

## Company Focus

25 October 2007 | 11 pages

# Nagarjuna Construction (NGCN.BO)

Target price change   
 Estimate change

## Buy: Moving Up the Value Chain – Raise Target Price to Rs336

- Raising target price to Rs336** – We raise our target price to Rs336 from Rs235 driven by: 1) revisions in earnings estimates by -9% to +14% over FY08E-10E 2) increasing target multiple for core business to 19x from 16x earlier due to a structural change in the business mix, and 3) rolling forward our target basis to Sept. '09E from Mar. '09E.
- Moving up the value chain** – Nagarjuna is expanding into newer areas like EPC for the metals and oil and gas sector. It has entered joint ventures with POSCO Korea and Naftogas Ukraine for the same.
- Rs11bn order from SAIL, a sign of things to come?** – Nagarjuna, in a JV with POSCO E&C, recently won an Rs11bn blast furnace order from SAIL for IISCO Steel Plant at Burnpur, West Bengal. This will be the largest blast furnace in India, according to the company. The company is bidding for E&C orders for oil refineries, laying of oil and gas pipelines, etc.
- Real estate division ramping up fast** – NCC Urban, the real estate arm of Nagarjuna, has a three-year plan for developing about 12.87mn sqft and targets revenues close to Rs24bn. It also has 243 acres earmarked for future development. NCC holds about 80% of NCC Urban.
- Blackstone placement ends overhang** – Nagarjuna has issued equity shares and warrants aggregating to US\$150mn to Blackstone. The funds will be used for investing in BOT projects and meeting working capital requirements.

<b>Buy/Medium Risk</b>	<b>1M</b>
Price (24 Oct 07)	Rs278.25
Target price	Rs336.00
	<i>from Rs235.00</i>
Expected share price return	20.8%
Expected dividend yield	0.4%
<b>Expected total return</b>	<b>21.2%</b>
Market Cap	Rs58,021M
	US\$1,466M

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



### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Mar	(RsM)	(Rs)	(%)	(x)	(x)	(%)	(%)
2006A	1,039	4.97	45.8	56.0	6.1	16.4	0.3
2007A	1,303	6.25	25.7	44.5	5.6	13.2	0.4
2008E	1,945	8.17	30.8	34.0	4.0	14.7	0.4
2009E	3,112	13.08	60.0	21.3	3.0	16.8	0.5
2010E	3,895	16.37	25.2	17.0	2.6	17.2	0.6

Source: Powered by dataCentral

See Appendix A-1 for Analyst Certification and important disclosures.

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<sup>1</sup>Citigroup Global Markets India Private Limited

Fiscal year end 31-Mar	2006	2007	2008E	2009E	2010E
<b>Valuation Ratios</b>					
P/E adjusted (x)	56.0	44.5	34.0	21.3	17.0
EV/EBITDA adjusted (x)	36.1	22.8	17.2	12.0	10.1
P/BV (x)	6.1	5.6	4.0	3.0	2.6
Dividend yield (%)	0.3	0.4	0.4	0.5	0.6
<b>Per Share Data (Rs)</b>					
EPS adjusted	4.97	6.25	8.17	13.08	16.37
EPS reported	4.97	7.28	8.17	13.08	16.37
BVPS	45.64	49.78	70.29	91.23	106.40
DPS	0.80	1.00	1.20	1.40	1.60
<b>Profit &amp; Loss (RsM)</b>					
Net sales	18,404	28,711	36,510	52,545	64,530
Operating expenses	-16,945	-26,312	-33,321	-47,860	-58,725
<b>EBIT</b>	<b>1,459</b>	<b>2,399</b>	<b>3,189</b>	<b>4,686</b>	<b>5,805</b>
Net interest expense	-217	-504	-435	-265	-265
Non-operating/exceptionals	20	52	25	25	25
<b>Pre-tax profit</b>	<b>1,262</b>	<b>1,947</b>	<b>2,778</b>	<b>4,445</b>	<b>5,565</b>
Tax	-223	-643	-834	-1,334	-1,669
Extraord./Min.Int./Pref.div.	0	216	0	0	0
<b>Reported net income</b>	<b>1,039</b>	<b>1,519</b>	<b>1,945</b>	<b>3,112</b>	<b>3,895</b>
Adjusted earnings	1,039	1,303	1,945	3,112	3,895
Adjusted EBITDA	1,641	2,698	3,651	5,255	6,453
<b>Growth Rates (%)</b>					
Sales	54.9	56.0	27.2	43.9	22.8
EBIT adjusted	82.8	64.4	32.9	46.9	23.9
EBITDA adjusted	80.9	64.4	35.3	43.9	22.8
EPS adjusted	45.8	25.7	30.8	60.0	25.2
<b>Cash Flow (RsM)</b>					
<b>Operating cash flow</b>	<b>-4,299</b>	<b>15</b>	<b>-541</b>	<b>-2,271</b>	<b>58</b>
Depreciation/amortization	182	299	462	569	648
Net working capital	-5,519	-1,853	-2,948	-5,951	-4,485
<b>Investing cash flow</b>	<b>-1,414</b>	<b>-6,502</b>	<b>-2,725</b>	<b>-2,025</b>	<b>-2,025</b>
Capital expenditure	-999	-2,612	-1,700	-1,000	-1,000
Acquisitions/disposals	-415	-3,891	-1,025	-1,025	-1,025
<b>Financing cash flow</b>	<b>7,150</b>	<b>6,151</b>	<b>3,233</b>	<b>4,278</b>	<b>2,075</b>
Borrowings	1,981	6,774	-575	2,600	2,500
Dividends paid	-188	-287	-318	-372	-425
<b>Change in cash</b>	<b>1,437</b>	<b>-336</b>	<b>-32</b>	<b>-17</b>	<b>108</b>
<b>Balance Sheet (RsM)</b>					
<b>Total assets</b>	<b>18,492</b>	<b>29,867</b>	<b>37,038</b>	<b>48,834</b>	<b>58,006</b>
Cash & cash equivalent	2,809	2,434	2,440	2,423	2,531
Accounts receivable	3,017	5,817	7,402	10,653	13,083
Net fixed assets	1,916	4,229	5,467	5,898	6,250
<b>Total liabilities</b>	<b>9,062</b>	<b>19,579</b>	<b>20,958</b>	<b>27,965</b>	<b>33,666</b>
Accounts payable	2,513	4,219	5,406	7,897	9,698
Total Debt	4,629	11,403	10,828	13,428	15,928
<b>Shareholders' funds</b>	<b>9,430</b>	<b>10,380</b>	<b>16,079</b>	<b>20,869</b>	<b>24,340</b>
<b>Profitability/Solvency Ratios (%)</b>					
EBITDA margin adjusted	8.9	9.4	10.0	10.0	10.0
ROE adjusted	16.4	13.2	14.7	16.8	17.2
ROIC adjusted	16.2	13.1	13.1	14.2	14.0
Net debt to equity	19.3	86.4	52.2	52.7	55.0
Total debt to capital	32.9	52.3	40.2	39.2	39.6

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## Moving up the value chain

Nagarjuna Construction is steadily moving up the value chain in its construction business by expanding into newer businesses like EPC for metals and oil and gas sectors. This should lead to a structural change in its business mix as growth should accelerate, while returns should increase. This also places it in a league higher than peers like IVRCL in the construction space.

Joint venture with POSCO to do EPC contracts in metals space

- **Metals** -Nagarjuna is looking to participate in the expansion of existing steel plants and the construction of greenfield capacity. Nagarjuna has entered a joint venture with POSCO of South Korea, who is the technology partner. The JV will compete with construction companies like L&T and Punj Lloyd in this space.

**Early Win - Rs11bn order win from SAIL** - The Nagarjuna-POSCO E&C JV recently won an Rs15.5bn order from Steel Authority of India Ltd for the IISCO Steel Plant at Burnpur, West Bengal. Nagarjuna's share of the order is Rs11bn. The project entails setting up a blast furnace complex with a completion schedule of 30 months. This will be the largest blast furnace in India, according to the company.

US\$40bn of metals capex over next six years

Figure 1. India – Metals Capex (Rsbn)

Company	FY08E	FY09E	FY10E	FY11E	FY12E	FY13E	Total
Hindalco	22	43	66	62	34	-	226
Nalco	15	17	2	-	-	-	34
Hindustan Zinc	13	1	-	-	-	-	13
Vedanta Alumina	14	25	32	16	-	-	86
JSW Steel	49	41	42	28	-	-	160
Tata Steel	40	49	83	93	34	34	333
SAIL	38	77	134	134	-	-	384
Posco	16	31	54	72	35	78	286
Ispat Industries	2	4	7	7	-	-	21
RINL	8	17	29	29	-	-	83
<b>Total</b>	<b>217</b>	<b>304</b>	<b>450</b>	<b>441</b>	<b>102</b>	<b>112</b>	<b>1,626</b>

Source: Citi Investment Research estimates

- **Oil and Gas Pipelines** - Nagarjuna is also looking to expand into laying of oil and gas pipelines in India. It has entered in to a joint venture with Naftogas of the Ukraine. Nagarjuna will hold about 70% stake in the venture.

Figure 2. India – Proposed Gas Pipelines (Kms)

Company	Kms
GAIL	5,181
GSPL	860
Reliance -KG basin pipelines	4,950
<b>Total</b>	<b>10,991</b>

Source: Citi Investment Research

## Real Estate – Ramping up fast

NCC Urban, the 80% owned real estate subsidiary of Nagarjuna is ramping up fast. NCC Urban has a three-year plan for developing about 12.87mn square feet. NCC Urban is targetting revenues close to Rs24bn from the 286.10 acres under development. The development plan given below improves visibility about the growth prospects of this subsidiary.

Figure 3. Development Plan for Real Estate

Name of project	Location	Extent of Land Acres	Built up Area Sqft	Revenues				Total
				FY08E	FY09E	FY10E	FY11E	
Gachibowli	Hyderabad	9.24	1.13	750	750	1,000		2,500
Kompally	Hyderabad	38	0.68	250	500	1,530		2,280
Games Village	Ranchi	55	2	1,250	1,870	0		3,120
Tulip Tower	Bangalore	8	0.8	750	750			1,500
Vizag - Madhudwada	Vizag	85	3	400	600	1,500	1500	4,000
Poppulaguda	Hyderabad	9.12	0.9		200	1,000	1200	2,400
Batchupally	Hyderabad	25	1.4		500	1,500	1500	3,500
Gajula Ramamram	Hyderabad	38	1.46		400	700	700	1,800
Symphony	Chennai	9.25	0.57		780	540		1,320
NCC premier	Bangalore	2	0.19	210	100			310
Green Valley	Cochin	2.16	0.15	130	130			260
Nagarjuna Astor Park	Bangalore	3.2	0.35	200	300			500
Maple Heights	Bangalore	2.13	0.24	110	200	60		370
<b>Total Revenues</b>		<b>286.1</b>	<b>12.87</b>	<b>4,050</b>	<b>7,080</b>	<b>7,830</b>	<b>4,900</b>	<b>23,860</b>

Source: Company, Citi Investment Research estimates

NCC also has ~243 acres of land for which development plans are not finalized

Figure 4. Land for Future Development

Future Development	Location	Extent of Land Acres	Book Value as on 31.12.2006
			Rs mn
Bowrampet District	Hyderabad	18.22	5.6
Banjara Hills	Hyderabad	2.22	49.3
Sri Sainath Gardens	Hyderabad	3.38	5.8
Keesara	Hyderabad	23	64.4
Kadubeesanahally	Bangalore	0.32	20.1
Gunjur Village	Bangalore	2	23
Church Road	Bangalore	0.13	28.4
Meyyur Village	Chennai	28.64	3.1
	Gurgaon	5	100
	Raipur	1	20
Nemam Village	Kakinada	150	236.2
	Goa	9	90
		<b>242.91</b>	<b>645.9</b>

Source: Citi Investment Research

## Aggressive Plans to Develop BOT Projects

Nagarjuna is increasing its focus on developing BOT projects. It has nine projects in various stages of implementation.

Figure 5. Nagarjuna BOT Projects

Project	Type	Project Cost Rsmn	Equity Rsmn	Debt Rsmn	Equity%	Debt%	NJCC stake	NJCC stake %	Equity IRR	Cost of Equity
<b>Road Projects</b>										
Brindavan Infrastructure	Annuity Based	2,475	450	2,025	18%	82%	150	33%	18%	12%
Western UP Tollway	Toll- Based	5,350	940	4,410	18%	82%	280	30%	16%	15%
Bangalore Elevated Tollway	Toll- Based	7,757	1,757	6,000	23%	77%	590	34%	16%	15%
OB Infrastructure	Annuity Based	5,848	1,462	4,386	25%	75%	940	64%	16%	12%
Pondicherry- Tindivanam	NHAI Toll Road Project	3,060	918	2,142	30%	70%	234	25%	20%	15%
<b>Power and other projects</b>										
Himachal Sorang	Hydropower Plant	6,000	1,200	4,800	20%	80%	400	33%	20%	15%
Himalayan Green	Hydropower Plant	14,500	4,350	10,150	30%	70%	2,180	50%	20%	15%
Machilipatnam Sea Port	Development of Sea Port	16,000	4,000	12,000	25%	75%	1,000	25%	20%	15%
Gautami Power	Gas based Power Project	14,333	4,300	10,033	30%	70%	430	10%	18%	15%

Source: Company, Citi Investment Research

### Future BOT projects would lead to further upside

Nagarjuna intends to invest in new BOT projects worth Rs46bn. It plans to invest Rs4.8bn of its equity in these projects. While we have not imputed any value to these BOT projects, such contract wins by Nagarjuna (parent) would mean significant upside to our revenue estimates.

### Blackstone placement ends overhang

Nagarjuna has issued 20.2mn equity shares at Rs202.5 and 9.11mn warrants at Rs225/- per warrant, together aggregating to around Rs6.15bn (US\$150mn) to Blackstone. The funds raised will be used for investing in BOT projects as well as meeting the working capital needs of the company.

### On track to achieve internal target of Rs58bn order inflows

Management had guided for FY08 order inflows of Rs58.5bn. It has already won orders worth Rs21bn so far, 36% of its internal targets for the year. We expect order inflows for the year to come in closer to Rs63bn.

### Increasing FD EPS estimates by 14% in FY09E & FY10E

We are increasing our FD EPS estimates by 14% in both FY09E and FY10E factoring in the following:

- **Increasing our revenue estimates** - by 5% in FY09E and FY10E on the back of the large order wins and higher-than-previously-expected order inflows.
- **Increasing margins by 50bps** – to account for the entry into verticals with higher margins.

- **Reduction in interest cost** – driven by high-cost debt being repaid through funds raised via the Blackstone placement.
- **Dilution of 12% on account of Blackstone placement** – We factor in dilution of 12% on account of the Blackstone placement.

**Reducing FY08E estimates** – We reduce our revenue estimates by 9% for FY08E to bring it in line with the management guidance of Rs37.5bn for the standalone company. Also, we reduce our FD EPS estimates to account for Blackstone placement dilution and the reduction in revenue estimates.

**Figure 6. Nagarjuna Estimate Changes**

	FY08E	FY09E	FY10E
Revenues Old	40,161	50,247	61,221
Revenues New	36,510	52,545	64,530
<b>% Change</b>	<b>-9%</b>	<b>5%</b>	<b>5%</b>
EBITDA Margins old	9.50%	9.50%	9.50%
EBITDA Margins new	10.00%	10.00%	10.00%
<b>Change bps</b>	<b>50</b>	<b>50</b>	<b>50</b>
PAT old	1,881	2,387	2,995
PAT new	1,945	3,112	3,895
<b>% Change</b>	<b>3%</b>	<b>30%</b>	<b>30%</b>
EPS Old	9.03	11.46	14.38
EPS New	8.17	13.08	16.37
<b>% Change</b>	<b>-9%</b>	<b>14%</b>	<b>14%</b>

Source: Citi Investment Research estimates

## Raise target price to Rs336.

We raise our target price for Nagarjuna to Rs336 on the back of:

- A 14% increase in earnings estimates over FY09E-10E. We now expect 38% earnings CAGR over FY07-10E.
- We also increase our target multiple for the core construction business to 19x from 16x given: (1) An evolving structural change in Nagarjuna's business mix towards high growth, high margin verticals, and (2) 38% earnings CAGR over the next three years, which is higher than our previous estimates of 32% and its peer group's earnings growth.
- We roll forward our target period basis to Sept09E from Mar09E.
- We increase our estimate for the value of BOT Projects to Rs32 per share from Rs19 per share earlier as we include Himalayan Green Project as well as the Pondicherry –Tindivanam road project.
- Real Estate – We value the real estate projects of NCC Urban at Rs12 per share, land bank at Rs3.2per share, and real estate projects of parent company at Rs7 per share.

**Figure 7. Nagarjuna Valuation Estimates**

Part	Remarks	Value
NJCC Core Construction Business	P/E of 19x, Sept 09E FD EPS	280
BOT Projects	P/BV	34
Real Estate	DCF, 14% Cost of Equity	19
Land Bank	Current Market value	3
<b>Total Sum-of-Parts Value</b>		<b>336</b>

Source: Citi Investment Research estimates

## Q208E – Sedate quarter ahead

We expect this to be a subdued quarter for Nagarjuna construction as this is a seasonally weak quarter as construction activity usually slows down during the monsoons. We expect recurring PAT to decline as the company will pay higher tax due to section 80IA withdrawal.

**Figure 8. Nagarjuna Q208E Estimates**

	Q207A	Q208E	Change Comments
Revenues	6,517	7,000	7% Due to slower execution since its a seasonally weak quarter
PAT	393	323	-18% Decline due to Section 80IA withdrawal

Source: Company reports, Citi Investment Research estimates

# Nagarjuna Construction

## Company description

Nagarjuna Construction Company (NJCC), with a controlling shareholders' stake of 26%, was established more than 27 years ago. It is one of the fastest growing construction companies in India. NJCC is a diversified player, and has executed projects across sectors and is well-positioned to capitalize on capex opportunities in areas such as transportation, power, and irrigation.

## Investment strategy

We rate Nagarjuna Construction shares Buy / Medium Risk (1M) with a target price of Rs336. We forecast a FD EPS CAGR of 38% for FY07-10E and an ROE of ~16-17%, and expect order backlog growth of 24% during this period. Entry into verticals like E&C for metals and oil and gas sectors should bolster order inflows.

## Valuation

Our sum-of-the-parts-based target price for NJCC of Rs336 per share is based on its four distinct parts: cash contract business, BOT projects, real estate projects, and landbank. We value the core construction business at a P/E of

19x Sept09E FD EPS to derive a value of Rs280 per share. We value its BOT projects at Rs34 per share, using the P/BV method to value its share in these projects. We then value its real estate projects at Rs19 per share based on DCF. Finally, we value its landbank at Rs3 per share, using management's estimates of its current market value.

## **Risks**

We rate NJCC shares Medium Risk. This differs from the High Risk rating suggested by our quantitative risk rating system, which tracks 260-day historical share price volatility. This is primarily because NJCC's order book of over Rs90bn implies sales coverage of 3x FY07 sales and provides good earnings visibility over the medium term. Risks to the shares reaching our target price include: rising material prices, project risks, commercial risks associated with BOT projects, equity dilution and a shortage of skilled manpower. It also faces risk from exposure to government-funded projects.



# Appendix A-1

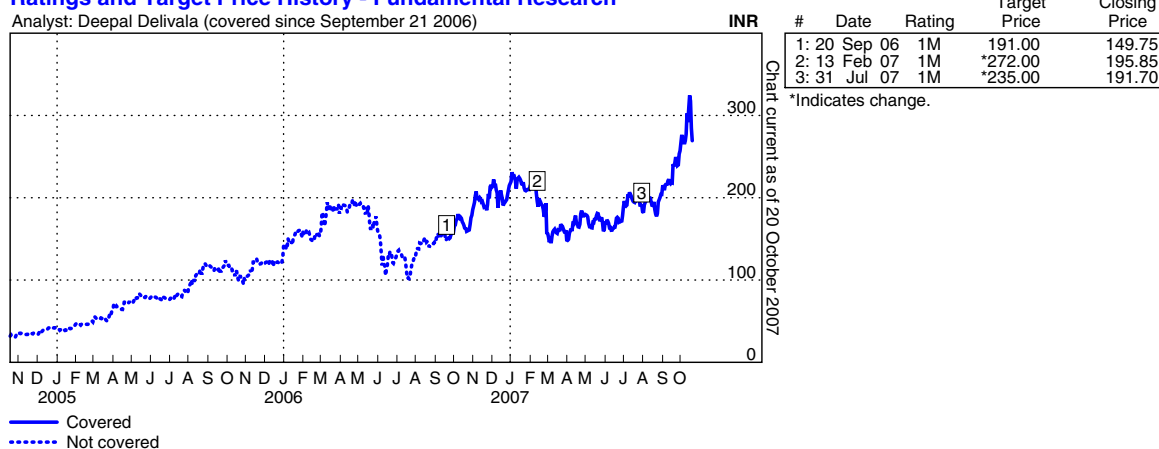
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Analyst: Deepal Delivala (covered since September 21 2006)



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