

CMP: ₹ 243

Target: ₹ 290 (19%)

Target Period: 12 months

BUY

November 16, 2022

Decent show; irrigation receivables key monitorable...

About the stock: KNR Constructions is one of the leading companies in the roads and highways sector having executed 6,000+ lane km of projects across 12 states in India. The company also has an established presence in irrigation and urban water infrastructure management.

- Reported 16.3% revenue CAGR over FY17-22 and has consistently delivered industry-leading operating margin of ~20% throughout past three years
- Prudent management, robust return ratios (RoCE: 20%+)

Q2FY23 Results: KNR delivered a decent set of numbers during Q2FY23.

- Standalone revenue improved 12.2% YoY to ₹ 847.4 crore. It also includes one-time income of ₹ 32.7 crore pertaining to early completion bonus and arbitration claims. Adjusted for these, revenue improved 7.8% YoY
- EBITDA came in at ₹ 188.8 crore (up 12.7% YoY) with consequent margin at 22.3%. However, adjusted for one-time income, margin was at ~19%
- PAT reported growth of 12.9% YoY to ₹ 107.6 crore

What should investors do? KNR's share price has grown at ~13% CAGR over the past five years (from ~₹ 133 in November 2017 to ~₹ 243 levels in November 2022).

- While near term execution could be muted, we expect the same to pick up pace by FY23 end. We maintain our **BUY** rating on the company

Target Price and Valuation: We value KNR at ₹ 290/share.

Key triggers for future price performance:

- KNR is likely to be one of the prime beneficiaries of roads & water segment
- Strong order book position, receipt of appointed date in most projects and execution pick-up to translate into 11.2% topline CAGR over FY22-24E
- While some execution and margin moderation is likely owing to slower irrigation execution; we expect an improvement by year end
- Asset-light strategy via monetisation to bring-in incremental cash flows

Alternate Stock Idea: Besides KNR, we like HG Infra in the EPC space.

- Strong execution, lean balance sheet and healthy order book
- BUY with a target price of ₹ 700/share

Key Financial Summary

₹ 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%	3,431.5	4,050.3	11.2%
EBITDA	487.1	535.8	677.7	24.2%	634.8	769.6	6.6%
EBITDA Margin (%)	21.7	19.8	20.7		18.5	19.0	
PAT	225.2	244.2	381.8	19.4%	381.9	473.3	11.3%
EPS (₹)	16.0	8.7	13.6		13.6	16.8	
P/E (x)	15.2	28.0	17.9		17.9	14.4	
EV/EBITDA (x)	14.4	12.5	9.6		10.1	8.3	
RoNW (%)	14.5	13.7	16.1		14.6	15.4	
RoCE (%)	19.0	23.4	25.8		20.4	21.1	

Source: Company, ICICI Direct Research



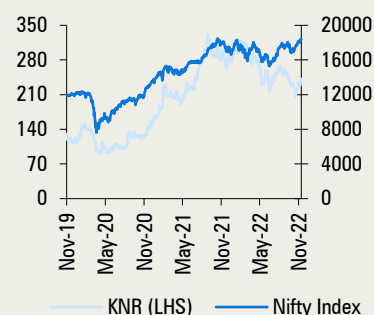
Particulars

Particular	Amount (₹ crore)
Market Capitalization	6,834.0
Total Debt (FY22)	0.0
Cash (FY22)	173.3
EV	6,660.7
52 week H/L (₹)	330/ 203
Equity capital	56.2
Face value (₹)	2

Shareholding pattern

	Dec-21	Mar-22	Jun-22	Sep-22
Promoters	51.5	51.5	51.6	51.1
DII	33.9	33.2	33.1	34.4
FII	4.6	5.7	5.7	5.7
Other	10.1	9.6	9.5	8.7

Price Chart



Key Risks

Key Risk: (i) Delay in execution for HAM and irrigation projects; (ii) Sustained working capital stress in water/irrigation projects

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Key business highlight and outlook

Order book position healthy;

KNR's order book at the end of Q2FY23 was at ₹ 8,041.5 crore, mainly contributed by roads - HAM (43%), roads - EPC (31%) and irrigation (26%) segments. Including L1 position in HAM project worth ₹ 765 crore, its order book position was healthy at ₹ 8,806.5 crore (2.5x book to TTM revenues). **Going forward, the company is targeting order inflows of ~₹ 3,000-4,000 crore during FY23, to be supported by continued traction in the roads segment.** On the execution front, KNR reported 16% revenue growth in H1FY23 (to ₹ 1,738 crore) driven by its healthy order book position and pick-up in execution, mainly in HAM projects. **Going forward, the company has indicated towards execution challenges with a) slowed execution pace in irrigation projects due to funding issues at the government level and b) extended monsoon season impacting construction activities.** Considering these, the company expects revenue to hover in the range of ₹ 3,300-3,500 crore during FY23 (vs. earlier guidance of ₹ 3,500+ crore). **In line with these, we expect the company to report 11.2% CAGR during FY22-24E with margin to hover at ~18.5-19%.**

Debt to come down; dues from irrigation remain elevated

KNR largely maintained a lean balance sheet structure backed by its prudent strategy to mainly focus on an asset light business model and efficient manage working capital. However, its net debt on a standalone basis has increased to ₹ 75.4 crore at Q2FY23-end (gross debt: ₹ 200.1 crore; vs. ₹ 124.7 crore at Q1FY23-end) on account of higher working capital requirement. Going forward, it has total equity requirement of ₹ 1,098.5 crore (₹ 538 crore already invested till Q2FY23; ₹ 295 crore estimated to be spent during remaining FY23, ₹ 160 crore in FY24 and balance ₹ 105 crore in FY25) towards already secured HAM projects. **Despite these, we expect its debt to remain at minimal levels with healthy operating cash flow generation arising from improved profitability and better cash flow management. Also, the receipt of pending dues during October 2022 from the completion of the Cube deal is expected to aid in debt reduction, going ahead. Further, its net working capital at the end of Q2FY23 improved to 54 days (vs. 60 days at Q1FY23-end). However, dues from the irrigation segment continued to remain elevated (currently at ~₹ 900 crore; including unbilled revenues) vs. ₹ 850 crore at Q1FY23-end due to funding issues for various state governments. With these, the company has become cautious towards incremental execution and is now focusing more towards clearance of pending bills, which would aid its working capital cycle to improve further.**

Key conference call takeaways

- **Industry outlook:** MoRTH has constructed 3,559 km of national highways during H1FY23 compared to 3,824 km constructed during H1FY22, mainly impacted by higher input cost along with a heavy and prolonged monsoon period. Further, the award figure was at 4,092 km in H1FY23 (vs. 4,609 km during H1FY22). Overall, the authority is aiming to award, construct ~6,500 km, ~12,000 km of road projects, respectively, during FY23
- **Order inflow:** Order inflows in the recent past have been impacted by a) heightened competition, b) the company's focus on margin protection and c) higher emphasis on projects in the southern region. However, **the company is targeting order inflows of ~₹ 3,000-4,000 crore during FY23 with higher focus on the roads and highways segment. The company may diversify itself into different geographies such as Uttar Pradesh and Bihar to maintain the momentum in inflows.** It has currently bid for ₹ 3,000 crore worth of projects in Kerala and expects a positive outcome from the same
- **Competitive intensity:** As per the management, the competitive intensity in the roads segment remains at an elevated level with higher participation from unorganised player trying to undercut project costs to bag higher market share
- **Under-construction HAM projects:** As on Q2FY23-end, the physical progress on KNR's five under-construction HAM projects was at: a) Trichy-Kallagam: 100%, b) Chittor-Mallavaram: 100%, c) Ramsanpalle-Mangloor: 100%, d) Magadi-Somwarpeth: 65.5% and e) Oddanchatram-Madathukulam: 81.9%

- **Newly secured HAM projects:** KNR has received appointed date for two HAM projects viz. a) Ramanattukara to Valanchery, and b) Valanchery to Kappirikkad on January 21, 2022. The physical progress as on Q2FY23 end was at 9.4% and 11.5%, respectively. Further, the company has signed concession agreement for Chittoor – Thatchur section (Package-3) on November 17, 2021 and achieved financial closure on March 30, 2022. The project is facing delays in land acquisition (72% available currently) and approval from National Green Tribunal (NGT). Receipt of appointed date is likely by December 2022
- **Irrigation projects:** KNR has slowed down its execution pace at its existing irrigation jobs due to major payment issues from state governments (outstanding current dues: ~₹ 900 crore). Revenue from the segment during Q2FY23 was at ~₹ 125 crore while it has received ~₹ 160 crore (payment of ~₹ 50-60 crore on a monthly basis). While the management has indicated towards possibility of faster clearance of dues with its irrigation project getting tied up with a bank/lender (with client), the monthly run rate of ~₹ 50-60 crore is likely to be maintained till then. After clearance of dues, execution pace is expected to get restored to near normalised level
- **Bonus:** The company has received bonus claim of ₹ 8.1 crore (inclusive of tax) for early completion by 52 days from one of its HAM project viz. KNR Tirumala Infra Pvt Ltd
- **One-time income:** During Q2FY23, two of company's JV i.e. Patel KNR JV and KNR Patel JV sold their pending arbitration claims through assignment deed. Accordingly, the company has recognised a share of revenue of ₹ 24.1 crore and ₹ 50 lakh, respectively. Considering ₹ 7.7 crore and ₹ 20 lakh of tax, the net impact of these on profit is ~₹ 17.3 crore. Overall, the company currently has total claims of ~₹ 500 crore
- **Deal with Cube Highways:** KNR has completed its transaction with Cube Highways on October 20, 2022 for three HAM projects viz. a) KNR Tirumala Infra Pvt Ltd (investment: ₹ 160.2 crore in form of equity and sub-debt; consideration received: ₹ 204.9 crore), b) KNR Shankarampet Projects Pvt Ltd (investment: ₹ 126.8 crore; consideration: ₹ 154.6 crore), and c) KNR Srirangam Infra Pvt Ltd (investment: ₹ 78.4 crore; consideration: ₹ 131.1 crore). Additionally, an amount totalling ₹ 34.1 crore is expected to be received subject to receipt of certain approvals from NHAI
- **Income tax matter:** The Income Tax (I-T) Department had carried out a search operation at the company's various business premises in March 2022. The company extended full cooperation to the I-T officials during the search. As on date, the company has not received any formal communication from the I-T department. However, it is known that the search team from the I-T department has submitted their report to the respective assessment division and the study of that report is going on. Going ahead, if some demand arises from the assessment division after the examination, the company have the option to challenge it. However, the management is currently of the view that this will not have any impact on the company's financial position. Hence, no provision for any liability has been recognised till now
- **Debt & debt position:** Standalone gross debt has increased to ₹ 200.1 crore vs. nil at FY22-end). Also, KNR holds cash & cash equivalent of ~₹ 66 crore. The increase in debt is mainly due to higher working capital requirement as the irrigation segment is suffering from payment issues (from state government). However, the management expects KNR to attain net debt free position by FY23-end with considerable decline in pending dues with clearance of bills
- **Capex:** KNR has incurred capex of ~₹ 75 crore during H1FY23. However, the management has guided for moderated level of overall capex to the tune of ₹ 100-120 crore in FY23 (vs. ₹ 200+ crore in FY22) with no major machinery to be added in the irrigation segment

KNR is a proxy play on increased focus on roads and overall infrastructure push. This is considering a) strong execution, b) healthy margins, c) monetisation of BOT/HAM assets, d) healthy balance sheet and e) strong return ratios. We maintain BUY rating on the stock with an SOTP based target price of ₹ 290.

Exhibit 1: Variance analysis

Particulars	Q2FY23	Q2FY23E	Q2FY22	YoY (%)	Q1FY23	QoQ (%)	Comments
Total Operating Income	847.4	808.5	755.6	12.2	890.6	-4.8	Pick-up in execution led to topline growth
Other Income	7.6	9.5	10.5	-28.1	9.1	-16.6	
Consumption of raw materials	315.4	390.5	274.6	14.9	433.1	-27.2	
Employee benefit expenses	46.9	36.4	36.1	30.2	38.6	21.7	
Other Expenses	54.0	46.1	65.0	-17.0	48.0	12.5	
EBITDA	188.8	149.6	167.5	12.7	165.0	14.4	
EBITDA Margin(%)	22.3	18.5	22.2	10 bps	18.5	375 bps	Margin improved with better project mix and receipt of one time income
Depreciation	36.6	33.7	32.0	14.5	32.7	12.1	
Interest	8.4	6.6	7.2	16.8	6.9	21.3	
PBT	151.3	118.9	138.9	8.9	134.5	12.5	
Taxes	43.8	30.0	43.7	0.2	33.6	30.2	
PAT	107.6	88.9	95.2	12.9	100.8	6.7	

Source: Company, ICICI Direct Research

Exhibit 2: Change in estimates

(₹ Crore)	FY23E			FY24E			Comments
	Old	New	% Change	Old	New	% Change	
Revenue	3,598	3,432	(4.6)	4,207	4,050	-3.7	Realign estimates
EBITDA	612	635	3.7	778	770	-1.1	
EBITDA Margin (%)	17.0	18.5	150 bps	18.5	19.0	50 bps	Elevated margin reported during H1; to aid overall margin performance
PAT	372	382	2.7	493	473	-4.0	Change in PAT due to realignment of revenue, depreciation and tax rate
Diluted EPS (₹)	13.2	13.6	2.7	17.5	16.8	-4.0	

Source: Company, ICICI Direct Research

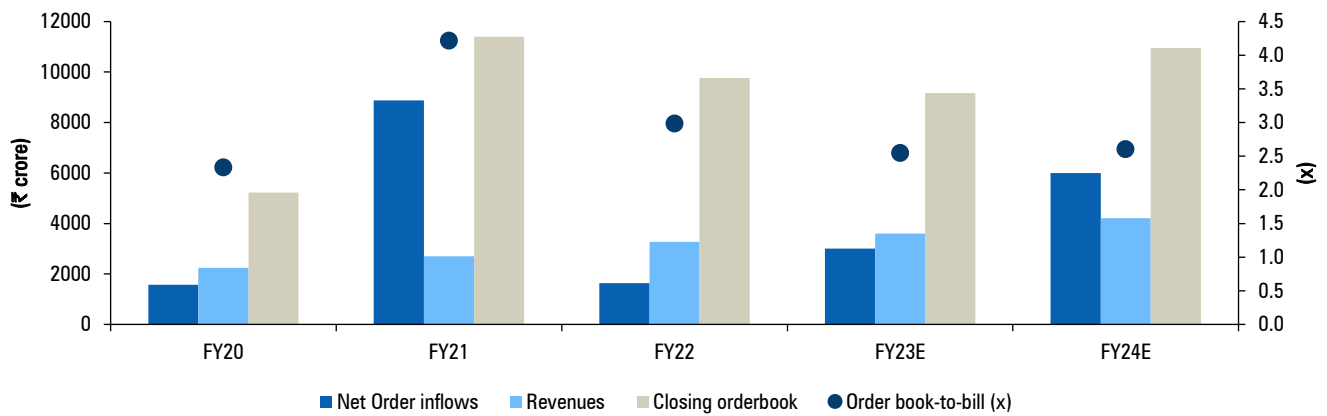
Company Analysis

Exhibit 3: Order book update

Key Projects	(₹ crore)
Ramanattukara to Valanchery bypass project (HAM)	1,581
Valanchery Bypass to Kappirikkad project (HAM)	1,411
Bangalore-Mangalore Project (Periya Shanthi to Bntwal) (EPC)	879
Elevated Highway along Avinashi Road in Coimbatore City (EPC)	758
Cheyur-Panayur Road (EPC)	351
Top Five projects	4,979
Other Road projects	941
Irrigation projects	2,121
Total	8,042

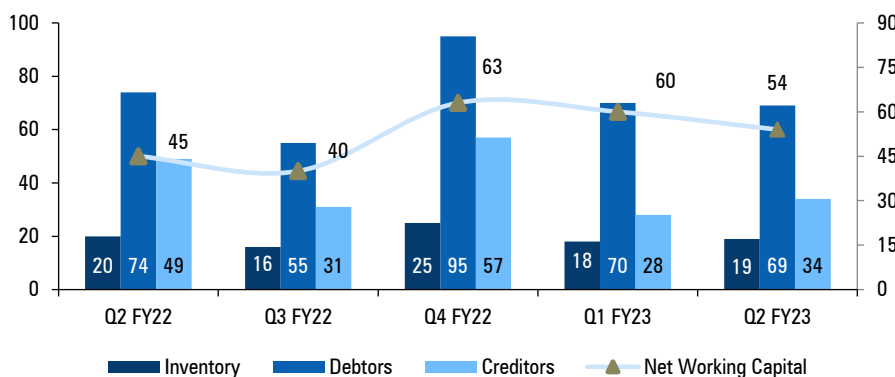
Source: Company, ICICI Direct Research

Exhibit 4: Healthy order book position



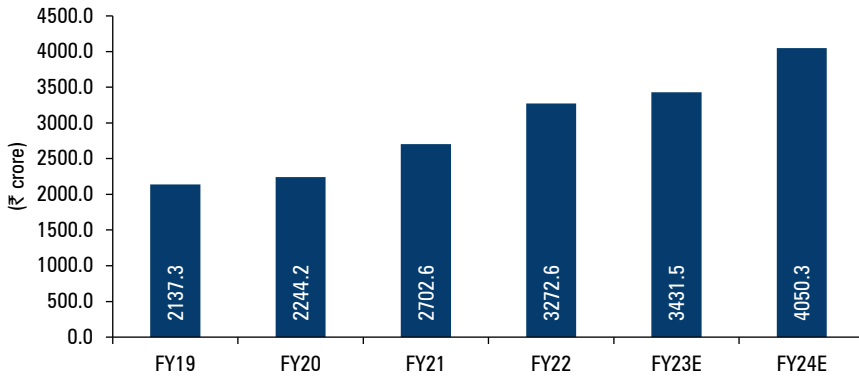
Source: Company, ICICI Direct Research; FY21 order book includes won 2 HAM and 1 EPC project worth ₹4,323 crore

Exhibit 5: Net working capital days trend



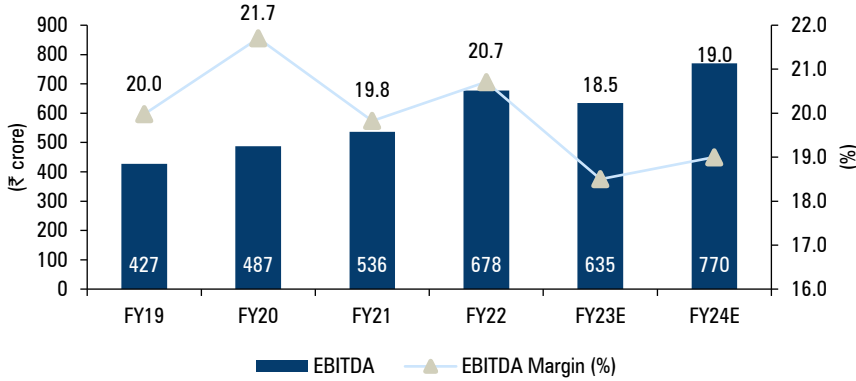
Source: Company, ICICI Direct Research

Exhibit 6: Healthy revenue growth ahead



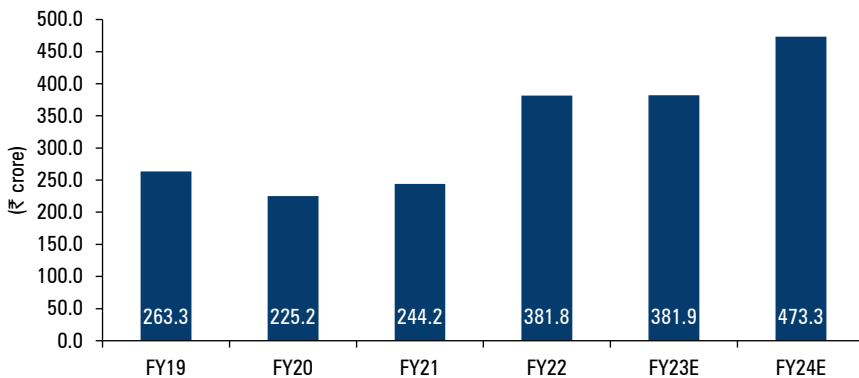
Source: Company, ICICI Direct Research

Exhibit 7: EBITDA & EBITDA margin trend



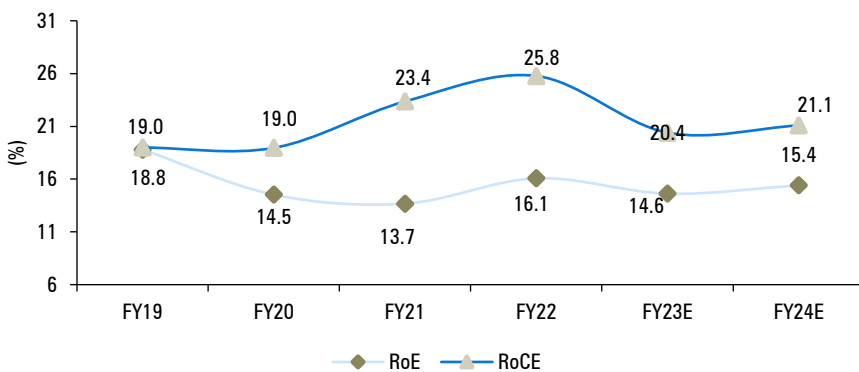
Source: Company, ICICI Direct Research

Exhibit 8: PAT trend



Source: Company, ICICI Direct Research

Exhibit 9: Return ratios trend



Source: Company, ICICI Direct Research

Valuation & Outlook

KNR is a focused road based EPC player that enjoys a strong execution track record with the reputation of completing projects on time/ahead of the schedule. The company also enjoys a healthy balance sheet and strong return ratios. Also, its equity commitment is likely to be supported by internal cash generation, HAM monetisation and irrigation dues recovery. While debt at the standalone level has increased during Q2FY23, the company is likely to attain net debt free position by FY23-end with considerable decline in pending dues with clearance of bills.

Hence, we maintain our BUY recommendation on the stock with an SoTP based target price of ₹ 290/share. We value its core EPC business at ₹ 269/share (16x FY24E P/E).

Exhibit 10: SoTP valuation

	Value (₹ crore)	Per Share (₹)	Comment
EPC Business (A)	7573	269	16x FY24E P/E
BOT toll Investment (B = C+D)	90	3	
Muzaffarpur tollway (D)	90	3	1x P/BV
HAM Projects Investment (E)	538	19	
Total Equity Investment (F=B+E)	628	22	
SoTP Value (A+F-G)	8201	292	
Rounded-off target price	8200	290	

Source: Company, ICICI Direct Research

Financial summary

Exhibit 11: Profit and loss statement				
	₹ crore			
(₹ Crore)	FY21	FY22	FY23E	FY24E
Net Sales	2,702.6	3,272.6	3,431.5	4,050.3
Other operating income	-	-	-	-
Total Revenues	2,702.6	3,272.6	3,431.5	4,050.3
Raw Material Expense	926.5	1,180.7	1,269.7	1,498.6
Other Construction Exp.	810.0	1,016.5	1,063.8	1,235.4
Employee benefit expenses	132.1	144.8	154.4	182.3
Other Expenses	298.3	252.9	308.8	364.5
Total Operating Exp	2,166.8	2,594.9	2,796.7	3,280.8
EBITDA	535.8	677.7	634.8	769.6
Other Income	49.6	41.7	42.0	45.5
Interest	48.7	27.4	29.3	22.3
Depreciation	144.4	134.6	138.3	161.7
PBT	381.1	578.8	509.3	631.1
Total Tax	137.0	197.0	127.3	157.8
Reported PAT	244.2	381.8	381.9	473.3
Adjusted PAT	255.4	360.4	381.9	473.3
EPS (Diluted)	8.7	13.6	13.6	16.8

Source: Company, ICICI Direct Research

Exhibit 13: Balance sheet				
	₹ crore			
(₹ Crore)	FY21	FY22	FY23E	FY24E
Liabilities				
Share Capital	56.2	56.2	56.2	56.2
Reserves & Surplus	1,811.6	2,185.7	2,556.2	3,015.3
Networth	1,867.8	2,242.0	2,612.4	3,071.6
Secured Loan	0.7	-	-	-
Unsecured Loan	-	-	-	-
Total Debt	0.7	-	-	-
Deferred Tax Liability	-	-	-	-
Total Liabilities	1,888	2,269	2,639	3,099
Assets				
Gross Block	1,285.9	1,497.2	1,627.2	1,797.2
Net Block	337.7	414.4	406.1	414.3
Capital WIP	2.4	20.6	20.6	20.6
Non-current Investments	555.7	407.2	666.4	957.0
Current Assets				
Inventories	148.0	227.0	225.6	255.2
Sundry Debtors	863.2	849.4	752.1	832.3
Loans and Advances	33.8	38.4	38.9	40.8
Other Current Assets	633.1	753.0	933.0	1,113.0
Cash	117.3	173.3	251.5	285.0
Total Current Assets	1,678.1	1,867.9	1,949.7	2,241.3
Creditors	239.7	294.5	308.9	364.5
Provisions	25.7	24.0	25.1	29.7
Other Current Liabilities	766.9	742.0	752.1	887.7
Other Long Term Liabilities	11.0	17.0	17.0	17.0
Total Current Liabilities	1,032.4	1,060.5	1,086.1	1,281.9
Net Current Assets	736.8	1,093.8	1,228.1	1,357.5
Total Assets	1,888	2,269	2,639	3,099

Source: Company, ICICI Direct Research

Exhibit 12: Cash flow statement				
	₹ crore			
₹ crore	FY21	FY22	FY23E	FY24E
Profit before Tax	381.1	578.8	509.3	631.1
Depreciation	144.4	134.6	138.3	161.7
Interest Paid	48.7	27.4	29.3	22.3
Others	2.8	(49.0)	(42.0)	(45.5)
Cash Flow before WC changes	577.1	691.8	634.8	769.6
Net Increase in Current Assets	(361.5)	(224.5)	(67.1)	(322.6)
Net Increase in Current Liabilities	161.1	58.6	25.6	195.8
Taxes paid	(78.7)	(182.6)	(127.3)	(157.8)
Net CF from Operating Activities	298.0	343.2	466.1	485.1
(Purchase)/Sale of Fixed Assets	(93.9)	(293.9)	(130.0)	(170.0)
Loans and Inv in JV/SPV	138.8	29.3	(259.2)	(290.6)
Others	16.3	16.3	42.0	45.5
Net CF from Investing Activities	61.2	(248.3)	(347.2)	(415.0)
Debt Proceeds/Repayment	(229.0)	(0.7)	-	-
Interest Paid	(45.9)	(31.2)	(29.3)	(22.3)
Others	-	(7.0)	(11.5)	(14.2)
Net CF from Financing Activities	(274.9)	(39.0)	(40.7)	(36.5)
Net Cash flow	84.3	56.0	78.2	33.6
Opening Cash/ Cash Equivalent	33.0	117.3	173.3	251.5
Closing Cash/ Cash Equivalent	117.3	173.3	251.5	285.0

Source: Company, ICICI Direct Research

Exhibit 14: Key ratios				
(Year-end March)	FY21	FY22	FY23E	FY24E
Per Share Data				
EPS (Fully Diluted)	8.7	13.6	13.6	16.8
Cash EPS	13.8	18.4	18.5	22.6
BV	66.4	79.7	92.9	109.2
Operating Ratios				
EBITDA / Net Sales	19.8	20.7	18.5	19.0
PAT / Net Sales	9.5	11.0	11.1	11.7
Inventory Days	20	25	24	23
Debtor Days	117	95	80	75
Creditor Days	32	33	33	33
Return Ratios				
RoE	13.7	16.1	14.6	15.4
RoCE	23.4	25.8	20.4	21.1
RoIC	32.3	35.6	31.8	35.9
Valuation Ratios				
EV / EBITDA	12.5	9.6	10.1	8.3
P/E	28.0	17.9	17.9	14.4
EV / Net Sales	2.5	2.0	1.9	1.6
Market Cap / Sales	2.5	2.1	2.0	1.7
Price to Book Value	3.7	3.0	2.6	2.2
Turnover Ratios				
Asset turnover	1.4	1.4	1.3	1.3
Gross Block Turnover	2.1	2.2	2.1	2.3
Solvency Ratios				
Debt / Equity	0.0	-	-	-
Current Ratio	1.6	1.8	1.8	1.7
Debt / EBITDA	0.0	-	-	-
Quick Ratio	1.5	1.5	1.6	1.5

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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