

## Knife River Corp

## More evidence the turnaround is taking hold

Reiterate Rating: BUY | PO: 83.00 USD | Price: 69.39 USD

## Quality over quantity remains the mantra

We recently [initiated on Knife River](#) (see report) with a Buy, on our thesis of improved practices/ops, consolidation, and favorable valuation. We believe Q4 results/2024 guide are further confirmation of this transformation taking place. High demand, EDGE initiatives, and mild weather (extended construction season ~\$50mn benefit) drive Q4 growth. EBITDA of \$72.4mn (+45% vs consensus), was above the high end of guide, as gross margin of 17.4% expanded 400bps YoY led by significant margin expansion across: Aggregates (+910bps YoY), Contracting (+480bps YoY) and Liquid Asphalt (+540bps YoY). Pricing was a bright spot across materials, as were volumes which were up in Q4 after declining through the year. Knife River expects to see a repeat of higher price/lower volumes in 2024 as the firm continue to pursue higher quality projects over quantity, guiding to MSD-HSD pricing, flat to down LSD volumes, and ~5% cost inflation.

## Outlook above the street, M&amp;A a likely source of upside

Knife River guided to flattish YoY revenue for 2024 (\$2.75-\$2.95bn, +1% at the midpoint), and \$425-\$475mn in EBITDA (15.8% margin, +50bps at the midpoint). EBITDA outlook is 3% ahead of consensus at \$438mn. Energy Services was broken out as a segment and is expected to generate \$50-\$60mn in EBITDA (vs \$78.1mn 2023). Dynamic pricing is still in early innings and should provide a long tail benefit to margins. Work on internal EDGE initiatives is ongoing, however KNF expects to pivot focus more towards M&A in 2024. Low leverage (1.1x YE, vs 2.5x L-term annual target) provides the firm with significant balance sheet optionality to pursue a myriad of opportunity in the pipeline. Any M&A taking place will remain aggregate centric given the firm's committed to increase aggregate exposure.

## Buy: raising PO following results

While we lower our 2024/25E revenue estimates 3%, we maintain our EBITDA estimates of \$450/\$495mn for 2024/25 respectively. Our 2024 estimate leaves us in line with the midpoint of outlook. We raise our PO to \$83 (\$81) on the same 11.0x 2024E EBITDA on lower net debt. Our valuation remains at a substantial discount to peers in the space. While the trajectory of non-resi (warehouses, data centers) stays a front of mind risk for the broader sector, KNF's internal initiatives and high exposure to public infrastructure provide it with idiosyncratic levers for growth. We reiterate our Buy rating as we see upside as the firm executes on EDGE initiatives, progresses to l-term targets (20% EBITDA), and begins to pursue inorganic growth.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	2.06	3.23	3.45	3.72	4.02
EPS Change (YoY)	NA	56.8%	6.8%	7.8%	8.1%
Consensus EPS (Bloomberg)			3.26	3.72	4.27
DPS	0	0	0	0	0
Valuation (Dec)					
P/E	33.7x	21.5x	20.1x	18.7x	17.3x
EV / EBITDA*	14.3x	10.4x	9.9x	9.0x	8.5x
Free Cash Flow Yield*	1.3%	5.6%	5.0%	5.1%	4.8%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 4.

16 February 2024

## Equity

## Key Changes

(US\$)	Previous	Current
Price Obj.	81.00	83.00
2024E Rev (m)	2,930.0	2,850.0
2025E Rev (m)	3,050.0	2,950.0
2026E Rev (m)	NA	3,075.0
2024E EPS	3.36	3.45
2025E EPS	3.76	3.72
2026E EPS	NA	4.02
2026E EBITDA (m)	NA	525.0

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## Stock Data

Price	69.39 USD
Price Objective	83.00 USD
Date Established	16-Feb-2024
Investment Opinion	C-1-9
52-Week Range	33.67 USD - 72.63 USD
Mrkt Val (mn) / Shares Out (mn)	3,941 USD / 56.8
Free Float	99.2%
Average Daily Value (mn)	26.99 USD
BofA Ticker / Exchange	KNF / NYS
Bloomberg / Reuters	KNF US / KNF.N
ROE (2024E)	14.4%
Net Dbt to Eqty (Dec-2023A)	33.1%

LSD: Low-Single Digit

MSD: Mid-Single Digit

HSD: High-Single Digit

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Timestamp: 16 February 2024 05:00AM EST

# iQprofile<sup>SM</sup> Knife River Corp

## iQmethod<sup>SM</sup> – Bus Performance\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Return on Capital Employed	NA	10.3%	9.7%	9.9%	9.7%
Return on Equity	22.6%	15.9%	14.4%	13.5%	12.7%
Operating Margin	7.7%	10.5%	10.9%	11.6%	11.9%
Free Cash Flow	52	220	197	199	188

## iQmethod<sup>SM</sup> – Quality of Earnings\*

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash Realization Ratio	1.8x	1.8x	1.9x	1.7x	1.6x
Asset Replacement Ratio	1.3x	0.9x	1.3x	1.2x	1.3x
Tax Rate	26.8%	25.4%	26.0%	26.0%	26.0%
Net Debt-to-Equity Ratio	65.6%	33.1%	15.2%	1.4%	-8.6%
Interest Cover	6.5x	5.1x	6.9x	6.1x	6.5x

## Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Sales	2,535	2,830	2,850	2,950	3,075
% Change	NA	11.7%	0.7%	3.5%	4.2%
Gross Profit	361	539	558	593	626
% Change	NA	49.3%	3.5%	6.2%	5.7%
EBITDA	313	432	450	495	525
% Change	NA	37.9%	4.1%	10.0%	6.1%
Net Interest & Other Income	(35)	(51)	(45)	(56)	(56)
<b>Net Income (Adjusted)</b>	<b>116</b>	<b>183</b>	<b>196</b>	<b>212</b>	<b>229</b>
<b>% Change</b>	<b>NA</b>	<b>57.3%</b>	<b>7.2%</b>	<b>7.9%</b>	<b>8.0%</b>

## Free Cash Flow Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Net Income from Cont Operations (GAAP)	116	183	196	212	229
Depreciation & Amortization	118	129	130	140	140
Change in Working Capital	(21)	24	40	16	1
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	(5)	0	2	3	3
Capital Expenditure	(155)	(116)	(171)	(171)	(184)
<b>Free Cash Flow</b>	<b>52</b>	<b>220</b>	<b>197</b>	<b>199</b>	<b>188</b>
<b>% Change</b>	<b>NA</b>	<b>320.8%</b>	<b>-10.4%</b>	<b>1.3%</b>	<b>-5.5%</b>
Share / Issue Repurchase	NA	NA	NA	NA	NA
Cost of Dividends Paid	NA	NA	NA	NA	NA
Change in Debt	1	902	0	0	0

## Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Cash & Equivalents	10	262	459	658	847
Trade Receivables	210	267	254	242	244
Other Current Assets	388	384	366	368	373
Property, Plant & Equipment	1,315	1,315	1,356	1,387	1,432
Other Non-Current Assets	371	371	371	371	371
<b>Total Assets</b>	<b>2,294</b>	<b>2,600</b>	<b>2,806</b>	<b>3,028</b>	<b>3,267</b>
Short-Term Debt	238	7	7	7	7
Other Current Liabilities	279	340	349	355	363
Long-Term Debt	447	675	675	675	675
Other Non-Current Liabilities	302	312	312	312	312
<b>Total Liabilities</b>	<b>1,266</b>	<b>1,334</b>	<b>1,342</b>	<b>1,349</b>	<b>1,357</b>
<b>Total Equity</b>	<b>1,029</b>	<b>1,266</b>	<b>1,464</b>	<b>1,679</b>	<b>1,910</b>
<b>Total Equity &amp; Liabilities</b>	<b>2,294</b>	<b>2,600</b>	<b>2,806</b>	<b>3,028</b>	<b>3,267</b>

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 4.

## Company Sector

Building Materials

## Company Description

Knife River is a leading provider of aggregate based construction materials and contracting services. The firm is vertically integrated, with aggregates used in downstream products such as ready-mix concrete and asphalt. Knife River operates primarily in the Pacific, North West and Mountain regions, targeting high-growth mid size markets.

## Investment Rationale

We rate Knife River shares at a Buy. With the split from MDU, there is room for greater focus on operational improvements, driving margin and earnings. The operational improvements come at a time when non-residential construction is underpinned by stimulus and other factors driving a sustained period of growth. We believe investors are likely to appreciate KNF's ability to drive operational improvement, favorable territories and favorable relative valuation vs other public aggregate names.

## Stock Data

Average Daily Volume 388,892

## Quarterly Earnings Estimates

	2023	2024
Q1	-0.73A	-0.82E
Q2	1.00A	1.14E
Q3	2.58A	2.58E
Q4	0.37A	0.56E

## Price objective basis & risk

### Knife River Corp (KNF)

Our \$83 price objective is based on 11.0x 2024E EV/EBITDA, which is largely in line with the broad peer group, at a significant discount to aggregate heavy names, and a slight discount to material and construction firms such as ROAD given KNF's limited history of independent operation and still expanding aggregate footprint. In our view, several factors are likely to underpin Knife River's multiple: i) Infrastructure stimulus provides funding visibility over the coming years ii) Improving operating driving margin and earnings and, iii) minimal exposure to the more uncertain themes facing Industrials (China, equipment supply chains, capacity constraints). Downside risks are: 1) aggregates prices and volumes fail to rise as we forecast, 2) bottlenecks (labor, etc.) slow down or push out volume growth, 3) dislocation in rates results in a more broad slow down in construction recovery, 4) price-cost dynamics or operating leverage see limited improvement.

## Analyst Certification

I, Sherif El-Sabbahy, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

### US - Machinery Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	AECOM	ACM	ACM US	Michael Feniger
	Blue Bird Corp	BLBD	BLBD US	Sherif El-Sabbahy
	Caterpillar Inc	CAT	CAT US	Michael Feniger
	CNH Industrial NV	CNHI	CNHI US	Michael Feniger
	Construction Partners Inc.	ROAD	ROAD US	Michael Feniger
	ESAB Corp	ESAB	ESAB US	Sherif El-Sabbahy
	Finning International Inc.	YFTT	FTT CN	Sherif El-Sabbahy
	H&E Equipment Services Inc	HEES	HEES US	Sherif El-Sabbahy
	Knife River Corp	KNF	KNF US	Sherif El-Sabbahy
	Republic Services	RSG	RSG US	Michael Feniger
	Techtronic Industries Co Ltd	TTNDF	669 HK	Michael Feniger
	Techtronic Industries Co Ltd	TTNDY	TTNDY US	Michael Feniger
	United Rentals Inc	URI	URI US	Michael Feniger
	Vulcan Materials	VMC	VMC US	Michael Feniger
	Waste Connections Inc	WCN	WCN US	Michael Feniger
	WillScot Mobile Mini	WSC	WSC US	Sherif El-Sabbahy
<b>NEUTRAL</b>				
	AGCO Corp	AGCO	AGCO US	Michael Feniger
	Deere & Co	DE	DE US	Michael Feniger
	Fluor	FLR	FLR US	Michael Feniger
	GFL Environmental Inc	GFL	GFL US	Michael Feniger
	GFL Environmental Inc	YGFL	GFL CN	Michael Feniger
	Jacobs Eng.	J	J US	Michael Feniger
	Kennametal Inc.	KMT	KMT US	Michael Feniger
	Martin Marietta Materials	MLM	MLM US	Michael Feniger
	NV5 Global Inc.	NVEE	NVEE US	Michael Feniger
	PACCAR Inc	PCAR	PCAR US	Michael Feniger
	RB Global, Inc	RBA	RBA US	Michael Feniger
	Waste Management	WM	WM US	Michael Feniger



**US - Machinery Coverage Cluster**

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>UNDERPERFORM</b>				
	Allison Transmission Holdings Inc.	ALSN	ALSN US	Sherif El-Sabbahy
	Casella	CWST	CWST US	Michael Feniger
	Cummins Inc	CMI	CMI US	Michael Feniger
	Herc Holdings Inc	HRI	HRI US	Sherif El-Sabbahy
	IPG Photonics	IPGP	IPGP US	Michael Feniger
	Oshkosh Corp.	OSK	OSK US	Michael Feniger
	Terex Corp.	TEX	TEX US	Michael Feniger
	Timken Company	TKR	TKR US	Michael Feniger

**iQmethod<sup>SM</sup> Measures Definitions****Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

**Numerator**

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

**Denominator**

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization

Shareholders' Equity

Sales

N/A

N/A

**Quality of Earnings**

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

**Numerator**

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash &amp; Equivalents

EBIT

**Denominator**

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

**Valuation Toolkit**

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

**Numerator**

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities

Enterprise Value

**Denominator**

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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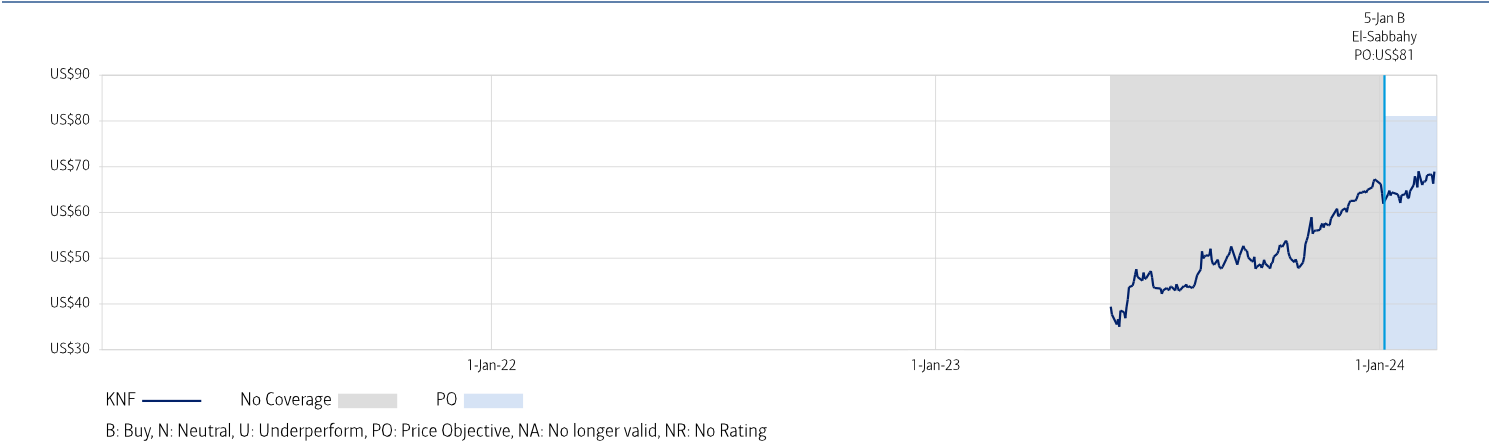
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### Knife River (KNF) Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

### Equity Investment Rating Distribution: Building Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	39	44.83%	Buy	22	56.41%
Hold	18	20.69%	Hold	11	61.11%
Sell	30	34.48%	Sell	8	26.67%

### Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

<sup>R1</sup> Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster <sup>R2</sup>
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

<sup>R2</sup> Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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