June 27, 2022

On road to better future…

Activities under the infrastructure sector have been clearly growing at a decent pace – being the Government's focused area and with consistent increase in budgetary allocations. Additionally, the roads segment within infra has put up a stellar show with improving construction pace and robust awarding. Moreover, measures undertaken by the NHAI/MoRTH such as a) shifting from milestone-based billing to monthly billing, b) releasing of retention money/performance security in proportion to execution, and c) faster resolution of disputes through reconciliation ensured continuance of gained momentum. While these actions have benefited developers with better working capital during uncertain times, inflows got impacted for organised players due to increased participation from the unlisted small contractors. Going forward, expected restoration to original bidding norms in the near term is likely to aid inflows for organised players. Further, healthy order book position for players provides revenue visibility over the next two to three years. Built-in raw material price variation clauses offer much-needed cushion against margin volatility. Additionally, pick-up in demand for real estate and commercial space to aid contractors offering a diversified range of construction and allied services. **Overall, we are positive on roads and construction sector. Also, recent stock price correction offers good entry point to accumulate companies having healthy b/s, pan India presence and sustained long term revenue and earnings growth prospects. Key top picks: KNR Constructions, HG Infra and PSP Projects.**

Awarding activities to pick up ahead; inflows muted for listed players due to higher competition

Long term tendering activities by NHAI have been improving consistently – increasing from 2,222 km in FY19 to 4,788 km in FY21. Further, awarding has inched up to 6,306 km during FY22 with capital expenditure by NHAI reaching an all-time high of ₹ 1,68,770 crore (despite hindrance from several waves of Covid-19). However, major players remained conservative on bidding stage and witnessed modest order inflows in the recent times as tendering norms were eased since H2FY21, which led to higher competitive intensity. With the expectations of NHAI going back to normal bidding norms and continued strength in awarding actions (target: 6,500km in FY23), organised developers are likely to witness healthy inflows tractions.

Healthy order book positions to drive revenue growth; margins likely to normalise with softening in RM prices

The order book position for most listed organised players remains healthy at 2.5-3.5x of FY22 sales (despite inflows being impacted due to higher competitions), providing revenue visibility for the next two to three years. Additionally, the increase in commodity prices has marginally impacted the margin performance during FY22 protected by built-in escalation clauses in most of NHAI's projects. However, margins are expected to normalise, going forward, with softening in key raw material prices such as steel and cement.

Lean balance sheet positions, prudent working capital management augurs well

Most of the EPC developers, in our coverage, have lean balance sheet structure backed by their prudent strategy to mainly focus on an asset light business model and efficient manage working capital. Also, we not expect major swing in debt position going forward for the considered companies (under over top bets) with their healthy operating cash flow generation arising from improved profitability. Asset monetization in some cases would be added trigger.

Sector View: Positive

Top Picks in Infra Space

	Rating	CMP	Target price	Upside
KNR Construction	BUY	233	310	33%
HG Infra	BUY	531	735	38%
PSP Projects	BUY	529	630	19%

Key risks to our call

- Delay in execution for EPC/HAM projects
- Working capital stress in water/ irrigation projects

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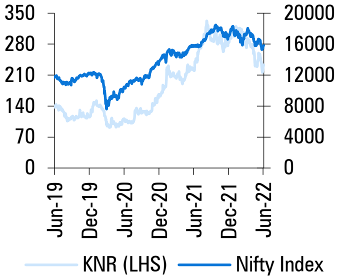
Top bets in Infrastructure Universe

KNR Constructions Ltd (KNRCON)

KNR Constructions is one of the leading companies in the roads and highways sector having executed 6,000+ lane km of projects. It also has an established presence in irrigation & urban water infrastructure management.

- KNR is likely to be the major recipients of thriving roads and water supply segments. Order book at FY22-end was healthy at ₹ 9,766 crore (including L1 worth ₹ 765 crore; 3x book to FY22 revenues)
- The company has reported robust 21.1% revenue growth in FY22 (to ₹ 3,272.6 crore). Going forward, its strong order book position, decent inflows, and receipt of appointed date in most of its projects to translate into 14.3% topline CAGR over FY22-24E
- Price escalation clause in NHAI's contract, and better margins at irrigation jobs to keep operating margins at an elevated level of ~17-18.5%. Cash surplus position at FY22-end, strategy to focus on asset light business, and efficient manage working capital augurs well
- **We maintain BUY rating with target price of ₹ 310 (based on SoTP valuation)**

Price Chart



Particulars

Particular	Amount (₹ crore)
Market Capitalization	6,564.0
Total Debt (FY22)	0.0
Cash (FY22)	173.3
EV	6,390.7
52 week H/L (₹)	344/ 208
Equity capital	56.2
Face value (₹)	2

Exhibit 1: Financial summary for KNR Constructions Ltd

₹ 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%	3,578.0	4,273.2	14.3%
EBITDA	487.1	535.8	677.7	24.2%	608.3	790.5	8.0%
EBITDA Margin (%)	21.7	19.8	20.7		17.0	18.5	
PAT	225.2	244.2	381.8	19.4%	348.5	494.3	13.8%
EPS (₹)	16.0	8.7	13.6		12.4	17.6	
P/E (x)	14.5	26.8	17.2		18.8	13.3	
EV/EBITDA (x)	13.8	12.0	9.2		10.2	7.8	
RoNW (%)	14.5	13.7	16.1		13.5	16.2	
RoCE (%)	19.0	23.4	25.8		19.4	21.9	

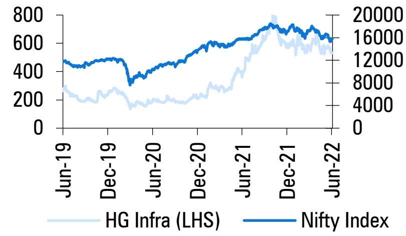
Source: Company, ICICI Direct Research

HG Infra Engineering (HGINF)

HG Infra Engineering is a Jaipur (Rajasthan) based infrastructure company with primary focus on roads and allied sectors. The company is also actively looking to diversify itself by targeting the railways and water infra segments.

- HG Infra's order book as on March 31, 2022 was at ₹ 7,972.9 crore (2.2x book to FY22 revenues). Inflows target to the tune of ~₹ 10,000 crore in FY23 to be driven by strong order pipeline in roads segment and growing opportunities in the other infrastructure verticals
- Healthy order book position, receipt of appointed date in most of its projects and execution pick-up to translate into 18.4% topline CAGR over FY22-24E. Current order mix with built-in raw material price variation clauses provides margin sustainability at ~15.5%
- Double-digit return ratios, comfortable b/s position and healthy operating cash flow generation arising from improved profitability augurs well. **We maintain BUY rating with target price of ₹ 735 (based on SoTP valuation)**

Price Chart



Particulars

Particular	Amount
Market Capitalization	3,448.5
Total Debt (₹ crore)	410.6
Cash (₹ crore)	158.5
EV (₹ crore)	3,700.6
52 week H/L (₹)	830 / 362
Equity capital	65.2
Face value	10.0

Exhibit 2: Financial summary for HG Infra Engineering Ltd

(₹ Crore)	FY20	FY21	FY22	5 yr CAGR (FY17-22)	FY23E	FY24E	2 yr CAGR (FY22-24E)
Net Sales	2,196.1	2,535.0	3,615.2	27.9%	4,387.0	5,066.5	18.4%
EBITDA	342.4	418.1	584.8	36.3%	680.2	783.9	15.8%
EBITDA Margin (%)	15.6	16.5	16.2		15.5	15.5	
Net Profit	165.7	211.0	338.8	44.7%	395.2	442.5	14.3%
EPS (₹)	25.4	32.4	52.0		60.6	67.9	
P/E (x)	20.8	16.3	10.2		8.7	7.8	
EV/EBITDA (x)	10.9	8.3	6.3		5.7	4.9	
RoCE (%)	23.2	25.9	28.7		25.8	24.6	
RoE (%)	20.2	20.4	24.8		22.5	20.2	

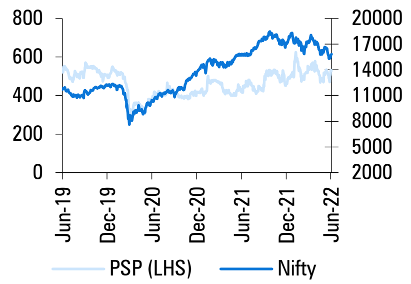
Source: Company, ICICI Direct Research

PSP Projects (PSPPRO)

PSP Projects (PSP) is a Gujarat based construction company offering a diversified range of construction and allied services across industrial, institutional, government, government residential and residential projects.

- PSP's pre-qualification for public projects would rise to ₹ 2,000+ crore with the completion of the Surat Diamond Bourse project. Addition of big ticket sized projects to boost its order book position
- Significant traction and orders for pre-cast facility is likely to bring incremental benefits and associated revenue.
- PSP is likely to post 15.3% CAGR in FY22-24E with comfortable order book position, and pick-up in execution. Operating margin to moderate (to 12.8% in FY24E) due to increasing volatility in raw material prices, increased competitive intensity, higher contribution from fixed-price government jobs
- At the CMP, the company is trading at a valuation of 10.5x FY24E P/E. **We maintain BUY rating with a target price of ₹ 630 (12.5x FY24E P/E)**

Price Chart



Particulars

Particular	Amount
Market Capitalization (₹ crore)	1,904.9
Debt (FY22) (₹ crore)	114.7
Cash (FY22) (₹ crore)	195.2
EV (₹ crore)	1,824.4
52 week H/L (₹)	639 / 406
Equity capital (₹ crore)	36.0
Face value (₹)	₹ 10

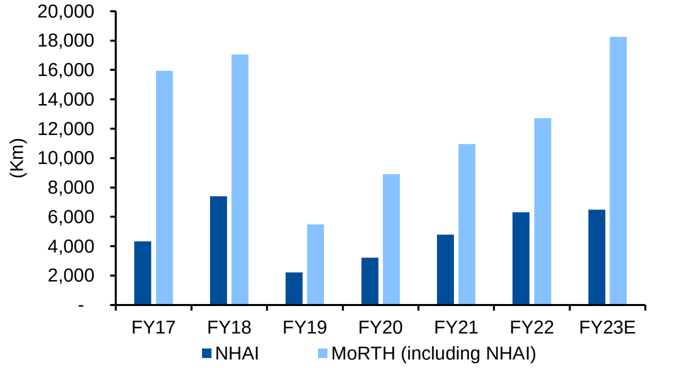
Exhibit 3: Financial summary for PSP Projects Ltd

(₹ Crore)	FY20	FY21	FY22	5 Year CAGR (FY17-22)	FY23E	FY24E	2 Year CAGR (FY22-24E)
Net Sales	1,499.3	1,240.9	1,748.8	34.3	2,035.7	2,325.2	15.3
EBITDA	191.0	134.8	256.5	31.2	254.0	298.8	7.9
EBITDA Margin (%)	12.7	10.9	14.7		12.5	12.8	
Net Profit	129.3	80.8	162.4	31.3	153.0	182.1	5.9
EPS (₹)	35.9	22.4	45.1		42.5	50.6	
P/E (x)	14.7	23.6	11.7		12.4	10.5	
EV/EBITDA (x)	9.3	13.0	7.1		7.4	6.2	
RoCE (%)	35.9	20.7	31.0		24.9	24.9	
RoE (%)	28.3	15.5	23.7		18.9	19.0	

Source: Company, ICICI Direct Research

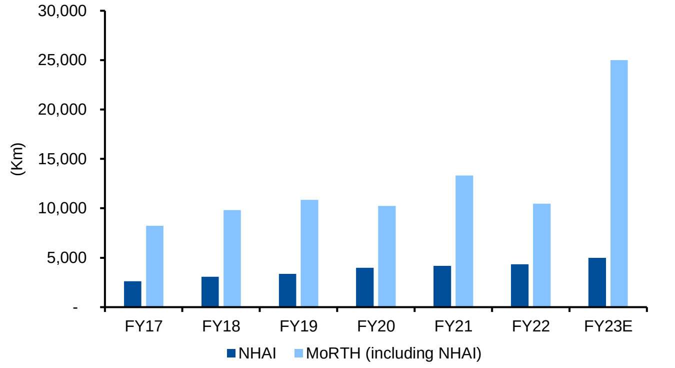
Focus Charts

Exhibit 4: MoRTH/NHAI awarding trend



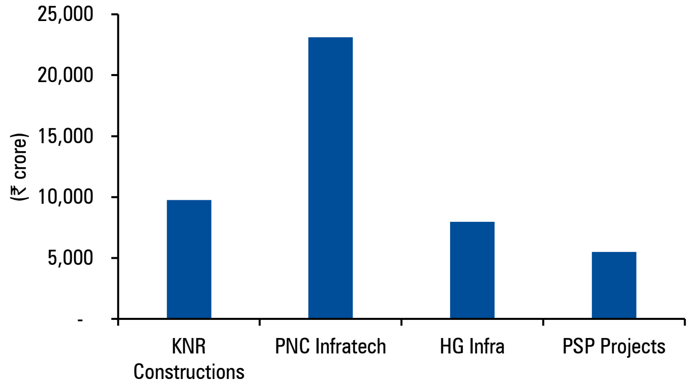
Source: NHAI, MoRTH, Media articles

Exhibit 5: MoRTH/NHAI construction trend



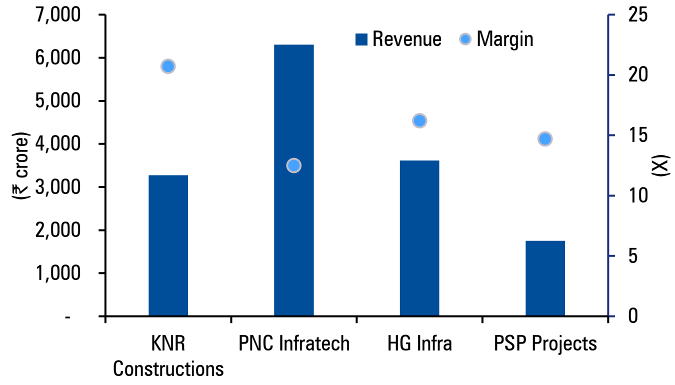
Source: NHAI, MoRTH, Media articles

Exhibit 6: Order book position*



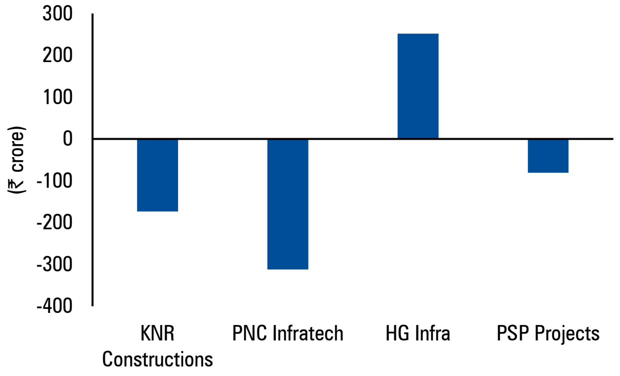
Source: Company, ICICI Direct Research; including L1 and recently won projects

Exhibit 7: Revenue and margin profile*



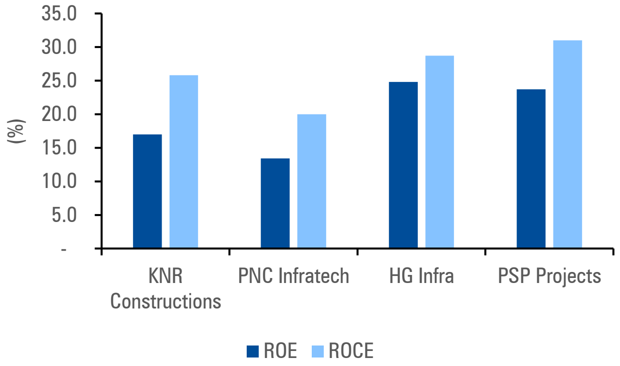
*Source: Company, ICICI Direct Research; *during FY22*

Exhibit 8: Net debt free position for most of the companies*



Source: Company, ICICI Direct Research; during FY22

Exhibit 9: FY22 Return Ratios*



Source: Company, ICICI Direct Research; during FY22

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Hold: -5% to 15%;

Reduce: -5% to -15%;

Sell: <-15%

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