



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	✓	↔	✓

ESG Disclosure Score

NEW

ESG RISK RATING
Updated Jul 08, 2022

39.81

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

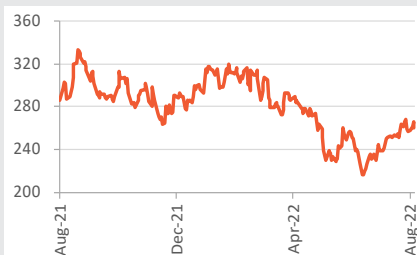
Company details

Market cap:	Rs. 7,311 cr
52-week high/low:	Rs. 344 / 208
NSE volume: (No of shares)	2.2 lakh
BSE code:	532942
NSE code:	KNRCON
Free float: (No of shares)	13.6 cr

Shareholding (%)

Promoters	51.6
FII	5.7
DII	33.3
Others	9.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	5.7	13.0	-14.0	-9.0
Relative to Sensex	-5.4	0.4	-19.5	-16.3

Sharekhan Research, Bloomberg

KNR Constructions Ltd

Healthy Q1; Irrigation receivables key monitorable

Infrastructure

Sharekhan code: KNRCON

Reco/View: Buy



CMP: Rs. 260

Price Target: Rs. 333



Upgrade



Maintain



Downgrade

Summary

- KNR Constructions Limited (KNR) reported a healthy beat in execution while OPM remained in-line for Q1FY2023. However, net earnings beat estimates led by lower than expected depreciation and higher other income.
- Management retained a Rs. 4,000-5,000 crore order inflow target for FY2023. It largely maintained Rs. 3500 crore plus standalone revenue guidance and 17-18% OPM for FY2023. It expects FY2024 standalone revenues to rise 10-15% y-o-y.
- High receivables outstanding in irrigation segment may lead to lower execution in the near term and hit OPM. However, collections are expected to start post two months.
- We retain a Buy on KNR with an unchanged PT of Rs. 333, considering healthy growth outlook led by strong order book.

KNR Constructions Limited (KNR) reported healthy beat on standalone revenues (Rs. 891 crore, up 20% y-o-y), in-line OPM (18.5%, down 84 bps y-o-y) while net earnings beat estimates led by lower-than-expected depreciation (down 18% q-o-q, lower capex on Irrigation) and higher other income (up 89% y-o-y). The order book including recently won hybrid-annuity model (HAM) projects, remains healthy at Rs. 9351 crore (2.7x TTM standalone revenues) while it retained its order inflow target of Rs. 4000-5000 crore for FY2023. The management largely retained its Rs. 3500 crore plus revenue and 18-19% OPM guidance for FY2023 and expects 10-15% standalone revenue growth for FY2024. However, high outstanding receivables in Irrigation (Rs. 850 crore) from Telangana state government can slow execution and subsequently hit overall OPM (Irrigation has 17-18% OPM) in the near term. The management expects to start receiving payments after two months as communicated by the state government.

Key positives

- Standalone revenues grew by 20% y-o-y for Q1FY2023 along with OPM remaining in-line at 18.5% led by higher share of revenues from the irrigation segment.
- Other income was up 89% y-o-y while depreciation was lower 18% q-o-q.

Key negatives

- Standalone debt increased to Rs. 125 crore from nil in Q4FY2022 on account of increasing receivables from Irrigation segment.
- Order inflows remained muted in the industry which is expected to pick up from next month.

Management Commentary

- The company retained its order inflow target of Rs. 4000-5000 crore for FY2023 while it would need to bag minimum Rs. 3000 crore orders to sustain growth post FY2024. It also largely retained Rs. 3500 crore plus standalone revenue guidance for FY2023 and expects a 10-15% revenue growth for FY2024. OPM for FY2023 is expected to be at 18-19%.
- The NHAI awarding is expected to pick up from next month. The company is participating in Rs. 2000 crore works in Kerala, three projects in Tamil Nadu, Flyovers in Chennai, few projects in Bihar and UP and some projects in Telangana.
- It would take another two months to close the deal. It would be receiving Rs. 200-220 crores.

Revision in estimates – We have marginally increased our net earnings estimates for FY2023 and FY2024, factoring in lower depreciation.

Our Call

Valuation – Retain Buy with an unchanged PT of Rs. 333: KNR continued to report strong execution along with high OPM which is largely to sustain over FY2023-FY2024. However, high irrigation receivables outstanding pose a challenge in terms of lower execution and pressure on overall OPM due to high margins in the irrigation vertical. The company's order book provide healthy revenue visibility over the next two years but would have to bag projects from hereon to sustain revenue growth post FY2024. The company would turn again nil debt once it starts receiving pending payments in Irrigation vertical. We retain our Buy recommendation with an unchanged price target (PT) of Rs. 333, considering healthy growth outlook led by strong order book.

Key Risks

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

Valuation (Standalone)

Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenue	2,702.6	3,272.6	3,543.8	3,893.3
OPM (%)	19.8	20.7	19.1	19.1
Adjusted PAT	255.4	360.4	424.6	469.1
% YoY growth	8.3	41.1	17.8	10.5
Adjusted EPS (Rs.)	9.1	12.8	15.1	16.7
P/E (x)	28.6	20.3	17.2	15.6
P/B (x)	3.8	3.2	2.7	2.3
EV/EBITDA (x)	12.7	10.1	10.1	9.2
RoNW (%)	14.5	17.5	17.4	16.3
RoCE (%)	15.3	18.5	18.1	16.8

Source: Company; Sharekhan estimates

Healthy operational performance; PAT beat estimates

KNR reported a 20.4% y-o-y rise (-11.9% q-o-q) in standalone net revenues at Rs. 891 crore which was 5% higher than our estimate. OPM at 18.5% (-84 bps y-o-y, -205 bps q-o-q) was in-line with our estimate. Standalone operating profit grew by 15.1% y-o-y (down 20.7% q-o-q) to Rs. 165 crore which was 5% higher than our estimate. Lower-than-expected depreciation (up 21% y-o-y), higher other income (up 89% y-o-y) and lower effective tax rate (25% vs 35.5% in Q1FY2022) led to strong beat on standalone net profit which stood at Rs. 101 crore (up 38% y-o-y). Standalone net working capital days reduced to 60 days versus 63 days in Q4FY2022. The order book stands strong at Rs. 9,351 crore, 2.7x TTM standalone revenues.

Key conference call takeaways

- ♦ **Guidance:** The company retained its order inflow target of Rs. 4000-5000 crore for FY2023 while it would need to bag minimum Rs. 3000 crore orders to sustain growth post FY2024. It also largely retained Rs. 3500 crore plus standalone revenue guidance for FY2023 and expect a 10-15% revenue growth for FY2024. The OPM for FY2023 are expected to be at 18-19%.
- ♦ **Bid pipeline:** The NHAI awarding is expected to pick up from next month. The company is participating in Rs. 2000 crore works in Kerala, three projects in Tamil Nadu, Flyovers in Chennai, few projects in Bihar and U.P. and some projects in Telangana.
- ♦ **Cube deal:** It would take another two months to close the deal. KNR would be receiving Rs. 200-220 crores.
- ♦ **Industry:** The inflationary environment affected construction activities during Q1FY2023. Road construction stood at 22km/day in Q1FY2023 as against 25km/day in Q1FY2022. The construction is expected to remain subdued in Q2 and expected to bounce back from H2FY2023. As per CRISIL, road construction is expected at 32-34km/day for FY2023. MORTH and NHAI is targeting to award 12000-13000km road projects in FY2023. NHAI's planned reduction of upfront payment in HAM projects from 40% to 20% is expected to curtail non-serious bidders. Its monetisation plan of operational highways would ease balance sheet leverage. The road ministry is planning for GPD-based toll collections.
- ♦ **Irrigation:** The company has outstanding receivables of Rs. 850 crore as on June 2022 in Irrigation. The receivables increased from Rs. 650 crore as on 31st May to Rs. 850 crore as on July 2022. Post March 2022, it had received Rs. 130 crore. Due to piling of outstanding receivables, it has slowed down execution. The Telangana state government is expected to pay after two months.
- ♦ **Q1FY2023 revenue mix:** The revenue break up is as follows - Irrigation - 35%, Roads - HAM 40% and Road EPC 20%. It has booked Rs. 300 crore revenues from Irrigation on work completion basis while about Rs. 400 crores have not been reduced from the irrigation order book awaiting certification of work by authorities.
- ♦ **Equity investment:** Out of the total equity requirement of Rs. 1092 crore in HAM projects, it has invested Rs. 522 crore and balance Rs. 570 crore will be invested as follows Rs. 305 crore in FY2023, Rs. 160 crore in FY2024 and Rs. 105 crore in FY2025.
- ♦ **Order book:** The order book as on June 2022 stood at Rs. 8586 crore comprising EPC & HAM projects – 74% and Irrigation – 26%. Including recently won HAM project, the order book is at Rs. 9,351 crore.
- ♦ **Debt:** Standalone debt and cash stood at Rs. 125 crore and Rs. 45 crore. Consolidated debt and cash stood at Rs. 1,592 crore and Rs. 200 crore. The consolidated net debt to equity is at 0.66x.
- ♦ **Depreciation:** KNR accounts for a 3-year lifecycle for irrigation equipments and 7 years for roads. The lower depreciation in Q1FY2023 is on account of no additions in irrigation machinery. The depreciation is expected to be at Rs. 30-33 crore per quarter level going ahead.
- ♦ **Capex:** The company incurred Rs. 60-crore capex in Q1FY2023.
- ♦ **IT raids:** In 2011, the tax authorities had conducted search operations and levied claims and penalties which the company had initially paid and then challenged the order and received the amount back.
- ♦ **Project execution update:** The Chittoor-Mallavaram, Ramsanpalle-Mangloor and Trichy-Kallagam projects are complete. Magadi-Somwarpet – 59.1%, Oddanchatram-Madathukulam – 68.3%, Ramanattukara-Valanchery – 5.6% and Valanchery-Kappirikkad – 6.4%.

Results (Standalone)

					Rs cr
Particulars	Q1FY2023	Q1FY2022	Y-o-Y %	Q4FY2022	Q-o-Q %
Net revenue	890.6	740.0	20.4%	1010.7	-11.9%
Other income	9.1	4.8	88.9%	18.5	-51.0%
Total income	899.7	744.8	20.8%	1029.3	-12.6%
Total expenses	725.6	596.7	21.6%	802.7	-9.6%
Operating profit	165.0	143.3	15.1%	208.0	-20.7%
Depreciation	32.7	26.9	21.3%	39.9	-18.0%
Interest	6.9	7.9	-12.2%	6.0	15.4%
Exceptional items	0.0	0.0		0.0	
Profit Before Tax	134.5	113.3	18.7%	180.6	-25.6%
Taxes	33.6	40.3	-16.5%	67.9	-50.5%
PAT	100.8	73.0	38.1%	112.8	-10.6%
Adjusted PAT	100.8	73.0	38.1%	112.8	-10.6%
EPS (Rs.)	3.6	2.6	38.1%	4.0	-10.6%
			bps		bps
OPM (%)	18.5%	19.4%	-84	20.6%	-205
NPM (%)	11.3%	9.9%	146	11.2%	16
Tax rate (%)	25.0%	35.5%	-1055	37.6%	-1256

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Roads to remain one of the 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 improved execution run-rate from Q3FY2021. Working capital issues of the companies have been handled by proactive payments from the NHAI.

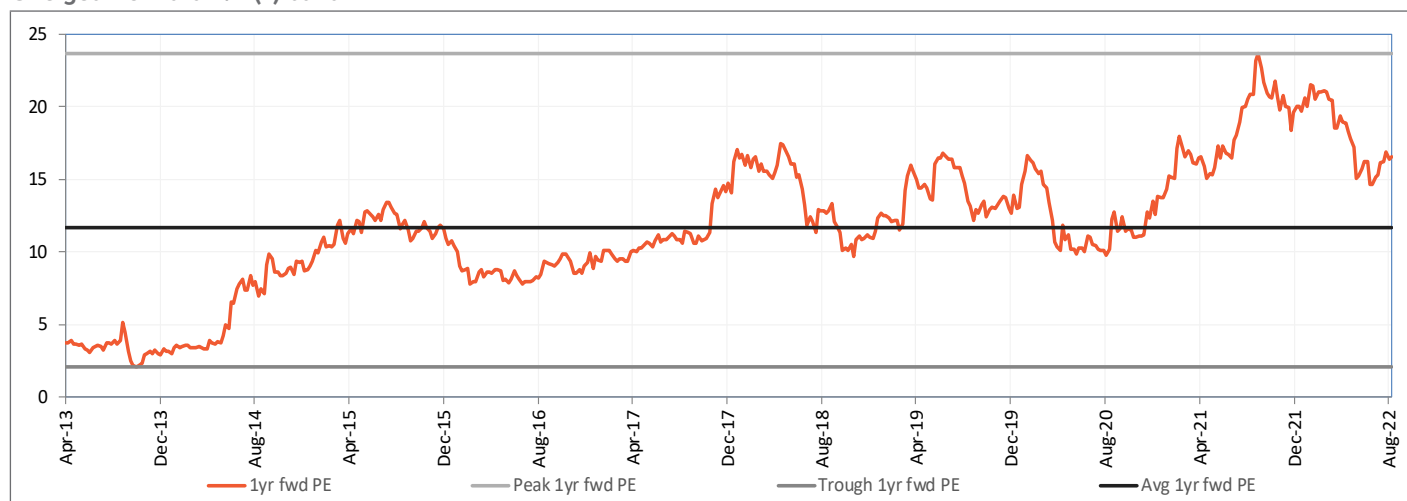
■ Company Outlook – Strong order backlog provides comfort

The company is conservatively targeting over Rs. 3500 crore in standalone revenues for FY2023 owing to half of its order book concentrated in states that have received early arrival of monsoons. The company was unable to bag projects during FY2022 due to weak tendering activities till February 2022, while March 2022 saw increased competitive environment. However, KNR targets to bag Rs. 4,000-5,000 crore orders in FY2023 and may look at other sectors such as railways, metro projects, and mining if it is unable to bag projects till Q3FY2023. The company has a strong order backlog at almost 3x its TTM standalone revenue, providing strong revenue visibility over the next two years. However, new project order wins during FY2023 would be a key monitorable.

■ Valuation – Retain Buy with a revised PT of Rs. 333

KNR continued to report strong execution along with high OPM which is largely to sustain over FY2023-FY2024. However, high irrigation receivables outstanding pose a challenge in terms of lower execution and pressure on overall OPM due to high margins in the irrigation vertical. The company's order book provide healthy revenue visibility over the next two years but would have to bag projects from hereon to sustain revenue growth post FY2024. The company would turn again nil debt once it starts receiving pending payments in Irrigation vertical. We retain our Buy recommendation with an unchanged price target (PT) of Rs. 333, considering healthy growth outlook led by strong order book.

One-year forward P/E (x) band



Source: Company, 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	12.3	11.2	6.9	6.3	1.7	1.5	14.9	14.2
KNR Constructions	17.2	15.6	10.1	9.2	2.7	2.3	17.4	16.3

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 the possibility of receiving an early completion bonus.

Key Risks

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

Additional Data

Key management personnel

Mr. K. Narasimha Reddy	Founder Promoter and Managing Director
Mr. K. Jalandhar Reddy	Promoter and Executive Director
Mr. M.V. Venkata Rao	Company Secretary and 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. Ltd.	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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