

## Nagarjuna Constructions Co Ltd

### Pick-up in order inflow but execution slips

Nagarjuna Constructions' (NCC) Q3FY11 results fell short of our and street estimates with revenue/EBITDA growth slowing to 13%/8% YoY, while PAT declined 7%. Working capital has risen by Rs 3.2bn QoQ, leading to a Rs 2.8bn hike in net debt and higher net leverage of 0.9x. Order inflow, though, was robust at Rs 27.4bn, led by building (45%), irrigation (14%) and water (9%) projects. However, we believe that NCC will miss its 'external' order inflow target of Rs 100bn (having secured Rs 62bn in 9mFY11), which will have a bearing on our FY12 revenue estimate. NCC's 55% subsidiary, Nelcast Energy, expects to achieve financial closure for its 1,320MW coal-based power plant in a couple of months, which will generate a Rs 45bn EPC contract for the parent company. We have cut FY11/FY12/FY13 revenues by 9%/11%/14% and PAT by 16%/17%/12%. Our revised 12-month price target stands at Rs 185. Maintain BUY.

**Q3 below estimates:** NCC reported a 13% YoY rise in revenues and a 17% drop in adjusted PAT. The EBITDA margin was down 40bps YoY, marginally lower than estimates. Order inflow was robust at Rs 27bn, primarily in the buildings (45%), irrigation (14%) and water (9%) segments, taking consolidated order backlog to Rs 173bn. The potential order inflow from the Rs 15bn Ranchi-Jamshedpur road project is uncertain due to the ongoing court case filed by Madhucon Projects (MPL) against MPL's disqualification in the technical round of bidding.

**Financial closure of 1,320MW project expected in coming months:** NCC acquired a 55% stake in Nelcast Energy (balance held by Gayatri Projects), which is developing a 1,320MW power project in Nellore, Andhra Pradesh. Land acquisition has been completed and environmental clearance secured. Coal linkages for 70% of the coal requirement are also in place, while the remaining will be imported. The total project cost is likely to be Rs 70bn, which will be funded in a debt-equity ratio of 3:1.

**FY11 revenue guidance cut by 10%; working capital remains high:** Management has cut its FY11 revenue guidance by ~10% as extended monsoons and client-side delays slowed the pace of work. Working capital moved up by Rs 3.2bn QoQ, leading to a Rs 2.8bn rise in net debt. We are building in a gradual improvement in working capital (as a percentage of sales) in the next few years. However, equity infusion in power projects will raise net leverage from 0.9x to 1.5x by end-FY13.

**Estimates cut; maintain BUY:** We lower our revenue/PAT estimates for FY11-FY13 and revise our 12-month SOTP target price to Rs 185 (from Rs 210). This includes Rs 128 for the standalone construction business and Rs 57 for subsidiaries.

What's New?	Target	Rating	Estimates
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CMP	TARGET	RATING	RISK
Rs 103	Rs 185	BUY	HIGH

BSE	NSE	BLOOMBERG
500294	NAGARCONST	NJCC IN

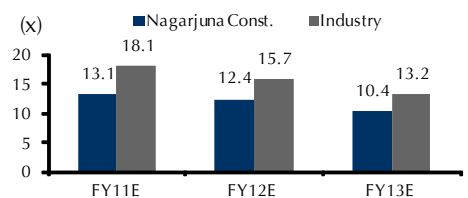
#### Company data

Market cap (Rs mn / US\$ mn)	26,471 / 581
Outstanding equity shares (mn)	257
Free float (%)	79.8
Dividend yield (%)	0.6
52-week high/low (Rs)	198 / 102
2-month average daily volume	1,330,780

#### Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
NCC	103	(29.2)	(32.3)	(37.7)
Sensex	18,008	(12.1)	(13.8)	(1.1)

#### P/E comparison



#### Valuation matrix

(x)	FY10	FY11E	FY12E	FY13E
P/E @ CMP	13.2	13.1	12.4	10.4
P/E @ Target	23.7	23.7	22.4	18.7
EV/EBITDA @ CMP	10.7	9.9	8.2	6.8

#### Financial highlights

(Rs mn)	FY10	FY11E	FY12E	FY13E
Revenue	47,778	52,877	63,453	76,143
Growth (%)	15.1	10.7	20.0	20.0
Adj net income	1,917	2,011	2,130	2,543
Growth (%)	24.7	4.9	5.9	19.4
FDEPS (Rs)	7.8	7.8	8.3	9.9
Growth (%)	16.4	0.2	5.9	19.4

#### Profitability and return ratios

(%)	FY10	FY11E	FY12E	FY13E
EBITDA margin	10.1	9.8	10.0	10.0
EBIT margin	9.0	8.6	8.7	8.8
Adj PAT margin	4.0	3.8	3.4	3.3
ROE	9.8	8.7	8.6	9.5
ROIC	8.9	6.8	6.4	6.8
ROCE	9.7	7.5	7.3	7.6





## Result highlights

**Fig 1 - Actual vs estimated performance**

(Rs mn)	Actual	Estimate	% Variance
Net sales	13,355	14,838	(10.0)
EBITDA	1,276	1,513	(15.7)
EBITDA margins (%)	9.6	10.2	(65bps)
Adj net income	444	583	(23.8)
FDEPS (Rs)	1.7	2.3	(23.8)

Source: RCML Research

**Fig 2 - Quarterly performance**

(Rs mn)	Q3FY11	Q3FY10	% Chg YoY	Q2FY11	% Chg QoQ
Net sales	13,355	11,870	12.5	12,013	11.2
Expenditure	12,079	10,690	13.0	10,780	12.1
EBITDA	1,276	1,181	8.1	1,234	3.4
Other income	23	14	68.0	54	(57.8)
Interest	438	306	43.3	375	17.0
Depreciation	175	133	31.5	168	3.8
PBT	686	756	(9.2)	745	(7.9)
Tax	242	277	(12.8)	245	(1.5)
Adj. PAT*	444	479	(7.1)	500	(11.1)
EBITDA margin (%)	9.6	9.9	(39bps)	10.3	(71bps)
FDEPS (Rs)	1.7	1.9	(7.1)	1.9	(11.1)

Source: Company, RCML Research \* This excludes Rs 40mn additional tax provisioning in Q3 to cover a tax penalty which could potentially be imposed by the IT department

**Fig 3 - Revised estimates**

Key parameters (Rs mn)	FY11E			FY12E		
	Old	New	% Chg	Old	New	% Chg
Revenue	58,289	52,877	(9.3)	71,113	63,453	(10.77)
EBITDA margin (%)	10.2	9.8	(30.7)	10.2	10.0	(28.6)
Net profit	2,395	2,011	(16.1)	2,565	2,130	(17.0)
FDEPS (Rs)	9.3	7.8	(16.1)	10.0	8.3	(17.0)

Source: RCML Research

Numbers lower than estimated due to lower sales and moderation in margins

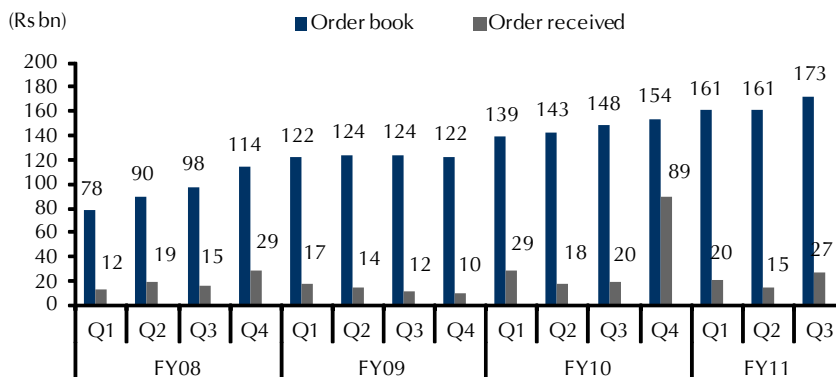
Net revenues up 13% YoY

Adj. PAT declined 16% YoY; excluding additional provisioning for a potential tax penalty, adj. PAT declined 7%

Downward revision in revenues to factor in slower execution in Q3 and slower order inflow in 9mFY11

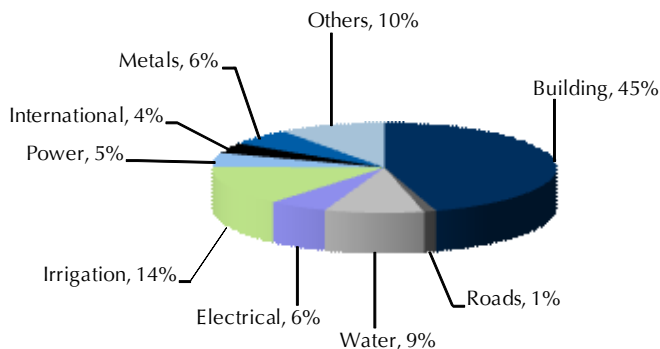


**Fig 4 - Order inflow picked up after being lukewarm in last two quarters**



Source: Company, RCML Research Note – Order backlog is on consolidated basis

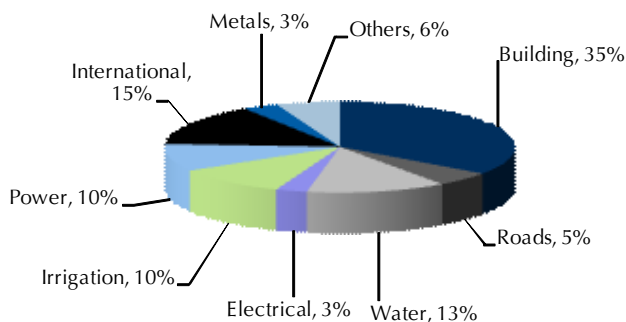
**Fig 5 - Segmental order intake break-up during Q3FY11 (consol)**



Order inflow in Q3 was driven by buildings (45%), irrigation (14%) and water (9%) projects

Source: Company, RCML Research

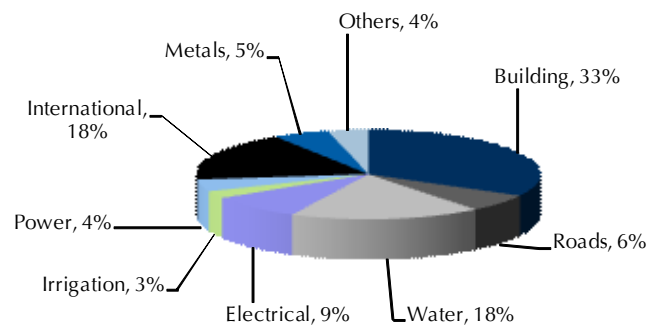
**Fig 6 - Segmental order book break-up (consol)**



Source: Company, RCML Research



Fig 7 - Q3FY11 segmental revenue break-up (consol)



Source: Company, RCML Research

Fig 8 - SOTP based 12 month price target of Rs 185

Sum of the parts	Business	Method	Multiple	Value (Rs mn)	Per share value (Rs)
NCC standalone	Construction	P/E 1 year forward	14x	32,707	128
International subsidiary	Construction	P/E 1 year forward	10x	3,678	14
NCC Urban Infra (80% stake)	Real estate	NAV		1,066	4
Jubilee Hills	Real estate	BV	1x	453	2
HUDA	Real estate	BV	1x	825	3
NCC Vizag Urban	Real estate	BV	1x	499	2
BOT Project	Road/Power	P/BV	1x	8,398	33
<b>Total</b>				<b>47,626</b>	<b>185</b>

Source: RCML Research



## Standalone financials

### Profit and Loss statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
<b>Revenues</b>	<b>47,919</b>	<b>52,877</b>	<b>63,453</b>	<b>76,143</b>
Growth (%)	15.4	10.3	20.0	20.0
<b>EBITDA</b>	<b>4,976</b>	<b>5,208</b>	<b>6,314</b>	<b>7,626</b>
Growth (%)	33.3	4.7	21.3	20.8
Depreciation & amortisation	525	657	788	935
EBIT	4,450	4,551	5,527	6,691
Growth (%)	39.1	2.3	21.4	21.1
Interest	1,965	2,170	3,057	3,653
Other income	679	630	720	770
EBT	3,165	3,011	3,189	3,808
Income taxes	1,204	1,000	1,059	1,265
Effective tax rate (%)	38.1	33.2	33.2	33.2
Extraordinary items	(502)	-	-	-
Min int. / inc from associates	-	-	-	-
Reported net income	1,458	2,011	2,130	2,543
Adjustments	(1,004)	-	-	-
<b>Adjusted net income</b>	<b>2,462</b>	<b>2,011</b>	<b>2,130</b>	<b>2,543</b>
Growth (%)	60.1	(18.3)	5.9	19.4
Shares outstanding (mn)	256.5	256.5	256.5	256.5
<b>FDEPS (Rs) (adj)</b>	<b>10.1</b>	<b>7.8</b>	<b>8.3</b>	<b>9.9</b>
Growth (%)	49.5	(22.0)	5.9	19.4
DPS (Rs)	1.3	1.3	1.3	1.3

### Cash flow statement

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Net income + Depreciation	1,984	2,667	2,918	3,478
Non-cash adjustments	311	(51)	104	125
Changes in working capital	(3,345)	(9,230)	(3,437)	(2,566)
Cash flow from operations	(1,050)	(6,614)	(415)	1,037
Capital expenditure	(1,628)	(1,731)	(2,065)	(2,365)
Change in investments	(1,519)	(3,100)	(3,000)	(3,000)
Other investing cash flow	(1,305)	-	-	-
Cash flow from investing	(4,451)	(4,831)	(5,065)	(5,365)
Issue of equity	3,580	-	-	-
Issue/repay debt	2,863	11,000	6,800	5,300
Dividends paid	(294)	(389)	(389)	(389)
Other financing cash flow	-	-	-	-
Change in cash & cash eq	647	(834)	931	583
Closing cash & cash eq	1,993	1,160	2,091	2,673

### Economic Value Added (EVA) analysis

Y/E March	FY10	FY11E	FY12E	FY13E
WACC (%)	11.8	11.8	11.8	11.8
ROIC (%)	8.7	6.8	6.4	6.8
Invested capital (Rs mn)	35,756	53,756	62,098	69,961
EVA (Rs mn)	(1,130)	(2,702)	(3,382)	(3,533)
EVA spread (%)	(3.2)	(5.0)	(5.4)	(5.1)

### Balance sheet

Y/E March (Rs mn)	FY10	FY11E	FY12E	FY13E
Cash and cash eq	1,993	1,160	2,091	2,673
Accounts receivable	12,995	15,936	18,254	20,861
Inventories	7,539	8,976	10,419	12,018
Other current assets	18,552	25,973	29,332	32,744
Investments	9,413	12,513	15,513	18,513
Gross fixed assets	7,546	9,311	11,376	13,741
Net fixed assets	5,532	6,640	7,917	9,347
CWIP	434	400	400	400
Intangible assets	-	-	-	-
Deferred tax assets, net	(255)	(354)	(458)	(583)
Other assets	-	-	-	-
<b>Total assets</b>	<b>56,206</b>	<b>71,246</b>	<b>83,470</b>	<b>95,976</b>
Accounts payable	9,058	9,189	10,906	13,070
Other current liabilities	8,439	10,591	12,325	14,921
Provisions	957	1,242	1,474	1,766
Debt funds	15,302	26,302	33,102	38,402
Other liabilities	-	-	-	-
Equity capital	513	513	513	513
Reserves & surplus	21,935	23,407	25,148	27,302
Shareholder's funds	22,448	23,920	25,661	27,815
<b>Total liabilities</b>	<b>56,206</b>	<b>71,246</b>	<b>83,470</b>	<b>95,976</b>
BVPS (Rs)	87.5	93.3	100.0	108.4

### Financial ratios

Y/E March	FY10	FY11E	FY12E	FY13E
<b>Profitability &amp; Return ratios (%)</b>				
EBITDA margin	10.1	9.8	10.0	10.0
EBIT margin	9.0	8.6	8.7	8.8
Net profit margin	4.0	3.8	3.4	3.3
ROE	9.8	8.7	8.6	9.5
ROCE	9.7	7.5	7.3	7.6
<b>Working Capital &amp; Liquidity ratios</b>				
Receivables (days)	89	100	98	94
Inventory (days)	73	72	71	68
Payables (days)	75	80	74	73
Current ratio (x)	2.3	2.6	2.6	2.4
Quick ratio (x)	0.7	0.8	0.8	0.7
<b>Turnover &amp; Leverage ratios (x)</b>				
Gross asset turnover	6.9	6.3	6.1	6.1
Total asset turnover	0.9	0.8	0.8	0.8
Interest coverage ratio	2.2	2.1	1.8	1.8
Adjusted debt/equity	0.7	1.2	1.4	1.5
<b>Valuation ratios (x)</b>				
EV/Sales	1.1	1.0	0.8	0.7
EV/EBITDA	10.7	9.9	8.2	6.8
P/E	13.2	13.1	12.4	10.4
P/BV	1.2	1.1	1.0	0.9



### Quarterly trend

Particulars	Q3FY10	Q4FY10	Q1FY11	Q2FY11	Q3FY11
Revenue (Rs mn)	11,870	15,227	10,865	12,013	13,355
YoY growth (%)	15.6	38.7	8.6	12.6	12.5
QoQ growth (%)	11.3	28.3	(28.6)	10.6	11.2
EBITDA (Rs mn)	1,181	1,527	1,038	1,234	1,276
EBITDA margin (%)	9.9	10.0	9.5	10.3	9.6
Adj net income (Rs mn)	479	643	414	500	444
YoY growth (%)	32	68	8	14	(7)
QoQ growth (%)	9	34	(36)	21	(11)

### DuPont analysis

(%)	FY09	FY10	FY11E	FY12E	FY13E
Tax burden (Net income/PBT)	67.5	77.8	66.8	66.8	66.8
Interest burden (PBT/EBIT)	71.2	71.1	66.2	57.7	56.9
EBIT margin (EBIT/Revenues)	7.7	9.3	8.6	8.7	8.8
Asset turnover (Revenues/Avg TA)	95.9	94.2	83.0	82.0	84.9
Leverage (Avg TA/Avg equity)	265.8	258.7	274.9	312.0	335.6
<b>Return on equity</b>	<b>9.4</b>	<b>12.5</b>	<b>8.7</b>	<b>8.6</b>	<b>9.5</b>

### Company profile

NCC is a Hyderabad-based leading civil construction company promoted by Mr. A.V.S. Raju. Established in 1980, the company has transformed itself from a subcontractor in residential and industrial construction to a diversified infrastructure conglomerate with BOT and real estate projects in its gamut. Today, it has a well-diversified, derisked business mix with a presence across various sectors – buildings and housing, transportation, water and environment, electrical, irrigation, hydropower, metals and power.

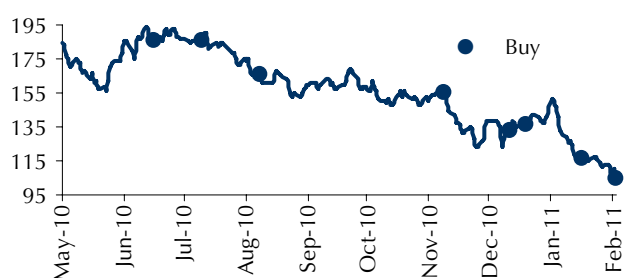
### Shareholding pattern

(%)	Jun-10	Sep-10	Dec-10
Promoters	20.2	20.1	20.4
FIIIs	34.4	33.7	35.4
Banks & FIs	22.8	20.1	18.9
Public	22.8	26.1	25.7

### Recommendation history

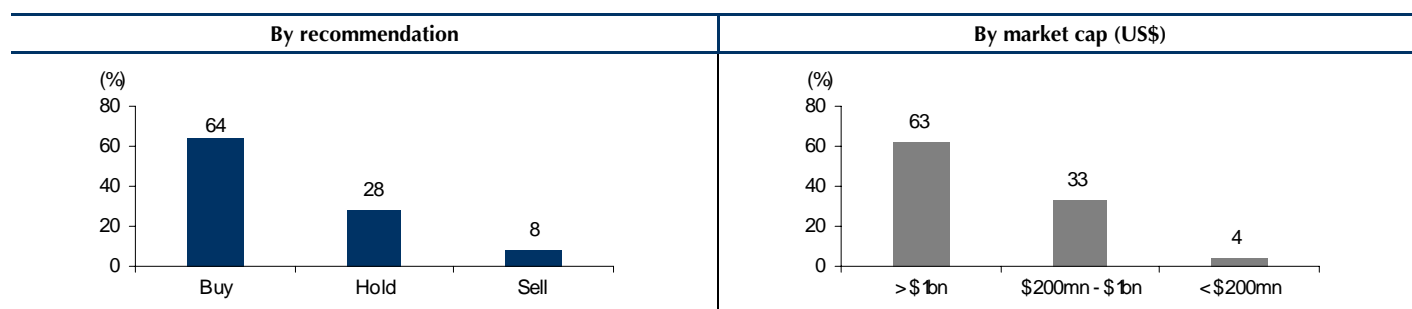
Date	Event	Reco price	Tgt price	Reco
24-Jun-10	Initiating Coverage	186	210	Buy
12-Jul-10	Company Update	185	210	Buy
10-Aug-10	Results Review	166	210	Buy
10-Nov-10	Results Review	155	210	Buy
14-Dec-10	Company Update	133	210	Buy
21-Dec-11	Company Update	137	210	Buy
18-Jan-11	Company Update	116	210	Buy
06-Feb-11	Results Review	103	185	Buy

### Stock performance





### Coverage Profile



### Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and -5%
Sell	Less than -5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

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