March 15, 2010

Simplex Infrastructure Ltd (SIMCON)

Rs 435

Healthy, well diversified order book...

Simplex Infrastructure (SIL) is one of the oldest construction companies in India with well diversified project expertise. Currently, SIL has an order book of Rs 10,606 crore, 2.3x order to bill ratio (on a TTM basis). With a marginal increase in the order book during FY09-FY12E, we see a favourable shift in the order book ensuring a stable EBITDA margin. Considering its well diversified order book and stable EBITDA scenario ensuring earning CAGR of 16.7% during FY09-FY12E, we are initiating coverage on SIL with BUY recommendation and a price target of Rs 483.

Healthy, well diversified order book but has stagnated there

Currently, SIL has a healthy well diversified order book of Rs 10,606 crore, implying an order book to bill ratio of 2.3x. Additionally, SIL is currently L-1 bidder for orders worth Rs 886 crore. However, SIL's order book has remained stagnant at ~Rs 10,000 crore for the last six quarters. This was due to slower order intake on account of the slowdown in the economy, in general, and management focus on better pricing for its order inflow, in particular. Going forward, we expect SIL's order inflow to grow at a CAGR of 18.9% during FY10E-FY12E.

EBITDA margin to remain stable, going forward

SIL's EBITDA margin has improved by 60 bps to 9.9% in 9MFY10 on account of management focus on better pricing of order inflow and softening commodity prices. Going forward, we have built in a stable EBITDA margin of 9.6-9.7% during FY10E-FY12E as the favourable project mix and better pricing in order intake could get offset by any hike in commodity prices.

Other initiatives

SIL bought an oil rig at ~Rs 50 crore and entered into a two-year contract with OIL at US$16,000 per day. Furthermore, SIL is in a sweet spot to benefit from the huge opportunities in the road BOT vertical.

Valuations

At the CMP, SIL is trading at 14.6x FY11E earning and 11.8x FY12E earning estimates. Considering its well diversified order book and stable EBITDA scenario ensuring earning CAGR of 16.7% during FY09-FY12E, we are initiating coverage on SIL with BUY recommendation and a price target of Rs 483. We have valued SIL's core construction business at Rs 476 (16x FY11 earning estimates and SIL's 85% stake in the oil rig business at Rs 7 per share (based on the NPV method).

Exhibit 1: Valuation matrix

	FY08	FY09	FY10E	FY11E	FY12E
Net sales	2812.1	4662.7	4614.4	5108.8	6035.9
EBITDA	267.4	395.5	442.3	494.5	577.8
Adj net profit	90.0	115.2	117.3	147.6	183.0
EPS (Rs)	20.9	23.2	23.6	29.7	36.8
EPS Growth %		10.8	1.8	25.9	23.9
EBITDA margin (%)	9.5	8.5	9.6	9.7	9.6
PER (x)	20.8	18.8	18.4	14.6	11.8
P/BV(x)	2.5	2.4	2.1	1.9	1.7
RoCE (%)	16.5	14.7	12.9	14.0	16.0
RoNW (%)	17.5	13.9	12.3	13.7	14.9

Source: Company, ICICIdirect.com Research

Rating Matrix

Rating	:	**Buy**
Target	:	Rs 483
Target Period	:	12-15 months
Potential Upside	:	11%

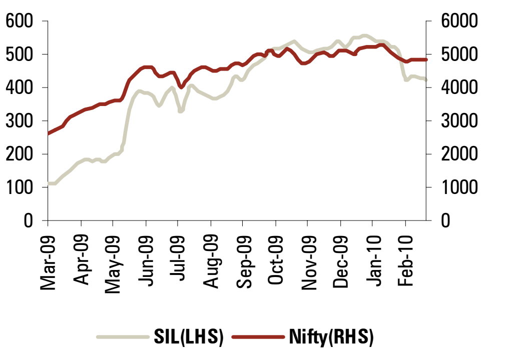
YoY Growth (%)

Y-oY growth(%)	FY09	FY10E	FY11E	FY12E
Net sales	65.8	-1.0	10.7	18.1
EBITDA	47.9	11.8	11.8	16.9
Net profit	27.9	1.8	25.9	23.9
EPS	10.8	1.8	25.9	23.9

Stock Metrics

Bloomberg code	SINF IN
Reuters code	SINF.BO
Face value (Rs)	2
Promoters Holding	54.7%
Market cap (Rs cr)	2160
52 weeks H/L	563/102
Sensex	17179
Average volume	22588

Price movement (Stock vs. Nifty)



Target Multiple

	FY09	FY10E	FY11E	FY12E
Target PE	20.8	20.5	16.3	13.1
EV/EBITDA	8.3	7.3	6.3	5.4
EV/sales	0.7	0.7	0.6	0.5
P/BV	2.4	2.1	1.9	1.6

Analyst's name

Deepak Purswani
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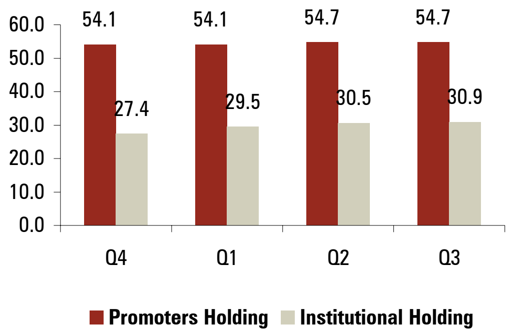
Promoter and institutional holding trend (%)



Source: Company, ICICIdirect.com Research

Company Background

Simplex Infrastructure Ltd (SIL) was originally incorporated as Simplex Concrete Piles (India) Ltd in 1924 by RA Lancaster, an Englishman. The company came under Indian management in 1947, when the Mundhra family took over the business. SIL went for an IPO in 1993 and changed its name to Simplex Infrastructures Ltd in 2005. SIL has an excellent track record of successful project implementation across a wide range of projects. Till date, it has completed ~2,300 projects across India and overseas. The company has executed projects across all verticals. SIL is associated with more than 80% of thermal power plants in India, 15 steel plants, 24 petrochemical and chemical plants and over 100 bridges, roads and railway projects. The company also has very well known clientele and gets repeat orders from its clients.

Exhibit 2: SIL's vertical wise details

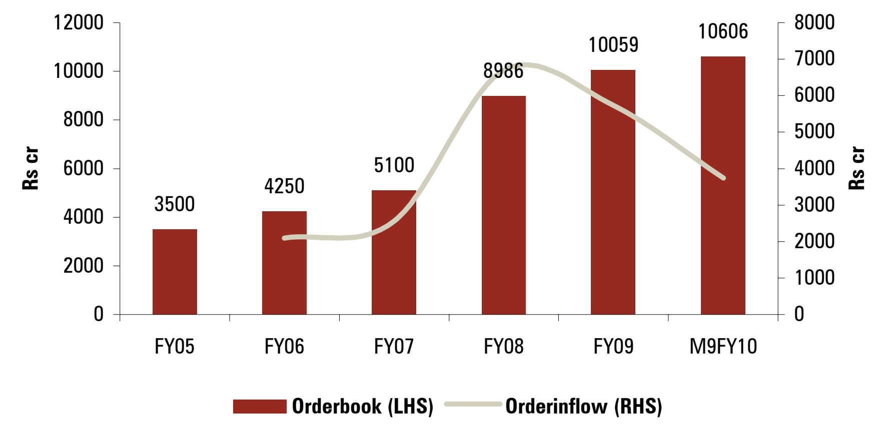
Vertical	9MFY10 Revenues (%)	Orderbook (%)	Clients	Comment
Piling & Ground Engineering	10	4	L&T & DLF	Pioneer in ground engineering techniques in India in 1924 Major orders: Gujarat UMPP, Bhel, Qatar power plant, Qatar Petroleum
Industrial	23	15	Vedanta, Reliance, Grasim, & SAIL	Associated with many industrial majors with several repeat orders since 1935 Presence across varied industries – cement, steel, aluminum, copper, engineering, automobile, petrochemicals, oil & gas, fertilisers, paper, textiles, chemicals, pharmaceuticals and shipyard Currently building : 8 cement plants, 8 metal plants and 5 oil refineries
Bldg & Housing	11	19	Unitech, Brigade, Sheth	Started its operation in this vertical in 1955. Introduced its first RCC-framed structure in South East Asia (designed and built 18-storied National Tower at Kolkata) Currently, 80 towers involving 18 mn sq ft area are under construction Currently building for Sheth, Brigade, HDIL, Keppel, Unitech, Central Park, Ritz Carlton, Al Arab contractor, Al-Tejir & Hilton
Power	20	28	NTPC, Bhel, GMR & NHPC	Has a presence in this vertical since 1960. Worked on thermal power plants –coal, gas, oil-based (10 MW to 1000 MW turbines), nuclear power plants, hydel plants Associated with more than 80% of thermal power plants in India Major Orders -Maithon ,Doosan, Bhel,Vedanta, NHPC ,Gujarat UMPP, Jindal.
Marine	8	4	Mundra Port, DP World	Started work with King George Docks in Mumbai in 1940 in this vertical Associated with many major ports in India and area of operations includes design & construction.of onshore and offshore structures Major orders – Cochin Port, Adani, Marg, Paradeep
Roads	2	2	NHAI	Entered this vertical in 1980 and is associated with projects under GQ, NSEW Major orders - NHAI Currently, SIL has lower exposure in the road segment. However, looking at NHAI's aggressive plans and SIL's intention to bid for BOT projects, this vertical could experience huge growth
Railway & Bridges	16	12	Indian Railway	Involved in this vertical since 1982 and has constructed various flyovers in many metro and mini metro cities Is involved in elevated road corridors in Hyderabad, Mumbai, Delhi, six flyovers in Muscat, RVNL
Urban Infrastructure	10	16	Delhi Metro & Mumbai Metro	In this segment, work ranges from water & sewerage systems to airports, sports & enterainment complexes Is involved in work in Mumbai Metro, Delhi Metro, Bangalore Metro, Dubai Metro and AAI –Udaipur and Jaipur

Source: Company, ICICIdirect.com Research

In terms of order book, SIL currently has a healthy order book of Rs 10,606 crore, implying an order book to bill ratio of 2.3x (on a TTM basis). SIL's order book is also very well diversified both in terms of vertical and geography. While we like SIL's healthy, well diversified order book, it has been stagnant for the last six quarters. This has lowered its revenue visibility compared to its peers. The stagnant order book was on account of a decline in the order inflow. This can be attributed to the slowdown, in general, and the focus of the management of SIL on the quality of order inflow and the EBITDA margin, in particular.

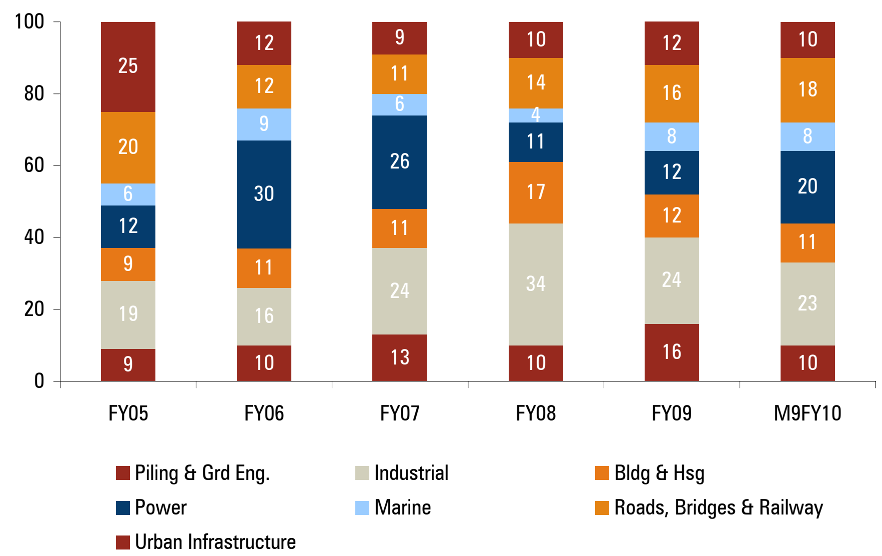
The order inflow has been on a declining trend due to the slowdown, in general, and the management focus on better pricing in its order inflow, in particular

Exhibit 3: Trend in order book & order inflow (Rs cr)



Source: Company, ICICIdirect.com Research

Exhibit 4: Order book break-up (%)



Source: Company, ICICIdirect.com Research

So far, SIL has completed ~2,300 projects across all verticals and is currently executing 150 projects across India

Investment Rationale

Proven track record & strong execution

SIL is one of the leading EPC players in India and has been in the construction business since 1924. Having started its operations from its very specialised pioneering services of pile foundation in 1924, SIL has developed execution capabilities across projects. Till date, the company has completed ~2,300 projects across India and overseas and across all verticals. The company is associated with more than 80% of thermal power plants, 15 steel plants, 24 petrochemical and chemical plants and over 100 bridges, roads and railway projects. SIL is currently executing 150 projects across India and overseas with experienced manpower of 7,468 employees.

Healthy, well diversified order book

SIL currently has a healthy order book of Rs 10,606 crore, implying an order book to bill ratio of 2.3x on a TTM basis. Additionally, the company was L-1 bidder for orders aggregating Rs 886 crore. This provides revenue visibility over the next two years. Furthermore, SIL's order book is well diversified in terms of verticals. Hence, a slowdown in any one vertical would not affect the company's performance much.

SIL's order book is relatively very well diversified

Exhibit 5: Q3FY10 vertical wise order book break-up (%)

	SIL(%)	IVRCL*(%)	HCC(%)	Patel Eng* (%)	NCC (%)
Piling & Ground Engineering	4.0	-	-	-	
Industrial	15.0	-	-	-	5.0
Bldg & Housing	19.0	23.0	-	-	25.0
Power	28.0	9.0	52.0	45.0	11.0
Marine	4.0	-	-	-	-
Roads	2.0	23.0	15.0	10.0	4.0
Railway	1.0	-	-	-	-
Bridges	11.0	-	-	-	-
Urban Utilities	16.0	-	-	-	-
Water & Irrigation	-	45.0	29.0	45.0	29.0
Others	-	-	4.0	-	26.0
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Source: Company, ICICIdirect.com Research
**break up is inclusive of L-1 bids*

SIL's order book is also well diversified in terms of geographies. International orders account for 22% of the total order book, which bodes well for margins, going forward. Apart from providing diversification, the international order book enables SIL to command better pricing enabling it to improve its margin, going forward.

Even geography wise, its order book is diversified

Exhibit 6: Segment wise order book break-up (%)

	Domestic (%)	Overseas (%)	Total (%)
Piling & Ground Engineering	3.0	1.0	4.0
Industrial	10.0	5.0	15.0
Bldg & Housing	7.0	12.0	19.0
Power	26.0	2.0	28.0
Marine	3.0	1.0	4.0
Roads	2.0	0.0	2.0
Railway	1.0	0.0	1.0
Bridges	10.0	1.0	11.0
Urban Utilities	16.0	0.0	16.0
Total	**78.0**	**22.0**	**100.0**

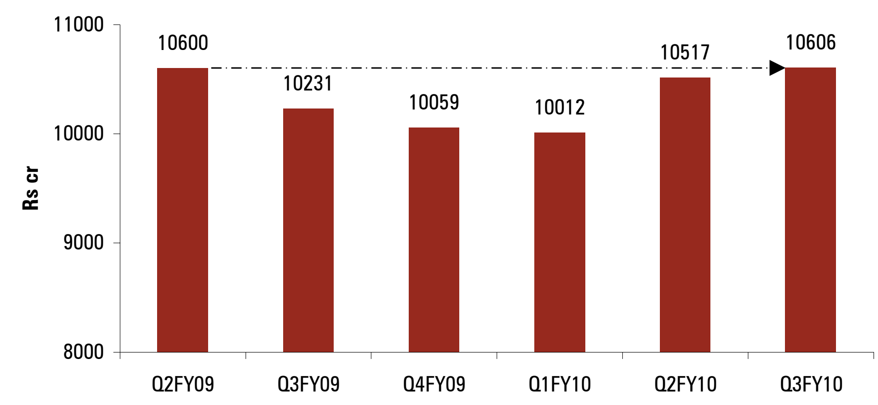
Source: Company, ICICIdirect.com Research

However, order book has remained stagnant for the last six quarters

Though SIL has a healthy, well diversified order book, it has stagnated at the ~Rs 10,000-10,600 crore level for the last six quarters on account of slower order intake. This was partly on account of a slowdown in the economy, in general, and the management's intention to focus on better pricing of order inflow, in particular. SIL's stagnant order book has lower revenue visibility (reflected in order book to bill ratio) compared to its peers. SIL's current order book to bill ratio has come down to 2.3x, which is significantly lower than its peers of 2.9x.

Stagnant order book lowering revenue visibility remains a concern

Exhibit 7: Quarterly trend in order book



Source: Company, ICICIdirect.com Research

Exhibit 8: Order book to bill ratio (on TTM basis)

Particular	Q2FY09	Q3FY09	Q4FY09	Q1FY10	Q2FY10	Q3FY10
IVRCL	3.2	3.1	2.9	2.7	2.8	3.4
Nagarjuna Construction	3.1	2.9	2.9	3.3	3.4	3.4
HCC	2.7	3.0	4.4	4.1	3.9	3.9
SIL	**2.9**	**2.4**	**2.2**	**2.1**	**2.2**	**2.3**
Patel Engineering	2.8	3.2	2.9	2.9	2.5	2.2
Average	**2.8**	**2.8**	**2.9**	**2.9**	**2.9**	**3.1**

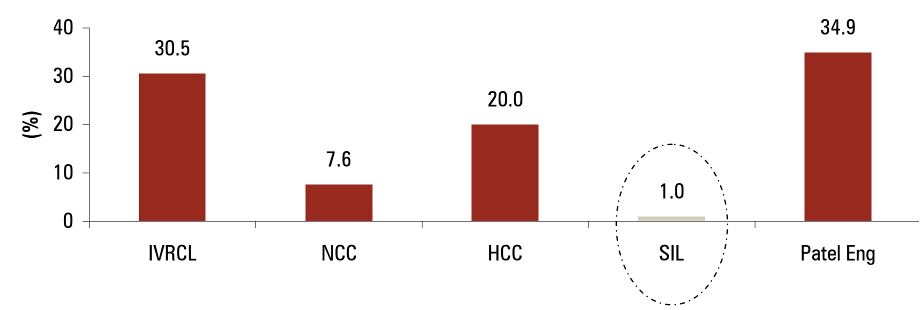
Source: Company, ICICIdirect.com Research

Insulated from troublesome AP market

There has been political instability in the Andhra Pradesh (AP) region due to the Telangana issue. This has affected key construction projects in the AP region. However, this is unlikely to affect SIL as its exposure in the AP region is pretty miniscule. The AP market accounts for just ~1% of its order book compared to 7-35% for its peers.

SIL is insulated from the troublesome AP market

Exhibit 9: AP exposure (%) in Q3FY10 order book



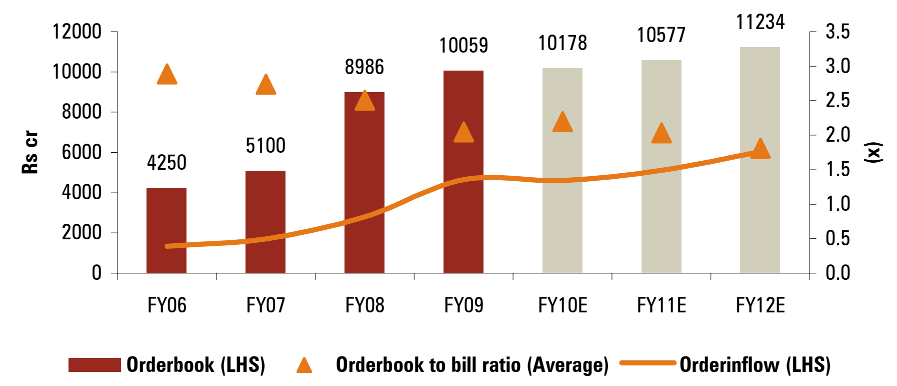
Source: Company, ICICIdirect.com Research

Order book to grow slowly but we see a favourable shift in the order book

The order book of SIL has grown at a CAGR of 33.3% during FY06-FY09 due to a growth rate of 39.9% CAGR in the order inflow during the same period. Going forward, we expect the order inflow to grow at a CAGR of 18.9% during FY10-FY12E despite building up de-growth in building & construction. The growth in order inflow is likely to be driven by power and urban infrastructure. On the other hand, we expect SIL's revenues to grow a CAGR of 14.4% during FY10E-12E. Consequently, we expect the order book to grow at a CAGR of 3.8% during FY10E-12E.

We expect SIL's order inflow to grow at a CAGR of 18.9% during FY10E-FY12E but the order book will remain stagnant

Exhibit 10: Revenue growth

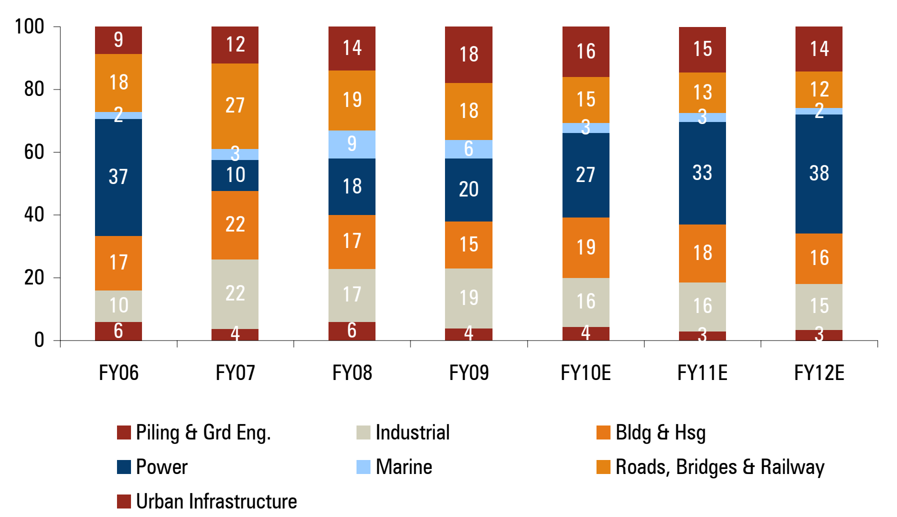


Source: Company, ICICIdirect.com Research

Though the order book is expected to grow at a slower pace, we see a favourable shift in the order book. We expect the order inflow from the relatively high margin power and urban infrastructure to grow, going forward. We expect the contribution of power and urban infrastructure in the order book to grow to 52.2% in FY12E from 42.9% in FY10E. This will have a positive impact at the EBITDA level.

However, we expect a favourable movement in the project mix

Exhibit 11: Order book composition (%)



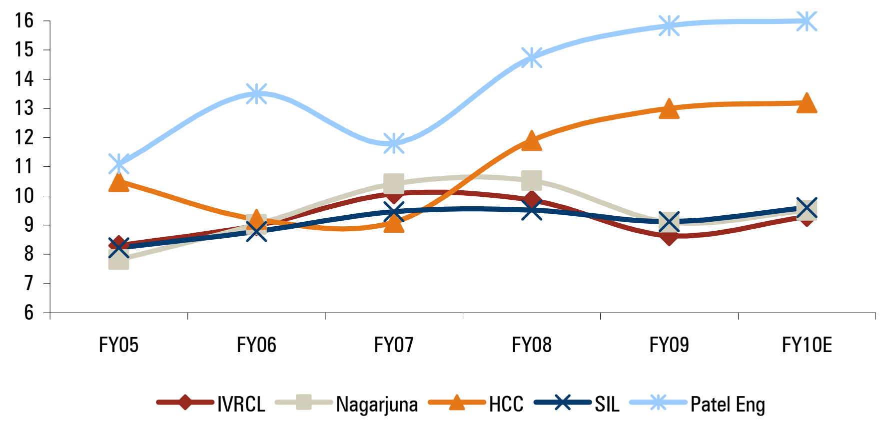
Source: Company, ICICIdirect.com Research

EBITDA of SIL largely in line with peers but NPM lower than its peers

SIL's EBITDA margin has been in the range of 8.2-9.6% during FY05-FY10E. This is largely in line with its peers. Only HCC and Patel Engineering have a better EBITDA margin on account of higher exposure to hydropower projects, which command better margins.

EBITDA margins of SIL are largely in line with its peers

Exhibit 12: SIL's EBITDA comparison (%)

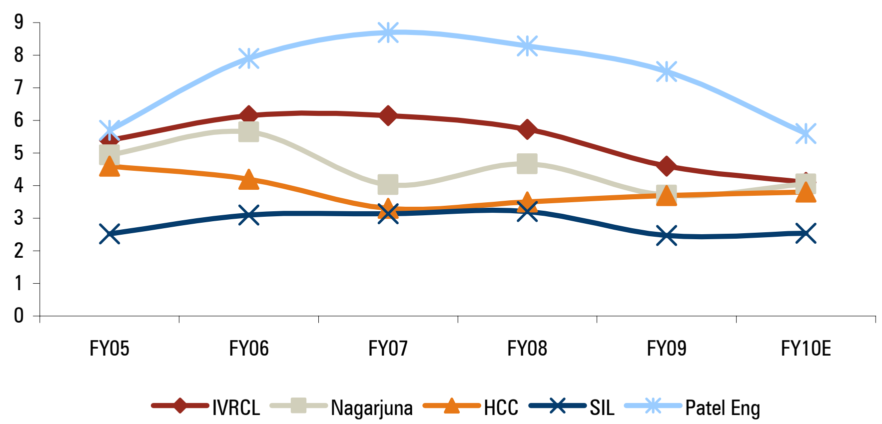


Source: Company, ICICIdirect.com Research

At the NPM level, SIL comes at the lower end of the NPM band of the industry. The NPM of SIL has been in the range of 2-3.2% during FY05-FY10E. The NPM of SIL has been lower than its peers largely on account of higher interest outgo on the debt.

However, NPM was at the lower band compared to its peers largely due to higher interest outgo

Exhibit 13: SIL's NPM comparison (%)



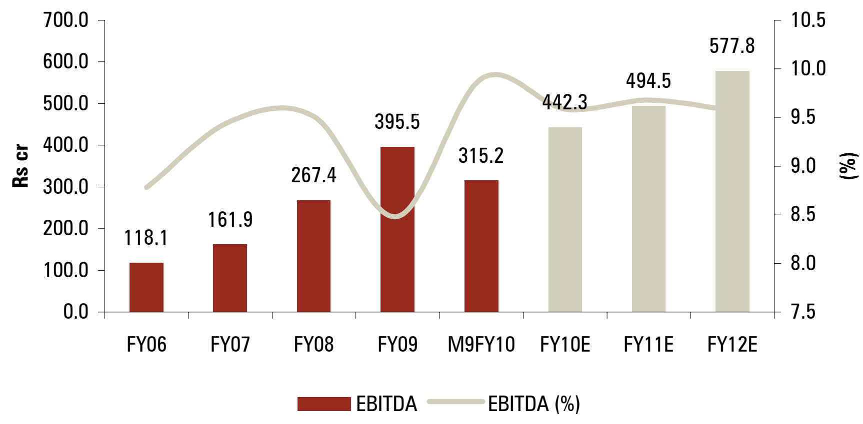
Source: Company, ICICIdirect.com Research

EBITDA margin to remain stable, going forward

Given the softening of commodity prices, strong control in project execution, favourable project mix (higher proportion of revenues from the high margin power vertical), SIL has witnessed a sharp improvement in the margin to 9.9% in 9MFY10 against 8.5% in FY09. Going forward, we expect SIL to maintain these level of margins as any hike in commodity prices is likely to be offset by a favourable project mix. We expect the contribution of the power vertical to increase from 12% in FY09 to 27% in FY12 enabling it to absorb any kind of rise in commodity price hike and maintain the current level of margins.

The EBITDA margin improved to 9.9% in 9MFY10 due to favourable project mix, softening of commodity prices and the intention of the management to focus on better pricing in order intake

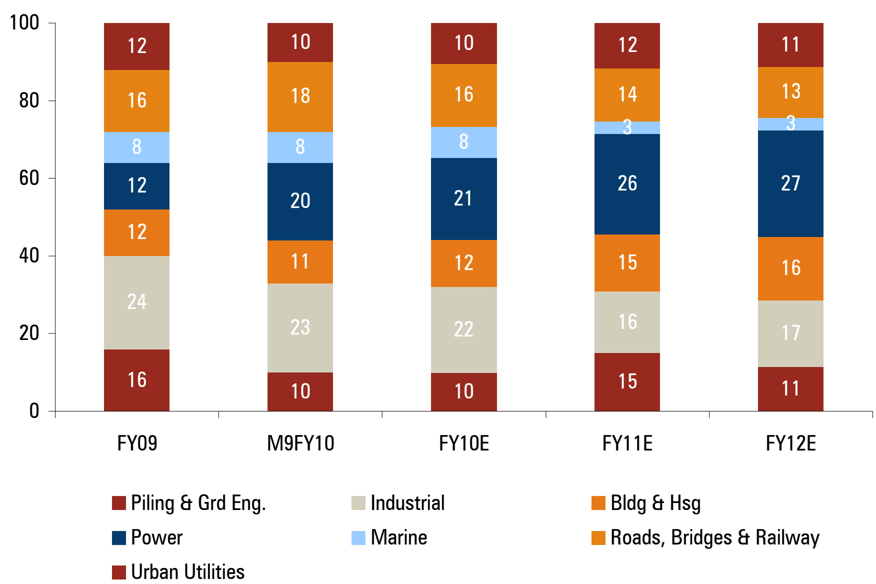
Exhibit 14: Trend in EBITDA



Source: Company, ICICIdirect.com Research

While the proportion of the high margin power vertical is expected to improve in revenues, we are building a stable EBITDA margin scenario as a favourable project mix could get offset by a hike in commodity prices

Exhibit 15: Revenue break-up (%)



Source: Company, ICICIdirect.com Research

SIL in sweet spot for BOT projects in road segment

Post the implementation of the BK Chaturvedi recommendation as well as NHAI's recent norm places SIL in a better position for BOT projects

Recently, NHAI has introduced new norms that will bar a developer from bidding for new projects if the company is unable to achieve financial closure after receiving letter of intent for two projects. Currently, most of the leading developers are awaiting approval for financial closure on BOT projects for which they have already received letter of intents. This eventually bodes well for SIL. Historically, SIL has stayed away from BOT projects due to the unattractiveness of BOT projects. However, post the recommendation of the BK Chaturvedi committee on road projects, road projects have become attractive for developers. Also, since most developers have financial closure pending, they will be unable to bid for new projects until they achieve financial closure for pending projects. This effectively means SIL can win BOT projects at better bids given the lesser competition. SIL is already in the initial stage of bidding for three projects ranging from 150 km to 200 km worth Rs 500-Rs 1500 crore.

Exhibit 16: Status of financial closure

Company	No of projects pending for financial closure
L&T	2
HCC	3
IVRCL Infrastructure	2
GMR Infrastructure	3
Reliance Infra	3

Source: Press reports, ICICIdirect.com Research

Exhibit 17: BK Chaturvedi Committee key recommendation

Key changes	Earlier	Now	Impact
Bidding method flow	First bid out on BOT toll basis. On failure, bid out on BOT annuity basis and then on EPC basis	Depending upon financial viability & threshold traffic volume, concurrent bidding in all modes is possible	This is likely to result in saving in significant time in the bidding process
Single bid	Tenders with single bid were rejected	NHAI Board is now empowered to accept a single bid after examining its reasonableness	Should speed up the process for awarding projects
Termination clause	If the actual traffic exceeds the design capacity for three years, the developer would have to expand the lanes or else the concessions would get terminated	If the actual traffic exceeds the design capacity for three years, the developer would get an option for augmentation of lane capacity with an assured IRR of 15%. This would be provided by extending the concession period limiting the extension of concession period to a maximum of five years	Earlier, lenders were not comfortable due to non-availability of upside to developers. Now, developers have incentives for capacity augmentation; this also provides comfort to lenders
Exit clause	Developers were required to hold 51% in SPVs till the construction period & this can be reduced to 26%, thereafter, till the end of the concession period	Developers are required to hold 51% stake in the SPV and can exit from the project after the commercial operation date	This can eventually free up capital for developers to bid for other projects
VGF extension	VGF is paid equally (20% each) during the construction and O&M period	Entire 40% VGF is paid upfront (during the construction period)	Given the earlier inflow of cash flow, the IRR for developers should improve
Security for lenders	Since the developer does not have ownership, the loan was classified as unsecured by bank, which led to higher cost of funds for developer	Now, provision in MCA allows lenders to create charge on the escrow account maintained for toll collection	This would lower the cost of funds for developers
Conflict of Interest clause	If common shareholders have more than 5% stake in two bids, the bids will get disqualified	The limit triggering conflict of interest has been raised to 25%	Apart from other developers, this should also raise the interest from other investors such as private equity players
Government support		Support NHAI in issuing tax free bonds, provide guarantee to NHAI borrowing and assistance in loans from World Bank and ADB	Currently, it has been granted in-principal approval. This would effectively increase NHAI's capacity to fund more projects

Source: Company, ICICIdirect.com Research

Foray into onshore oil rig business

We value SIL's oil rig operation at Rs7 per share

Capitalising on the piling and drilling expertise, SIL has forayed into the highly profitable onshore oil drilling services business in FY08. The company bought a 1500 HP oil rig worth Rs 50 crore and entered into a two-year contract with Oil India Ltd (OIL) for the deployment of the same at a day rate of US$16000 per day in December 2007. The oil rig business is carried out in a JV in which SIL has 85% share. Depending on the success of the current contract, the company intends to add three or four more rigs, going forward. However, we have not considered aggressive plans in the oil rig business. We have just valued the operational oil rig. Based on the NPV methodology, we have valued SIL's 85% share in the oil rig business at Rs 7 per share.

Real estate business plans

We are not assigning any value to SIL's real estate business plan

Leveraging on its construction expertise, SIL is foraying into the real estate sector. The company plans to develop 2.25 mn sq ft in joint ventures with several landowners. The table below gives the real estate project details of the company. In terms of valuation, we are not assigning any value to these real estate businesses as we would like to see any ramp up on these projects before assigning any value to it. Hence, any development on these projects could provide a marginal upside to our valuation.

Exhibit 18: Real estate project details

	Area (in mn sq ft)	SILs stake(%)	Comment
Ranchi	0.3	70	Looking to do development in 70:30 JV with Govt of Jharkhand The project is expected to be 60% commercial development & 40% residential development
Kolkata	2.0	50	Looking to do development in 50:50 JV with local player The project is expected to be 60% residential development & 40% commercial development
Total	**2.3**		

Source: Company, ICICIdirect.com Research

Infrastructure spending to remain strong even in XIIth plan

We expect infrastructure investment at US$361 billion against US$500 billion, still 1.7x of the Xth Five Year Plan

In order to accelerate the GDP growth rate, the government has laid emphasis on investment in infrastructure. While the government is targeting the share of infrastructure spending of 9.3% in FY12, it is likely to get delayed by two or three years. In our view, considering the overall slowdown in the economy in the last one year and slippages based on past experience, investment in infrastructure spending is likely to be to the tune of US$361.3 billion against the government target of US$500 billion. Nonetheless, based on our estimates, the investment in infrastructure spending is likely to be 1.7x of investment of infrastructure spending in the Xth Plan. Areas such as power, roads and water & irrigation are likely to be major thrust areas for the government in the Eleventh and Twelfth Five Year Plans. Construction player such as SIL with their well diversified project execution capabilities are likely to be key beneficiaries of this increased spending, going forward.

In the XIIth Plan, investment is likely to be US$667.6 billion indicating sustainable opportunities for strong players such as SIL

Even considering a conservative estimate of sustainable GDP growth rate of 8% and moderate increase in the share of infrastructure spending in the Twelfth Five Year Plan, there is going to be massive investment to the tune of US$667.6 billion, 1.8x XIth Five Year Plan infrastructure spending. This clearly indicates that construction companies are expected to sustain their growth trajectory even at the end of the XIIth Five Year Plan.

Exhibit 19: Infrastructure spending (top down approach)

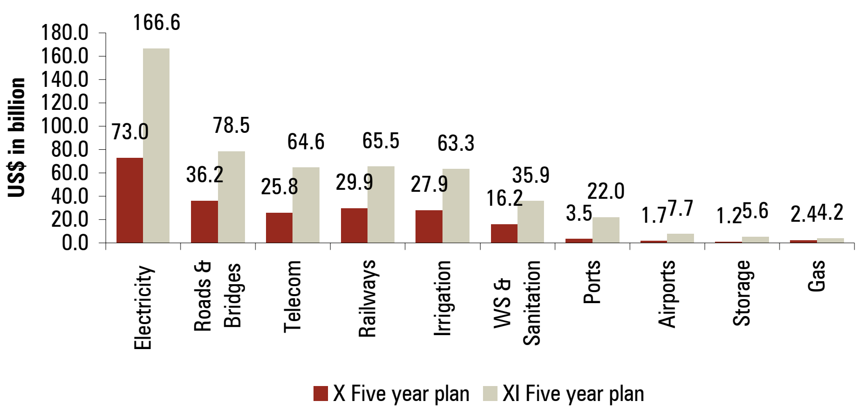
		XIth plan					XIIth plan				
	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17
GDP (Rs trn)	41.5	45.2	48.0	51.4	55.3	59.7	64.5	69.7	75.2	81.3	87.8
GDP growth rate %		9.1%	6.1%	7.2%	7.5%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
GCF in Infrastructure as % of GDP	5.0	6.0	5.8	5.8	6.5	7.0	7.5	7.5	8.0	8.0	8.5
GCF in Infrastructure (Rs trn)	2.1	2.7	2.8	3.0	3.6	4.2	4.8	5.2	6.0	6.5	7.5
GCF in Infrastructure (US$ in bn)*	46.1	60.3	61.9	66.3	79.9	92.9	107.5	116.1	133.8	144.5	165.8
Total GCF in Infrastructure (US$bn)				**361.3**					**667.6**		

Source: Planning commission, ICICIdirect.com Research
** exchange rate has been assumed at Rs45/USD*

In terms of verticals, power is likely to be the key beneficiary, SIL's focused area

In terms of verticals, power, roads and water & irrigation are likely to see higher allocation in the XIth Five Year Plan. SIL, being associated with power companies for structural work for their plants, is likely to be the key beneficiary of the sharp increase in the power vertical.

Exhibit 20: Vertical wise spending in XIth Five Year Plan



Source: Planning commission, ICICIdirect.com Research

A 25 bps change in the raw material cost will have a 6% impact on earnings

A 50 bps change in the interest rate will have ~3% impact on earnings

Risks and Concerns

Volatility in commodity prices

Commodities such as steel and cement are key raw materials for construction companies. Though SIL has an escalation clause in over 90% of its order book, the company may not pass on the entire hike to clients. Hence, if there is any spike in commodity prices, SIL may find it difficult to pass on the hike to clients. Hence, its margin could come under pressure, going forward. As can be seen in the Exhibits below, a 25 bps increase in the raw material cost would lead to ~6% downgrade to our earning estimates.

Exhibit 21: Sensitivity of raw material for FY11 EPS

Net Raw Material cost (as % of revenues)	39.7	40.0	40.2	40.5	40.7
Change in earnings (%)	11.5	5.8	0.0	-5.8	-11.5

Source: Company, ICICIdirect.com Research

Higher leverage than its peers

SIL has a higher debt-equity ratio compared to its peers. As on Q3FY10, the company's net debt to equity stood at 1.2x. Hence, SIL's earnings are highly sensitive to the interest rate movement. As can be seen in the exhibit below, a 50 bps uptick in the interest rate would lead to a ~3% downgrade to our earning estimates.

Exhibit 22: Sensitivity of interest rate for FY11 EPS

Interest rate on debt (%)	8.3	8.8	9.3	9.8	10.3
Change in earnings (%)	5.7	2.8	0.0	-2.8	-5.7

Source: Company, ICICIdirect.com Research

Shortage of skilled manpower

Though the construction company did not face any shortage of skilled manpower in the last one and a half years or so due to the slowdown in the economy, the industry could face a shortage of skilled manpower given the revival in the construction industry.

Exposure to international market

The international market, particularly Middle East, accounts for 22% of SIL's order book. The Middle East market is highly dependent on oil prices. SIL could face some delay in execution of projects in these regions.

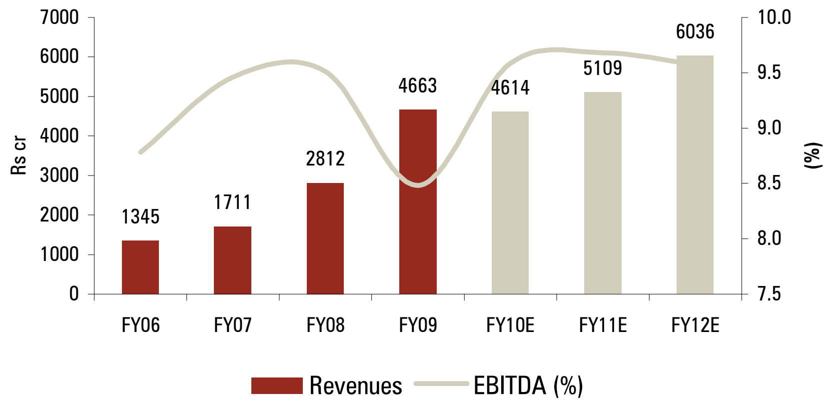
Financials

Revenues to grow 14.4%, EBITDA margin to remain stable

On the back of execution of the strong order book, we expect SIL's revenues to grow at a CAGR of 14.4% during FY10E-FY12E. In terms of EBITDA margin, though, we remain positively biased on the margin due to the company's focus on cherry picking of orders, better pricing in the international market and a favourable shift in the revenues mix. We have kept our EBITDA margin constant as these factors should provide a cushion to any hike in commodity prices, which could put pressure on the margin, going forward.

We expect the topline to grow at a CAGR of 13.8% during FY09-FY12E on the back of strong execution of the order book

Exhibit 23: Trend in revenues & EBITDA (%)



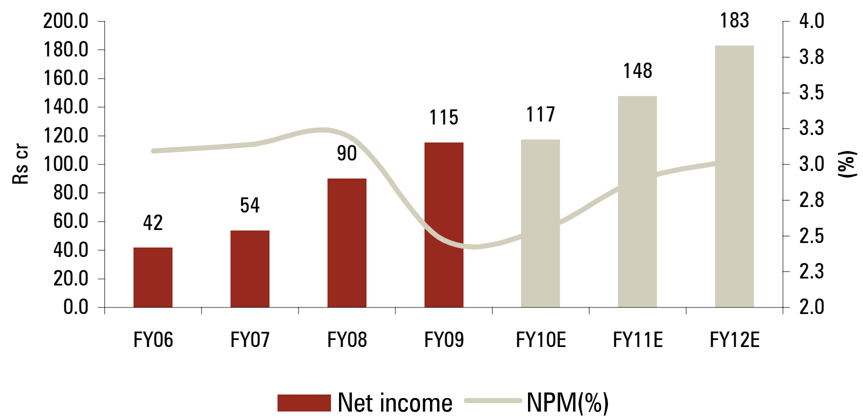
Source: Company, ICICIdirect.com Research

Net profit to grow at a CAGR of 16.7%

We expect SIL's net profit to grow at a CAGR of 16.7% during FY10E-12E on the back of the revenue growth, better operating leverage (through depreciation expenses) and financial leverage. As a result, we expect SIL's NPM to improve to 3% in FY12E compared to 2.5% in FY10E.

NPM will improve to 3% in FY12E from 2.5% in FY10E due to better operating leverage (through depreciation expenses) and financial leverage

Exhibit 24: Trend in net income & NPM (%)



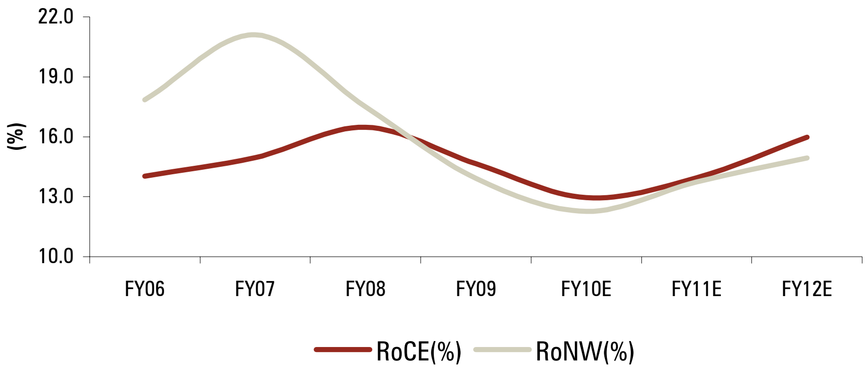
Source: Company, ICICIdirect.com Research

The RoCE will show improvement in FY12; RoNW will remain stable due to reduction in leverage

Return ratio to improve marginally

We expect SIL's RoCE to improve to 15.8% in FY12E from 14.7% in FY09 on account of a marginal improvement in the NPM (%) and asset turnover ratio. In terms of RoNW, it is expected to improve to 14.6% in FY12E from 13.9% in FY09. The improvement in RoNW was marginally lower than the RoCE due to the reduction in the leverage position (debt to equity ratio is expected to come down to 0.8x in FY12E from 1.1x in FY10E).

Exhibit 25: Return ratio trend



Source: Company, ICICIdirect.com Research

Valuation

We value SIL's core construction business at Rs 476 per share (16x FY11 earning estimates) and SIL's oil rig business at Rs 7 per share (based on NPV method)

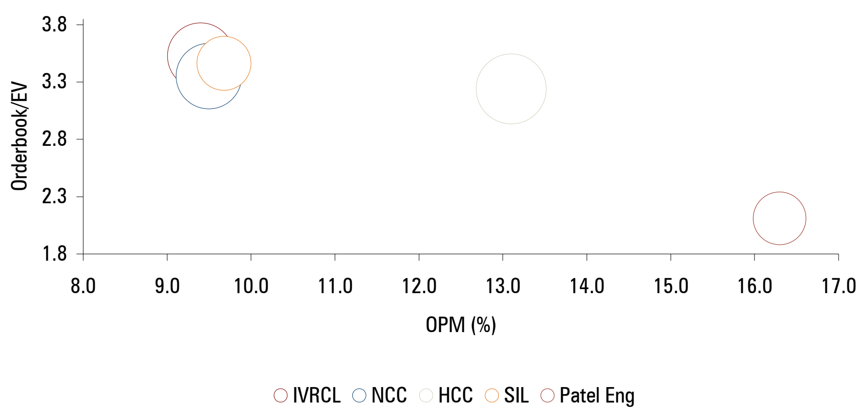
At the CMP, SIL is trading at 14.6x FY11E earning and 11.8x FY12E earning estimates. Considering its well diversified order book, stable EBITDA scenario ensuring earning CAGR of 16.7% during FY09-FY12E, we are initiating coverage on SIL with **BUY** recommendation and a price target of Rs 483. We have valued SIL's core construction business at Rs 476 (16x FY11 earning estimates of Rs 29.7 per share) and SIL's 85% stake in the oil rig business at Rs 7 per share (based on the NPV method). SIL's construction business' target multiple of 16x is in line with its peers and is at a ~7% discount to its average historical multiple of 17.2x.

On a relative basis, SIL's valuation is largely in line with its peers. We have looked at SIL based on three matrices:- i) Order book to EV ratio, OPM (%) and order book to bill ratio (Exhibit 26) ii) Earnings CAGR during FY10E-FY12E and P/E multiple (Exhibit 27)and iii) P/BV and RoE (%) (Exhibit 28). Looking at all these parameters, SIL appears to be trading largely in line with its peers. Out of these matrices, matrix I (Exhibit 26) is more relevant in finding the value pick as earnings and revenues of construction companies would depend on the subjective judgment of completion of order.

SIL's lower revenue visibility is already captured in the order book/EV, which is at ~10% discount to its peers

Looking at Exhibit 26, while SIL's OPM (%) is in line with its peers, it has relatively lower revenue visibility as reflected in the lower order book to bill ratio (2.3x) compared to its peer's order book to bill ratio (IVRCL - 3.4x, NCC-3.4x and HCC-3.9x), which is shown in the size of the ring in the exhibit shown below. However, this is already reflected in SIL's valuation as indicated by the order book/EV. SIL is currently trading at a higher order book/EV (3.4x) compared to its peer's average of 3.1x indicating that SIL is already available at over10% discount to its peers. This can be attributed to lower revenue visibility, in our view.

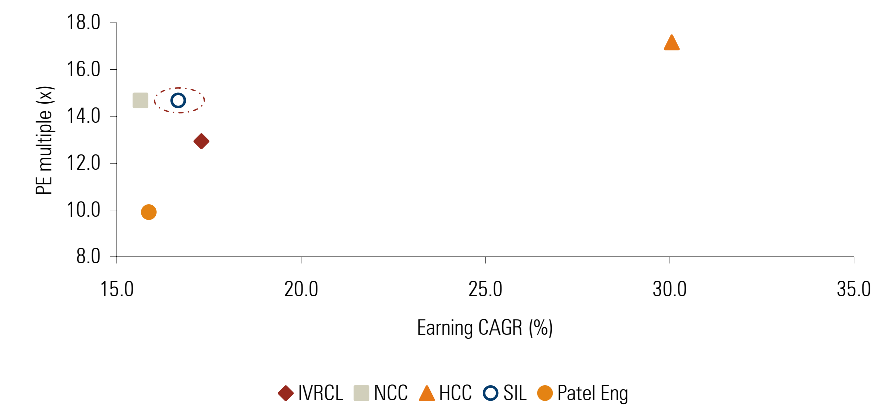
Exhibit 26: Order book/EV, OPM (%) & order book to bill ratio



Source: Bloomberg,, Company, ICICIdirect.com Research
Note that Size of the ring indicates order book to bill ratio
EV valuation have been adjusted for real estate, power & BOT project

SIL is trading at 14.6x FYT1 earnings with earnings CAGR of 16.7% during FY09-12E, in line with its peers

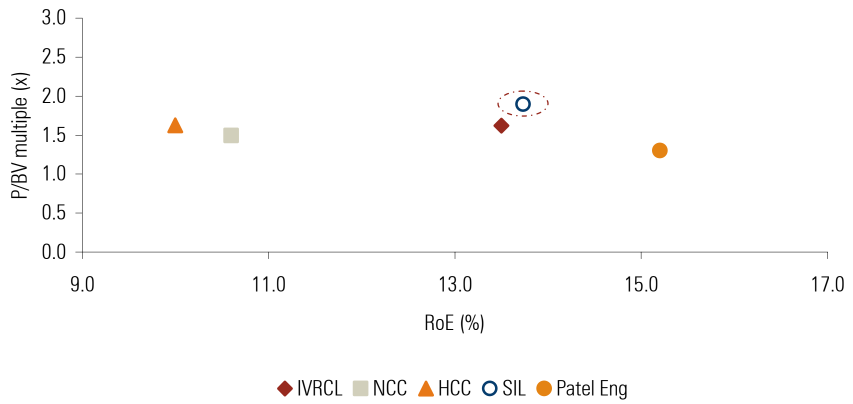
Exhibit 27: P/E & earnings CAGR (%)



Source: Bloomberg, ICICIdirect.com Research
Note that P/E has been considered after adjusting for the real estate, power & BOT projects

SIL is commanding better P/BV with relatively better RoE than its peers

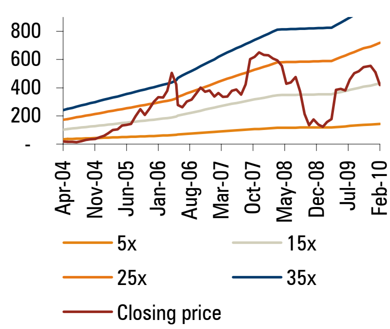
Exhibit 28: RoE (%) & P/BV



Source: Bloomberg, ICICIdirect.com Research
Note that P/BV has been considered after adjusting for the real estate, power & BOT projects

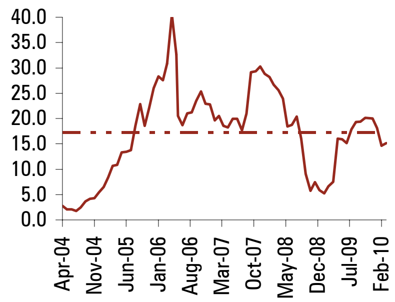
Currently, SIL is trading at 14.8x on one year forward basis against its historical average of 17.2x

Exhibit 29: One-year forward P/E band



Source: ICICIdirect.com Research

Exhibit 30: One year forward avg P/E multiple



Source: ICICIdirect.com Research

Table and Ratios

Exhibit 31: Profit & loss account (Rs cr)

	FY08	FY09	FY10E	FY11E	FY12E
Sales	2812.1	4662.7	4614.4	5108.8	6035.9
Growth (%)		65.8	-1.0	10.7	18.1
Op.Expenditure	2544.7	4267.1	4172.1	4614.3	5458.0
EBITDA	**267.4**	**395.5**	**442.3**	**494.5**	**577.8**
Growth (%)		47.9	11.8	11.8	16.9
Other income	27.6	44.7	14.9	17.8	19.6
Depreciation	64.3	129.9	155.1	165.8	185.5
EBIT	230.7	310.3	302.1	346.5	412.0
Interest	103.7	141.8	124.7	126.2	136.9
PBT	**127.0**	**168.5**	**177.4**	**220.3**	**275.1**
Tax	37.0	47.7	60.2	72.7	92.2
Extraordinary item	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Rep. PAT before MI	**90.0**	**120.8**	**117.3**	**147.6**	**183.0**
MI	0.0	0.0	0.0	0.0	0.0
Rep. PAT after MI	**90.0**	**120.8**	**117.3**	**147.6**	**183.0**
Adjustment	0.0	5.6	0.0	0.0	0.0
Adj. Net Profit	**90.0**	**115.2**	**117.3**	**147.6**	**183.0**
Growth (%)	**29.1**	**27.9**	**1.8**	**25.9**	**23.9**

Source: Company, ICICIdirect.com Research

Exhibit 32: Key ratio (%)

	FY08	FY09	FY10E	FY11E	FY12E
Contract expenses	76.5	77.2	75.1	74.8	74.9
Admin & Gen exps	14.2	14.0	14.3	15.3	15.5
Average cost of Debt	14.4	14.4	9.9	9.9	11.1
Effective tax rate	29.1	28.3	34.2	33.0	33.5
Profitability ratio (%)					
EBITDA Margin	9.5	8.5	9.6	9.7	9.6
PAT Margin	3.2	2.6	2.5	2.9	3.0
Adj. PAT Margin	3.2	2.5	2.5	2.9	3.0
Per share data (Rs)					
Revenue per share	654.0	938.8	929.1	1024.9	1202.7
EV per share	617.6	697.6	692.7	669.4	669.9
Book Value	175.1	181.7	202.9	229.5	262.4
Cash per share	28.7	20.2	42.1	55.3	44.8
EPS	20.9	23.2	23.5	29.5	36.0
Cash EPS	35.9	49.4	54.7	62.9	73.4
DPS	2.3	2.0	2.0	2.4	2.7

Source: Company, ICICIdirect.com Research

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Exhibit 33: Balance sheet (Rs cr)

	FY08	FY09	FY10E	FY11E	FY12E
Equity capital	9.9	9.9	9.9	9.9	9.9
Reserves & Surplus	743.2	892.7	998.2	1130.5	1293.7
Shareholder's fund	753.1	902.6	1008.1	1140.4	1303.6
Minority Interest	0.0	0.0	0.0	0.0	0.0
Secured & unsecured debt	749.3	1220.5	1305.5	1255.5	1205.5
Deferred Tax Liablity	37.1	57.9	57.9	57.9	57.9
Sources of funds	**1539.6**	**2181.0**	**2371.4**	**2453.8**	**2566.9**
Gross Block	756.7	1206.6	1276.6	1376.6	1476.6
less: Acc. Depreciation	127.2	205.2	360.3	526.1	711.5
Net Block	629.5	1001.4	916.3	850.5	765.1
Capital WIP	24.3	13.9	13.9	13.9	13.9
Net Fixed Assets	**653.7**	**1015.3**	**930.2**	**864.4**	**778.9**
Investment	9.9	20.1	20.0	20.0	20.0
Inventories	474.1	676.1	650.2	697.2	847.5
Trade Receivables	1149.7	1667.6	1625.6	1745.6	2094.9
Cash	123.2	100.2	209.7	275.3	223.0
Loans & Advances	283.9	331.2	464.5	449.4	475.1
Other current assets	83.4	125.0	185.9	208.4	236.1
Total current assets	2114.3	2900.0	3135.9	3375.8	3876.5
Current Liab. & Prov.	1238.3	1754.8	1715.0	1806.7	2108.8
Net Current Asset	876.0	1145.3	1420.9	1569.1	1767.7
Misc Expenditure	0.0	0.0	0.0	0.0	0.0
Application of funds	**1539.6**	**2180.9**	**2371.4**	**2453.7**	**2566.9**

Source: Company, ICICIdirect.com Research

Exhibit 34: Key ratio (%)

Return ratio (%)	FY 08	FY 09	FY10E	FY11E	FY12E
RoNW	17.5	13.9	12.3	13.6	14.6
ROCE	16.5	14.7	12.9	13.9	15.8
RoIC	22.4	17.7	14.2	15.9	18.0
Financial health ratio					
Operating CF (Rs cr)	62.1	60.3	216.0	337.9	230.8
FCFF (Rs cr)	-299.7	-351.7	221.2	255.8	150.4
Cap. Emp (Rs cr)	1539.6	2180.9	2371.4	2453.7	2566.9
Debt to equity (x)	0.8	1.2	1.1	0.9	0.8
Debt to cap.Emp. (x)	0.4	0.5	0.5	0.4	0.4
Int Coverage ratio (x)	2.2	2.2	2.4	2.7	3.0
Debt to EBITDA (x)	2.3	2.8	2.5	2.0	1.7
DuPont Ratio Analysis					
PAT/PBT	0.7	0.7	0.7	0.7	0.7
PBT/EBIT	0.6	0.5	0.6	0.6	0.7
EBIT/Net Sales	0.1	0.1	0.1	0.1	0.1
Net Sales/Total Assets	2.5	2.5	2.0	2.1	2.4
Total Asset/NW	2.3	2.2	2.4	2.2	2.1
Spread of RoIC over WACC					
RoIC	22.4	17.7	14.2	15.9	18.0
WACC	14.0	14.0	14.0	14.0	14.0
EVA	86	66	5	41	89
RoIC-WACC	8.4	3.7	0.2	1.9	4.0

Source: Company, ICICIdirect.com Research

Exhibit 35: Cash flow statement (Rs cr)

	FY08	FY09	FY10E	FY11E	FY12E
Net Profit before tax	70.2	127.0	177.4	218.5	269.1
Depreciation & Amortisation	39.1	64.3	155.1	165.8	185.5
Interest expenses (net)	88.2	115.4	124.7	126.2	136.9
Exchange (Gain)/ Loss (Net)	0.2	-5.3	0.0	0.0	0.0
Dividend income	-0.6	0.0	0.0	0.0	0.0
Others	91.3	152.3	-14.9	-17.8	-19.6
Direct tax paid	-22.8	-27.7	-60.7	-72.1	-90.2
CF before change in WC	265.6	426.0	381.6	420.6	481.7
Inc/Dec in Trade Recv.	-430.8	-557.0	41.9	-120.0	-349.2
Inc/Dec in Inventories	-216.8	-242.1	25.8	-46.9	-150.3
Inc/Dec in Loans & Adv	0.0	0.0	-133.3	15.1	-25.8
Inc/Dec in other current assets	0.0	0.0	-60.9	-22.5	-27.7
Inc/Dec in cur liabilities	444.1	433.4	-39.7	91.7	302.1
CF from operations	**62.1**	**60.3**	**215.5**	**337.9**	**230.8**
Purchase of Fixed Assets	-315.7	-402.7	-70.0	-100.0	-100.0
(Inc)/Dec in investments	-46.1	-9.3	75.2	17.8	19.6
CF from investing	**-361.8**	**-412.0**	**5.2**	**-82.2**	**-80.4**
Inc/(Dec) in Debt	-27.0	326.0	-39.7	-176.2	-186.9
Inc/(Dec) in Net worth	408.0	-12.0	-11.6	-14.1	-15.8
CF from Financing	**381.0**	**314.0**	**-51.3**	**-190.2**	**-202.7**
Net Inc/Dec in cash & eq.	80.8	-23.2	109.2	65.5	-52.3
Opening cash balance	42.5	123.3	100.1	209.3	274.9
Closing cash balance	**123.3**	**100.1**	**209.3**	**274.9**	**222.6**

Source: Company, ICICIdirect.com Research

Exhibit 36: Key ratio (%)

Working capital ratios	FY08	FY09	FY10E	FY11E	FY12E
Working cap./sales	0.3	0.2	0.3	0.3	0.3
Debtor turnover	9.8	3.3	2.8	3.0	3.1
Creditors turnover	1.3	1.3	1.5	1.1	1.2
Current ratio	1.7	1.7	1.8	1.9	1.8
Quick ratio	1.6	1.6	1.7	1.7	1.7
Cash to abs. Liab	0.1	0.1	0.1	0.2	0.1
WC(Excl. Cash)/sale	0.3	0.2	0.3	0.3	0.3

YoY Growth (%)	FY08	FY09	FY10E	FY11E	FY12E
Net Sales	27.3	65.8	-1.0	10.3	17.3
EBITDA	37.1	47.9	11.8	11.4	16.1
Adj. Net Profit	29.1	27.9	1.8	24.9	22.2
EPS	-56.7	10.8	1.8	24.9	22.2
Cash EPS	-52.2	37.5	11.1	14.7	16.7
Net worth	18.3	19.9	11.7	13.1	14.3

Valuation	FY08	FY09	FY10E	FY11E	FY12E
PE	22.5	20.4	20.0	16.0	13.1
EV/EBITDA	9.9	8.8	7.8	6.7	5.8
EV/sales	0.9	0.7	0.7	0.7	0.6
Div Yield (%)	0.5	0.4	0.4	0.5	0.6
Price/BV	2.7	2.6	2.3	2.1	1.8

Source: Company, ICICIdirect.com Research

Appendix

Exhibit 37: Key Orders in SIL order book (Rs cr)

Client	Contract value	Orderbook	Comment
Building & Housing			
International company for Investment services	386	386	Tower block on 543 Haitri street
GEO Tamouh Investments	380	380	Construction of Building at plot RT -4 - C-38 & 39, Central Business District, Abu Dhabi
International company for Investment services	236	236	Leisure complex - Abu Niwas
HDIL	207	207	Construction of Majestic Residential Tower
Keppel Purvankara Development Pvt ltd	158	157	Construction of high rise residential development at Kanakapura Elita Horizon
Keppel Magus dev pvt ltd	177	143	Civil & structural work for Elita Garden, Rajarhat, Kolkata
Ilyas & Mustafa	130	126	Building
Al Tajir Real estate LLC	227	116	Construction of 3 Residential buildings with amenities
Total (A)	**1901**	**1751**	
Bridges			
Mumbai Metropolitan region authority	531	438	Flyover from Prince of Wales Museum to Anik Panjarpole area in Mumbai
Muscat Municipality	326	153	6 Flyover over Seab Chronic road in Muscat
Executive Engg, Commonwealth project division	195	151	Construction of Ring road Bypass from Salimgarh Fort to Veldrom Road
Bangalore Development Aiithority	117	117	Construction of Flyover
Total (B)	**1169**	**859**	
Industrial			
Saud Bahwan	470	401	Employee Housing scheme
			Piling, civil, architechural, geo technical, topological survey & settlement monitoring work for PLL
Cinda Engg & Constr Pvt ltd	226	226	LNG Regus Facilities of LNG Terminal
SAIL	127	117	Civil work for BOF & CCP at SMS II of Rourkela Steel plant
Total (C)	823	744	
Marine			
India Gateway Termainal pvt ltd	574	130	Civil work for ICTT kochi Phase I A
Total (D)	**574**	**130**	
Power			
Jindal Power Ltd	328	328	Civil & structural work for 4-600 MW Thermal power plant
NTPC	261	250	2X500 MW power plant at Vindhyachal
NTPC Ltd	239	231	2X500 MW power plant at Rihand
Mailton Power limited	481	226	2X525 MW thermal power plant at Chandwa
Abhijeet Infra Ltd	199	199	2X270 MW thermal power plant at Chandra
Jindal Power Ltd	247	195	6X155 MW,Angul
Gati infra Bhasmey Hydro Power project	160	160	Hydel power plant at Rangpo Bazar,Sikkim
Total (E)	**1915**	**1589**	
Urban Infra			
Mumbai Metro One Pvt Ltd	406	267	Civil work for construction of Via Duct VA & VB - VAG corridor
Angal Anant pur Barrage	252	244	Urban
Bilaspur Municipal	223	211	Sewerage pipeline
Bangalore Metro Rail corporation	196	184	Elevated Structure between Chainage 500 to 6350 M - Mysore Road terminal to Magadi Road
Executive Engineer, public work dept, govt of Mar	229	169	Design & Construction of Capital complex at Manipur
Indore Municipality	175	143	Sewerage system & allied work in Indore under JNNURM
Meinhardt- Govt of Jabalpur	137	123	Sewarage lines at Jabalpur
Total (F)	**1618**	**1341**	
Grand Total (A+B+C+D+E+F)	**8000**	**6414**	

Source: Company, ICICIdirect.com Research

RATING RATIONALE

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Strong Buy: 20% or more;
Buy: Between 10% and 20%;
Add: Up to 10%;
Reduce: Up to -10%
Sell: -10% or more;

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