



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. 286	
Price Target: Rs. 350	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

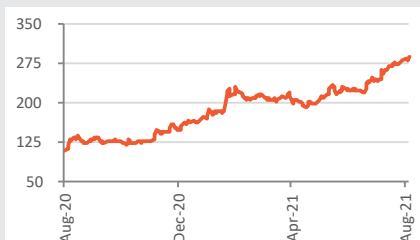
Company details

Market cap:	Rs. 8,038 cr
52-week high/low:	Rs. 294 / 105
NSE volume: (No of shares)	2.2 lakh
BSE code:	532942
NSE code:	KNRCON
Free float: (No of shares)	13.1 cr

Shareholding (%)

Promoters	53.3
FII	2.3
DII	34.4
Others	10.1

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	17.7	37.5	30.6	166.4
Relative to Sensex	12.9	23.8	24.3	120.0

Sharekhan Research, Bloomberg

KNR Constructions Ltd

Upping the ante

Infrastructure

Sharekhan code: KNRCON

Result Update

Summary

- Execution continued to be better than expected; Net working capital days reduced q-o-q. Standalone and consolidated balance sheet remained strong.
- Management raised FY22 revenue guidance, assuming the third wave of COVID-19 does not pose challenges. On order intake, guidance stayed conservative at Rs. 2000-3000 crore.
- Expect receivables from irrigation segment to majorly clear up in the next 2-3 months.
- We retain a Buy on KNR Constructions with a revised price target of Rs. 350, factoring in upwardly revised estimates.

Execution continued to beat expectations for KNR Constructions Limited (KNR) in Q1FY2022, even in the face of COVID-19 challenges. Standalone revenues grew 54% y-o-y (but fell 21% q-o-q) to Rs. 740 crore, led by strong execution of captive HAM projects, as labour availability reached pre-COVID levels and supply chain issues eased. OPM remained almost stable at 19.4% (down 31 bps y-o-y and 10 bps q-o-q) in line with estimates led by a higher contribution from hybrid annuity model (HAM) projects. Operating profit grew by 52% y-o-y to Rs. 143 crore, beat expectations. A 23% y-o-y fall in interest expenses and a 19% y-o-y decline in depreciation drove up PBT by 98% y-o-y to Rs. 113 crore. Growth in standalone PAT was slightly lower at 83% y-o-y (-5% q-o-q) at Rs. 73 crore, owing to a higher effective tax rate of 35.5% (versus 30.3% in Q1FY2021), but this was still above our estimates. Assuming a third wave of COVID-19 does not cause disruptions, the management upped its standalone revenue guidance for FY22 to over Rs. 3400 crore versus Rs. 3000 crore earlier. OPM is expected to continue to be at 17-18% in the near term. The company bagged one HAM project worth Rs. 1042 crore, while it conservatively maintained order intake target at Rs. 2000-3000 crore for FY2022. Net working capital days fell to 66 days as of Q1FY2022 as against 82 days in Q4FY2021 as debtor days fell to 86 days versus 117 days in Q4FY2021. The company's order book including three HAM and one EPC projects awaiting financial closure stands strong at Rs. 11,679 crore, translating to 4x TTM standalone revenues providing strong revenue visibility over the next two years. KNR is left with Rs. 200 crore (Rs. 135 crore in FY2022, Rs. 65 crore in FY2023) equity requirement for its five under construction HAM projects. For the three HAM projects that await financial closure, KNR would be investing Rs. 530 crore over the 2-2.5 years. Its irrigation order book of Rs. 3000 crore has slow moving order of Rs. 700 crore while balance projects are under execution. The company has Rs. 650 crore receivables (billed and un-billed) from the Telangana government, which is expected to recover majorly in 2-3 months. The company's remains standalone net cash surplus with Rs. 47 crore while consolidated net debt to equity is comfortable at 0.4x.

Key positives

- Overall earnings beat estimates led by higher than expected execution.
- Net working capital fell q-o-q due to lower debtor days.
- Management ups revenue guidance for FY2022.
- Strong order book position provides healthy revenue visibility.

Key negatives

- Conservative order inflow guidance for FY2022
- Pending receivables from Telangana government pertaining to Irrigation projects

Our Call

Valuation –Retain Buy with a revised price target of Rs. 350: KNR has been able to ramp-up its execution over the past four quarters and also maintained high OPM. The company has further upped its revenue guidance for FY2022 if a potential third wave of COVID-19 does not pose challenges. The company's standalone and consolidated balance sheet continue to remain strong. Conclusion of the Cube deal will further free up equity for future projects infusions. The company's strong order book and healthy bidding pipeline provide comfort. We raise our estimates for FY2022-FY2023 factoring higher execution and introduce FY2024E earnings in this note. 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. 350.

Key Risks

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

Valuation (Standalone)

Particulars	FY21	FY22E	FY23E	FY24E
Revenue	2,702.6	3,311.9	3,823.9	4,465.0
OPM (%)	19.8	18.9	18.9	19.0
Adjusted PAT	255.4	388.4	451.4	534.6
% YoY growth	8.3	52.0	16.2	18.4
Adjusted EPS (Rs.)	9.1	13.8	16.1	19.0
P/E (x)	31.5	20.7	17.8	15.0
P/B (x)	4.2	3.5	2.9	2.5
EV/EBITDA (x)	14.1	12.0	10.4	8.9
RoNW (%)	14.5	18.9	18.4	18.2
RoCE (%)	15.3	19.6	19.0	18.8

Source: Company; Sharekhan estimates

Strong beat on execution led by captive HAM project execution

Execution continued to beat expectations for KNR Constructions Limited (KNR) in Q1FY2022, even in the face of COVID-19 challenges. Standalone revenues grew 54% y-o-y (but fell 21% q-o-q) to Rs. 740 crore, led by strong execution of captive HAM projects, as labour availability reached pre-COVID levels and supply chain issues eased. OPM remained almost stable at 19.4% (down 31 bps y-o-y and 10 bps q-o-q) in line with estimates led by a higher contribution from hybrid annuity model (HAM) projects. Operating profit grew by 52% y-o-y to Rs. 143 crore, beat expectations. A 23% y-o-y fall in interest expenses and a 19% y-o-y decline in depreciation drove up PBT by 98% y-o-y to Rs. 113 crore. Growth in standalone PAT was slightly lower at 83% y-o-y (-5% q-o-q) at Rs. 73 crore, owing to a higher effective tax rate of 35.5% (versus 30.3% in Q1FY2021), but this was still above our estimates.

Management ups revenue guidance for FY2022

Assuming a third wave of COVID-19 does not cause disruptions, the management upped its standalone revenue guidance for FY22 to over Rs. 3400 crore versus Rs. 3000 crore earlier. OPM is expected to continue to be at 17-18% in the near term. The company bagged one HAM project worth Rs. 1042 crore, while it conservatively maintained order intake target at Rs. 2000-3000 crore for FY2022. Net working capital days fell to 66 days as of Q1FY2022 as against 82 days in Q4FY2021 as debtor days fell to 86 days versus 117 days in Q4FY2021. The company's order book including three HAM and one EPC projects awaiting financial closure stands strong at Rs. 11,679 crore, translating to 4x TTM standalone revenues providing strong revenue visibility over the next two years. KNR is left with Rs. 200 crore (Rs. 135 crore in FY2022, Rs. 65 crore in FY2023) equity requirement for its five under construction HAM projects. For the three HAM projects that await financial closure, KNR would be investing Rs. 530 crore over the 2-2.5 years. Its irrigation order book of Rs. 3000 crore has slow moving order of Rs. 700 crore while balance projects are under execution. The company has Rs. 650 crore receivables (billed and un-billed) from the Telangana government, which is expected to recover majorly in 2-3 months.

Key Conference call takeaways

- ♦ **Guidance:** The company has upped its standalone revenue guidance from Rs. 3000 crore to over Rs. 3,400 crore for FY2022 provided the COVID-19 pandemic does not play spoilsport. OPM is expected to be at 17-18% in the near term. The company targets order inflow of Rs. 2000-3000 crore for FY2022. It would target 2-3 HAM projects for FY2022.
- ♦ **Industry update:** About 2284 km of roads were constructed in Q1FY2022 which were up 25% y-o-y. The government is looking to set up a dedicated financial institution for highways. July month saw toll collections improve 15% m-o-m.
- ♦ **Q1FY2022:** HAM projects drove up execution during the quarter. Workforce has reached pre-COVID-19 levels.
- ♦ **Equity requirement:** Out of Rs. 625 crore equity requirement for 5 HAM projects, it has infused Rs. 425 crore as of Q1FY2022 end. It would invest Rs. 135 crore and Rs. 65 crore in FY2022 and FY2023 respectively. The two new HAM projects would require Rs. 430 crore equity and one HAM in which it is L1 would need Rs. 100 crore equity over two to two and half years.
- ♦ **Order book:** The company bagged one HAM project of Rs. 1042 crore during Q1FY2022. The current order book including recently bagged projects is Rs. 11,679 crore.
- ♦ **Debt:** Consolidated debt rose to Rs. 982 crore versus Rs. 734 crore in Q4FY2021. The consolidated net debt to equity is at 0.4x versus 0.3x in FY2021. Standalone net cash stands at Rs. 47 crore.
- ♦ **Irrigation:** In irrigation, Rs. 700 crore project has not taken off. The company has Rs. 650 crore billed plus unbilled receivables from the Telangana state government that it expects to receive major amount in 2-3 months.
- ♦ **Other numbers:** Mobilisation advance is Rs. 134 crore, dues to customers are at Rs. 305 crore, Dues from customers are at Rs. 220 crore.

Results (Standalone)

	Rs cr				
Particulars	Q1FY2022	Q1FY2021	Y-o-Y %	Q4FY2021	Q-o-Q %
Net revenues	740.0	479.4	54.4%	935.8	-20.9%
Other income	4.8	6.1	-21.3%	9.4	-48.8%
Total income	744.8	485.5	53.4%	945.2	-21.2%
Total expenses	596.7	385.0	55.0%	753.6	-20.8%
Operating profit	143.3	94.3	51.9%	182.2	-21.3%
Depreciation	26.9	33.1	-18.6%	38.8	-30.5%
Interest	7.9	10.2	-22.7%	4.3	82.9%
Profit Before Tax	113.3	57.1	98.3%	148.5	-23.7%
Taxes	40.3	17.3	132.2%	71.5	-43.7%
PAT	73.0	39.8	83.5%	77.0	-5.2%
EPS (Rs.)	2.6	1.4	83.5%	2.7	-5.2%
			bps		bps
OPM (%)	19.4%	19.7%	-31	19.5%	-10
NPM (%)	9.9%	8.3%	157	8.2%	164
Tax rate (%)	35.5%	30.3%	520	48.2%	-1261

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 manpower 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.

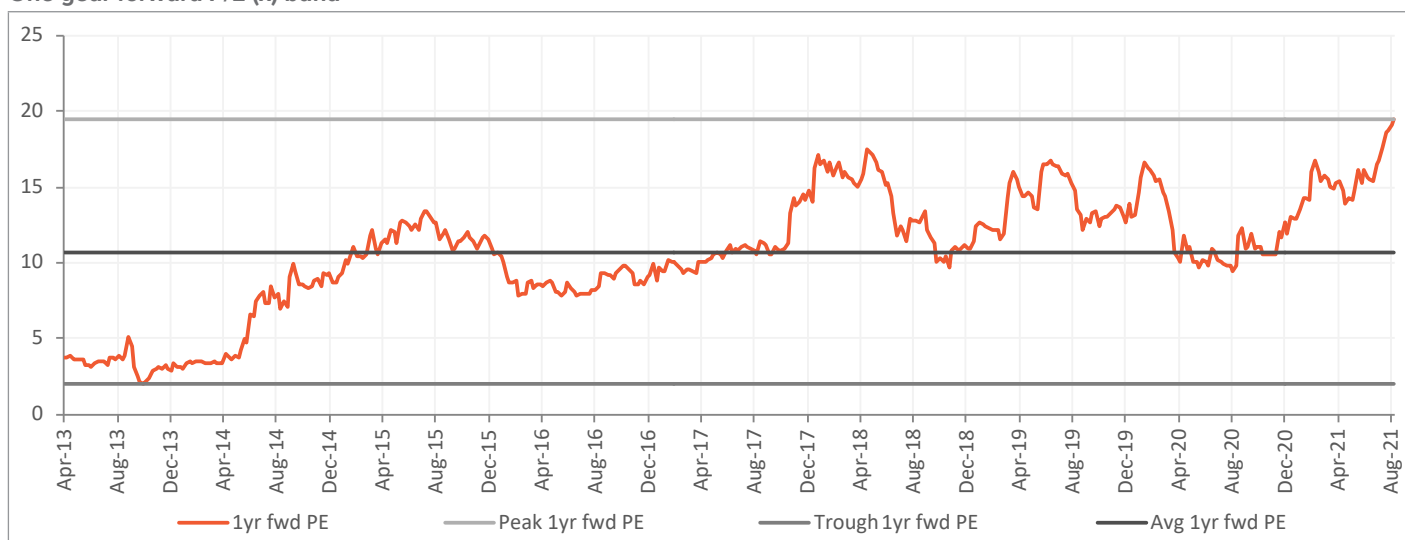
■ Company outlook – Expect execution and order intake to improve

The management is eyeing revenues of over Rs. 3400 crore in FY2022 assuming a third wave of COVID-19 does not pose challenges on execution. The operating margins are expected to continue at 17-18% range in the near future. Further, the management conservatively guided for order intake of Rs. 2000-3000 crore for FY2022. The company has a strong order backlog at 4x TTM standalone revenues providing strong revenue visibility over next two years. Standalone and consolidated balance sheet continue to remain strong. The conclusion of Cube deal will further free up equity for future projects infusions. A strong order book and healthy bidding pipeline provide comfort.

■ Valuation – Retain Buy with a revised price target of Rs. 350

KNR has been able to ramp-up its execution over the past four quarters and also maintained high OPM. The company has further upped its revenue guidance for FY2022 if a potential third wave of COVID-19 does not pose challenges. The company's standalone and consolidated balance sheet continue to remain strong. Conclusion of the Cube deal will further free up equity for future projects infusions. The company's strong order book and healthy bidding pipeline provide comfort. We raise our estimates for FY2022-FY2023 factoring higher execution and introduce FY2024E earnings in this note. 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. 350.

One-year forward P/E (x) band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E	FY23E	FY24E
PNC Infratech	14.7	13.0	8.3	7.4	2.0	1.8	15.0	14.7
KNR Constructions	17.8	15.0	10.4	8.9	2.9	2.5	18.4	18.2

Source: Sharekhan Research

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 than 6,000 lane km of road projects across 12 states in India.

Investment theme

KNR is one of the best managed road construction companies with more 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 ensure on-schedule project completion (history of receiving early completion bonuses). KNR entered into a complete stake sale agreement with Cube Highways for four of its hybrid annuity projects, 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	6.40
6	YASHODA KAMIDI	4.27
7	Reddy Mereddy Rajesh	4.27
8	UTI Asset Management Co Ltd	2.21
9	Franklin Resources Inc	2.00
10	Invesco Asset Management India Pvt	1.91

Source: Bloomberg

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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 deteriorating 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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