporated in 1995, KNR has over two decades of experience in project execution. The company is one of the leading companies providing engineering, procurement and construction (EPC) services, majorly concentrated in the roads and highways segment. The company also has a minor presence in the irrigation and urban water infrastructure management segments. Till date, KNR has successfully executed more than6,000 lane km of road projects across 12 states in India.

Investment theme

KNR is one of the best managed road construction companieswithmore than two decades of experience executing over 6,000 lane km road projects across 12 states in India. KNR has in-house construction capabilities, which ensureon-schedule project completion (history of receiving early completion bonuses). KNR entered into a complete stake sale agreementwith Cube Highways for four of its hybrid annuityprojects, which will aid in lower equity requirement along with booking of EPC work with possibility of receiving an early completion bonus.

Key Risks

- Delay in project execution of hybrid annuity projects.
- Slowdown in the macroeconomy leading to muted road project awards from NHAI and Ministry of Road Transport.

Additional Data

Key management personnel

Mr. K. Narasimha Reddy	Founder Promoter & Managing Director
Mr. K. Jalandhar Reddy	Promoter & Executive Director
Mr. M.V. Venkata Rao	Company Secretary & Compliance Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Reddy Kamidi Narasimha	32.53
2	Reddy Kamidi Jalandhar	13.96
3	ICICI Prudential Asset Management	7.38
4	DSP Investment Managers Pvt Ltd	6.85
5	HDFC Asset Management Co Ltd	6.4
6	YASHODA KAMIDI	4.27
7	Reddy Mereddy Rajesh	4.27
8	UTI Asset Management Co Ltd	2.21
9	Franklin Resources Inc	2
10	Invesco Asset Management India Pvt	1.91

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;