

13 February 2023

## KNR Construction

*Irrigation exposure pruned, orders needed; retaining our Buy rating*Rating: **Buy**

Target Price: Rs.322

Share Price: Rs.263

On healthy recoveries from Telangana irrigation orders and as the monetisation of three hybrid annuities was consummated in entirety, KNR regained its net-cash status. Irrigation receipts mean execution stabilises at such orders, and the recent appointment of Chittor-Thatchur mean the project is set to start contributing. These augur well, but order additions remain an area of concern, and need to be addressed at the earliest. A general trend of year-end surge in awarding, and openness to explore new segments could work to KNR's benefit, but it is not willing to compromise on margins. Though near-term challenges persist, KNR has its priorities right. We retain our Buy rating, with a slightly lower TP of Rs322 (from Rs328 earlier).

**Need orders, to explore new segments.** Though it did not have any orders in Q3, the inclusion of the recently appointed Chittor-Thatchur hybrid annuity in the OB upped the assurance ~Rs0.6bn q/q to ~Rs81bn (~2.3x TTM). It looks to add Rs40bn-50bn more in a year to keep growing, and has its eyes set on 10-12 tenders in Feb'23, and 22 for Mar'23. Stiff competition in roads concerns KNR. It does not intend to add orders at the cost of profitability. Openness to explore Railways (scouting for a JV partner), and metro-rail orders augur well.

**Telangana exposure, update.** With ~Rs4.5bn of gross receipts subsequent to Q2 FY23, the balance sheet exposure is down to ~Rs6.5bn (from ~Rs9bn a quarter back). Management expects a healthy payment cycle for the funded order (Kaleshwaram Package-IV, lenders in place), and hopes for receipts of ~Rs0.5bn a month for the other three orders, funded from the state budget.

**Net-cash status regained.** Monetisation proceeds (~Rs2.2bn, net of taxes) and pruned irrigation exposure (~Rs2.5bn q/q) more than sufficed to cover the ~Rs1.2bn equity infused and ~Rs0.35bn capex, and also helped repay end-Q2 gross debt of ~Rs2bn. At end-Q3, KNR was left with ~Rs1.25bn net cash.

**Valuation.** We prune FY23e inflows. We incorporate more-than-expected profits from asset monetisation and additional tax provisioning in Q3. Net income is, thus, ~0.4% down for FY23, ~3% for FY24 and ~1% for FY25. At the CMP, the stock (excl. investments) trades at 11.7x FY25e EPS. **Risk:** Delayed orders.

Key financials (YE Mar)	FY21	FY22	FY23e	FY24e	FY25e
Sales (Rs m)	27,026	32,726	35,698	39,529	45,470
Adj. Net profit (Rs m)	2,554	3,658	3,661	4,472	5,171
EPS (Rs)	9.1	13.0	13.0	15.9	18.4
Growth (%)	8.3	43.2	0.1	22.1	15.6
P/E (x)	23.5	21.8	20.2	16.5	14.3
EV / EBITDA (x)	11.0	11.5	10.1	9.6	8.4
P/BV (x)	3.2	3.6	2.7	2.3	2.0
RoE (%)	14.6	17.5	13.7	15.3	15.2
RoCE (%)	25.9	30.4	24.5	22.2	21.9
Net debt / equity (x)	-0.1	-0.1	-0.1	-0.1	-0.1

Source: Company, Anand Rathi Research

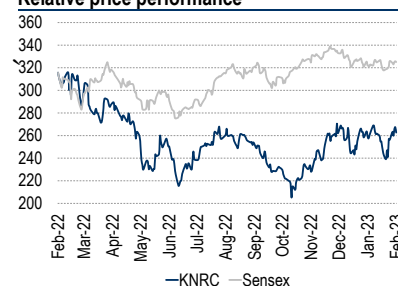
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Key data	KNRC IN / KNRL.BO
52-week high / low	Rs324 / 203
Sensex / Nifty	60683 / 17857
3-m average volume	\$1.2m
Market cap	Rs74bn / \$895.3m
Shares outstanding	281m

Shareholding pattern (%)	Dec'22	Sep'22	Jun'22
Promoters	51.1	51.1	51.6
- of which, Pledged	-	-	-
Free float	48.9	48.9	48.4
- Foreign institutions	5.8	5.7	5.7
- Domestic institutions	34.9	34.6	33.3
- Public	8.2	8.6	9.4

Estimates revision (%)	FY23	FY24	FY25
Revenue	-	-3.5	-1.6
EBITDA	0.3	-3.3	-1.3
Net Income	-0.4	-3.4	-1.2
Adj. PAT	-8.6	-3.4	-1.2

### Relative price performance



Source: Bloomberg

Prem Khurana  
Research Analyst

## Quick Glance – Financials and Valuations (standalone)

Fig 1 – Income statement (Rs m)

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
Order backlog	71,179	90,008	86,470	96,352	100,899
Order inflows	45,479	50,928	31,841	49,411	50,017
<b>Net revenues</b>	<b>27,026</b>	<b>32,726</b>	<b>35,698</b>	<b>39,529</b>	<b>45,470</b>
Growth (%)	20.4	21.1	9.1	10.7	15.0
Direct costs	19,541	23,726	26,322	29,580	34,275
SG&A	2,127	2,223	2,428	2,621	2,854
<b>EBITDA</b>	<b>5,358</b>	<b>6,777</b>	<b>6,948</b>	<b>7,329</b>	<b>8,340</b>
EBITDA margins (%)	19.8	20.7	19.5	18.5	18.3
Depreciation	1,444	1,346	1,472	1,498	1,588
Other income	496	417	305	415	437
Interest expenses	487	274	373	271	279
PBT	3,924	5,574	5,407	5,976	6,910
Effective tax rate (%)	34.9	35.3	37.4	25.2	25.2
+ Associates / (Minorities)	-	-	-	-	-
Net income	2,442	3,818	4,766	4,472	5,171
Adjusted income	2,554	3,658	3,661	4,472	5,171
WANS (m)	281	281	281	281	281
FDEPS (Rs / sh)	9.1	13.0	13.0	15.9	18.4

Fig 3 – Cash-flow statement (Rs m)

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
PBT + Net interest expense	3,915	5,431	5,476	5,831	6,752
+ Non-cash items	1,444	1,346	1,472	1,498	1,588
Oper. prof. before WC	5,358	6,777	6,948	7,329	8,340
- Incr. / (decr.) in WC	1,613	3,872	1,933	595	1,290
Others incl. taxes	1,594	1,645	2,021	1,504	1,739
Operating cash-flow	2,152	1,260	2,994	5,230	5,311
- Capex (tang. + intang.)	953	2,374	1,561	1,648	1,747
Free cash-flow	1,199	-1,113	1,434	3,582	3,564
Acquisitions	-	-	-	-	-
- Div.(incl. buyback & taxes)	-	70	70	141	141
+ Equity raised	-	-	-	-	-
+ Debt raised	-2,166	296	-	-	-
- Fin investments	-1,692	-1,422	1,015	3,295	3,304
-Net interest expense + Misc.	-118	-25	-1,311	-145	-157
Net cash-flow	843	560	1,659	291	277

Source: Company, Anand Rathi Research

Fig 5 – Price movement



Source: Bloomberg

Fig 2 – Balance sheet (Rs m)

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
Share capital	562	562	562	562	562
Net worth	18,678	22,420	27,115	31,446	36,476
Debt	7	-	-	-	-
Minority interest	-	-	-	-	-
DTL / (Assets)	(1,486)	(1,183)	(1,183)	(1,183)	(1,183)
<b>Capital employed</b>	<b>17,199</b>	<b>21,237</b>	<b>25,933</b>	<b>30,264</b>	<b>35,294</b>
Net tangible assets	4,050	4,896	5,190	5,340	5,499
Net intangible assets	1	0	0	0	0
Goodwill	-	-	-	-	-
CWIP (tang. & intang.)	24	206	-	-	-
Investments (strategic)	4,076	2,653	3,669	6,964	10,268
Investments (financial)	-	1	-	-	-
Current assets (excl. cash)	18,397	22,622	23,231	24,563	27,090
Cash	1,173	1,733	3,392	3,684	3,961
Current liabilities	10,521	10,875	9,551	10,288	11,524
Working capital	7,875	11,747	13,680	14,275	15,566
<b>Capital deployed</b>	<b>17,199</b>	<b>21,237</b>	<b>25,933</b>	<b>30,264</b>	<b>35,294</b>
Contingent liabilities	981	1,767	-	-	-

Fig 4 – Ratio analysis

Year-end: Mar	FY21	FY22	FY23e	FY24e	FY25e
P/E (x)	23.5	21.8	20.2	16.5	14.3
EV / EBITDA (x)	11.0	11.5	10.1	9.6	8.4
EV / Sales (x)	2.2	2.4	2.0	1.8	1.5
P/B (x)	3.2	3.6	2.7	2.3	2.0
RoE (%)	14.6	17.5	13.7	15.3	15.2
RoCE (%)	25.9	30.4	24.5	22.2	21.9
Sales / FA (x)	6.6	6.4	6.9	7.4	8.3
DPS (Rs / sh)	-	0.3	0.3	0.5	0.5
Dividend yield (%)	-	0.1	0.1	0.2	0.2
Dividend payout (%) - incl. DDT	-	2.0	2.1	3.1	2.7
Net debt / equity (x)	-0.1	-0.1	-0.1	-0.1	-0.1
Receivables (days)	117	95	94	90	90
Inventory (days)	20	25	20	21	21
Payables (days)	32	33	33	35	38
CFO : PAT %	84.3	34.5	81.8	117.0	102.7

Source: Company, Anand Rathi Research

Fig 6 – EV / EBITDA band



Source: Company, Anand Rathi Research

## Concall highlights

### Income statement

- **Hybrids, the key contributor; irrigation grew the most, q/q.** With ~32% y/y more revenue, hybrid annuities hold the key to KNR's Q3 ~8% y/y higher revenue from operations (to ~Rs8.3bn). Though the segment contributed q/q as well, it couldn't cover for the sharp drop in contribution from road EPC (incl. back-to-back sub-contracted works). The q/q movement was further weighed down by absence of an early-completion bonus and assignment of pending arbitration claims. Consequently, overall revenue from operations contracted ~2% q/q. Irrigation, up ~46%, grew the most q/q, driven by healthy recoveries in Q3 FY23.
- Q2 FY23 included an early-completion bonus of ~Rs0.7bn, and KNR's share of ~Rs0.2bn from the sale of pending arbitration claims by the JV entities (through the assignment route). Adjusted for these, q/q revenue is ~2%, higher, against the reported ~2% drop.

**Fig 7 – Financial highlights**

Particulars (Rs m)	Q1 FY22	Q2 FY22	Q3 FY22	Q4 FY22	Q1 FY23	Q2 FY23	Q3 FY23	% Y/Y	% Q/Q
Sales	7,400	7,556	7,663	10,107	8,906	8,474	8,302	8.3	-2.0
EBITDA	1,433	1,675	1,589	2,080	1,650	1,888	1,560	-1.8	-17.3
EBITDA margins (%)	19.4	22.2	20.7	20.6	18.5	22.3	18.8	-194bps	-348bps
Finance costs	79	72	64	60	69	84	160	151.3	89.9
Depreciation	269	320	358	399	327	366	381	6.3	4.0
Other income	48	105	78	185	91	76	59	-25.0	-22.4
Exceptional gains / (losses)	-	-	214	-	-	-	1,380	544.7	-
PBT	1,133	1,389	1,460	1,806	1,345	1,513	2,458	68.4	62.5
Tax	403	437	452	679	336	438	840	85.9	91.9
PAT	730	952	1,008	1,128	1,008	1,076	1,618	60.6	50.5
Adj. PAT	730	952	848	1,128	1,008	1,076	513	-39.5	-52.3

Source: Company

- With ~32% y/y, ~4% q/q higher revenues, hybrid annuities held the key to KNR's Q3 FY23. With this, the segment's share rose to ~44% (from ~36% a year ago, ~43% the quarter prior). The two Kerala projects come as key contributors in Q3 FY23.
- Road EPC (incl. back-to-back sub-contracted works) is the second-largest contributor with a ~33% share in Q3 revenue from operations. The segment grew ~19% y/y on the healthy pace of execution, but declined ~18% q/q on depleting segment OB (for four quarters). The segment's share, resultantly, expanded three percentage points y/y to ~33%. It was a drop from a peak of ~41% the previous quarter.
- Irrigation recorded the strongest q/q growth of all the segments (q/q better execution on healthy recoveries), but the pace was still sub-optimal y/y. The segment revenue, thus, was up ~46% q/q but down ~27% y/y. This led to its share rising from ~16% in Q2 to ~23%. It paled in comparison to ~34% in the quarter a year ago.
- **EBITDA margin contracts.** The reported EBITDA margin contracted ~194 bps y/y, ~348bps q/q, to ~18.8%. The y/y contraction is mostly on the compressed gross margin, whereas a large part of the

sequential compression could be attributed to absence of an early-completion bonus / sale of arbitration claims.

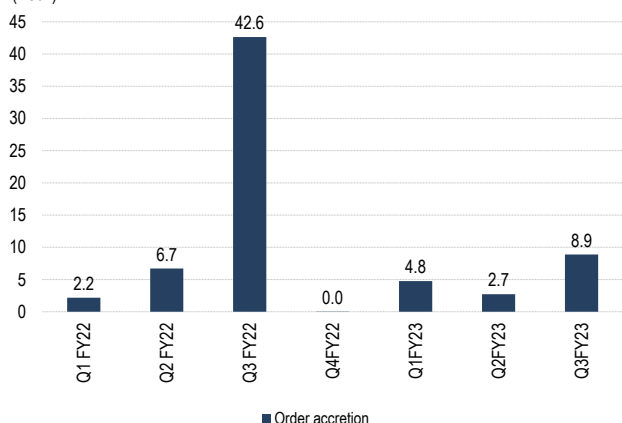
- The core gross margin (adj. for the early-completion bonus or claims) expanded ~31bps q/q to ~31.9%, but was still down ~220bps y/y. The q/q expansion, we believe, is mostly on more contribution from the higher-margin irrigation segment and some softening in key inputs. Though falling sequentially, key inputs were still elevated compared to past levels. Thus, the core gross margin was down ~220bps y/y. The lesser contribution from the higher-margin irrigation orders, too, would have had a role to play here.
  - A large part of sequential compression in EBITDA margin could be attributed to the absence of early-completion bonus and sale of arbitration claims. The two together had added ~304bps to the Q2 margin. Adjusted for this, sequential compression works out to ~44bps.
- **Reported PAT not truly comparable.** Q3 net income of ~Rs1.6bn is a significant, ~61% y/y, ~51% q/q, growth. However, this is not truly comparable as Q3s (of FY22 and FY23) include exceptional gains of various magnitudes, and Q3 FY23 has the impact of tax provisioning (as a matter of prudence, pursuant to the income-tax search operations conducted in Mar'22).
- Q3 FY23 includes exceptional gains of ~Rs1.4bn from monetisation of the balance 51% stake in two hybrid annuities to Cube Highways, and the entire 100% stake in the third. The quantum of exceptional gains in the corresponding quarter last year was only ~Rs0.2bn.
  - Q3 FY23 also includes ~Rs0.3bn of provision (~Rs248m reflected as tax for earlier years, and ~Rs95m as interest on this tax) pursuant to the income-tax search conducted in Mar'22. The final assessment is yet awaited, but provision has been made as a prudent policy.
  - Adjusting for the exceptional gains on monetisation of hybrid annuities, adj. PAT is estimated at ~Rs0.5bn (down ~39% y/y, ~52% q/q). Further adjusting for the provision, Q3 profit works out to ~Rs0.9bn (up ~1% y/y, but q/q down ~21%).

## Order backlog and scope

- On the continuing intense competition in road segments, and management's unwillingness to compromise on margins (just to add assurance), KNR couldn't have any success with order additions in Q3. With the exception of a small order in Q2 FY23, of ~Rs0.34bn, KNR, now, has not had any orders in the last five quarters. Ordinary awarding by the NHAI in 9M FY23 (that too, scattered and not bunched-up) also appears to have worked against KNR.
- Though it did not have any new order in the quarter, the Chittor-Thatchur hybrid annuity order, on the recent appointment, became a part of the firm OB. Consequently, the OB rose ~Rs0.6bn q/q to ~Rs81bn. Based on TTM revenue from operations, the OB implied assurance of ~2.3x TTM revenues.
  - The Chittor-Thatchur hybrid annuity project entails ~Rs7.65bn of EPC potential and attained the appointed date effective 25<sup>th</sup> Jan'23. With this, the project is now set to start contributing.

**Fig 8 – Q3 addition led by appointment of earlier hybrid annuity**

(Rsbn)

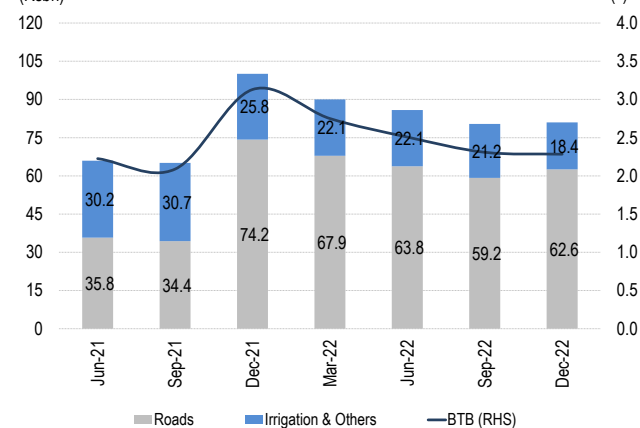


■ Order accretion

Source: Company, Anand Rathi Research Note: Inflows include change-in-scope

**Fig 9 – End-Dec'22 firm OB: ~Rs81n; BtB: ~2.3x**

(Rsbn)



■ Roads

■ Irrigation &amp; Others

— BTB (RHS)

Source: Company

- However, as a portion of the revenues booked has yet to be certified (reflected as unbilled revenue in the balance sheet), this portion forms a part of the reported OB. We estimate this portion at ~Rs4.9bn. Adjusting for this, the unexecuted OB is estimated at ~Rs76bn.
- Geographically, its current OB is well spread out across its strongholds. AP and Telangana (together) command the lion's share ~37% (up from ~31% a quarter ago), higher chiefly due to the inclusion of the recently appointed Chittoor-Thatchur (Andhra Pradesh) hybrid annuity project in the firm OB. Kerala, with two large hybrid annuity orders, followed with ~35% (down from ~37% at end-Q2 FY23). Karnataka held the third position with ~15% (down from ~16% on 30<sup>th</sup> Sep'22) and Tamil Nadu was a close fourth with ~13% (down from ~16% a quarter ago).
- State orders comprised ~36% of the total (down from ~42% at end-Q2 FY23); the balance was mostly from the NHAI (incl. captive-hybrid annuity orders).
- Though the current order backlog is good to take care of growth in the short term, but as any new order generally tends to take some time to get going on the ground, growth beyond would need KNR to add more at the earliest. Realising this, management retained its guidance of adding Rs40bn over the next one year.
- It looks to participate in 10-12 tenders in Feb'23, and 22 tenders are on radar for Mar'23. The identified tenders, management highlights, entail opportunity sizes ranging from Rs5bn to 10bn (some also exceed Rs10bn).
- Management continues to cite intense competition in roads. It highlights that while older players in roads have started quoting sensibly (as some have learnt from mistakes made earlier), new players striving to make a mark in the segment bid aggressively (in some cases quoting 25-30% below base cost estimates). This intense competition concerns KNR, but it does not wish to compromise on margins just to bolster the assurance. Management highlights that it does not mind declining for a year, but does not intend to risk profitability.
- It continues to look for opportunities in irrigation, but the segment has limited opportunities on offer.

- To address the keen competition in roads and limited opportunities in irrigation, and to reduce risk emanating from sector concentration, it is open to look at newer segments. For now, it looks at exploring opportunities in Railways, and metro-rail.
  - For Railways, it is in the process of scouting for a JV partner to have qualifications in place. It is looking to bid for composite orders.
  - Since experience in flyovers counts for metro-rail qualification, it does not mind going solo for such orders.

### Hybrid annuity projects, equity infusion updates

- **Magadi-Somwarpeth (KSHIP).** Physical progress at this project at end-Q3 was ~68.9%, up from ~65.5% a quarter back. Cumulative equity infusion at this project was ~Rs0.99bn at end-Q3 (up ~Rs5m q/q). Though it has already made good progress, the SPV has yet to draw any debt, and appears to be being funded through a mix of equity infused, grant disbursed and EPC dues to KNR. The SPV has cumulatively received grants of ~Rs5.2bn (~Rs0.7bn received in the quarter) of the total ~Rs7.5bn.
  - Of the total length of ~166km, ~115km have already been completed based on the RoW made available. Management looks to receive the PCOD for the completed length by Mar'23.
  - Management would continue to work on the balance stretch as and when the RoW is made available. It expects to receive another 15km in a month, and hopes to receive land for the bye-pass area sooner than later (since land payments are underway).
  - Management expects to finish the project in another 8-9 months, subject to land being made available.
- **Oddanchatram-Madathukulam.** Physical progress at this project at end-Q3 was ~85.6%, up from ~81.9% a quarter back. In the quarter, KNR infused ~Rs34m equity (~Rs0.64bn cumulatively). The SPV did not draw any fresh debt in Q3 (~Rs2bn at end-Q3) to fund project execution. Milestone-linked grants of ~Rs3.5bn have been received (~Rs0.4bn received in Q3).
  - Management, in Sep'22, submitted the PCOD request to the NHAI for the length made available. This is 32 days ahead of scheduled completion. It looks to have PCOD for the length in another 10-15 days for the length completed.
  - It has recently been provided another 8.5km, and the work is underway. Management looks to finish this stretch, and complete the entire project by May'23.
- **Ramanattukara-Valanchery.** Physical progress at end-Q3 was ~14.3% (up from ~9% a quarter ago). Progress could have been better were it not for the extended rainy season till Dec'22. Also, issues such as work stoppages during school hours/night-time are curtailing the pace of execution. Management recently met the officials concerned to seek a resolution of these issues, and hopes for better execution ahead. Cumulative equity investment in this was ~Rs1.2bn at end-Q3 (up ~Rs1.15bn q/q). The SPV has cumulatively received grants of ~Rs2.6bn (~Rs0.8bn during the quarter).
- **Valanchery-Kappirikkad.** Execution at this project is not optimal, impacted by the extended rainy season and work stoppages (similar to the Ramanattukara-Valanchery project). Physical progress at end-Q3

was ~16.8% (up from ~11.5% a quarter ago). Ahead, management expects the pace to improve. In the quarter, it infused ~Rs19m equity, cumulatively pegged at ~Rs131m at end-Q3. The SPV received a ~Rs0.49bn grant in the quarter (cumulatively ~Rs2.5bn). It has yet to draw any debt.

- **Chittor-Thatchur.** The project was appointed only recently, with 25<sup>th</sup> Jan'23 as the effective appointed date. This paves the way for this project with bid project cost of ~Rs10.4bn (and ~Rs7.65bn EPC potential) to get going on the ground, and start contributing.

**Fig 10 – Appointed hybrid annuities @ a glance**

Particulars	Magadi-Somwarpet	Oddanchatram Madathukulam	Ramanattukara to Valanchery	Valanchery to Kappirikkad	Chittor to Thatchur
Authority	KSHIP	NHAI	NHAI	NHAI	NHAI
Project length (km)	166	45	40	37	35
Award dates	May'18	Mar'19	Mar'21	Mar'21	Sep'21
Financial closure	Achieved	Achieved	Achieved	Achieved	Achieved
Appointed dates	12 <sup>th</sup> Feb'20	05 <sup>th</sup> Oct'20	21 <sup>st</sup> Jan'22	21 <sup>st</sup> Jan'22	25 <sup>th</sup> Jan'23
PCOD/ COD	-	-	-	-	-
Scheduled construction period (years)	2	2	2.5	2.5	2
Concession period after COD (years)	9	15	15	15	15
Bid project cost (Rs m)	11,445	9,200	23,675	21,400	10,415
Gross EPC value (Rs m)	9,000	6,400	17,450	15,950	7,650
<b>Means of finance (Rs m)</b>					
Grants	7,485	3,945	10,250	9,243	4,502
Debt	2,570	3,170	9,000	8,260	3,846
Equity	1,221	805	2,250	2,092	962
Equity invested	987	644	1,169	131	1
Debt drawn	-	2,000	-	-	-
Grant received	5,240	3,489	2,590	2,494	-

Source: Company

- **Chittor-Mallavaram.** In the quarter, KNR transferred the balance 51% stake in the SPV to Cube Highways, for ~Rs0.7bn. This is in addition to the ~Rs1.37bn received earlier in FY22, toward a 49% equity stake and the sub-debt. With this, it has received ~Rs2.05bn, against ~Rs1.7bn invested. Also, it is eligible to receive a further ~Rs0.14bn subject to receipt of certain approvals from the NHAI.
- **Trichy-Kallagam.** In the quarter, KNR transferred the balance 51% stake in the SPV to Cube Highways, for ~Rs0.5bn. This is in addition to the ~Rs1.09bn received earlier in FY22, toward a 49% equity stake and the sub-debt. With this, it has received ~Rs1.55bn, against ~Rs1.27bn invested. Also, it is eligible to receive a further ~Rs46m subject to receipt of certain approvals from the NHAI.
- **Ramsanpalle-Mangloor.** During Q3 FY23, KNR transferred the entire 100% equity stake (along with sub-debt) in the SPV to Cube Highways for ~Rs1.3bn. This is against equity invested (incl. sub-debt) of ~Rs0.78bn. KNR is eligible to receive a further ~Rs0.15bn subject to receipt of certain approvals from NHAI
- **Equity commitment, infusion schedule.** With monetisation of the three hybrid annuities consummated, KNR is now left with five hybrid annuities. Equity investment for these five is estimated at ~Rs7.3bn.
  - Cumulatively, KNR has infused ~Rs2.93bn equity (incl. sub-debt) in these SPVs, including ~Rs1.2bn infused in Q3 FY23.

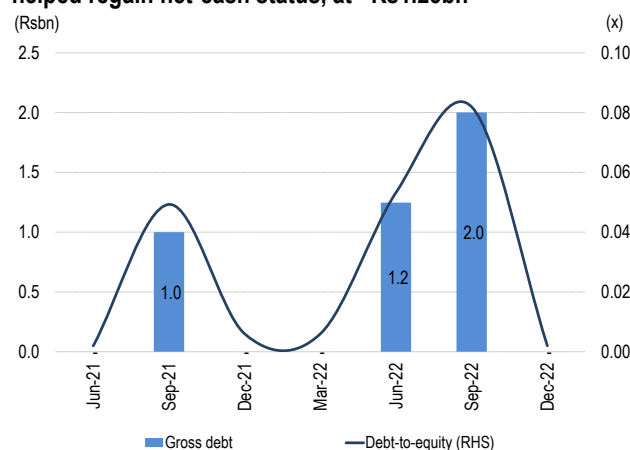


- In the two FY21 additions (Kerala projects), KNR further infused ~Rs1.2bn in Q3 to take cumulative equity infusion to ~Rs1.3bn. At end-Q3, the balance equity to be infused is estimated at ~Rs3bn.
- For Oddanchatram-Madathukulam (Tamil Nadu) project, the company infused Rs34m in Q3, and the cumulative equity infusion by end-Q3 was ~Rs644m. The balance equity to be infused was ~Rs161m.
- The Chittor-Thatchur project has been appointed recently (25<sup>th</sup> Jan'23 as effective date). Equity required is estimated at ~Rs962m.
- Based on the current estimated execution schedule of the projects, management expects to infuse ~Rs0.8bn in Q4 FY23, ~Rs2.6bn in FY24 and ~Rs1bn in FY25.

## Balance sheet

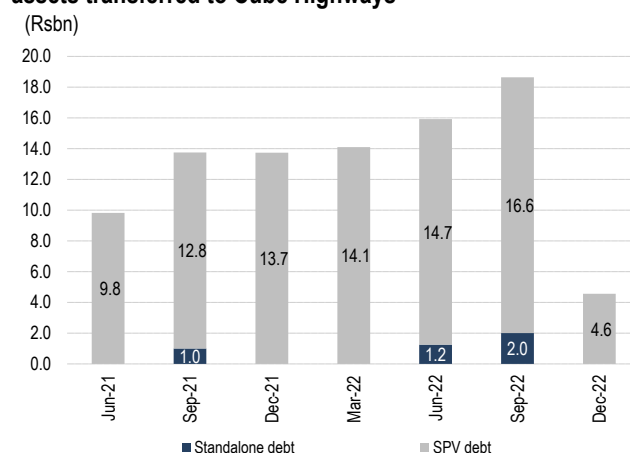
- Recoveries from the Telangana state government toward irrigation orders, and monetisation proceeds from the consummation of transaction with the Cube Highways helped KNR turn net-cash again with a (net cash) balance of ~Rs1.25bn at end-Q3 FY23. This is against ~Rs1.6bn net debt at end-Q2.

**Fig 11 – Pruned irrigation exposure, monetisation proceeds helped regain net-cash status, at ~Rs1.25bn**



Source: Company

**Fig 12 – SPV gross debt down on de-linking of debt related to assets transferred to Cube Highways**



Source: Company

- In the quarter, gross recoveries from the Telangana irrigation exposure were ~Rs4.5bn, but net accretion, since it continued with the order execution, was ~Rs2.5bn.
- On the transfer of the balance 51% in two of the hybrid annuity SPVs, and the entire 100% in the third to Cube Highways, KNR received, in the quarter, ~Rs2.5bn as monetisation proceeds. Adjusting for the tax obligation, net accretion is estimated at ~Rs2.2bn.
- Pruned exposure to the Telangana irrigation orders and the monetisation proceeds more than sufficed to cover for ~Rs1.2bn of equity infused during the quarter, and ~Rs0.35bn of capex incurred. A large part of the balance proceeds were utilised to repay end-Q2 gross debt of ~Rs2bn.
- Consolidated debt fell ~14.1bn q/q to end Q3 FY23 at ~Rs4.6bn. This is largely on the de-linking of SPV debt for the three hybrid annuity assets transferred to Cube Highways, and the repayment of the entire



end-Q2 standalone gross debt. For the yet available under-construction hybrid annuity assets, gross debt, at ~Rs2bn, was flat q/q. The Muzaffarpur-Barauni BOT-toll SPV explains the balance debt of ~Rs2.6bn (down ~Rs52m q/q).

- Gross debt for the two annuity SPVs (not consolidated line-by-line as it has a 40% stake in each) declined ~Rs0.13bn q/q to ~Rs4.1bn.
- In the quarter, the inventory cycle lengthened by a day; the receivables cycle turned two days shorter. The trade payables cycle was unchanged q/q. Hence, the cash-conversion cycle contracted by a day q/q to 53.
  - Trade receivables declined ~Rs0.4bn q/q to ~Rs6.3bn, and inventories were ~Rs1.87bn (up from ~Rs1.85bn). Trade payables were pegged at ~Rs2.11bn, down from ~Rs2.17bn a quarter ago.
  - The above three key constituents of the working-capital cycle, together helped see the release of ~Rs0.3bn, but this appears to have been mostly offset by q/q higher unbilled revenues (~Rs0.2bn q/q to ~Rs4.9bn).
- As management continues to delay debt drawdowns at hybrid annuity SPVs, and on the healthy Q3 pace of execution, trade receivables from hybrid annuity SPVs rose ~Rs0.7bn q/q to ~Rs2.7bn.
  - The ~Rs0.7bn q/q rise in exposure corresponds to ~Rs3.7bn of Q3 revenue recognised. This would imply recoveries of ~Rs2.9bn. The recoveries appear to have been facilitated by equity infused and grant sought.
  - Debt at the under-construction SPVs is the same as the previous quarter.
- Of the balance Telangana irrigation exposure of ~Rs6.5bn (down from ~Rs9bn the quarter prior), management pegs the value of bills certified at ~Rs3.35bn; the balance have yet to be certified by the client. Management remains sanguine of receiving at least the certified portion during Q4, and efforts to receive more would continue.
  - Management highlights that the Kaleshwaram Package-IV is a funded project, with funding slated to come from identified lenders. With disbursements having started already (~Rs3.5bn received during the quarter), it does not see any reason for the lenders to delay further disbursements. With civil construction already taken care of, mechanical work on this pump-house project is set to start, and the company is in the process of sourcing the equipment from BHEL.
  - Funding for the other three Telangana irrigation orders (Kaleshwaram – III, Vettam, Mallana-Sagar) is supposed to come from the state budget. Management looks to receive ~Rs0.5bn a month for these orders, and the project progress would take into account the release of payments.
- During the quarter, KNR incurred ~Rs0.35bn capex. With this, the 9M capex incurred is pegged at ~Rs1.1bn. Management looks to spend another Rs0.3bn-0.4bn in Q4. It expects FY24 capex to largely mirror FY23, but could change on the basis of orders received.

### **BOT-toll projects**

- **Operational performance.** KNR has only one operational BOT-toll asset, Muzaffarpur-Barauni.

- Toll collection at this project was ~Rs116m, up ~32% y/y, ~18% q/q. The SPV debt fell ~Rs52m in the quarter, to ~Rs2.6bn at end-Q3.
- The SPV had earlier invoked *force majeure*, and management had earlier highlighted that the project is due for augmentation from two to four lanes. The concession agreement provides for such situations. At an appropriate time, management had hoped to take a call on options available.

## Guidance

- With the recent appointment of the Chittor-Thatchur hybrid annuity project and envisaging a better pace of execution at its two Kerala hybrid annuity projects and Telangana irrigation orders (since disbursements have begun), management sees FY23 revenue of ~Rs35bn as possible. For FY24, it would look to scale that figure up to ~Rs40bn.
  - The share of the irrigation segment in revenue from operations had dipped from an average of ~30% in FY22 to ~16% in Q2 FY23. It recovered to ~23% in Q3 FY23. In FY24, management, based on current assessment, expects a contribution of 20-25%.
- Management continues to identify 16-17% as the ideal EBITDA margin range, but does not rule out the possibility of delivering 18-19% (depending on project mix and cost savings). It has a long track record of surpassing its guidance.
- Even though competition is still cut-throat, management said it would look to add orders of Rs40bn-50bn over the next one year. For this, it has set its eyes on 10-12 tenders due for bidding in Feb'23, and another 22 tender submission are likely in Mar'23. Management is also open to explore newer segments. For now, it identifies Railways (in a JV with a partner), and metro-rail as preferred segments. Management does not wish to significantly compromise on margins just to add assurance.
- In the quarter, it infused ~Rs1.2bn equity in its hybrid annuity projects. It expects to infuse ~Rs0.78bn in Q4 FY23, ~Rs2.6bn in FY24 and ~Rs0.97bn in FY25.
- With ~Rs0.35bn in Q3, 9M capex incurred is pegged at ~Rs1.1bn. Management looks to spend another Rs0.3bn-0.4bn in Q4. It expects FY24 capex to largely mirror FY23, but could change on the basis of orders received.

## Other highlights

- **Update on key irrigation orders.** The end-Q3 FY23 irrigation OB is pegged at ~Rs18.4bn (down ~Rs2.8bn q/q). However, the reported OB includes orders executed (and revenue booked) but yet to be certified by the client. Adjusting for the uncertified portion, the unexecuted EPC OB is estimated at ~Rs15.3bn. Updates regarding the four major orders are:
  - **Mallanna Sagar from Megha Engineering.** This sub-contracted irrigation order is almost complete. With additional work executed in Q3, the balance-sheet exposure to the order rose from ~Rs0.5bn (at end-Q2) to ~Rs0.8bn.
  - **Pallamuru RangaReddy from Navayuga Engineering.** Work has picked up at the project with pending RoW issues settled. However, payments are a challenge as funds are from the state

government's budgetary support. Recoveries here form a part of the ~Rs0.5bn monthly payments assured for the three state-funded projects (no lender, monies to come from the state budget). The work is going well. Management highlights that if payments are timely, it is possible to complete the project before the Telangana state elections.

- **Kaleshwaram project, Package-III.** The balance-sheet exposure to this order is up from ~Rs1.5bn the prior quarter to ~Rs1.75bn (on added work executed). This again is a state-funded project, with monies come from the state budget.
- **Kaleshwaram project, Package-IV.** Civil work at this project is almost complete. For the pump-house, it is in the process of sourcing electro-mechanical machinery from BHEL. With a pick-up in execution, management expects this project to be complete by end-FY24. At this project, the company is no longer faced with major payment issues as it is a funded project with lenders already in place. In the quarter, it received ~Rs3.5bn towards earlier dues, and the balance-sheet exposure at end-Q3 is estimated at ~Rs1bn.
- **Status on payments.** Management highlights that it recovered ~Rs4.5bn in the quarter, from an exposure of ~Rs9bn at end-Q2. With additional works carried out, the net reduction was ~Rs2.5bn, and the exposure is now ~Rs6.5bn. Of the total, ~Rs3.35bn is certified exposure (reflected as a part of trade receivables), with the balance yet to be certified by the client (reflected as unbilled revenue in the balance sheet). Management hopes to receive at least the certified portion by end-FY23.
- **Execution cycle for the unexecuted OB.** Management said that, if payments are timely, it could complete the project before state elections. The pace of execution continues to track receipts.
- **Income tax matter.** With respect to the search conducted by the Income-Tax Department in Mar'22, the assessing officer initiated proceedings for re-assessment of income for FY17-22. While there is no demand from the income-tax department yet, KNR, based on deliberations with the assessing officer and as a matter of prudence, in Q3 FY23 made a tax provision of ~Rs0.24bn for earlier years and ~Rs95m for interest on the tax provision.

## Valuation

With only a single order added in the year, we prune our FY23e inflows substantially. Though this does not have a bearing on our FY23e revenue, FY24e and FY25e revenues are down respectively ~3% and ~2%. We also take into account the more-than-expected profits from asset monetisation, and income-tax searches-led tax-provisioning for earlier years (as a matter of prudence). All combined lead to FY23e net income declining ~0.4% than earlier estimated. FY24e net income is down ~3%, and FY25e ~1%. FY23e adj. PAT dips more steeply (~9%) on tax provided (and interest on income tax) for earlier years. Since the additional tax provisioning was compensated by higher exceptional gains, the impact on FY23e net income was contained (hence, the smaller change in net income).

On our revised estimates, our sum-of-parts target of Rs322 a share (against Rs328 earlier) is derived using a 15x FY25e PE multiple for the construction business (Rs276 a share, reduced from Rs279 earlier). The asset-ownership business has been assumed at the invested value (Rs47 a share, against Rs49 earlier).

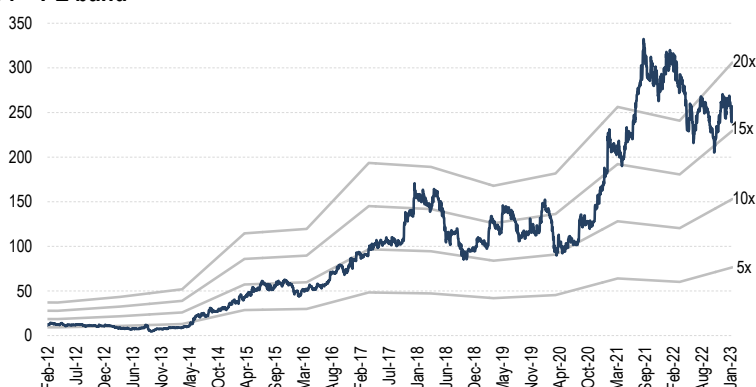
**Fig 13 – Estimates revision**

(Rs m)	Original			Revised			Change (%)		
	FY23e	FY24e	FY25e	FY23e	FY24e	FY25e	FY23	FY24	FY25
Revenue	35,698	40,956	46,191	35,698	39,529	45,470	-	-3.5	-1.6
EBITDA	6,930	7,575	8,451	6,948	7,329	8,340	0.3	-3.3	-1.3
Net Income	4,783	4,628	5,233	4,766	4,472	5,171	-0.4	-3.4	-1.2
Adj. PAT	4,007	4,628	5,233	3,661	4,472	5,171	-8.6	-3.4	-1.2

Source: Anand Rath Research

At the ruling price, the stock (excl. investments) quotes at PERs of 18.4x FY23e, 14.3x FY24e and 11.7x FY25e.

**Fig 14 – PE band**



Source: Company, Bloomberg, Anand Rath Research

## Risks

- Considerable delay in adding orders.
- Slower-than-expected pace of execution.
- Significant rise in irrigation receivables.

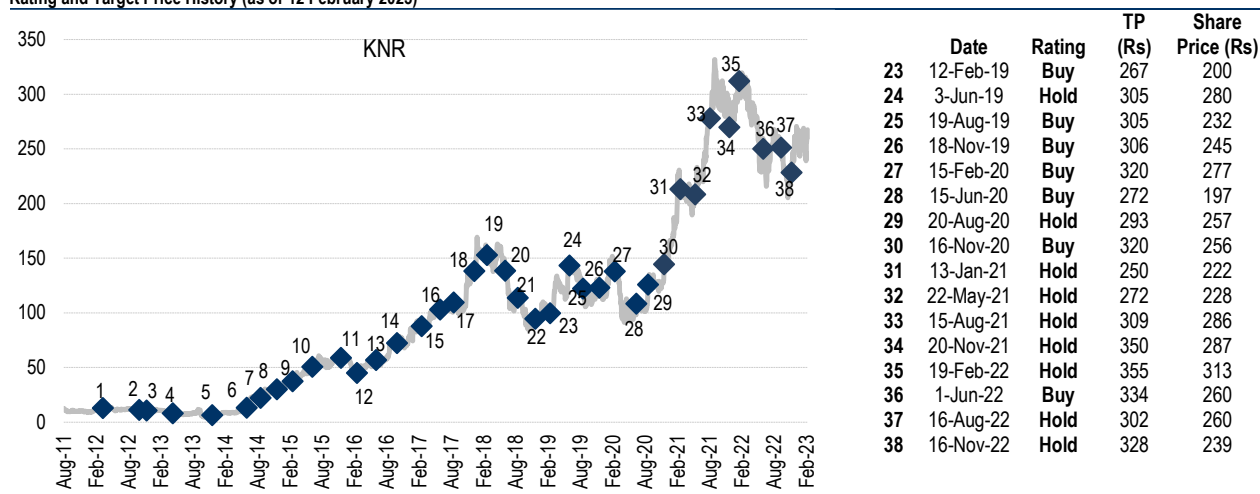
## Appendix

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