



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 Dec 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. 7,381 cr
52-week high/low:	Rs. 324 / 203
NSE volume: (No of shares)	2.2 lakh
BSE code:	532942
NSE code:	KNRCON
Free float: (No of shares)	13.8 cr

Shareholding (%)

Promoters	51.1
FII	5.8
DII	34.9
Others	8.2

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.9	14.6	-1.1	-15.7
Relative to Sensex	0.9	16.4	-3.4	-20.1

Sharekhan Research, Bloomberg

KNR Constructions Ltd

Stays prudent in a competitive environment

Infrastructure

Sharekhan code: KNRCON

Reco/View: Buy



CMP: Rs. 262

Price Target: Rs. 310



Upgrade



Maintain



Downgrade

Summary

- KNR Constructions Limited (KNR) reported a marginal miss on standalone operational performance. Stake sale transfer in SPVs boosted net profit, although adjusted net earnings still lagged.
- Management has retained its Rs. 4,000-5,000 crore order inflow target for FY2023, which is a tall ask, considering highly competitive bidding and delays in bid openings. Management has maintained its revenue guidance for FY2023 and FY2024.
- Order book at 2.3x TTM remains strong, although new project wins are critical for high growth post FY2024. Entry in railways and metro is being contemplated. Irrigation receivables tread lower q-o-q.
- We retain Buy on KNR with a revised PT of Rs. 310, rolling forward our valuation multiple to FY2025E earnings and considering healthy growth outlook for the sector.

KNR Constructions Limited (KNR) reported standalone revenue growth of 8.3% y-o-y at Rs. 830 crore, which was marginally below our estimate. OPM at 18.8% (down 194 bps y-o-y) was a tad lower than our estimate. The dip in OPM y-o-y was led by lower revenue contribution from the high-margin irrigation division (23% in Q3FY2023 vs. 35% in Q3FY2022), which led to operating profit dip of 2% y-o-y at Rs. 156 crore. Adjusting for the exceptional profit from stake transfer in three SPVs and provisions related to income tax of the prior period, adjusted net profit was up 8% y-o-y at Rs. 85.5 crore (lower than our estimate). The company's order book remains healthy at Rs. 8,100 crore (2.3x TTM standalone revenue). The company has retained its order inflow target of Rs. 4,000-5,000 crore for FY2023, which is a tall ask, considering the highly competitive environment and delays in opening bids by NHAI. The company is looking at diversifying in other business verticals such as railways (through JV) and metro projects. However, the company has retained its Rs. 3,000-3,500 crore/Rs. 4,000 revenue guidance for FY2023/FY2024. Order inflow would become critical for growth post-FY2024 and remain a key monitorable.

Key positives

- The company booked profit of Rs. 110.5 crore (net of tax) related to the transfer of balance stake in three projects to Cube Highways.
- Irrigation receivables, including work done but not certified, came down to Rs. 650 crore in Q3FY2023 from Rs. 900 crore in Q2FY2023.

Key negatives

- Nil order wins owing to highly competitive bidding on roads and highways.
- The company made provision for income tax of Rs. 34.2 crore (including interest on income tax) as a prudent measure related to IT assessment pertaining to FY2017-FY2022.

Management Commentary

- Irrigation is not expected to contribute more than 20-25% to FY2024 revenue, which is expected to bring down OPM on a y-o-y basis.
- The market has been very aggressive with bidders quoting as low as 35%. The company expects the competitive environment to remain over 3-4 months.
- This month, the company will be bidding for 10-12 bids; and in March month, it would bid for 22 tenders (~Rs. 17,000 crore out of Rs. 35,000 crore pipeline) in roads. The irrigation pipeline is limited.

Revision in estimates – We have fine-tuned our estimates for FY2023-FY2025.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 310: KNR is expected to benefit from the government's infrastructure spending, especially in roads and highways; although in the near term, the company faces a highly competitive environment along with delays in opening up of bids. Management remains prudent and mindful in the bidding for road projects. Additionally, the company is looking at other sectors such as railways and metros, which can provide growth – although initially at lower margins as per its standards. The company's current order book remains strong for providing growth over the next two years. However, new order wins would be required by H1FY2024 to provide healthy growth visibility post FY2024. The company's de-leveraged balance sheet and declining outstanding receivables in irrigation provide comfort. We retain our Buy rating on the stock with a revised price target (PT) of Rs. 310, rolling forward our valuation multiple to FY2025E earnings and considering a healthy sector growth outlook.

Key Risks

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

Valuation (Standalone)

Rs cr

Particulars	FY22	FY23E	FY24E	FY25E
Revenue	3,272.6	3,408.5	3,876.5	4,334.6
OPM (%)	20.7	19.5	19.1	19.1
Adjusted PAT	360.4	390.2	456.1	518.3
% YoY growth	41.1	8.3	16.9	13.6
Adjusted EPS (Rs.)	12.8	13.9	16.2	18.4
P/E (x)	20.5	19.0	16.2	14.3
P/B (x)	3.2	2.8	2.4	2.0
EV/EBITDA (x)	10.2	10.4	9.4	8.3
RoNW (%)	17.5	16.1	16.1	15.7
RoCE (%)	18.5	17.1	16.6	16.1

Source: Company; Sharekhan estimates

Project divestments boost PAT; Adjusted earnings marginally lag

KNR reported standalone net revenue growth of 8.3% y-o-y (-2% q-o-q) at Rs. 830 crore, which was 4% lower than our estimate. Operating profit margin (OPM) at 18.8% (-194bps y-o-y, -348bps q-o-q) was a tad below our estimate of 19%. Standalone operating profit declined by 1.8% y-o-y (down 17.3% q-o-q) to Rs. 156 crore, which was 5% lower than our estimate. During the quarter, the company concluded the transfer of balance 51% stake in three HAM projects to Cube Highways, resulting in profit booking of Rs. 138 crore and tax of Rs. 27 crore. The company also provided for Rs. 25 crore towards income tax for FY2017-FY2022 and Rs. 9 crore towards interest on income tax as a prudent measure after the assessing officer's initiation of proceedings for re-assessment of income tax for the said period. Exceptional profit booking from the transfer of stake in three HAM projects led to reported standalone net profit of Rs. 162 crore, up 61% y-o-y. However, adjusting for the above exceptional items, the standalone adjusted net profit stood at Rs. 86 crore, up 7.8% y-o-y. Adjusted net profit was 11% lower than our estimate. The order book stands at Rs. 8,100 crore, 1.4x TTM standalone revenue.

Key conference call takeaways

- ♦ **Guidance:** The company has retained its target order inflow of Rs. 4,000-5,000 crore for FY2023. The company targets revenue of Rs. 3,000-3,500 crore for FY2023 and Rs. 4,000 crore for FY2024. Irrigation is not expected to contribute more than 20-25% to FY2024 revenue, which is expected to bring down OPM on a y-o-y basis. KNR would try to finish irrigation projects before elections, but it would depend on the payments being made by the state government.
- ♦ **Competitive environment:** The market has been very aggressive with bidders quoting as low as 35%. The company expects the competitive environment to remain over 3-4 months. NHAI is yet to bring down the contribution from 40% to 20% in HAM projects, which has not led to easing of competitive pressures.
- ♦ **Order pipeline:** This month, KNR will be bidding for 10-12 bids; and in March, it would bid for 22 tenders (~Rs. 17000 crore out of Rs. 35,000 crore pipeline) in roads. The irrigation pipeline is limited. The company is in discussion with a few players to form a JV for making an entry into railway projects. The company may also go ahead alone in metro projects.
- ♦ **Irrigation receivables:** Irrigation receivables stand at Rs. 650 crore (Rs. 335 crore receivables, Rs. 315 crore work done but yet to be certified) as against Rs. 900 crore in Q2FY2023. KNR is receiving timely payment for Package IV irrigation project as it is bank-funded (Rs. 350 crore received last quarter) and expects it to be completed in FY2024. A couple of other irrigation projects have budgetary support with monthly payment assurance (although it did not receive Rs. 50 crore during last month). The old irrigation receivables are expected to close by March.
- ♦ **Order book:** The current order book stands at Rs. 8,100 crore with EPC (roads and HAM projects) comprising 77% and irrigation comprising 33%. Third-party orders comprise 51% and captive HAM projects constitute 49% of the total order book.
- ♦ **Debt:** Standalone debt is nil and cash is Rs. 125 crore. Consolidated debt is Rs. 456 crore and cash is Rs. 145 crore.
- ♦ **Budget:** The key highlights of the Union Budget were its focus on infrastructure investments, which are expected at Rs. 10 lakh crore, up 33% y-o-y and 3.3% of GDP. The outlay towards highways has increased to Rs. 2.7 lakh crore from Rs. 2.17 lakh crore in FY2023RE. NHAI outlay has increased to Rs. 1.62 lakh crore from Rs. 1.42 lakh crore in FY2023RE. The Jal Shakti Mission outlay is Rs. 97,278 crore.
- ♦ **Divestment of three projects:** The company completed transfer of balance stake in three SPVs. In Tirumala/Shankarampet/Sriranagm projects, KNR had invested Rs. 160.22 crore/Rs. 126.81 crore/Rs. 78.36 crore, of which it has already received Rs. 204.94 crore/Rs. 154.6 crore/Rs. 131.15 crore, while it has received an additional Rs. 14.05 crore/Rs. 4.61 crore/Rs. 15.4 crore subject to the receipt of certain approvals from NHAI. During Q3, the company booked profit of Rs. 137.97 crore and tax of Rs. 27.47 crore.

- ♦ **IT demand:** With respect to the search operation conducted by the IT department and subsequent initiation of proceedings by the assessing officer for the re-assessment of income relevant from FY2017-FY2022, it has made a provision of Rs. 24.75 crore towards income tax and Rs. 9.45 crore towards interest on income tax in Q3 as a prudent measure. The assessing officer has not raised any demand yet, while results of the same are expected over 6-12 months.
- ♦ **Equity requirement:** Out of the revised equity requirement of Rs. 732 crore for HAM projects, it has invested Rs. 293 crore. The balance would be invested as follows – Q4FY2023: Rs. 77.98 crore, FY2024: Rs. 256.06 crore; and FY2025: Rs. 96.7 crore.
- ♦ **Capex:** KNR did capex of Rs. 190 crore in 9MFY2023. The company estimates Rs. 140-150 crore capex for FY2024, while FY2025 capex could be Rs. 150 crore, provided it is able to receive projects.

Results (Standalone)

Particulars	Q3FY2023	Q3FY2022	Y-o-Y %	Q2FY2023	Q-o-Q %
Net revenue	830.2	766.3	8.3%	847.4	-2.0%
Other income	5.9	7.8	-25.0%	7.6	-22.4%
Total income	836.1	774.1	8.0%	855.0	-2.2%
Total expenses	674.2	607.4	11.0%	658.6	2.4%
Operating profit	156.0	158.9	-1.8%	188.8	-17.3%
Depreciation	38.1	35.8	6.3%	36.6	4.0%
Interest	16.0	6.4	151.3%	8.4	89.9%
Exceptional items	-76.3	-21.4		0.0	
Profit Before Tax	245.8	146.0	68.4%	151.3	62.5%
Taxes	84.0	45.2	85.8%	43.8	91.9%
PAT	161.8	100.8	60.6%	107.6	50.5%
Adjusted PAT	85.5	79.4	7.8%	107.6	-20.5%
EPS (Rs.)	3.0	2.8	7.8%	3.8	-20.5%
			bps		bps
OPM (%)	18.8%	20.7%	-194	22.3%	-348
NPM (%)	10.3%	10.4%	-5	12.7%	-239
Tax rate (%)	34.2%	31.0%	320	28.9%	524

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Roads to remain one of the key focus areas in the 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.

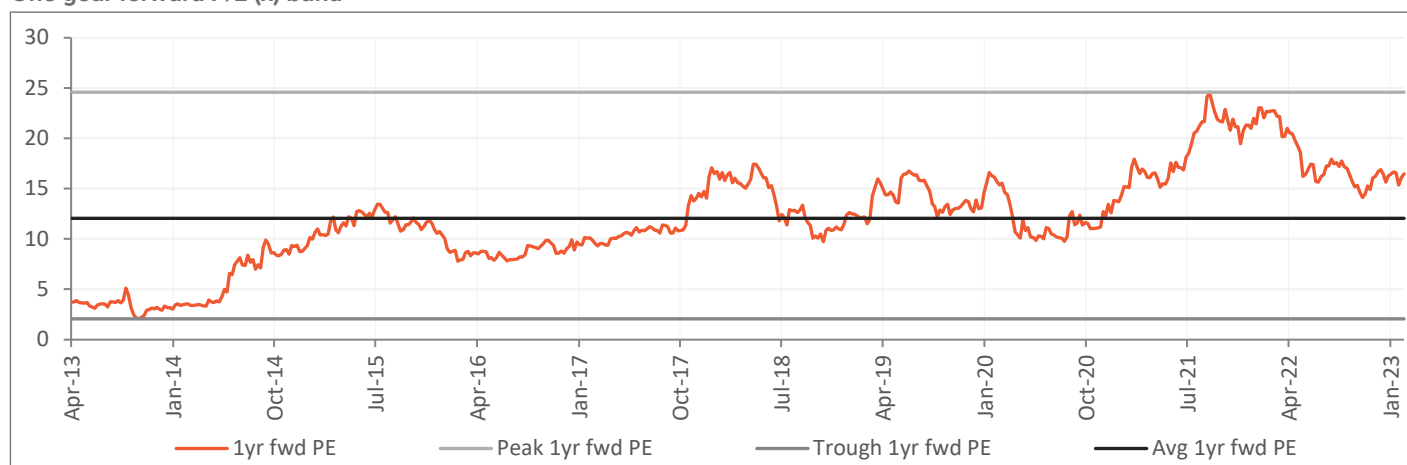
■ Company Outlook – Well placed to gain from positive sector outlook

KNR is conservatively targeting Rs. 3,000-3,500 crore in standalone revenue for FY2023 owing to half of its order book concentrated in states that had received early arrival of monsoons. The company targets to achieve Rs. 4,000 crore standalone revenue for FY2024 owing to a healthy order book. The company targets to bag Rs. 4,000 crore-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. KNR remains prudent in bidding for projects in a highly competitive environment. The company has a healthy order backlog at almost 2.3x its TTM standalone revenue, providing healthy revenue visibility over the next two years. However, new project order wins during FY2024 would be a key monitorable.

■ Valuation – Retain Buy with a revised PT of Rs. 310

KNR is expected to benefit from the government's infrastructure spending, especially in roads and highways; although in the near term, the company faces a highly competitive environment along with delays in opening up of bids. Management remains prudent and mindful in the bidding for road projects. Additionally, the company is looking at other sectors such as railways and metros, which can provide growth – although initially at lower margins as per its standards. The company's current order book remains strong for providing growth over the next two years. However, new order wins would be required by H1FY2024 to provide healthy growth visibility post FY2024. The company's de-leveraged balance sheet and declining outstanding receivables in irrigation provide comfort. We retain our Buy rating on the stock with a revised PT of Rs. 310, rolling forward our valuation multiple to FY2025E earnings and considering a healthy sector growth outlook.

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	14.4	12.9	9.1	8.2	2.2	1.9	16.4	15.7
KNR Constructions	19.0	16.2	10.4	9.4	2.8	2.4	16.1	16.1

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 requirements 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 the 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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