KNR Constructions Limited

Riding on improving sectoral outlook

Infrastructure	Sharekhan code: KNRCON	Company 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. 305**	
Price Target: **Rs. 367**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 4,292 cr
52-week high/low:	Rs. 320/172
NSE volume: (No of shares)	2.2 lakh
BSE code:	532942
NSE code:	KNRCON
Free float: (No of shares)	6.3 cr

Shareholding (%)

Promoters	55.0
FII	1.5
DII	34.3
Others	9.1

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	19.9	20.9	54.5	34.9
Relative to Sensex	12.8	1.5	20.2	22.2

Sharekhan Research, Bloomberg

Summary

- We retain a Buy on KNR Constructions with a revised price target of Rs. 367 as we believe that improving industry outlook and strengthening balance sheet are strong growth levers.
- Road project awarding and construction activities increased during October 2020. Toll project revenues are also rising robustly as seen by FASTag and NHAI toll collections.
- Bank credit deployment to roads sector has started to show improvement with healthy y-o-y rise during September and October which should aid execution of ongoing projects and financial closure of new projects going ahead.
- Liquidity conditions set to improve with completion of BOT asset deal and expected receipts from Telangana state government.

KNR Constructions Limited (KNR) is expected to benefit from the improving outlook for the roads sector. The sector saw a strong rise in awarding activity for FY2021 till October with projects of 5778 km being awarded, up 1.9x y-o-y. Further, in October 2020, construction of projects grew 2x y-o-y to 1,005km. Additionally, November 2020 saw continued momentum in FASTag issuances with 13% rise compared to February 2020 while it was up 2.1% m-o-m. NHAI had also witnessed toll collections reaching 114% of pre-COVID levels during early November. The rising toll collections bode well for asset monetisation and faster churning of capital for companies. Further, bank credit deployment in the roads sector has been rising since the start of FY2021 with September and October months witnessing a 7% and 6.4% y-o-y rise respectively. The higher deployment of bank credit to the road sector highlights easing of funding requirements for the sector and would help improve execution of under-construction projects and financial closure of newly-bagged projects. The government's Rs. 111 lakh crore investments envisaged over FY2020-FY2025 entails Rs. 20.3 lakh crore (18% share) investments in the road sector. Hence, going ahead, the roads sector is expected to continue to witness increasing tendering activity providing strong growth opportunities for companies like KNR Constructions. The company already has a strong order backlog of Rs. 8,555 crore (3.7x TTM standalone revenues) as on Q2FY2021 end. Improving tendering activities in the sector are likely to aid in further order accretion. The company had also completed divestment of its Walayar BOT project freeing up equity and paring standalone and consolidated debt, which would ease liquidity. Outstanding receivables of Rs. 740 crore from Telangana government is expected to be received by the end of FY2021 that would further improve balance sheet. Overall, we expect KNR to benefit from a better outlook for the road sector and strengthening balance sheet of the company. KNR is currently trading at a P/E of 15.3x FY2023E standalone earnings with enough levers of earnings upgrade going ahead. Hence, we maintain our Buy rating on the stock with a revised PT of Rs. 367.

Our Call

Valuation –Retain Buy with a revised price target of Rs. 367: KNR is expected to be one of the key beneficiaries from the government's planned investments in the road sector up to FY2025. An already strong order backlog, normalising labour availability, increasing industry tendering, rising toll collections and improving balance sheet are some growth levers, which can lead to earnings upgrade for the company going ahead. Hence, we maintain our Buy rating on the stock with a revised PT of Rs. 367.

Key Risks

Execution delays and a weak macroeconomic environment will lead leading to lull in new project awards.

Valuation (Standalone) Rs cr

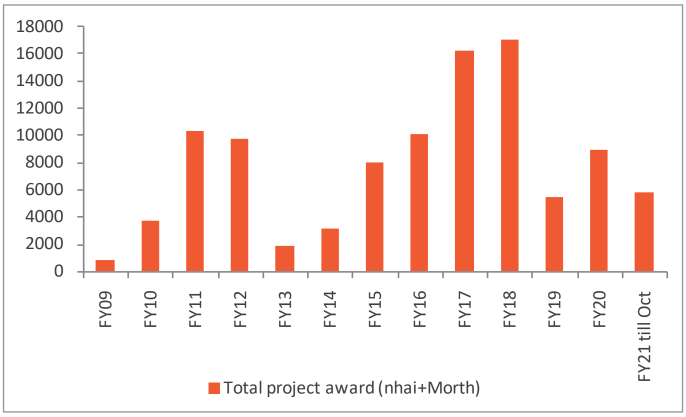
Particulars	FY20	FY21E	FY22E	FY23E
Revenue	2,244.2	2,177.6	2,576.3	2,889.5
OPM (%)	21.7	19.5	19.6	19.5
Adjusted PAT	248.5	190.0	245.0	281.1
% YoY growth	(6.5)	(23.5)	28.9	14.7
Adjusted EPS (Rs.)	17.7	13.5	17.4	20.0
P/E (x)	17.3	22.6	17.5	15.3
P/B (x)	2.6	2.3	2.1	1.8
EV/EBITDA (x)	7.8	9.0	7.5	6.8
RoNW (%)	16.4	11.1	12.7	12.9
RoCE (%)	16.1	11.3	12.9	13.0

Source: Company; Sharekhan estimates

Key indicators hint at better times ahead

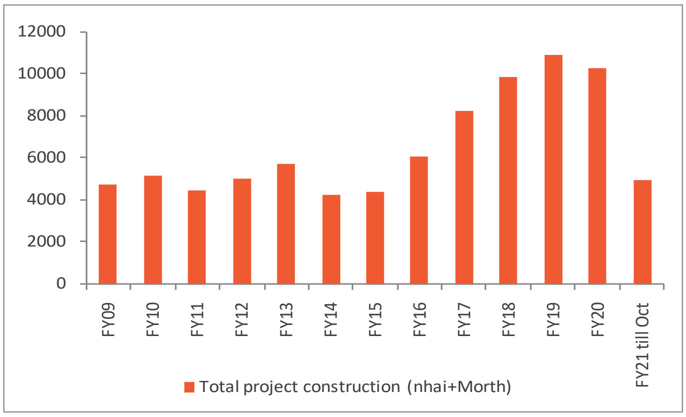
The roads sector saw strong rise in awarding activity for FY2021 till October with project awards of 5,778 km, up 1.9x y-o-y. In October 2020, project awards amounted to 726km, down 17% y-o-y. Overall project construction during FY2021 till October stood at 4,956 km, down 3.3% y-o-y. However, during October 2020, construction of projects was up 2x y-o-y at 1,005 km. Further, November 2020 saw continued momentum in FASTag issuances with a 13% rise compared to February 2020 while it was up 2.1% m-o-m. NHAI had also witnessed toll collections reaching 114% of pre-COVID levels during early November. Rising toll collections bode well for asset monetisation and faster churning of capital for companies. Further, bank credit deployment in the road sector has been rising the since start of FY2021, rising by 7% and 6.4% y-o-y in September and October, respectively. Higher deployment of bank credit to the road sector highlights easing of funding requirements for the sector and would aid in improving execution of under-construction projects and financial closure of newly-bagged projects.

Project Award (MORTH+NHAI) trend



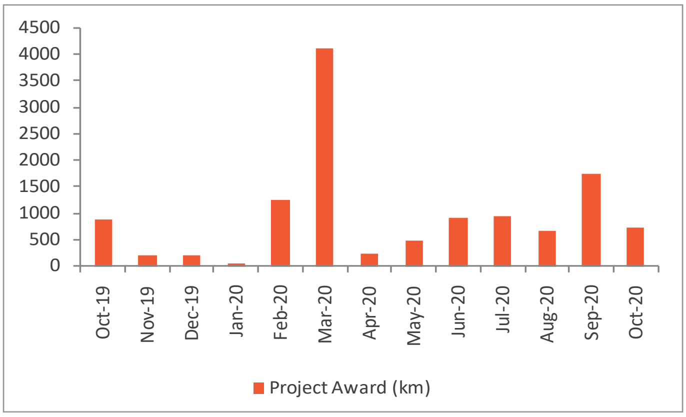
Source: Industry; Sharekhan Research

Project Construction (MORTH+NHAI) trend



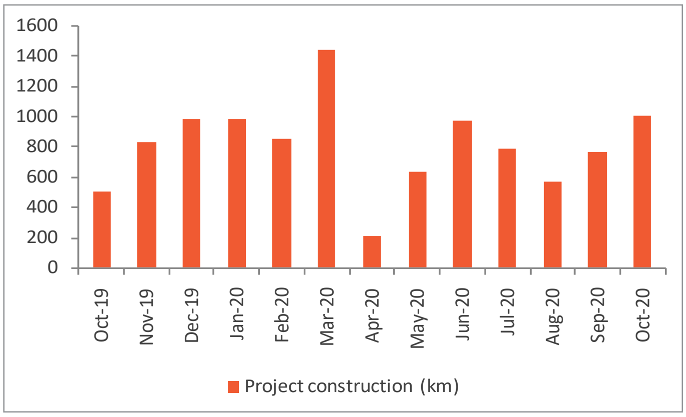
Source: Industry; Sharekhan Research

Project Award Monthly trend



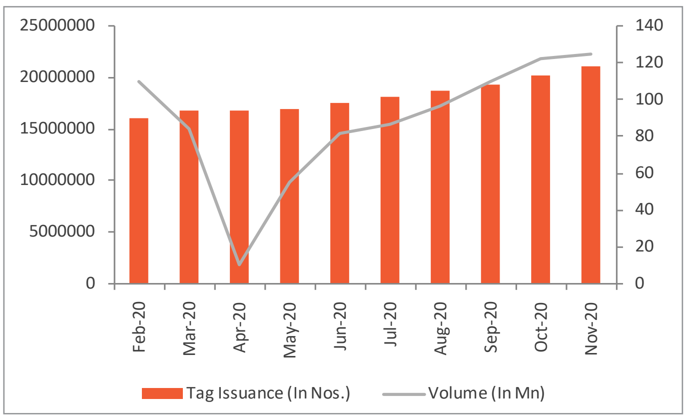
Source: Industry; Sharekhan Research

Project Construction monthly trend



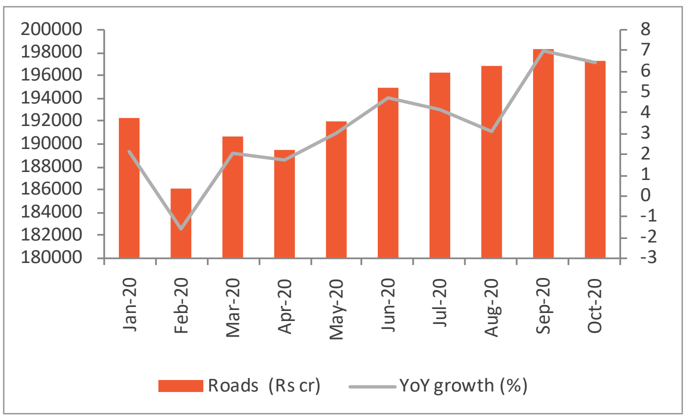
Source: Industry; Sharekhan Research

FASTag trend



Source: Industry; Sharekhan Research

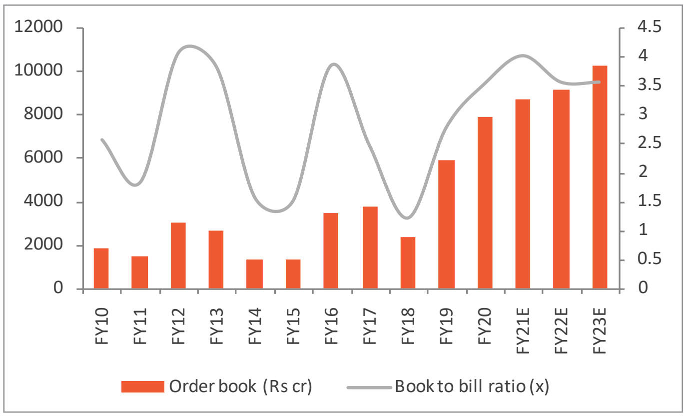
Bank credit deployment in Roads



Source: Industry; Sharekhan Research

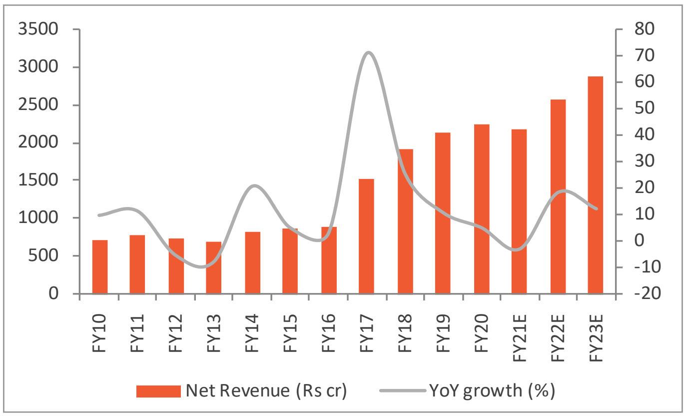
Financials in charts

Order Book trend



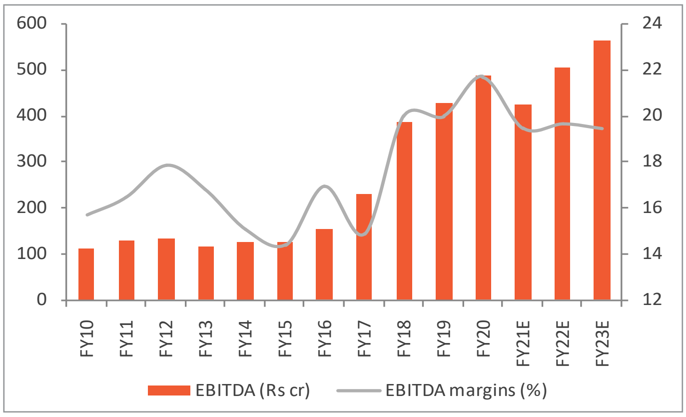
Source: Company, Sharekhan Research

Standalone Revenue trend



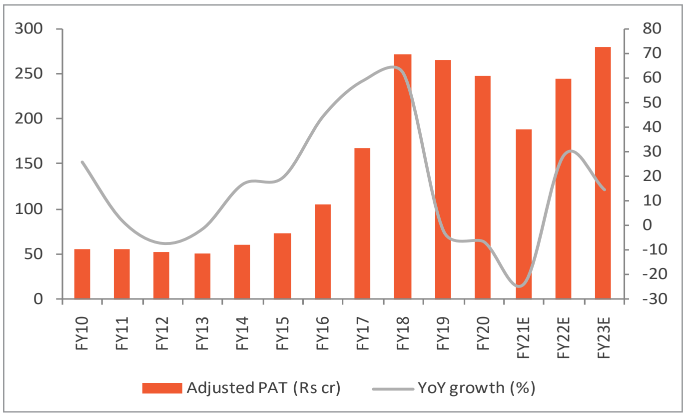
Source: Company, Sharekhan Research

Standalone EBITDA trend



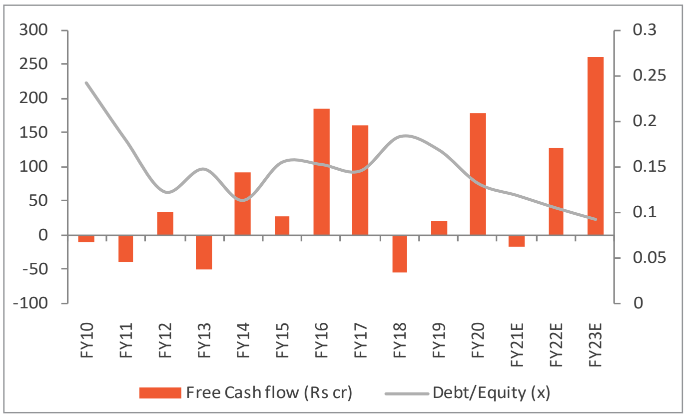
Source: Company, Sharekhan Research

Standalone PAT trend



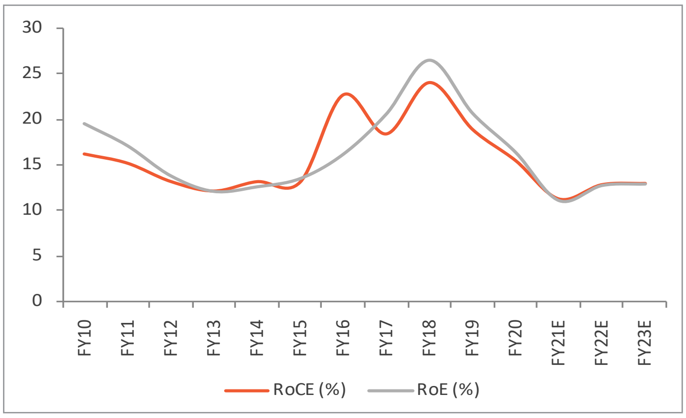
Source: Company, Sharekhan Research

Free Cash Flow and D/E trend



Source: Company, Sharekhan Research

ROCE/ROE trend



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 roads sector is expected to witness Rs. 20 lakh crore investments during the same period. Huge investments along with favourable government policies are expected to provide strong growth opportunities for industry players. The road sector is recovering with near pre-COVID level man-power strength and availability of materials post easing of restrictions after the COVID-19 pandemic led lockdown in the country. 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 NHAI.

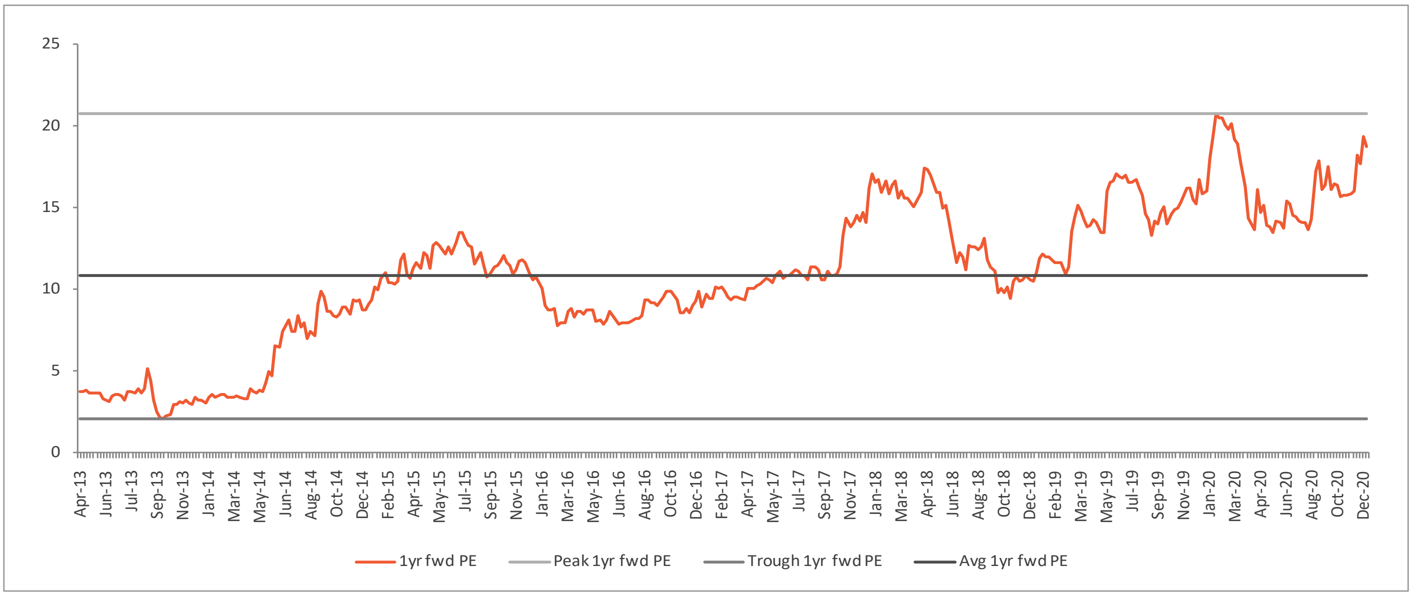
■ Company outlook - Expect execution and order intake to improve

KNR broadly maintained its standalone revenue guidance for FY2021 with Q3FY2021 revenue expected to be similar as that of Q2FY2021 while Q4FY2021 revenue is expected to be better at ~Rs. 700 crore. On the order inflow front, the company expects to bag another Rs. 2000-2500 crore orders for the balance fiscal year. The company's order backlog to Rs. 8,555 crore translates to 3.7x TTM standalone revenues, providing a healthy revenue visibility going ahead. Out of the Rs 740 crore receivables from Telangana government, it expects to receive ~Rs. 300 crore by current month end and balance in Q4FY2021. 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.

■ Valuation - Retain Buy with a price target of Rs. 367

KNR is expected to be one of the key beneficiaries from the government's planned investments in the road sector up to FY2025. An already strong order backlog, normalising labour availability, increasing industry tendering, rising toll collections and improving balance sheet are some growth levers, which can lead to earnings upgrade for the company going ahead. Hence, we maintain our Buy rating on the stock with a revised PT of Rs. 367.

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	13.2	11.2	6.4	5.6	1.4	1.3	11.7	12.3
Sadbhav Engineering	7.3	6.1	5.3	4.8	0.5	0.5	6.9	7.8
KNR Constructions	17.5	15.3	7.5	6.8	2.1	1.8	12.7	12.9

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

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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