

Company Flash

31 October 2007 | 6 pages

Nagarjuna Construction (NGCN.BO)

Muted Quarter, Intact Outlook

- Revenue growth muted at 4%, guidance maintained** — Project execution in Q208 was affected by rainy weather and the delay in land acquisition for some road projects in UP. Management said that revenue slippage of Rs1.5-2bn would be made up in H208 and they would achieve guided revenues of Rs37.5bn for the full year.
- Margins expanded 305bps, recurring PAT in line with expectations** — Margins at 12.5% have expanded by 305bps YoY, largely driven by projects that were capital intensive, which led to higher fixed costs and lower direct costs. Recurring PAT at Rs337mn was up 3%YoY, in line with our expectations of Rs323mn. Management guided for EBITDA margins of 10.5%-11% and PAT margins of 5-5.5% for the full year.
- Order backlog Rs90bn up 34%YoY, guidance for full year hiked to Rs95bn** — Current order backlog at Rs90bn represents more than 3x FY07 sales, providing good visibility in the near term. Management raised the year-end guidance of end order backlog from Rs90bn to Rs95bn. Almost 75% of the order backlog has escalation clauses, which should help maintain margins.
- Entering into new verticals** — Nagarjuna is moving into areas like EPC for Oil and Gas, Metals and Power sectors. Apart from having entered into Joint ventures with Posco E&C and Naftogas, Nagarjuna is now in talks with Chinese power equipment suppliers for a joint venture to participate in Balance of Plant work for power plants and expects to announce this JV by the end of Q308.

Buy/Medium Risk	1M
Price (31 Oct 07)	Rs316.00
Target price	Rs336.00
Expected share price return	6.3%
Expected dividend yield	0.4%
Expected total return	6.7%
Market Cap	Rs65,893M
	US\$1,675M

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



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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	63.6	6.9	16.4	0.3
2007A	1,303	6.25	25.7	50.6	6.3	13.2	0.3
2008E	1,945	8.17	30.8	38.7	4.5	14.7	0.4
2009E	3,112	13.08	60.0	24.2	3.5	16.8	0.4
2010E	3,895	16.37	25.2	19.3	3.0	17.2	0.5

Source: Powered by dataCentral

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

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Figure 1. Nagarjuna Q208 Results

Rs m	Q207	Q208A	Change	Q208E	Comments
Net Sales	6,517	6,772	4%	7,000	Growth muted due to rains, delay in land acquisition by clients
(Increase)/Decrease in Stock in Trade	48	199			
Consumption of Raw materials as a % of net sales	(2,667) 40%	(2,339) 32%		(2,380) 34.0%	
Other Construction expenses as a % of net sales	(2,172) 33%	(2,600) 38%		(2,870) 41.0%	
Labour as a % of net sales	(760) 12%	(659) 10%		(630) 9.0%	
Staff Cost as a % of net sales	(198) 3.0%	(343) 5.1%		(280) 4.0%	
Other Expenses as a % of net sales	(150) 2%	(182) 3%		(140) 2.0%	
Total Expenditure	(5,899)	(5,923)		(6,300)	
EBITDA	618	848	37%	700	Margins expanded due to lower direct costs
EBITDA margin%	9.48%	12.53%	305	10.00%	
Depreciation	(69)	(117)		(104)	
EBIT	549	731		596	
EBIT margin%	8%	11%		9%	
Interest	(96)	(233)		(145)	Would reduce going forward as Rs2.5bn of debt has been repaid in October
Other Income	10	4		11	
PBT	462	502	8%	462	
PBT margin%	7%	7%	31	7%	
Tax	(135)	(165)	22%	(138)	
Effective Tax Rate%	29%	33%		30%	
Recurring PAT	327	337	3%	323	Inline with expectations
Recurring PAT margin%	5%	5%		5%	

Source: Company reports and Citi Investment Research

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

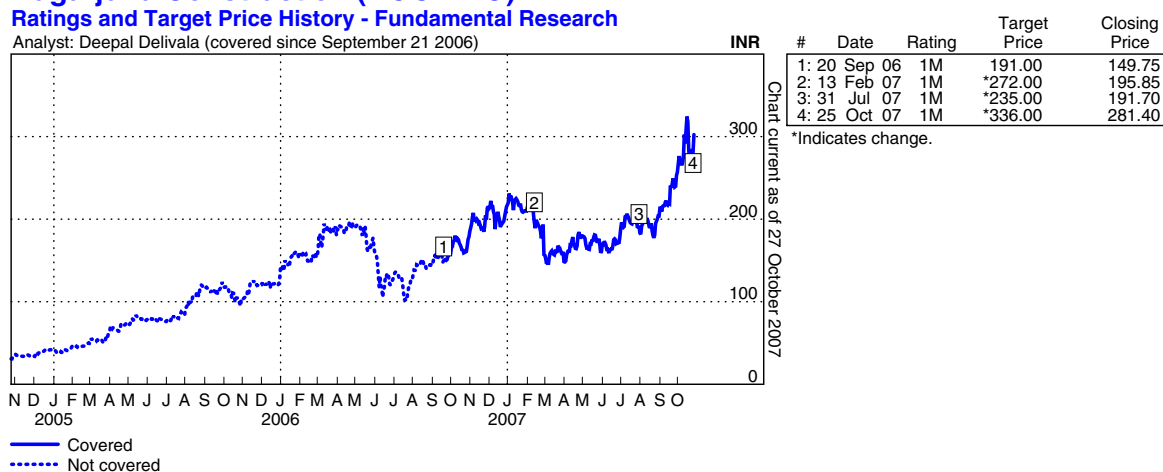
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Analyst: Deepal Delivala (covered since September 21 2006)



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