



## Nagarjuna Construction

STOCK INFO.	BLOOMBERG
BSE SENSEX: 13,024	NJCC IN
	REUTERS CODE
S&P CNX: 3,769	NGCN.BO

30 October 2006

Buy

Previous Recommendation: Buy

Rs176

		YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
		END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
Equity Shares (m)	206.6	3/06A	18,404	1,049	5.1	35.7	34.6	1.9	16.6	14.7	2.1	23.2
52-Week Range	202/94	3/07E	29,498	1,841	8.9	75.5	19.7	1.7	18.2	17.1	1.4	14.4
1,6,12 Rel. Perf. (%)	-6/-17/4	3/08E	47,000	2,871	13.9	55.9	12.6	1.4	24.0	20.4	1.0	10.2
M.Cap. (Rs b)	36.3											
M.Cap. (US\$ b)	0.8											

**Robust 2QFY07 financial performance:** During 2QFY07, Nagarjuna Constructions reported revenues of Rs6.5b (up 77% YoY), EBITDA of Rs618m (up 63% YoY) and net profit of Rs393m (up 88% YoY). Reported numbers have been better than our estimates: revenues Rs5,523m, EBITDA Rs554m and net profit Rs366m. Order backlog as of September 2006 stood at Rs66.9b, up 29.6% YoY

### Management guidance maintained

- Revenues of Rs30b in FY07 v/s Rs18.4b in FY06 (up 63% YoY)
- Order intake of Rs43b in FY07 v/s Rs36b in FY06 (up 19% YoY)
- Order backlog of Rs70b in March 2007 v/s Rs54b in March 2006

**Key takeaways from conference call:** (1) For FY07, NCC is working on two key initiatives in the construction segment - international business and gas pipeline vertical; (2) NCC's three BOT road projects have achieved financial closure by August 2006; (3) real estate revenues targeted at Rs700-Rs800m in FY07 v/s Rs460m in FY06; (4) NCC Urban Infra (100% subsidiary) has a land bank of 132 acres valued at Rs3b; to inject equity of Rs1.5b over next 6-9 months for further land acquisition; and (5) capex plans of Rs1b in FY07 v/s Rs930m in FY06.

**Valuation and view:** We expect Nagarjuna Constructions to report net profit of Rs1.8b during FY07 (up 76% YoY) and Rs2.9b in FY08 (up 56% YoY). At the CMP of Rs176, the stock trades at reported PER of 19.7x FY07E and 12.6x FY08E. BOTs, real estate and cash/investments account for Rs35/sh of our price target of Rs202/sh. Maintain **Buy**.

Y/E MARCH	QUARTERLY PERFORMANCE										(Rs Million)	
	FY06				FY07				FY06	FY07E		
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE				
<b>Sales</b>	3,594	3,682	4,724	6,404	6,517	6,517	6,992	9,472	18,404	29,498		
Change (%)	54.6	52.3	78.8	42.3	81.4	77.0	48.0	47.9	54.9	60.3		
<b>EBITDA</b>	278	379	457	531	550	618	688	1,001	1,640	2,857		
Change (%)	61.3	95.3	108.9	65.2	97.8	63.0	50.6	88.4	80.8	74.2		
As of % Sales	7.7	10.3	9.7	8.3	8.4	9.5	9.8	10.6	8.9	9.7		
Depreciation	34	41	53	54	58	69	70	67	182	255		
Interest	43	89	97	44	57	96	98	92	217	343		
Other Income	13	15	17	5	8	10	10	14	20	41		
<b>PBT</b>	214	264	324	439	443	462	530	856	1,262	2,301		
Tax	22	55	56	90	59	69	119	214	223	460		
Effective Tax Rate (%)	10.4	20.9	17.3	20.5	13.3	14.9	22.4	25.0	17.7	20.0		
<b>Reported PAT</b>	192	209	268	349	384	393	412	642	1,039	1,841		
<b>Adj PAT</b>	192	209	268	349	384	393	412	642	1,039	1,841		
Change (%)	88.9	83.3	121.6	47.9	100.3	88.1	57.4	83.8	74.6	77.3		

E: MOST Estimates

**Robust 2QFY07 financial performance**

During 2QFY07, Nagarjuna Constructions reported revenues of Rs6.5b (up 77% YoY), EBITDA of Rs618m (up 63% YoY) and net profit of Rs393m (up 88% YoY). Reported numbers have been better than our estimates: revenues Rs5,523m, EBITDA Rs554m and net profit Rs366m. The robust performance is being driven by strong revenue growth and margin expansion. Net profit margins improved to 6% in 2QFY07 (up from 5.7% in 2QFY06).

**2QFY07 revenues higher than 4QFY06**

Nagarjuna has been amongst the few construction companies where 2QFY07 revenues (Rs6.5b) have been higher than 4QFY06 (Rs6.4b). This is rare, as traditionally, 2Q is a lean season due to the monsoons. The key revenue driver during 2QFY07 for Nagarjuna Construction has been the ramp up in execution of the Devadula Irrigation project (NCC's share Rs9.45b), which has been completed to the extent of 45%. The project is to be executed over the next 18 months.

TREND IN FINANCIAL PERFORMANCE (RS M)

	1QFY06	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07
Revenue	3,594	3,682	4,724	6,404	6,517	6,517
EBIDTA	278	379	457	531	550	618
PAT	192	209	268	349	384	393

Source: Company

TREND IN SEGMENT-WISE REVENUE COMPOSITION (RS M)

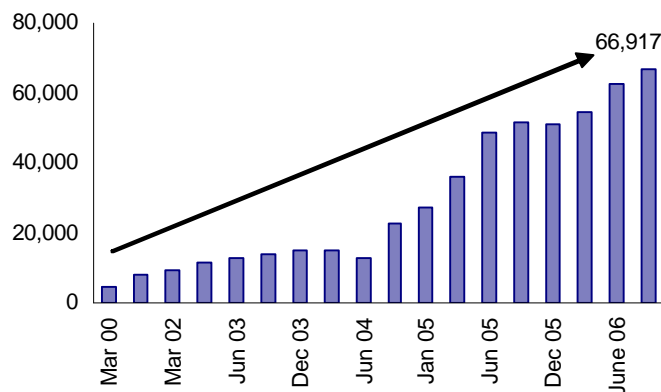
	1QFY06	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07
Roads	690	502	1,185	1,634	1,594	1,402
Buildings	1,460	1,276	1,330	1,190	862	1,556
Water	1,010	1,196	1,317	2,223	3,010	2,475
Irrigation / HEP	140	242	348	653	410	240
Electricals	150	202	489	631	608	684
<b>Total</b>	<b>3,450</b>	<b>3,418</b>	<b>4,669</b>	<b>6,331</b>	<b>6,486</b>	<b>6,384</b>

Source: Company

**Order book at Rs67b (3.6x FY06 revenues)**

Order backlog as of September 2006 stood at Rs66.9b, up 29.6% YoY. In addition, the company has emerged as the lowest cost bidder for projects worth Rs4b, resulting in an effective order book of Rs70b (equivalent to 3.8x FY06 revenues). The execution period of the current order book stands at 2.25 years.

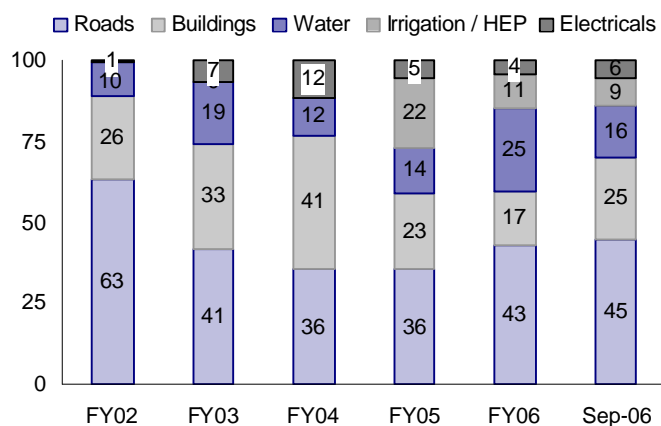
TREND IN ORDER BACKLOG (RS M)



Source: Company

During 2QFY07, order intake for the company was Rs10.6b comprising Buildings of Rs8.3b; Water Rs1.6b; Roads of Rs563m and Rs105m from Electricals and balance from Irrigation. Share of roads in the order backlog stood at 45% in 2QFY07 v/s 43% in FY06; while the share of buildings has increased to 25% in 2QFY07 v/s 17% in FY06. Share of the water segment has declined to 16% in 2QFY07 v/s 26% in FY06, due to ramp-up in execution of the Devadula Irrigation project. Management indicated that the margins on buildings and the electricals segment have increased, and thus they have picked up more orders in the segment.

ORDER BOOK COMPOSITION (%)



Note: Sept-06 denotes as of September, 2006. Source: Company

## 2QFY07 EBITDA margins lower due to higher base effect

EBITDA margins stood at 9.5% during 2QFY07 (v/s 10.3% YoY), due to the higher base effect YoY. This compares with EBITDA margins of 8.4% during 1QFY07 and 8.3% in 4QFY06.

Interest paid increased to Rs96m during 2QFY07, up from Rs89m in 2QFY06. The company nets off the interest income (on surplus funds raised through GDR) from interest expenses, and this explains the lower base of interest expenditure.

## Key takeaways from the conference call

### Management guidance maintained

- ✍ Revenues Rs30b in FY07 v/s Rs18.4b in FY06 (up 63% YoY)
- ✍ Order intake of Rs43b in FY07 v/s Rs36b in FY06 (up 19% YoY)
- ✍ Order backlog of Rs70b in March 2007 v/s Rs54b in March 2006

### Two key initiatives in core construction business

- ✍ **International business:** NCC is targeting to enhance presence in the international markets. During 1HFY07, the company bagged two international projects of Rs8.4b (Rs7.2b road project in Oman and Rs1.2b from Muscat Municipality for pipeline). It has established offices in Muscat and Dubai to focus on roads, buildings and water pipeline projects in Middle East and Asia.
- ✍ **Gas pipeline segment:** NCC is expanding presence in the gas pipeline vertical (onshore), and has signed an MoU with an Italian company to bid for gas pipeline projects. The company intends to take the joint venture route to bid for projects in India and other Asian countries.

### BOT projects achieve financial closure

NCC currently has a portfolio of four BOT road projects and has emerged as the lowest cost bidder for 100MW hydro-power project in Himachal Pradesh. Further, the company has submitted bids for two national highway

projects in Andhra Pradesh, and is submitting bids for road projects in Uttar Pradesh and Punjab. The management intends to bag 2-3 road projects every year on BOT basis.

### Status of BOT projects:

- ✍ Bangalore-Maddur Annuity project (Rs2.5b, NCC's share: 33.3%) has been completed and commenced commercial operation in June 2006. Thus, consortium would be eligible for bonus of four months amounting to Rs297m, which will increase expected ROE to ~25% (v/s 18% at the time of bidding). The first annuity payment is expected in November 2006.
- ✍ Meerut-Muzzafarpur Toll project (project value: Rs5b, NCC's share: 50%) expected to achieve financial closure in September 2006
- ✍ Bangalore Elevated Corridor project (project value Rs7.65b, NCC's share 30%) achieved financial closure in September 2006
- ✍ Oral-Bhogipur (35km) and Bhognipur-Barah (17.8km) road projects on annuity basis (project value: Rs5.2b, NCC's share: 64%) achieved financial closure in August 2006.
- ✍ Sorang HEP (100MW) in Himachal Pradesh (project cost: Rs5b, NCC's share: 30%). The Detailed Feasibility Report is under preparation, and will be completed in next six months.

### Increased focus on Real Estate

During FY06, the Real Estate division contributed Rs460m as revenues, up from Rs429m in FY05. Management expects this to increase to Rs700-Rs800m in FY07. Also, the EBITDA margins in this segment are ~20%, as it involves both construction and development profits.

- ✍ NCC has a land bank of 132 acres spread across Bangalore, Hyderabad, Kochi, Vizag and Chennai, which would be developed over the next three years through NCC Urban Infrastructure (100% subsidiary). Management stated that the market value of this land bank is Rs3b, compared with the purchase cost of ~Rs240m, thus resulting in potential capital gains of Rs2.76b. NCC intends to inject equity funding of Rs1.5b in NCC Urban Infra over the next 6-12 months, for acquisition of further land banks.

- ✍ NCC, through NCC Urban Infrastructure (100% subsidiary) is executing the National Games Village project spread across 55 acres in Ranchi, Jharkhand, which is scheduled for completion by August 2007 at a cost of Rs2.2b. The company has signed a development agreement with the Government. The project involves construction of 1,818 villas, of which ,606 villas can be sold by the company post National Games in November 2007 and expected revenue from the project is Rs3b. The government has provided land in lieu of 12% of the developed area (212 villas) to be given as free.
- ✍ NCC has also entered into a development agreement for 85 acres of land at Vizag, with the Andhra Pradesh Housing Board. The land is transferred at Rs9.2m per acre. NCC has 89% stake in the venture, while Uppal Housing has 11%. The company would take possession of the land by December 2006, and has already paid 2 of the 5 installments (of ~Rs150m each). As per the agreement, 5% of the constructed area would be provided to the economically weaker sections at a cost of Rs460/sq ft, while the remaining can be sold. Also, as per development agreement, 75% of the area could be used for construction of residential houses and 25% for commercial purpose. Expected turnover of the

project is Rs4b, and the company is in the process of drawing up the development plans.

- ✍ Recently, NCC (25%) in consortium with ICICI Venture Funds (60%) and Maytas Infrastructures (15%) has acquired six acre plot in Jubilee Hills, Hyderabad for Rs3.4b. Development plans include construction of five star hotel, retail mall and commercial complex at cost of Rs7.8b. The entire debt has been tied up, and the promoters have also subscribed to their share of equity contribution.

### Capex

During FY06, the company incurred a capex of Rs930m, which is expected to increase to Rs1.0b in FY07. This is largely towards procurement of plant and machinery.

### Valuation and view

We expect Nagarjuna Construction to report net profit of Rs1.8b during FY07 (up 76% YoY) and Rs2.9b in FY08 (up 56% YoY). At the CMP of Rs176, the stock quotes at reported PER of 19.7x FY07 and 12.6x FY08E. BOTs, Real Estate and Cash/Investments account for Rs35/sh of our price target of Rs202/sh. Maintain **Buy**.

## Nagarjuna Construction: an investment profile

### Company description

Nagarjuna Construction Company is a Hyderabad-based construction company, and has its origins in the partnership business Nagarjuna Construction Corporation established in 1978. It is promoted by Mr. A.V.S. Raju. The company has a fairly diversified business mix with a presence across roads, buildings, water, irrigation, hydropower etc.

### Key investment arguments

- Effective current order book (including L1 projects and cash EPC contracts from own BOT portfolio) stand at Rs70b, 3.8x FY06 revenues
- Post fund raising, NCC has net worth of Rs9.4b in March 2006 (v/s Rs3.2b in March 2005) enabling it to bid for bigger ticket-sized projects and also build a BOT portfolio
- NCC is focusing on several new verticals like gas pipelines, real estate development etc.

### Key investment risks

- BOT projects depress initial RoE.
- Retention of experienced personnel is a challenge
- Infrastructure capex is highly cyclical and dependent on government policies

### Recent developments

- Has recommended 80% dividend for FY06
- Board of directors proposed bonus shares in ratio of 1:1

### Valuations and view

- Based on SOTP methodology, we arrive at our PT of Rs202/sh.
- At the CMP of Rs176, the stock trades at reported PER of 19.7x FY07 and 12.6x FY08E

### Sector view

- Increased government commitment towards infrastructure projects has led to several large projects taking off the ground
- We notice a trend of margin expansion, driven by changing composition of order book and higher margins at bidding stage
- BOT ventures could unlock sizable value

#### COMPARATIVE VALUATIONS

		NCC	IVRCL	HCC
P/E (x)	FY07E	19.7	23.3	25.0
	FY08E	12.6	15.7	18.2
P/BV (x)	FY07E	1.7	3.8	2.5
	FY08E	1.4	3.1	2.3
EV/Sales (x)	FY07E	1.4	1.4	1.4
	FY08E	1.0	1.1	1.1
EV/EBITDA (x)	FY07E	14.4	15.0	14.8
	FY08E	10.2	10.9	11.6

#### SHAREHOLDING PATTERN (%)

	SEP.06	JUN.06	SEP.05
Promoter	25.5	25.6	33.6
Domestic Inst	10.6	10.1	9.2
Foreign	32.0	29.8	4.8
Others	31.9	34.6	52.5

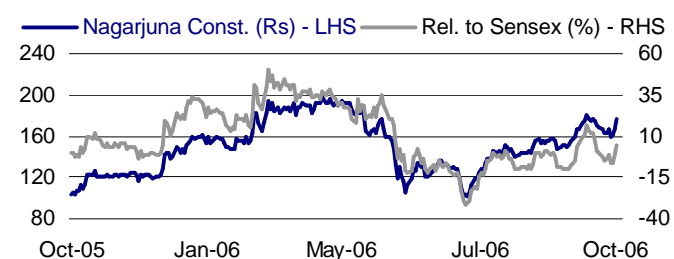
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	8.9	8.1	9.9
FY08	13.9	11.4	21.8

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
176	202	14.7	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
<b>Net Sales</b>	<b>11,885</b>	<b>18,404</b>	<b>29,498</b>	<b>47,000</b>	<b>60,000</b>	
Change (%)	56.8	54.9	60.3	59.3	27.7	
Construction Expenses	10,407	15,803	25,354	40,444	51,720	
Staff Cost	309	473	710	1,314	1,642	
Office and Site Establish. Exps	262	487	577	662	802	
<b>EBITDA</b>	<b>907</b>	<b>1,641</b>	<b>2,857</b>	<b>4,581</b>	<b>5,835</b>	
% of Net Sales	7.6	8.9	9.7	9.7	9.7	
Depreciation	109	182	255	339	444	
Interest	147	217	343	696	1,054	
Other Income	49	20	41	42	42	
<b>PBT</b>	<b>700</b>	<b>1,262</b>	<b>2,301</b>	<b>3,588</b>	<b>4,379</b>	
Tax	127	223	460	718	876	
Rate (%)	18.2	17.7	20.0	20.0	20.0	
<b>Reported PAT</b>	<b>573</b>	<b>1,039</b>	<b>1,841</b>	<b>2,871</b>	<b>3,504</b>	
Extra-ordinary Expenses	22	10	0	0	0	
<b>Adjusted PAT</b>	<b>595</b>	<b>1,049</b>	<b>1,841</b>	<b>2,871</b>	<b>3,504</b>	
Change (%)	88.0	76.3	75.5	55.9	22.0	

BALANCE SHEET		(Rs Million)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Share Capital	159	207	207	207	207	
Reserves	3,087	9,212	10,641	12,864	15,614	
<b>Net Worth</b>	<b>3,255</b>	<b>9,450</b>	<b>10,848</b>	<b>13,071</b>	<b>15,821</b>	
Loans	2,648	4,629	5,900	12,000	14,700	
Deferred Tax Liability	66	66	66	66	66	
<b>Capital Employed</b>	<b>5,969</b>	<b>14,145</b>	<b>16,814</b>	<b>25,137</b>	<b>30,586</b>	
Gross Fixed Assets	1,665	2,569	3,636	4,836	6,336	
Less: Depreciation	576	720	975	1,313	1,757	
<b>Net Fixed Assets</b>	<b>1,089</b>	<b>1,849</b>	<b>2,662</b>	<b>3,523</b>	<b>4,579</b>	
Capital WIP	9	67	0	0	0	
Investments	462	877	3,232	4,594	4,594	
<b>Curr. Assets</b>	<b>7,462</b>	<b>15,699</b>	<b>17,930</b>	<b>27,830</b>	<b>35,240</b>	
Inventory	1,523	3,893	4,849	7,726	9,863	
Debtors	1,916	3,017	4,841	7,718	9,855	
Cash & Bank Balance	1,372	2,809	1,058	1,399	1,653	
Loans & Advances	2,629	5,942	7,144	10,949	13,831	
Other Current Assets	21	39	39	39	39	
<b>Current Liab. &amp; Prov.</b>	<b>3,087</b>	<b>4,368</b>	<b>7,010</b>	<b>10,810</b>	<b>13,827</b>	
Creditors	2,160	3,107	5,210	8,310	10,627	
Other Liabilities	621	803	1,100	1,500	1,800	
Provisions	305	457	700	1,000	1,400	
<b>Net Current Assets</b>	<b>4,375</b>	<b>11,331</b>	<b>10,920</b>	<b>17,019</b>	<b>21,413</b>	
Misc. Expenses	34	22	0	0	0	
<b>Application of Funds</b>	<b>5,969</b>	<b>14,146</b>	<b>16,814</b>	<b>25,137</b>	<b>30,586</b>	

E: M O S t Estimates

RATIOS						
Y/E MARCH	2005	2006	2007E	2008E	2009E	
<b>Basic (Rs)</b>						
<b>Adjusted EPS</b>	<b>3.7</b>	<b>5.1</b>	<b>8.9</b>	<b>13.9</b>	<b>17.0</b>	
Growth (%)	-32.3	35.7	75.5	55.9	22.0	
Cash EPS	4.4	6.0	10.1	15.5	19.1	
Book Value	40.5	91.3	105.0	126.5	153.1	
DPS	0.6	0.8	1.8	2.8	3.2	
Payout (incl. Div. Tax.)	18.8	18.1	22.4	22.6	21.5	
<b>Valuation</b>						
P/E (standalone)		34.6	19.7	12.6	10.4	
Cash P/E		29.5	17.3	11.3	9.2	
EV/EBITDA		23.2	14.4	10.2	8.5	
EV/Sales		2.1	1.4	1.0	0.8	
Price/Book Value		1.9	1.7	1.4	1.1	
Dividend Yield (%)		0.5	1.0	1.6	1.8	
<b>Profitability Ratios (%)</b>						
RoE	24.5	16.6	18.2	24.0	24.3	
RoCE	18.5	14.7	17.1	20.4	19.5	
<b>Turnover Ratios</b>						
Debtors (Days)	59	60	60	60	60	
Inventory (Days)	47	77	60	60	60	
Creditors. (Days)	76	72	75	75	75	
Asset Turnover (x)	2.6	1.8	1.9	2.2	2.2	
<b>Leverage Ratio</b>						
Debt/Equity (x)	0.8	0.5	0.5	0.9	0.9	

CASH FLOW STATEMENT		(Rs Million)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
<b>PBT before Extraordinary Items</b>	<b>700</b>	<b>1,262</b>	<b>2,301</b>	<b>3,588</b>	<b>4,379</b>	
Add : Depreciation	109	182	255	339	444	
Interest	147	217	343	696	1,054	
Less : Direct Taxes Paid	127	223	460	718	876	
(Inc)/Dec in WC	-1,376	-5,519	-1,340	-5,758	-4,139	
<b>CF from Operations</b>	<b>-547</b>	<b>-4,082</b>	<b>1,098</b>	<b>-1,854</b>	<b>862</b>	
(Inc)/Dec in FA	-287	-999	-1,000	-1,200	-1,500	
(Pur)/Sale of Investments	-458	-415	-2,355	-1,362	0	
<b>CF from Investments</b>	<b>-745</b>	<b>-1,414</b>	<b>-3,355</b>	<b>-2,562</b>	<b>-1,500</b>	
(Inc)/Dec in Networth	1,154	5,357	-11	0	0	
(Inc)/Dec in Debt	1,108	1,981	1,271	6,100	2,700	
Less : Interest Paid	147	217	343	696	1,054	
Dividend Paid	108	188	412	648	754	
<b>CF from Fin. Activity</b>	<b>2,007</b>	<b>6,933</b>	<b>505</b>	<b>4,757</b>	<b>892</b>	
<b>Inc/Dec of Cash</b>	<b>715</b>	<b>1,437</b>	<b>-1,751</b>	<b>341</b>	<b>254</b>	
Add: Beginning Balance	657	1,372	2,809	1,058	1,399	
<b>Closing Balance</b>	<b>1,372</b>	<b>2,809</b>	<b>1,058</b>	<b>1,399</b>	<b>1,653</b>	

**N O T E S**

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**Nagarjuna Construction**

1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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