

January 21, 2008

Rating	BUY
Price	Rs279
Target Price	Rs396
Implied Upside	41.8%
Sensex	17,605

(Prices as on January 21, 2008)

#### Trading Data

Market Cap. (Rs bn)	63.9
Shares o/s (m)	228.7
Free Float	56.2%
Avg. Daily Vol ('000)	157.0
Avg. Daily Value (Rs m)	49.2

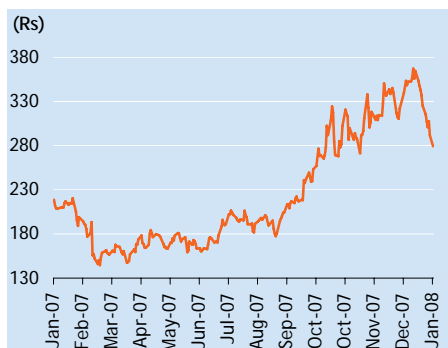
#### Major Shareholders

Promoters	24.3%
Foreign	36.5%
Domestic Inst.	23.1%
Public & Others	16.1%

#### Stock Performance

(%)	1M	6M	12M
Absolute	(13.3)	42.2	29.5
Relative	(5.2)	29.1	5.4

Price Performance (RIC: NGCN.BO, BB: NJCC IN)



Source: Bloomberg

## Nagarjuna Construction

### Scaling ops to put NCC in another league

We recently met with the management of Nagarjuna Construction Company (NCC) for an update on its various value accretive initiatives.

- Moving up the value chain:** NCC has established presence in transportation, irrigation and housing/industrial construction, the company is entering into alliances in value-added verticals like balance of plant, ports, airports and oil & gas pipeline.
- Infrastructure - strong growth driver:** NCC Infra has a portfolio of eight BOT projects with total value of Rs60bn and equity IRR of 16-20%. The company is now targeting to grow this portfolio to 12-15 projects in another 18-20 months. After attaining considerable scale in infrastructure business, the management plans value unlocking either through private equity or an IPO.
- Real estate business to gain scale:** NCC Urban Infra currently has total land reserve of 530 acres, of which 286 acres is under development, based on which the company is targeting a total rollout of 12.9 million sq.ft. over the next 3-4 years. Real estate development plans have the potential to generate revenue of Rs9.2-9.5bn for NCC over the next three years. Eventually, the target is to take its total land bank to 1,200-1,500 acres and unlock value through private equity or IPO.
- Valuation:** We are raising our SOTP price target to Rs396/share and upgrading our rating from Outperformer to BUY. NCC's core business has been valued at Rs312/share at a target multiple of 26x FY09E earnings as against 17x previously. Our one-year DCF value works to Rs360/share for its core business. We are valuing Rs17/share for its BOT portfolio, Rs28/share for real estates ventures by NCC Urban and Rs37/share for the Telapur Township project.

Key financials (Y/e March)	FY07	FY08E	FY09E	FY10E
Revenue (Rs m)	28,711	40,159	53,737	73,884
Growth (%)	56.0	39.9	33.8	37.5
EBITDA (Rs m)	2,698	3,940	5,341	7,845
PAT (Rs m)	1,519	1,909	2,722	4,240
EPS (Rs)	7.3	8.3	11.9	17.8
Growth (%)	44.9	14.5	42.6	49.8
Net DPS (Rs)	1.2	0.8	1.0	1.4

Source: Company Data; PL Research

Profitability & valuation	FY07	FY08E	FY09E	FY10E
EBITDA margin (%)	9.4	9.8	9.9	10.6
RoE (%)	15.3	14.3	15.6	19.6
RoCE (%)	9.3	9.6	10.7	13.2
EV / sales (x)	1.9	1.4	1.2	0.8
EV / EBITDA (x)	20.0	14.5	11.7	7.9
PE (x)	27.0	26.9	18.9	12.6
P / BV (x)	5.6	4.3	3.8	3.0
Net dividend yield (%)	0.4	0.3	0.3	0.5

Source: Company Data; PL Research

\* Valuations adjusted for BOT &amp; Real Estate

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## Highlights

### Increasing diversification into new verticals

NCC currently has an order book of Rs95bn, largely distributed across orders in roads, irrigation and water segments. However, in order to capitalise on emerging opportunities, the company has entered into various strategic partnerships/tie-ups. We believe the recent initiatives undertaken by the company would help them to capitalise on significant increase in infrastructure capex of US\$500bn. We estimate order book to grow at a CAGR of 37% between FY07-10E.

### Expanding scope into new verticals

In order to capitalise on new opportunities, NCC has expanded its scope of services by adding new verticals like hydro-power, airports, ports and oil & gas pipelines. NCC is working with POSCO for BOP work in the metals space, Naphogas of Ukraine in the oil & gas space, VIE India Projects in airports. Recent orders like the Rs11bn BOP from ISSCO, Rs3.5bn from IOC's Panipat refinery, etc. have put the company in a new league and are testimony to the company's success in bagging orders in these new verticals.

### International forays

While its main focus continues to be domestic business, the company has also been selectively evaluating opportunities in the Middle-East and has recently bagged two road projects worth Rs5.7bn in Muscat. In order to grow its business in the Middle-East, NCC has opened a regional office in Dubai and also formed a subsidiary in Muscat.

### Infra business to be strong growth driver

#### Current BOT portfolio of Rs60bn

NCC Infra Holdings (100% BOT subsidiary of the company) currently has a portfolio of five road, two power and one port project with a total project value of Rs60bn and equity IRR of 16-20%. These projects put together have a total equity commitment of Rs5.8bn, of which NCC has so far invested Rs2.0bn.

Apart from the existing portfolio of BOT projects, NCC is targeting to grow this portfolio to 12-15 projects in another 18-20 months. After attaining sizeable scale in infrastructure business, the management has indicated possible value unlocking either through private equity or an IPO.

## Machilipatnam port - upside potential

NCC has 25% stake in Machilipatnam port, with the other consortium partners being Maytas Infrastructure and SERI infrastructure. The project value is Rs16bn and has a concession period of 35 years, extendable for another 20 years. The concession agreement is expected to be signed during the current financial year and closure of the project is expected by December 2008. Additionally, the consortium has 8,000 acres of land to be developed on lease basis.

## Shimoga & Gulbarga airport projects

The company along with its consortium partners, Maytas Infrastructure and VIE India Projects & Development Holdings, have recently been awarded the Shimoga and Gulbarga airport projects by the Karnataka government. The project will be developed on BOT basis and will be operated for 30 year, extendable for another 30 years. Detailed Project Report (DPR) for the two airports is currently being prepared, after which more details on the project will be available.

## Real estate to gain scale

### Large scale-up plans for NCC Urban Infra

Currently, the real estate subsidiary, NCC Urban Infrastructure Ltd, has a total land reserve of 530 acres of which 286 acres is under development, based on which the company is targeting a total rollout of 12.9 million sq.ft. over the next 3-4 years. We believe real estate development plans have the potential to generate revenue of Rs9.2-9.5bn for NCC over the next three years.

While the company is in the process of finalising development plans for the remaining land, it is exploring other land acquisition opportunities. Eventually, the target is to take its total land bank to 1,200-1,500 acres and then unlock value through a possible listing or PE investment.

## Telapur Township scheduled for launch by April

DPR for the Telapur Township will be submitted by the end of the month and the company is targeting launch of the township by April 2008.



NCC is developing this township, in which it has 26% stake, along with Tishman Spyers and ICICI Ventures. The plan is to develop a saleable area of 30 million sq.ft. at a total cost of Rs54bn. Given the proximity of the location to the Hyderabad Outer Ring Road and Gachibowli, we believe that the project has the potential to be immensely value accretive. Based on development plans on Telapur, we have a NPV value of Rs32.5bn of which NCC's share works out to Rs8.5bn.

### Earnings growth momentum to continue

We expect revenue to grow at a CAGR of 37% between FY07-10E on the back of 38% CAGR growth of order intake during the same period.

We have assumed stable EBITDA margin for the contracting business over FY07-10E. However, we believe that there exists potential for margins to expand as NCC completes execution of bulk of its FY06 orders and increases execution of the better priced orders, both from its own BOT projects and cash contracts.

Overall we expect net profit to grow at a CAGR of 40% between FY07-10E.

### Valuation

We are raising our SOTP price target to Rs396/share and are upgrading our rating from Outperformer to BUY.

Given the strong order book and potential, both growth in order book and its composition as well as margin expansion, we have valued the core construction business at 26x FY09E earnings (against 17x previously), which is a 25% premium to its peers. The premium is on account of faster diversification into newer value accretive segments. Our one-year forward DCF value works out to Rs360/share for the core business.

We have a value of Rs17/share for the BOT portfolio and a value of Rs28/share for real estate ventures by NCC Urban Infra and Rs37/share for the Telapur Township project.

Additionally, we believe that there exist further valuation upsides for NCC on account of Machilipatnam port, Sikkim hydro-power project, Pondicherry-Tindivaram road and the two airport projects at Gulbarga and Shimoga. We have not yet taken these into account as the projects have yet to achieve financial closure.



## Valuation snapshot

SOTP		NCC value (Rs m)	Per share value (Rs)
Cash contracting	26x FY09 EPS - 25% premium to peers	71,857	314
Bangalore-Maddur	1.5x BV	219	0.96
Meerut-Muzzafarnagar	1.3x BV	367	1.60
Orai-Bhognipur	1.5x BV	1,376	6.01
Bangalore elevated corridor	1.3x BV	767	3.36
HEP - Sorang-HP - 100MW	1.6x BV	812	3.55
286 acres to be developed over 2008-12	NPV (12.9 m sq.ft.)	5,979	26.10
260 acres in NCC Urban Infra Ltd.	Book value	517	2.30
Investment in Gautami Power	Book value	420	1.80
JV with Tishman Spears & ICICI Ventures	NPV	8,434	36.87
<b>NCC value/share</b>		<b>91,041</b>	<b>396.57</b>



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#### PL's Recommendation Nomenclature

<b>BUY</b>	: > 15% Outperformance to BSE Sensex	<b>Outperformer (OP)</b>	: 5 to 15% Outperformance to Sensex
<b>Market Performer (MP)</b>	: -5 to 5% of Sensex Movement	<b>Underperformer (UP)</b>	: -5 to -15% of Underperformance to Sensex
<b>Sell</b>	: <-15% Relative to Sensex		
<b>Not Rated (NR)</b>	: No specific call on the stock	<b>Under Review (UR)</b>	: Rating likely to change shortly

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