

CMP: ₹ 260

Target: ₹ 310 (19%)

Target Period: 12 months

August 14, 2022

BUY

Strong execution during quarter...

About the stock: KNR Constructions is one of the leading companies in the roads and highways sector having executed 6,000+ lane km of projects across 12 states in India. The company also has an established presence in irrigation and urban water infrastructure management.

- Reported 16.3% revenue CAGR over FY17-22 and has consistently delivered industry-leading operating margin
- Prudent management, robust return ratios (RoCE: 20%+)

Q1FY23 Results: KNR delivered a strong set of numbers aided by execution pickup.

- Standalone revenue improved 20.4% YoY to ₹ 890.6 crore, mainly led by its strong order book position and pick-up in execution
- EBITDA margin moderated to 18.5% (down 84 bps YoY; still best in the industry). Effectively, EBITDA was at ₹ 165 crore, up 15.1% YoY
- PAT improved 38.1% YoY of ₹ 100.8 crore

What should investors do? KNR's share price has grown at 21% CAGR over the past five years (from ~₹ 109 in August 2017 to ~₹ 260 levels in August 2022).

- While near term execution could be muted owing to irrigation segment payment delays, we expect the same to pick up pace by FY23 end. We maintain our **BUY** rating on the company

Target Price and Valuation: We value KNR at ₹ 310/share.

Key triggers for future price performance:

- KNR is likely to be one of the prime beneficiaries of roads & water segment
- Strong order book position, receipt of appointed date in most of its projects, and execution pick-up to translate into 13.4% topline CAGR over FY22-24E
- While some near term execution and margin moderation is likely owing to slower irrigation execution; we expect improvement by year end
- Asset-light strategy via monetisation to bring-in incremental cash flows

Alternate Stock Idea: Besides KNR, we like GR Infraprojects in the EPC space.

- Heathy order book position, strong execution and lean balance sheet
- BUY with a target price of ₹ 1,690/share

Key Financial Summary

₹ crore	FY20	FY21	FY22	5 yr CAGR (FY17-22)	FY23E	FY24E	2 yr CAGR (FY22-24E)
Net Sales	2,244.2	2,702.6	3,272.6	16.3%	3,598.0	4,207.1	13.4%
EBITDA	487.1	535.8	677.7	24.2%	611.7	778.3	7.2%
EBITDA Margin (%)	21.7	19.8	20.7		17.0	18.5	
PAT	225.2	244.2	381.8	19.4%	371.6	492.5	13.6%
EPS (₹)	16.0	8.7	13.6		13.2	17.5	
P/E (x)	16.2	29.9	19.2		19.7	14.8	
EV/EBITDA (x)	15.4	13.4	10.3		11.4	8.9	
RoNW (%)	14.5	13.7	16.1		14.3	16.0	
RoCE (%)	19.0	23.4	25.8		19.8	21.7	

Source: Company, ICICI Direct Research



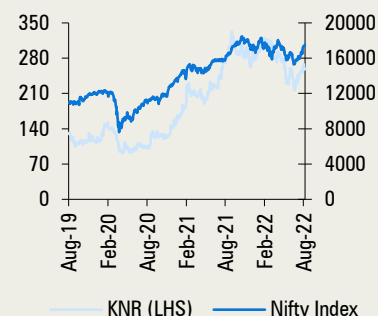
Particulars

Particular	Amount (₹ crore)
Market Capitalization	7,316
Total Debt (FY22)	0
Cash (FY22)	173
EV	7,143
52 week H/L (₹)	344/ 208
Equity capital	56.2
Face value (₹)	2

Shareholding pattern

	Sep-21	Dec-21	Mar-22	Jun-22
Promoters	51.5	51.5	51.5	51.6
DII	33.7	33.9	33.2	33.1
FII	4.3	4.6	5.7	5.7
Other	10.5	10.1	9.6	9.5

Price Chart



Key Risks

Key Risk: (i) Delay in execution of HAM and irrigation projects; (ii) Sustained working capital stress in water/ irrigation projects

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Key business highlight and outlook

Order book position healthy; execution slows down with funding issues in irrigation projects

KNR's order book at the end of Q1FY23 stood at ₹ 8,585.9 crore, mainly contributed by roads - HAM (44%), roads - EPC (30%) and irrigation (26%) segments. Including L1 position in HAM project worth ₹ 765 crore, its order book position is healthy at ₹ 9,350.9 crore (2.7x book to TTM revenues). Going forward, the company is targeting minimum order inflows of ~₹ 3,000 crore during FY23, to be supported by continued traction in roads segment. On the execution front, KNR reported 20.4% revenue growth in Q1FY23 (to ₹ 890.6 crore) driven by its healthy order book position and pick-up in execution mainly in HAM projects. Going forward, the company has guided for ₹ 3,500+ crore of revenue during FY23 and is targeting 10-15% YoY growth in FY24 (vs. ₹ 3,273 crore in FY22) to be aided by elevated level of execution in HAM and EPC projects. However, a) slowed execution pace in irrigation projects due to funding issues at government level and b) early onset of monsoon impacting construction activities to partly impact revenue growth. Further, it has guided that operating margin will moderate to 16-18% with expected change in project mix and increase in input prices such as bitumen, steel, and cement. In line with these, we expect the company to report 13.4% CAGR during FY22-24E with margin to hover at ~17-18.5%.

Debt increases QoQ; dues from irrigation at elevated levels

KNR largely maintains a lean balance sheet structure backed by its prudent strategy to mainly focus on an asset light business model and efficient manage working capital. However, its net debt on a standalone basis has increased to ₹ 80 crore at Q1FY23-end (gross debt: ₹ 124.8 crore; vs. net debt free status at FY22-end) on account of higher working capital requirement. Going forward, it has total equity requirement of ₹ 1,098.5 crore (₹ 522 crore already invested till Q1FY23; ₹ 305 crore estimated to be spent in FY23, ₹ 160 crore in FY24 and balance in FY25) towards already secured HAM projects. Despite these, we expect its debt to remain at minimal levels with healthy operating cash flow generation arising from improved profitability and better cash flow management. Further, its net working capital at the end of Q1FY23 improved to 60 days (vs. 63, 82 days at FY22-end, FY21-end, respectively). However, dues from the irrigation segment continued to remain at an elevated level (~₹ 850 crore; including unbilled revenues) as of Q1FY23-end vs. ₹ 650 at FY22-end due to funding issues for various state government. With these, the company has become cautious towards incremental execution and is now focusing higher on clearance of pending bills, which would aid its working capital cycle to improve further.

Key conference call takeaways

- Industry outlook and ordering pipeline:** The pace of highway construction during Q1FY23 slowed down to 22 km /day (vs. 25 km/day in Q1FY22) mainly impacted by higher input cost and early onset of monsoons. Further, ongoing heavy monsoon period and flood like situations in some places would continue to have an influence on overall construction activities during Q2FY23. However, pace is likely to improve during H2FY23 with softening in input prices. In terms of awarding, MoRTH has tendered 969 km during Q1FY23 (vs. 1,681 km in Q1FY22) and is likely to award 12,000-13,000 km of road projects, respectively, during FY23 (as per Crisil), offering strong order pipeline in the next few quarters. Also, MoRTH/NHAI are contemplating granting ~20% of bid project cost during the construction period of HAM projects (against current norm of 40%). While this would require additional investments by private developers, the authority would be able to bid out more projects with the same capital
- Order inflow:** Order inflows in the recent past have been impacted by a) heightened competition, b) the company's focus on margin protection and c) higher emphasis on projects on southern region. However, **KNR is targeting minimum order inflows of ~₹ 3,000 crore during FY23 with higher focus on roads and highways segment.** The company may diversify into other infra-related sectors such as railways, metro and mining, and different geographies such as Uttar Pradesh and Bihar to keep up momentum in inflows

- **Revenue Breakup:** Roads-HAM projects contributed 40% to the overall Q1FY23 revenue followed by irrigations projects (35%), roads-EPC (20%) and back-to-back contracts (5%). However, the mix is likely to change in the coming quarters with slowed down construction pace in irrigation jobs
- **Under-construction HAM projects:** As on Q1FY23-end, the physical progress on KNR's five under-construction HAM projects was at: a) Trichy-Kallagam: 100%, b) Chittoor-Mallavaram: 100%, c) Ramsanpalle-Mangloor: 100%, d) Magadi-Somwarpeth: 59.1% and e) Oddanchatram-Madathukulam: 68.3%
- **Newly secured HAM projects:** KNR has received appointed date for two HAM projects viz. a) Ramanattukara to Valanchery and b) Valanchery to Kappirikkad on January 21, 2022. The physical progress as on Q1FY23 end was at 5.6% and 6.4%, respectively. The management expects ~40% physical progress in these two projects by FY23-end (would have been better; but impacted by early onset of monsoons). Further, KNR signed a concession agreement for Chittoor – Thatchur section (Package-3) on November 17, 2021 and achieved financial closure on March 30, 2022. The project is facing delays in land acquisition (50% available currently; 80% expected by September 2022-end). Receipt of appointed date is likely by December 2022
- **Irrigation projects:** KNR has slowed down execution pace at its existing irrigation jobs due to major payment issues from state government (outstanding dues: ~₹ 850 crore at Q1FY23 end). The company has been communicated regarding partial payment over the next two to three months. However, it has become cautious towards incremental execution and is currently focusing more on clearance of pending bills. Additionally, heavy monsoons are currently impacting the execution pace
- **Deal with Cube Highways:** KNR has transferred its 49% stake in KNR Tirumala Infra Pvt Ltd and KNR Shankarampet Projects Pvt Ltd to Cube Highways for ₹ 136.8 crore and ₹ 108.5 crore, respectively. Additionally, the company expects to transfer its 100% stake in KNR Srirangam Infra Pvt Ltd in the near term. Overall, KNR expects to receive ₹ 200-220 crore from the sale, going ahead
- **Income tax matter:** The Income-Tax (IT) Department had carried out a search operation at the company's various business premises in March 2022. The company has extended full cooperation to IT officials during the search. As on date, KNR has not received any formal communication from the IT department. However, it is known that the search team from the I-T department is preparing an "appraisal report", which is likely to be passed on to the central circle (responsible to investigate the matter ahead). If some demand arises from the circle team after the examination, the company has the option to challenge it. However, the management is currently of the view that this will not have any impact on the company's financial position. Hence, no provision for any liability has been recognised till now
- **Debt and debt position:** Standalone gross debt at the end of Q1FY23 has increased to ₹ 124.8 crore vs. nil at FY22-end). Also, the company holds cash and cash equivalent of ₹ 45 crore. The increase in debt is mainly due to higher working capital requirement as KNR's irrigation segment is suffering from payment issues (from state government). However, the management expects KNR to attain net debt free position by FY23-end with considerable decline in pending dues with clearance of bills
- **Capex:** KNR has incurred a capex of ~₹ 60 crore during Q1FY23. However, the management has guided for moderated level of overall capex to the tune of ₹ 120-150 crore in FY23 (vs. ₹ 200+ crore in FY22) with no major machinery to be added in the irrigation segment

KNR is a proxy play on increased focus on roads and overall infrastructure push. This is considering a) strong execution, b) healthy margins, c) monetisation of BOT/HAM assets, d) healthy balance sheet and e) strong return ratios. We maintain BUY rating on the stock with an SOTP TP of ₹ 310.

Exhibit 1: Variance analysis

Particulars	Q1FY23	Q1FY23E	Q1FY22	YoY (%)	Q4FY22	QoQ (%)	Comments
Total Operating Income	890.6	777.0	740.0	20.4	1010.7	-11.9	Pick-up in execution led to topline growth
Other Income	9.1	8.0	4.8	88.9	18.5	-51.0	
Consumption of raw materials	433.1	279.7	329.2	31.5	306.7	41.2	
Employee benefit expenses	38.6	38.8	33.5	15.1	41.0	-5.8	
Other Expenses	48.0	62.2	62.7	-23.5	56.8	-15.5	
EBITDA	165.0	143.7	143.3	15.1	208.0	-20.7	
EBITDA Margin(%)	18.5	18.5	19.4	-84 bps	20.6	-205 bps	Margin moderated due to change in project mix and increase in raw material prices
Depreciation	32.7	41.9	26.9	21.3	39.9	-18.0	
Interest	6.9	6.0	7.9	-12.2	6.0	15.4	
PBT	134.5	103.9	113.3	18.7	180.6	-25.6	
Taxes	33.6	26.5	40.3	-16.5	67.9	-50.5	
PAT	100.8	77.4	73.0	38.1	112.8	-10.6	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	FY22		FY23E			FY24E			Comments
	Old	New	Old	New	% Change	Old	New	% Change	
Revenue	3,273	3,578	3,598		1	4,273	4,207	-1.5	Realign estimates
EBITDA	678	608	612		1	791	778	-1.5	
EBITDA Margin (%)	20.7	17.0	17.0		0 bps	18.5	18.5	0 bps	
PAT	382	349	372		6.6	494	493	-0.4	Change in PAT due to realignment of revenue, depreciation and tax rate
Diluted EPS (₹)	13.6	12.4	13.2		6.6	17.6	17.5	-0.4	

Source: Company, ICICI Direct Research

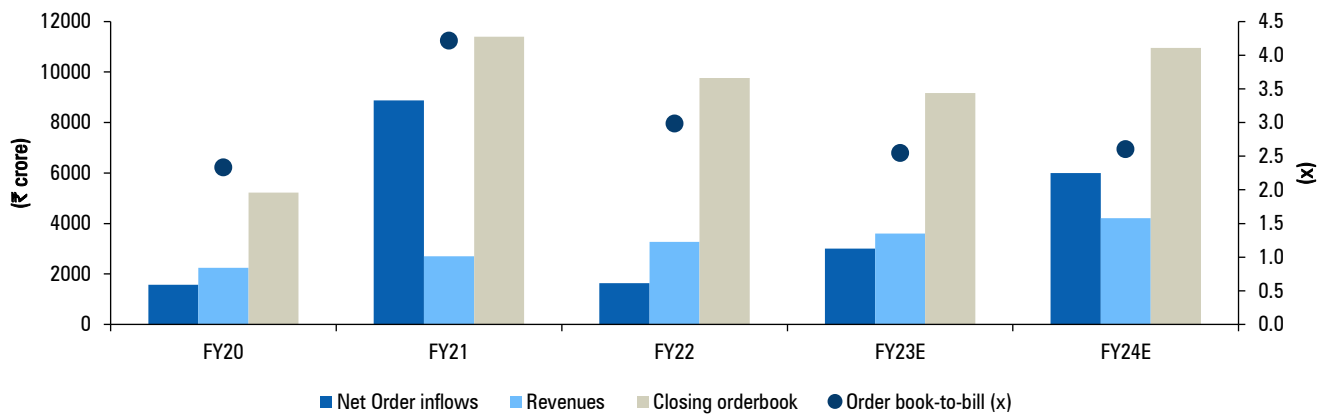
Company Analysis

Exhibit 3: Order book update

Key Projects	(₹ crore)
Ramanattukara to Valanchery bypass project (HAM)	1,648
Valanchery Bypass to Kappirikkad project (HAM)	1,494
Bangalore-Mangalore Project (Periya Shanthi to Bntwal) (EPC)	918
Elevated Highway along Avinashi Road in Coimbatore City (EPC)	784
Cheyur-Panayur Road (EPC)	426
Top Five projects	5,268
Other Road projects	1,108
Irrigation projects	2,210
Total	8,586

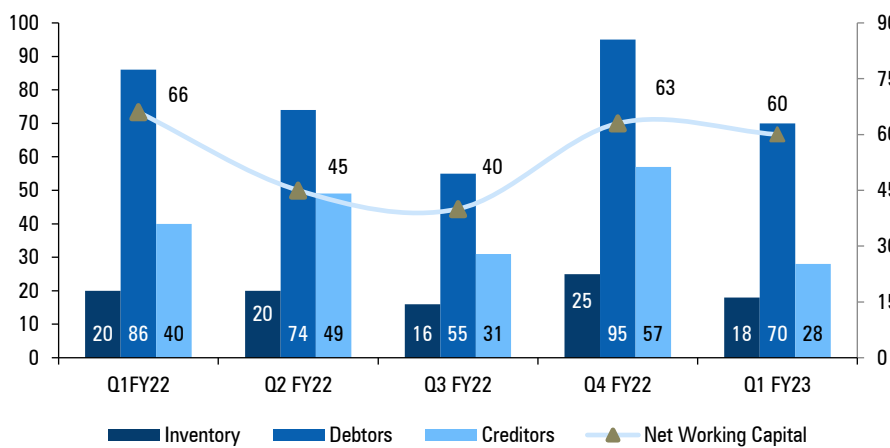
Source: Company, ICICI Direct Research

Exhibit 4: Strong order book position



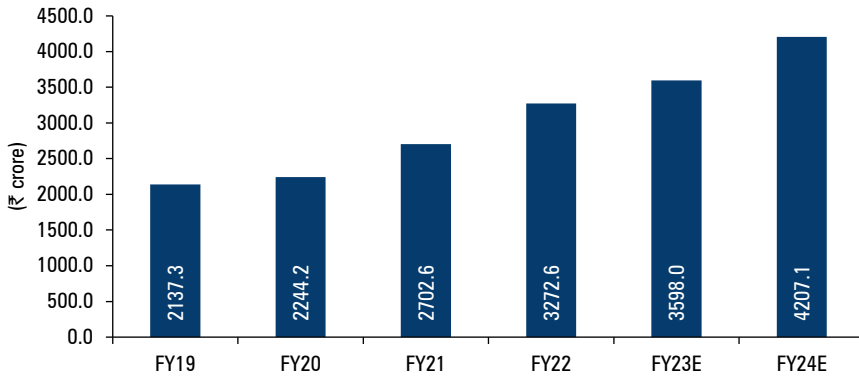
Source: Company, ICICI Direct Research; FY21 order book includes won 2 HAM and 1 EPC project worth ₹4,323 crore

Exhibit 5: Net working capital days trend



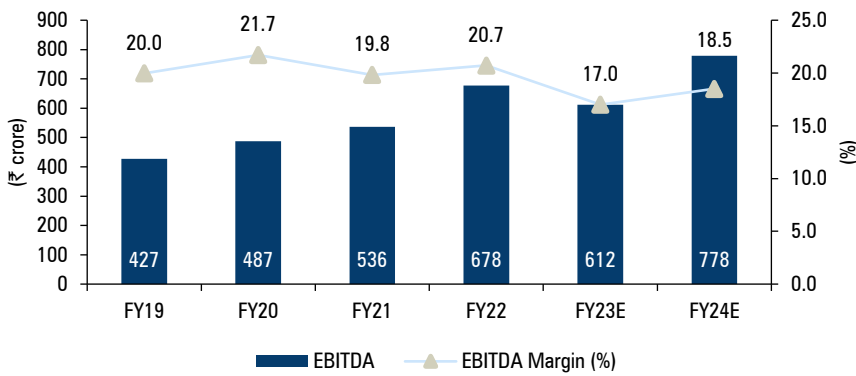
Source: Company, ICICI Direct Research

Exhibit 6: Healthy revenue growth ahead



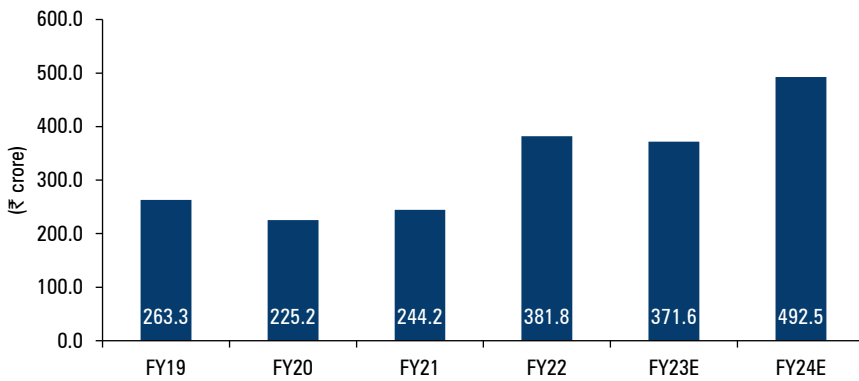
Source: Company, ICICI Direct Research

Exhibit 7: EBITDA & EBITDA margin trend



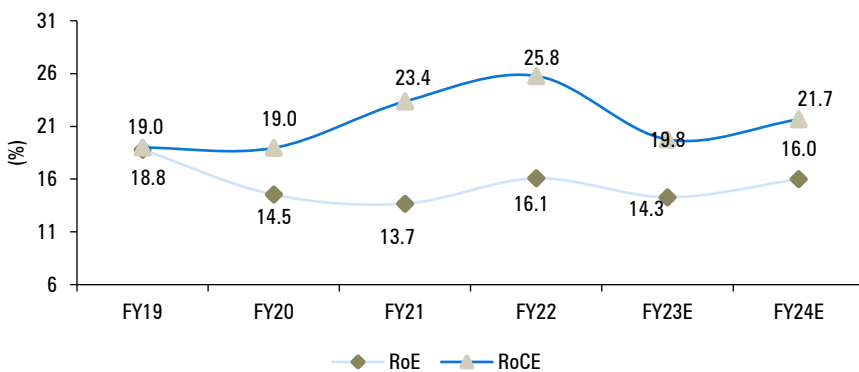
Source: Company, ICICI Direct Research

Exhibit 8: PAT trend



Source: Company, ICICI Direct Research

Exhibit 9: Return ratios trend



Source: Company, ICICI Direct Research

Valuation & Outlook

KNR is a focused road based EPC player that enjoys a strong execution track record with the reputation of completing projects on time/ahead of the schedule. The company also enjoys healthy balance sheet and strong return ratio. Also, its equity commitment is likely to be supported by internal cash generation, HAM monetisation and irrigation dues recovery. While debt at the standalone level has increased during Q1FY23, the company is likely to attain net debt free position by FY23-end with considerable decline in pending dues with clearance of bills.

Hence, we maintain our **BUY** recommendation on the stock with an SoTP based target price of ₹ 310/share. We value its core EPC business at ₹ 280/share (16x FY24E P/E).

Exhibit 10: SoTP valuation

	Value (₹ crore)	Per Share (₹)	Comment
EPC Business (A)	7881	280	16x FY24E P/E
BOT toll Investment (B = C+D)	90	3	
Muzaffarpur tollway (D)	90	3	1x P/BV
HAM Projects Investment (E)	623	22	Cube highway deal assigned value for tranferred project and 1x P/BV - investment till date for remaining
Total Equity Investment (F=B+E)	713	25	
SoTP Value (A+F-G)	8594	306	
Rounded-off target price		310	

Source: Company, ICICI Direct Research

Financial summary

Exhibit 11: Profit and loss statement				
	₹ crore			
(₹ Crore)	FY21	FY22	FY23E	FY24E
Net Sales	2,702.6	3,272.6	3,598.0	4,207.1
Other operating income	-	-	-	-
Total Revenues	2,702.6	3,272.6	3,598.0	4,207.1
Raw Material Expense	926.5	1,180.7	1,331.3	1,556.6
Other Construction Exp.	810.0	1,016.5	1,133.4	1,262.1
Employee benefit expenses	132.1	144.8	179.9	210.4
Other Expenses	298.3	252.9	341.8	399.7
Total Operating Exp	2,166.8	2,594.9	2,986.4	3,428.8
EBITDA	535.8	677.7	611.7	778.3
Other Income	49.6	41.7	46.3	50.3
Interest	48.7	27.4	24.3	17.3
Depreciation	144.4	134.6	138.3	154.6
PBT	381.1	578.8	495.4	656.7
Total Tax	137.0	197.0	123.9	164.2
Reported PAT	244.2	381.8	371.6	492.5
Adjusted PAT	255.4	360.4	371.6	492.5
EPS (Diluted)	8.7	13.6	13.2	17.5

Source: Company, ICICI Direct Research

Exhibit 13: Balance sheet				
	₹ crore			
(₹ Crore)	FY21	FY22	FY23E	FY24E
Liabilities				
Share Capital	56.2	56.2	56.2	56.2
Reserves & Surplus	1,811.6	2,185.7	2,546.1	3,023.9
Networth	1,867.8	2,242.0	2,602.4	3,080.1
Secured Loan	0.7	-	-	-
Unsecured Loan	-	-	-	-
Total Debt	0.7	-	-	-
Deferred Tax Liability	-	-	-	-
Total Liabilities	1,888	2,269	2,631	3,112
Assets				
Gross Block	1,285.9	1,497.2	1,627.2	1,777.2
Net Block	337.7	414.4	406.1	401.5
Capital WIP	2.4	20.6	20.6	20.6
Non-current Investments	555.7	407.2	695.5	991.4
Current Assets				
Inventories	148.0	227.0	236.6	265.1
Sundry Debtors	863.2	849.4	788.6	864.5
Loans and Advances	33.8	38.4	39.4	41.3
Other Current Assets	633.1	753.0	933.0	1,113.0
Cash	117.3	173.3	210.4	276.0
Total Current Assets	1,678.1	1,867.9	1,997.6	2,283.9
Creditors	239.7	294.5	323.8	378.7
Provisions	25.7	24.0	26.3	30.8
Other Current Liabilities	766.9	742.0	788.6	922.1
Other Long Term Liabilities	11.0	17.0	18.7	21.9
Total Current Liabilities	1,032.4	1,060.5	1,138.8	1,331.6
Net Current Assets	736.8	1,093.8	1,182.3	1,341.5
Total Assets	1,888	2,269	2,631	3,112

Source: Company, ICICI Direct Research

Exhibit 12: Cash flow statement				
	₹ crore			
₹ crore	FY21	FY22	FY23E	FY24E
Profit before Tax	381.1	578.8	495.4	656.7
Depreciation	144.4	134.6	138.3	154.6
Interest Paid	48.7	27.4	24.3	17.3
Others	2.8	(49.0)	(46.3)	(50.3)
Cash Flow before WC changes	577.1	691.8	611.7	778.3
Net Increase in Current Assets	(361.5)	(224.5)	(123.3)	(316.7)
Net Increase in Current Liabilities	161.1	58.6	80.0	195.9
Taxes paid	(78.7)	(182.6)	(123.9)	(164.2)
Net CF from Operating Activities	298.0	343.2	444.5	493.4
(Purchase)/Sale of Fixed Assets	(93.9)	(293.9)	(130.0)	(150.0)
Loans and Inv in JV/SPV	138.8	29.3	(288.3)	(295.9)
Others	16.3	16.3	46.3	50.3
Net CF from Investing Activities	61.2	(248.3)	(372.0)	(395.6)
Debt Proceeds/Repayment	(229.0)	(0.7)	-	-
Interest Paid	(45.9)	(31.2)	(24.3)	(17.3)
Others	-	(7.0)	(11.1)	(14.8)
Net CF from Financing Activities	(274.9)	(39.0)	(35.4)	(32.0)
Net Cash flow	84.3	56.0	37.1	65.7
Opening Cash/ Cash Equivalent	33.0	117.3	173.3	210.4
Closing Cash/ Cash Equivalent	117.3	173.3	210.4	276.0

Source: Company, ICICI Direct Research

Exhibit 14: Key ratios				
(Year-end March)	FY21	FY22	FY23E	FY24E
Per Share Data				
EPS (Fully Diluted)	8.7	13.6	13.2	17.5
Cash EPS	13.8	18.4	18.1	23.0
BV	66.4	79.7	92.5	109.5
Operating Ratios				
EBITDA / Net Sales	19.8	20.7	17.0	18.5
PAT / Net Sales	9.5	11.0	10.3	11.7
Inventory Days	20	25	24	23
Debtor Days	117	95	80	75
Creditor Days	32	33	33	33
Return Ratios				
RoE	13.7	16.1	14.3	16.0
RoCE	23.4	25.8	19.8	21.7
RoIC	32.3	35.6	30.3	37.1
Valuation Ratios				
EV / EBITDA	13.4	10.3	11.4	8.9
P/E	29.9	19.2	19.7	14.8
EV / Net Sales	2.7	2.1	1.9	1.6
Market Cap / Sales	2.7	2.2	2.0	1.7
Price to Book Value	3.9	3.3	2.8	2.4
Turnover Ratios				
Asset turnover	1.4	1.4	1.4	1.4
Gross Block Turnover	2.1	2.2	2.2	2.4
Solvency Ratios				
Debt / Equity	0.0	-	-	-
Current Ratio	1.6	1.8	1.8	1.7
Debt / EBITDA	0.0	-	-	-
Quick Ratio	1.5	1.5	1.5	1.5

Source: Company, ICICI Direct Research

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Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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