

IVRCL

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Impact of 80 IA

Our analysis and interaction with the management suggest that IVRCL will not feel a deep impact of the recent clarification (on Section 80 IA), as in the case of other construction companies. Construction companies have been excluded from the MAT purview and this will impact them in two ways: it will hit future earnings growth and immediate cash outflows due to non-payment of earlier taxes.

IVRCL's Practice of Tax Payment

IVRCL would be least impacted due to an increase in the tax rate since it paid advance tax and tax deducted at source (TDS), which was directly deducted by its client. Such amount was more than enough to take care of its tax payment as per normal tax rate. At the end of the year the provisioning was made according to MAT. The net amount was shown as assets under 'Loans & Advances' in its balance sheet.

TDS and Advance Tax	FY06	FY05
Gross Advance tax	686.12	446.57
Provision	241.65	150.74
Net Advance Tax	444.47	295.83

Balance sheet extract

The company estimated Rs 579.06 million as the net tax receivable from the government for FY01-'05, which will not be applicable now. But, there will be no additional cash outflow for the company towards non-payment of earlier taxes or as penalty.

The future earnings will be impacted by -15.2% in FY07E, -14.4% FY08E, and -12.2% in FY09E, due to an increase in the effective tax rate.

Valuation

Core business value reduced to Rs 234 per share from Rs 304 per share, at which it will trade at 14.7x FY09E and EV/EBITDA of 8.9x FY09E. Non-core business valuation remains intact. We recommend that investors BUY with a target price of Rs 415 (earlier Rs 483), which is an upside of 43%.

Valuation summary (Standalone)

Y/E Mar, Rs mn	FY05	FY06	FY07E	FY08E	FY09E
Net Sales	10,547	15,214	21,600	30,500	41,000
Growth, %	36.4%	44.2%	42.0%	41.2%	34.4%
Core EBIDTA	865	1,343	2,009	2,928	4,059
EBIDTA margins, %	8.2%	8.8%	9.3%	9.6%	9.9%
Net profit	567	930	1,057	1,588	2,166
Net profit margin, %	5.4%	6.1%	4.9%	5.2%	5.3%
EPS, Rs	8.2	9.7	8.9	11.9	15.9
EPS Growth, %	10.8%	17.5%	-7.8%	34.1%	33.3%
PER, x	18.7	15.9	17.2	12.9	9.6
EV/EBIDTA, x	28.9	18.6	12.4	8.5	6.2
EV/Net Sales, x	2.4	1.6	1.2	0.8	0.6
Price/Book Value, x	5.1	3.5	1.6	1.4	1.2
ROIC, %	15.1	15.0	12.3	13.8	15.3
ROE, %	14.1	19.5	8.6	10.5	12.7
Dividend Yield, %	0.3	0.3	0.3	0.4	0.5

Source: Company, Man Financial Research Estimates

Note: Valuations above are arrived at by deducting 75% value of non-core business.

Therefore they are based on the price of Rs 153.4 and not Rs 287, the CMP.

Maintain BUY / Rs 287
Target Rs 415 (+43%)

Sector (Relative to market)

OW	N	UW

Stock (Relative to market)

B	OP	N	UP	S
> 10%	5% to 10%	5% to -5%	-5% to -10%	< -10%

Bloomberg code : IVRC IN
Reuters code : IVRC.BO
www.hindpetro.com

BSE Sensex : 12884
NSE Nifty : 3761

Company data

O/S shares : 129mn
Market cap (Rs) : 37bn
Market cap (USD) : 861mn
52 - wk Hi/Lo (Rs) : 460 / 164
Avg. daily vol. (3mth) : 3.9mn
Face Value (Rs) : 2

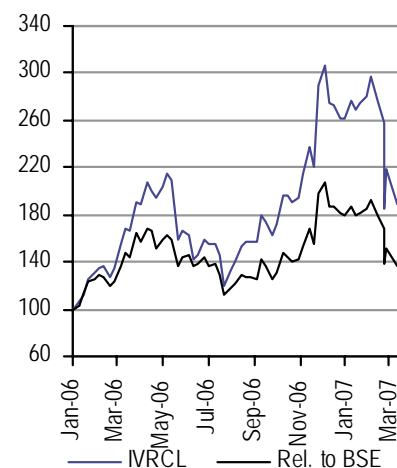
Share holding pattern, %

Promoters : 10.4
FI / NRI : 55.3
FI / MF : 16.2
Non Promoter Corp. Holdings : 6.6
Public & Others : 11.5

Price performance, %

	1mth	3mth	1yr
Abs	-29.8	-29.2	20.7
Rel to BSE	-25.3	-22.2	4.4

Price vs. Sensex



Source: Bloomberg, Man Financial Research

Least Impact

The Section 80 IA implications for IVRCL will be felt only to the extent of a reduction in future earnings. The company will not be liable for any penalty or will not have any additional cash outflows for the non-payment of taxes in earlier assessment years.

As there is no expected burden of an additional cash outflow, the future debt and interest cost will not be impacted, which will lead to a minimum reduction in earnings.

Pre-Budget	FY07E	FY08E	FY09E
ETR %	21.5	23.3	25.0
EPS	10.5	13.9	18.1
Post Budget			
ETR %	33.0	34.0	34.0
EPS	8.9	11.9	15.9
Change (Absolute)	-1.7	-2	-2.2
% change	-15.2%	-14.4%	-12.2%

Source: Man Financial Research

Comparison with other construction companies

Earnings FY08E	Pre-Budget	Post-Budget	Change %
IVRCL	10.5	8.9	-15.2
Gammon	19.8	14.7	-25.8
Patel	26.9	20	-25.7
Kirloskar Brothers	24.1	20.6	-14.5

Source: Man Financial Research

The impact on the earnings of other construction companies is higher as the debt burden of such companies is expected to increase to meet the additional cash flow requirement and thus, the interest cost will increase.

In the case of IVRCL, however, the impact would be felt only due to a change in ETR. IVRCL has paid an additional Rs 100 million during Q407E as advance tax to meet its full tax obligation for FY07E. IVRCL is expected to have +Rs 2.5 billion as cash by the end of FY07E, and hence, a debt burden will not accrue.

The net impact is estimated to be a Rs 570 to Rs 590 million reduction in net worth and the same amount being reduced from 'loans and advances' (in the balance sheet) as receivable from the government as excess taxes paid.

Reduction in price target

Our price target for the core business has been reduced as a consequence of a reduction in profitability and an increase in the risk-free rate. The PAT margins are expected to go down to 5% against +6% expected earlier. Also, the risk-free rate has been increased to 8% against 7.8% earlier. The target for the core business stands reduced at Rs 234 (-29.9%) from Rs 304 earlier. Our valuation for the non-core venture remains intact.

Valuation Summary

Valuation Summary	Value for		% to Total	Comment
	IVRCL	Per share		
Stand-alone company	36,001.9	234	56.9%	Based on DCF, Inversely works at EV/EBITDA of 8.9x FY09E and PE of 14.7x FY09E
IVR Prime (62.35% post IPO)	18,380.4	135	32.8%	Based on NAV, works at 30% discount to Cushman Wakefield's value
HDO (52.78% holding)	2,554.8	19	4.6%	Valued at 10x FY09E
Jalandhar BoT road project (100%)	760.9	6	1.4%	DCF, inversely at 1.84x equity
Salem BoT road project (100%)	852.3	6	1.5%	DCF, inversely at 1.07x equity
Kumarapalyam BoT road project (100%)	799.5	6	1.4%	DCF, inversely at 1.23x equity
Chennai Desalination Project (75%)	822.9	6	1.5%	DCF, inversely at 1.16x equity
Total Value	60,172.6	412	100.0%	

Source: Man Financial Research

Business momentum continues

We remain very upbeat about the company's core business prospects. The current order book stands at 3.6x FY07E sales, which will propel a 38% CAGR growth in revenue. Margins are estimated to improve to 10% by FY09E. Future project bids are expected to be taken at a higher margin to compensate the impact of higher taxes. Earnings growth in FY07E-09E is estimated to be 33.7% at Rs 15.9 per share.

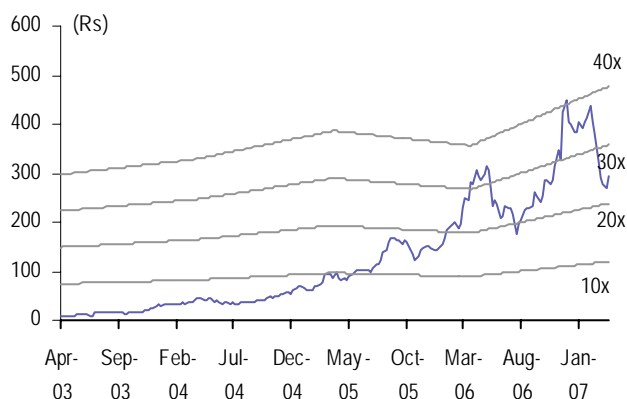
The Union Budget has been promising with increased irrigation potential, with 2.4 million hectares to be brought under irrigation projects. For FY08, under the AIBP, an additional irrigation potential of 0.9 million hectares has been created and the allocation has been increased to Rs 110 billion from Rs 71.2 billion last year. Andhra Pradesh is expected to cover 3,000 water bodies with a command area of 250,000 hectares.

Budgetary support for APDRP from Rs 6.5 billion in 2006-'07 to Rs 8 billion in 2008. The annual target for the Rajiv Gandhi Grameen Vidyutikaran Yojana has been increased to Rs 40 billion from Rs 30 billion in 2006-'07.

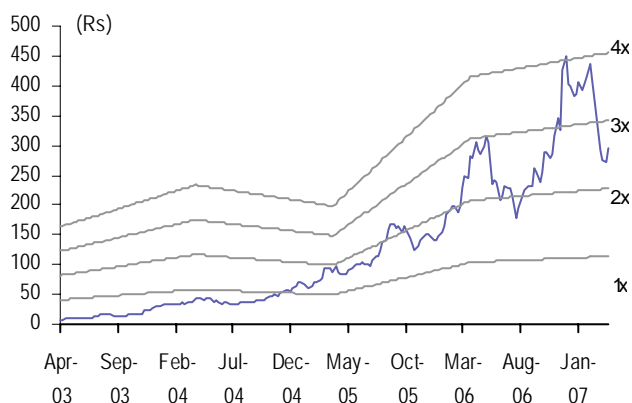
There is a very strong potential for unlocking value through the listing of IVRCL's real estate arm, IVR Prime, which is expected to go in for an IPO as soon as SEBI clarifies that if any additional disclosure is required for its real estate. IVRCL undertook a QIB during Q3FY07 and raised Rs 5,550 million, which is targeted towards future BoT projects in the road and water segments.

ABSOLUTE ROLLING VALUATION BAND CHARTS

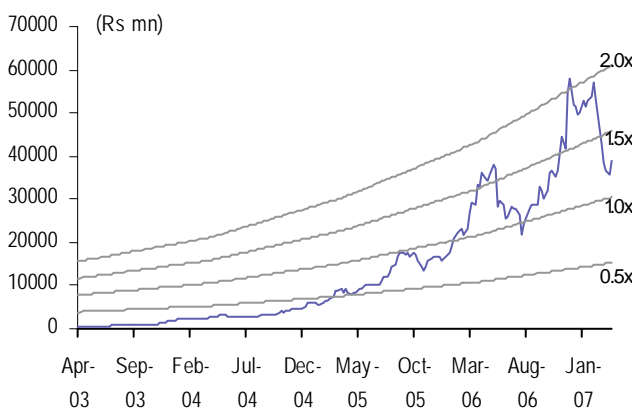
PE band



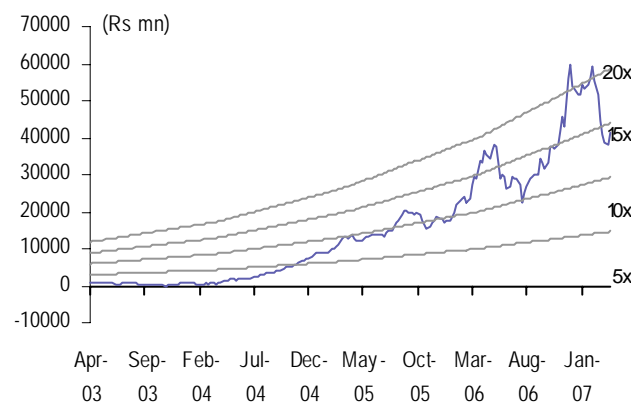
PBV band



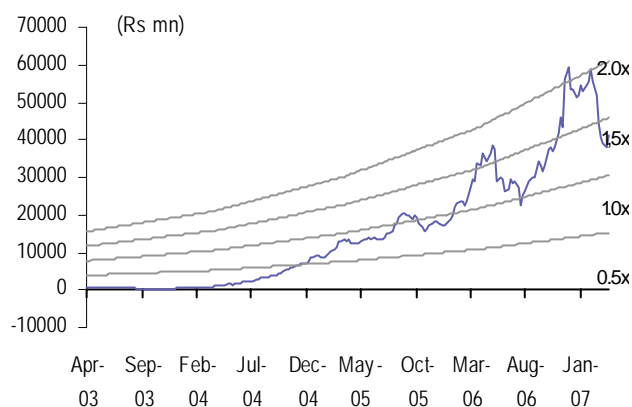
MCap/Sales band



EV/EBIDTA band



EV/Sales band



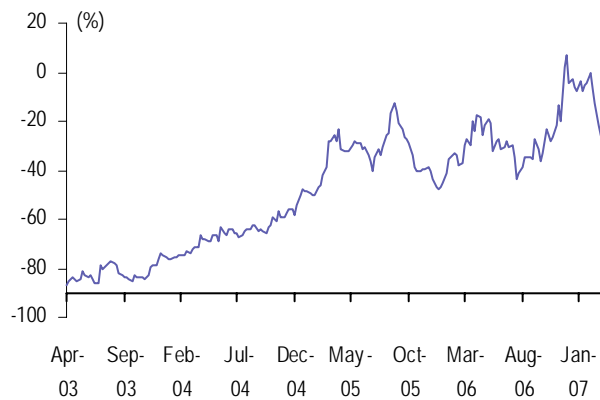
Source: Man Financial Research

PREMIUM / DISCOUNT TO SENSEX

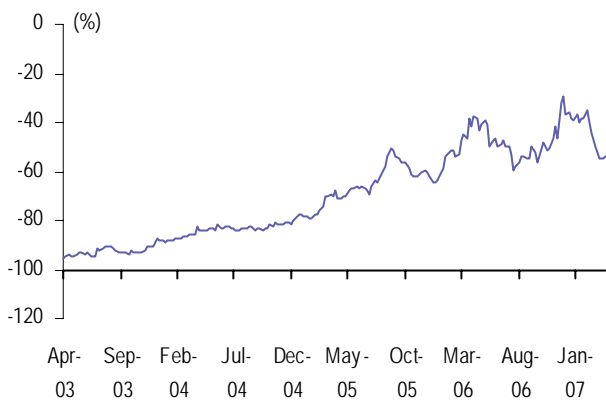
PE



PBV



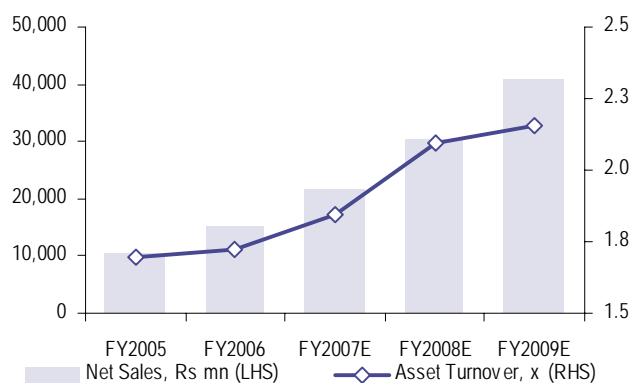
MCap/Sales



Source: Man Financial Research

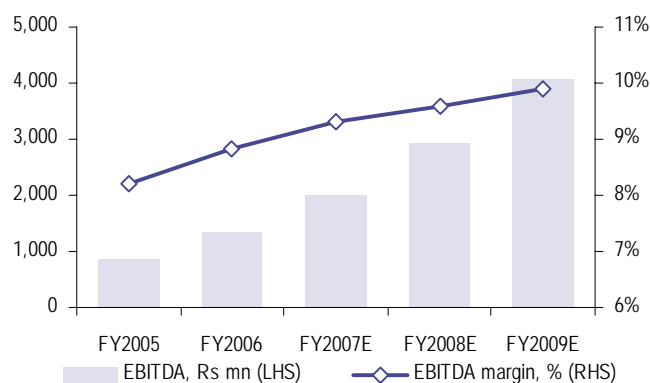
Value creation

Sales and asset turnover



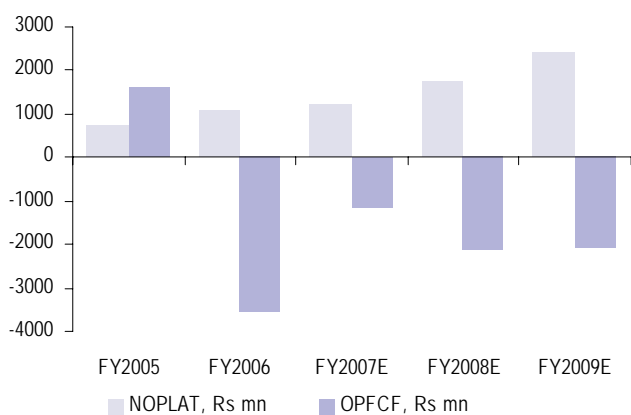
- Low capex requirement will lead to a better turnover ratio.

EBITDA and EBITDA margin



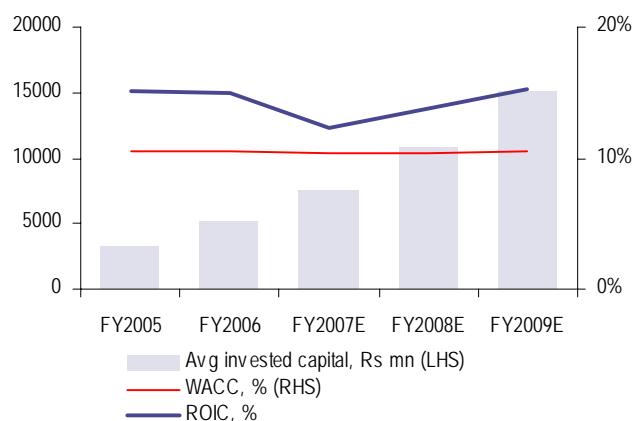
- EBITDA margin is expected to cross the 10% mark led by volume growth.

Noplat and OPFCF



- High WC requirement to grow sales at 40%.

Economic profit



- 36% growth in IC would be required over the next three years. ROIC is expected to improve to 16.5% by FY09E.

Source: Company, Man Financial Research estimates.

FINANCIALS

Income Statement

Y/E Mar, Rs mn	FY05	FY06	FY07E	FY08E	FY09E
Net sales	10,547	15,214	21,600	30,500	41,000
<i>Growth, %</i>	36.4%	44.2%	42.0%	41.2%	34.4%
Other income	24	57	150	180	150
Total income	10,571	15,272	21,750	30,680	41,150
Operating expenses	9,682	13,871	19,591	27,572	36,941
EBITDA	865	1,343	2,009	2,928	4,059
<i>Growth, %</i>	48.1%	55.3%	49.6%	45.8%	38.6%
<i>Margin, %</i>	8.2%	8.8%	9.3%	9.6%	9.9%
Depreciation	80	110	210	290	360
EBIT	785	1,233	1,799	2,638	3,699
<i>Growth, %</i>	61.3%	57.1%	45.9%	46.7%	40.2%
<i>Margin, %</i>	7.4%	8.1%	8.3%	8.6%	9.0%
Interest paid	214	253	360	400	550
Pre-tax profit	595	1,037	1,589	2,418	3,299
Tax provided	28	108	532	830	1,133
Profit after tax	567	930	1,057	1,588	2,166
MAN Net profit	567	930	1,057	1,588	2,166
Net Profit	567	930	1,057	1,588	2,166
<i>Growth, %</i>	86.7%	63.9%	13.7%	50.2%	36.4%
Unadj. shares (m)	85	108	130	136	136
Wtd avg shares (m)	69	96	119	133	136

Cash Flow

Y/E Mar, Rs mn	FY05	FY06	FY07E	FY08E	FY09E
Pre-tax profit	595	1,037	1,589	2,418	3,299
Depreciation	80	110	210	290	360
Chg in working capital	1,148	(4,273)	(1,820)	(3,410)	(4,097)
Total tax paid	(28)	(108)	(532)	(830)	(1,133)
Cash flow from operating activities	1,795	(3,233)	(553)	(1,533)	(1,571)
Capital expenditure	(351)	(523)	(800)	(800)	(900)
Chg in investments	(220)	(2,448)	(1,000)	(1,000)	(1,000)
Cash flow from investing activities	(571)	(2,972)	(1,800)	(1,800)	(1,900)
Free cash flow	1,224	(6,205)	(2,353)	(3,333)	(3,471)
Equity raised/(repaid)	747	22	7,259	1,465	-
Debt raised/(repaid)	750	4,315	(3,709)	1,035	3,500
Dividend (incl. tax)	(72)	(125)	(185)	(235)	(274)
Cash flow from financing activities	1,426	4,212	3,365	2,265	3,226
Net chg in cash	2,650	(1,993)	1,012	(1,067)	(245)

Balance Sheet

As at 31st Mar, Rs mn	FY05	FY06	FY07E	FY08E	FY09E
Cash & bank	4,527	2,443	2,876	1,809	1,564
Debtors	3,066	4,765	7,020	10,336	14,236
Inventory	178	286	450	720	968
Loans & advances	787	1,156	1,101	1,793	2,610
Other current assets	3,050	4,352	6,300	8,896	11,958
Total current assets	11,607	13,003	17,747	23,554	31,336
Investments	316	2,765	3,765	4,765	5,765
Net fixed assets	957	1,373	1,963	2,473	3,013
Total assets	12,881	17,141	23,475	30,792	40,115
Current liabilities	6,261	5,391	7,800	11,183	15,033
Provisions + Deferred Tax	118	194	276	357	437
Total current liabilities	6,379	5,585	8,076	11,540	15,470
Non-current liabilities	2,472	6,786	3,077	4,112	7,612
Total liabilities	8,850	12,371	11,153	15,652	23,082
Paid-up capital	170	215	260	272	272
Reserves & surplus	3,861	4,555	12,063	14,868	16,760
Shareholders' equity	4,030	4,770	12,322	15,140	17,033
Total equity & liabilities	12,881	17,141	23,475	30,792	40,115

Per-share data

	FY05	FY06	FY07E	FY08E	FY09E
MAN EPS (INR)	8.2	9.7	8.9	11.9	15.9
<i>Growth</i>	<i>10.8%</i>	<i>17.5%</i>	<i>-7.8%</i>	<i>34.1%</i>	<i>33.3%</i>
Book NAV/share (INR)	37.0	49.6	103.8	113.8	125.1
FDEPS (INR)	6.7	8.6	8.1	11.7	15.9
CEPS (INR)	7.6	9.7	9.8	13.8	18.6
CFPS (INR)	31.2	-18.5	7.8	-7.8	-1.8
DPS (INR)	0.8	1.2	1.4	1.7	2.0

Financial structure

	FY05	FY06	FY07E	FY08E	FY09E
Operating cash flow/Total debt (x)	0.7	(0.5)	(0.2)	(0.4)	(0.2)
Total debt/Equity (x)	0.6	1.4	0.2	0.3	0.4
Net debt/Equity (x)	(0.1)	0.9	0.0	0.2	0.4

Profitability, Productivity, Liquidity and Valuation Ratios

	FY05	FY06	FY07E	FY08E	FY09E
Return on assets (%)	4.4	5.4	4.5	5.2	5.4
Return on equity (%)	14.1	19.5	8.6	10.5	12.7
Return on Invested capital (%)	15.1	15.0	12.3	13.8	15.3
RoIC/Cost of capital (x)	1.1	1.1	0.9	1.0	1.1
RoIC - Cost of capital (%)	1.6	1.5	-1.2	0.3	1.8
Return on capital employed (%)	15.1	13.1	10.5	11.5	12.4
Cost of capital (%)	13.5	13.5	13.5	13.5	13.5
RoCE - Cost of capital (%)	1.6	-0.4	-3.0	-2.0	-1.1
Asset turnover (x)	1.7	1.7	1.8	2.1	2.2
Sales/Total assets (x)	0.8	0.9	0.9	1.0	1.0
Sales/Net FA (x)	11.0	11.1	11.0	12.3	13.6
Working capital/Sales (x)	0.5	0.5	0.5	0.4	0.4
Fixed capital/Sales (x)	0.1	0.1	0.1	0.1	0.1
Receivable days	106	114	119	124	127
Inventory days	6	7	8	9	9
Payable days	141	129	132	134	134
Current ratio (x)	1.8	2.3	2.2	2.0	2.0
Quick ratio (x)	1.8	2.3	2.1	2.0	2.0
Interest cover (x)	3.7	4.9	5.0	6.6	6.7
PSR(x)	2.0	1.4	1.0	0.7	0.5
PER (x)	18.7	15.9	17.2	12.9	9.6
PEG (x) - y-o-y growth	1.1	-2.0	0.5	0.4	0.3
PCE (x)	20.1	15.9	15.7	11.1	8.3
PCF (x)	7.9	(10.5)	20.6	(19.6)	(85.4)
Price/Book (x)	5.1	3.5	1.6	1.4	1.2
Yield (%)	0.3	0.3	0.3	0.4	0.5
EV/Net sales (x)	2.4	1.6	1.2	0.8	0.6
EV/EBITDA (x)	28.9	18.6	12.4	8.5	6.2
EV/EBIT (x)	31.9	20.3	13.9	9.5	6.8
EV/NOPLAT (x)	26.5	17.2	11.3	7.8	5.7
EV/CE	17.1	6.6	4.7	3.0	2.1
EV/IC (x)	2.8	2.1	1.7	1.3	1.1

Source: Company, Man Financial Research Estimates

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