Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

KNR Constructions Ltd

Earnings visibility intact; Focus on order wins

Infrastructure	Sharekhan code: KNRCON

Reco/View: Buy	↔	CMP: **Rs. 244**	Price Target: **Rs. 301**	↓

↑ Upgrade ↔ Maintain ↓ Downgrade

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 41.75
Updated May 08, 2023

Severe Risk

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

Source: Morningstar

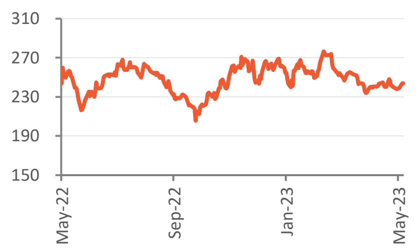
Company details

Market cap:	Rs. 6,861 cr
52-week high/low:	Rs. 281 / 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	5.9
DII	34.4
Others	8.6

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.4	-4.9	-6.9	-0.1
Relative to Sensex	-1.7	-11.7	-6.7	-12.7

Sharekhan Research, Bloomberg

Summary

- KNR Constructions Limited (KNR) reported better-than-expected standalone revenues led by a pick up in the execution of HAM projects. OPM missed a change in the revenue mix. Net earnings boosted by lower tax outgo.
- Management remained conservative on order inflow target of Rs. 4500 crore for FY2024 despite recent order inflows. FY2024 standalone revenue target retained.
- Order book at 2.4x TTM including recent wins remains healthy. It continues to explore for projects in state highways, irrigation, urban infrastructure, railways and metros.
- We retain Buy on KNR with a revised PT of Rs. 301, factoring downwardly revised estimates and considering healthy growth outlook for the sector.

KNR Constructions Limited (KNR) reported better-than-expected standalone revenue growth of 16.3% y-o-y at Rs. 1176 crore (much higher than our estimate) led by a strong pick up in the execution of HAM projects (40% revenue share). However, OPM at 18% (down 255 bps y-o-y and 77 bps q-o-q) came in lower than our estimate of 18.7%, led by a change in revenue mix (lower revenue share of high-margin irrigation division y-o-y). Consequently, operating profit marginally increased by 2% y-o-y at Rs. 212 crores. Further, a lower effective tax rate (25.9% Vs 37.6% in Q4FY2022) led to 14% jump in standalone net profit at Rs. 129 crore (higher than our estimate). Including the three recent HAM project wins, its order book remains healthy at Rs. 8,872 crores (2.4x TTM standalone revenue). The company gave a conservative order inflow target of Rs. 4500 crores for FY2024 despite Rs. 2000 crore order inflows YTD owing to cut-throat competition in NHAI project tenders. It broadly retained Rs. 4000 crores plus a standalone revenue target for FY2024. It continues to scout for projects in State highways, irrigation, urban infrastructure, railways and metros.

Key positives

- Strong beat on standalone revenues with 16% y-o-y growth led by a pick up in the execution of HAM projects.
- Won three HAM projects with an EPC value of Rs. 1780 crore taking its order book to 2.4x TTM standalone revenues.

Key negatives

- Standalone OPM at 18% lagged estimates owing to lower revenue share of high-margin irrigation projects.
- Irrigation receivables remain at Rs. 650 crore as funds receipt post-Q4FY2023 were offset by work done but not certified.

Management Commentary

- The company largely retained Rs. 4000 crores plus revenue target (Rs. 900 crore to Rs. 1000 crore from irrigation) for FY2024. However, the order inflow target for FY2024 remained conservative at Rs. 4500 crore despite achieving Rs. 2000 crore order intake in FY2024 to date.
- The current bid pipeline comprises of 26 projects from the Maharashtra government, 4-5 packages in irrigation from the Telangana government, NHAI projects from June onwards, city road projects from states like Karnataka, Bridge works in Pune, Nagpur, Bihar etc and Metro projects.
- Out of the total Rs. 733 crore equity requirement in HAM projects, it has invested Rs. 296 crore, balance Rs. 437 crore will be invested over three year period.

Revision in estimates – We have cut our net earnings estimates for FY2024-FY2025, factoring in lower OPMs.

Our Call

Valuation – Retain Buy with a revised PT of Rs. 301: KNR is expected to benefit from the government's infrastructure spending, especially on roads and highways;. However, in the near term, the company faces a highly competitive environment along with delays in opening up of bids. However, its order book remains healthy, providing revenue visibility over the next two years. Additionally, it is looking at other sectors, such as state highway projects, irrigation, urban infra, railways and metros, which can provide growth. The company's de-leveraged balance sheet and outstanding receivables in irrigation provide comfort. We retain our Buy rating on the stock with a revised price target (PT) of Rs. 301, factoring downwardly revised estimates 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	FY23	FY24E	FY25E
Revenue	3,272.6	3,743.8	3,990.4	4,323.6
OPM (%)	20.7	19.3	18.6	18.5
Adjusted PAT	360.4	360.9	435.7	471.2
% YoY growth	41.1	0.1	20.7	8.1
Adjusted EPS (Rs.)	12.8	12.8	15.5	16.8
P/E (x)	19.0	19.0	15.7	14.6
P/B (x)	3.0	2.5	2.1	1.9
EV/EBITDA (x)	9.4	8.8	8.6	8.0
RoNW (%)	17.5	14.5	14.8	13.9
RoCE (%)	18.5	15.7	15.6	14.6

Source: Company; Sharekhan estimates

Execution beat estimates, although OPM lagged

KNR reported standalone net revenue growth of 16.3% y-o-y (+41.6% q-o-q) at Rs. 1176 crore, 18% higher than our estimate. Standalone OPM at 18.0% (-255bps y-o-y, -77bps q-o-q) was below our estimate of 18.7%. Standalone operating profit increased marginally by 1.9% y-o-y (up 35.8% q-o-q) to Rs. 212 crore, which was 14% higher than our estimate. Lower OPM y-o-y was offset by a lower effective tax rate (25.9% versus 37.6% in Q4FY2022), leading to 14% y-o-y growth in reported standalone net profit of Rs. 129 crore.

Key conference call takeaways

- **Guidance:** The company largely retained Rs. 4000 crores plus revenue target (Rs. 900 crore to Rs. 1000 crore from irrigation) for FY2024. However, the order inflow target for FY2024 remained conservative at Rs. 4500 crore despite achieving Rs. 2000 crore order intake in FY2024 till date. Cut-throat competition continues in NHAI bidding, where it successfully won only three projects out of the 70-80 projects it quoted over 4-5 months. Consequently, it would explore projects in state highways, irrigation, urban infrastructure, railways and metros.
- **Bid pipeline:** The current bid pipeline comprises of 26 projects from the Maharashtra government, 4-5 packages in irrigation from the Telangana government, NHAI projects from June onwards, city road projects from states like Karnataka, Bridge works in Pune, Nagpur, and Bihar etc and Metro projects.
- **Industry performance:** NHAI awarded 6003 km of road projects in FY2023 versus a target of 6500 km. The total value of projects awarded by NHAI was down 15% y-o-y at Rs. 1.26 lakh crore. However, NHAI's highway construction increased 13% y-o-y to 4882 km in FY2023. Overall, road ministry constructed 8064 km in FY2023 till February as against the target of 12,000 km for FY2023. The pace of road projects awarded in FY2023 date stood at 7497 km, 121 km lower than in FY2022. FASTag collections in CY2022 were up 46% at Rs. 50,855 crore. NHAI has undertaken a 7% hike in toll fees effective April 1, 2023.
- **Q4FY2023 performance:** Standalone revenues were up 16% y-o-y at Rs. 1175 crore, EBITDA was up 2% y-o-y at Rs. 211 crore with EBITDA margin of 18%, net profit was up 14% y-o-y at Rs. 128 crore. Standalone working capital days increased to 67 days from 63 days last year. Standalone debt is almost nil. Consolidated debt stood at Rs. 610 crore versus Rs. 1428 crore last year, with Debt to equity of 0.22x vs 0.55x.
- **Equity requirement:** Out of the total Rs. 733 crore equity requirements in HAM projects, it has invested Rs. 296 crore, balance Rs. 437 crore will be invested over three year period.
- **Telangana receivables:** As on March 2023, it had Rs. 502 crore dues outstanding, out of which it received Rs. 134 crore in Q1FY2024. Currently, Rs. 650 crore dues are outstanding, which includes work done.
- **Capex:** It incurred a capex of Rs. 40 crore and Rs. 140 crore in Q4FY2023 and FY2023, respectively. The capex for FY2024 and FY2025 is expected to be at Rs. 130-140 crore per annum.
- **Other highlights:** Retention money stands at Rs. 237 crore, Mobilisation advance at Rs. 166 crore and unbilled revenues of Rs. 450 crore.

Results (Standalone) Rs cr

Particulars	Q4FY2023	Q4FY2022	Y-o-Y %	Q3FY2023	Q-o-Q %
Net revenue	**1175.6**	**1010.7**	**16.3**	**830.2**	**41.6**
Other income	9.6	18.5	-48.3	5.9	62.9
Total income	**1185.2**	**1029.3**	**15.1**	**836.1**	**41.7**
Total expenses	963.6	802.7	20.0	674.2	42.9
Operating profit	**211.9**	**208.0**	**1.9**	**156.0**	**35.8**
Depreciation	40.1	39.9	0.5	38.1	5.1
Interest	8.0	6.0	32.8	16.0	-50.1
Exceptional items	0.0	0.0		-76.3	
Profit Before Tax	**173.5**	**180.6**	**-4.0**	**245.8**	**-29.4**
Taxes	44.9	67.9	-33.9	84.0	-46.6
PAT	128.6	112.8	14.0	161.8	-20.5
Adjusted PAT	**128.6**	**112.8**	**14.0**	**85.5**	**50.3**
EPS (Rs.)	4.6	4.0	14.0	3.0	50.3
			bps		**bps**
OPM (%)	18.0	20.6	-255	18.8%	-77
NPM (%)	10.9	11.2	-22	10.3%	64
Tax rate (%)	25.9	37.6	-1170	34.2%	-830

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 after easing restrictions post COVID-19 led lockdowns. The industry expects strong order inflows and improved execution run-rate from Q3FY2021. Proactive payments from the NHAI have handled working capital issues of the companies.

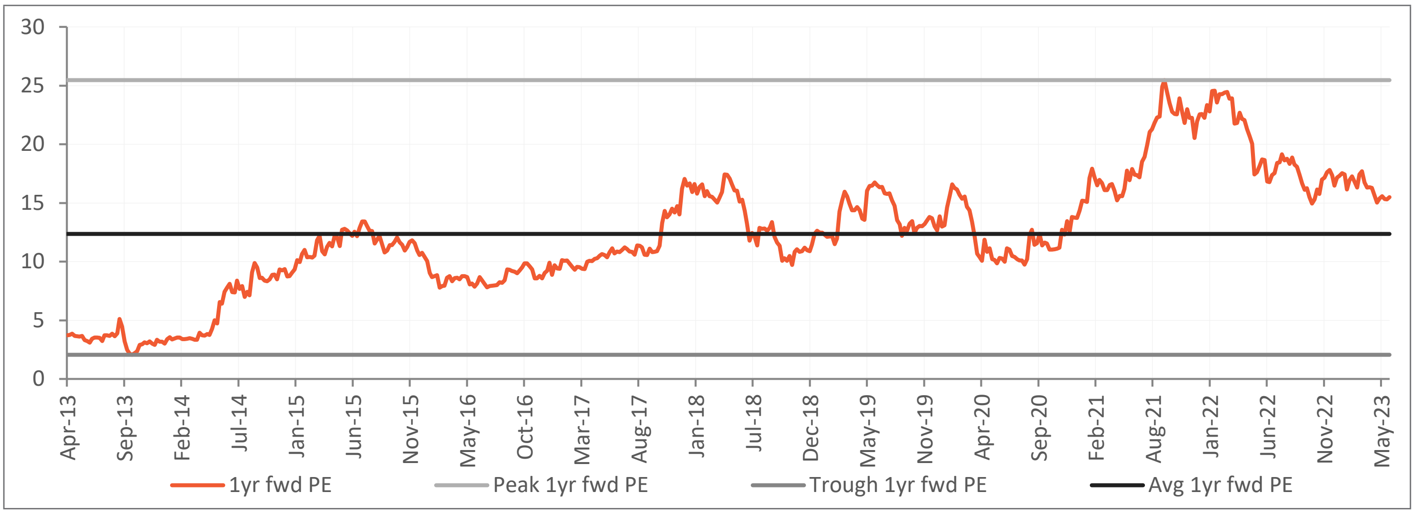
■ Company Outlook – Well placed to gain from positive sector outlook

KNR is conservatively targeting Rs. 4,500 crore order inflows for FY2024 due to cutthroat competition in NHAI bidding. However, it looks at other sectors, such as state highway projects, irrigation, urban infra, railways and metros, which can provide growth. The company targets to achieve Rs. 4,000 crore standalone revenue for FY2024 owing to a healthy order book. KNR remains prudent in bidding for projects in a highly competitive environment. The company has a healthy order backlog at almost 2.4x its TTM standalone revenue, providing healthy revenue visibility over the next two years. However, new project order wins going ahead would be a key monitorable. Its de-leverage balance sheet and contained irrigation receivables provide comfort.

■ Valuation – Retain Buy with a revised PT of Rs. 301

KNR is expected to benefit from the government's infrastructure spending, especially on roads and highways;. However, in the near term, the company faces a highly competitive environment along with delays in opening up of bids. However, its order book remains healthy, providing revenue visibility over the next two years. Additionally, it is looking at other sectors, such as state highway projects, irrigation, urban infra, railways and metros, which can provide growth. The company's de-leveraged balance sheet and outstanding receivables in irrigation provide comfort. We retain our Buy rating on the stock with a revised price target (PT) of Rs. 301, factoring downwardly revised estimates 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 (%)	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
PNC Infratech	11.4	10.3	7.5	6.8	1.7	1.5	16.2	15.4
KNR Constructions	15.7	14.6	8.6	8.0	2.1	1.9	14.8	13.9

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. To 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 and 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

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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