



Nagarjuna Construction

STOCK INFO.	BLOOMBERG
BSE SENSEX: 14,091	NJCC IN
	REUTERS CODE
S&P CNX: 4,083	NGCN.BO

31 January 2007

Buy

Previous Recommendation: Buy

Rs210

Equity Shares (m)	206.6	YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
52-Week Range	236/98	END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
1,6,12 Rel. Perf. (%)	-6/33/-5	3/06A	18,404	1,049	5.1	35.7	41.4	2.3	16.6	14.7	2.5	27.5
M.Cap. (Rs b)	43.4	3/07E	29,498	1,805	8.7	72.1	24.0	2.0	17.8	15.3	1.8	17.8
M.Cap. (US\$ b)	1.0	3/08E	47,000	2,739	13.3	51.7	15.8	1.7	23.1	17.7	1.2	12.1

Robust 3QFY07 financial performance: Nagarjuna Constructions (NCC) reported revenues of Rs7b (up 48% YoY), EBITDA of Rs802m (up 75.5% YoY) and Net profit of Rs449m (up 67.7% YoY). Reported numbers have been better than our estimates: Revenues Rs6.9b, EBITDA Rs667m and Net Profit Rs400m. The robust performance is being driven by strong revenue growth and margin expansion. Net profit margins improved to 6.4% in 3QFY07.

Improvement in EBITDA margins, driven by cash discounts: EBITDA margins during 3QFY07 improved by 179bp to 11.5% vs 9.7% in 3QFY06, partly because the company has availed cash discounts on purchase of raw materials. Cash discount leads to lower raw material costs, but higher interest costs. Thus, interest cost for Nagarjuna Construction during 3QFY07 increased to Rs185m, up from Rs97m during 3QFY06 and Rs96m during 2QFY07. NPM margin during 3QFY07 stood at 6.4% vs 6% in 2QFY07 and 5.7% in 3QFY06.

Key Takeaways from conference call: (1) NCC is working on two key initiatives in construction segment - international business and gas pipeline vertical (2) All three BOT road projects have achieved financial closure and entered construction phase (3) NCC Urban Infra (100% subsidiary) has land bank of 530 acres, of which finalized development plans over 267 acres (13.4m sq ft) (4) Capex plans of Rs2.2b in FY07, vs Rs930m in FY06 (5) Consortium comprising Nagarjuna Construction (25% stake), Maytas (26%), Port Operator (11%) and SREI Finance (38%) has emerged as L1 bidder for Machilipatnam sea port project, which also entails transfer of 8,000 acres of land to the consortium.

Valuation and view: We expect NCC to report net profit of Rs1.8b during FY07 (up 72.1% YoY), Rs2.7b in FY08 (up 51.7% YoY) and Rs3.2b in FY09 (up 16.6% YoY). At the CMP of Rs210, the stock quotes at reported PER of 24x FY07, 15.9x FY08E and 13.6x FY09E. Adjusted for the value of BOT projects (Rs6.3/sh), Real Estate (Rs31/sh) and Investments (Rs7/sh), the stock trades at PER of 19x FY07E, 12.5x FY08E and 10.8x FY09E. Maintain **Buy**.

Y/E MARCH	QUARTERLY PERFORMANCE								(Rs Million)	
	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Sales	3,594	3,682	4,724	6,404	6,517	6,517	6,998	9,466	18,404	29,498
Change (%)	54.6	52.3	78.8	42.3	81.4	77.0	48.1	47.8	54.9	60.3
EBITDA	278	379	457	531	550	618	802	946	1,640	2,916
Change (%)	61.3	95.3	108.9	65.2	97.8	63.0	75.5	78.0	80.8	77.8
As of % Sales	7.7	10.3	9.7	8.3	8.4	9.5	11.5	10.0	8.9	9.9
Depreciation	34	41	53	54	58	69	76	90	182	293
Interest	43	89	97	44	57	96	185	151	217	489
Other Income	13	15	17	5	8	10	5	19	20	41
PBT	214	264	324	439	443	462	546	724	1,262	2,175
Tax	22	55	56	90	59	69	97	145	223	370
Effective Tax Rate (%)	10.4	20.9	17.3	20.5	13.3	14.9	17.8	20.0	17.7	17.0
Reported PAT	192	209	268	349	384	393	449	579	1,039	1,805
Adj PAT	192	209	268	349	384	393	449	579	1,039	1,805
Change (%)	88.9	83.3	121.6	47.9	100.3	88.1	67.7	65.7	74.6	73.8

E: MOSSt Estimates

Robust 3QFY07 financial performance

During 3QFY07, Nagarjuna Constructions reported revenues of Rs7b (up 48% YoY), EBIDTA of Rs802m (up 75.5% YoY) and Net profit of Rs449m (up 67.7% YoY). Reported numbers have been better than our estimates: Revenues Rs6.9b, EBIDTA Rs667m and Net Profit Rs400m. The robust performance is being driven by strong revenue growth and margin expansion. Net profit margins improved to 6.4% in 3QFY07 (up from 5.7% in 3QFY06).

TREND IN SEGMENT-WISE REVENUE COMPOSITION (RS M)

	2QFY06	3QFY06	4QFY06	1QFY07	2QFY07	3QFY07
Roads	502	1,185	1,634	1,594	1,402	2,564
Buildings	1,276	1,330	1,190	862	1,556	1,782
Water	1,196	1,317	2,223	3,010	2,475	1,625
Irrigation / HEP	242	348	653	410	240	330
Electricals	202	489	631	608	684	558
Total	3,418	4,669	6,331	6,486	6,384	6,820

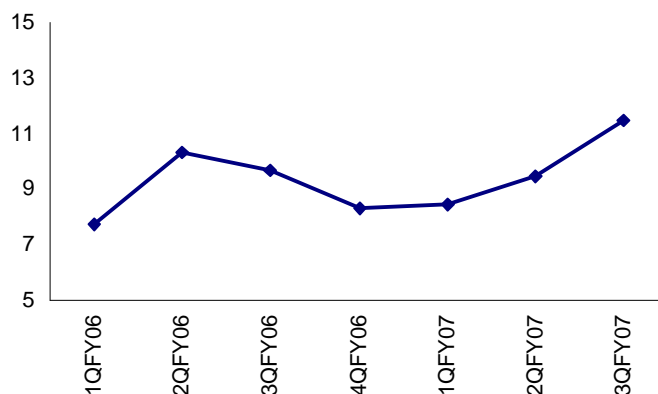
Source: Company

Continued improvement in EBIDTA margins

EBIDTA margins during 3QFY07 improved by 179bp to 11.5% vs 9.7% in 3QFY06. Apart from margin improvements from new orders which have factored in improved pricing scenario, the company has also availed cash discounts on purchase of raw materials, which have resulted in improvement in EBIDTA margins. Cash discounts leads to lower raw material costs, but higher interest costs. Thus, interest cost for Nagarjuna Construction during 3QFY07 increased to Rs185m, up from Rs97m during 3QFY06 and Rs96m during 2QFY07. NPM margin during 3QFY07 stood at 6.4% vs 6.0% in 2QFY07 and 5.7% in 3QFY06.

During 3QFY07, real estate division contributed Rs160m as revenues, up from Rs55m in 3QFY06. The management expects this to increase to Rs700-800m in FY07. The segment has high EBIDTA margins (20%+) which has also led to improved performance.

TREND IN EBIDTA MARGIN (%)

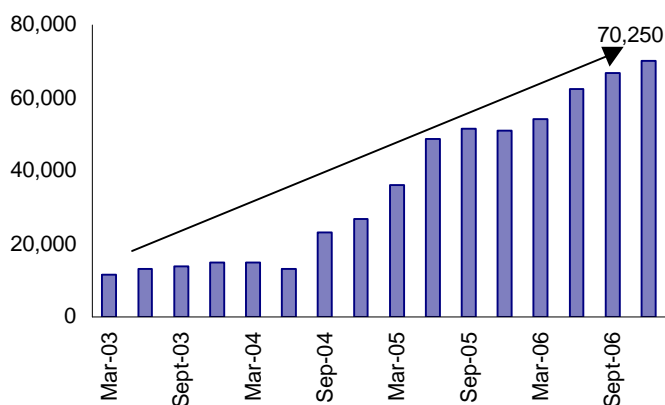


Source: Company

Robust order backlog ensures revenue visibility

Order backlog stood at Rs70.3b as at December 2006 which includes Rs6.5b from own BOT projects. Order book composition stands as: Roads - 42%, Buildings - 27.3%, Water - 18.9%, Irrigation/HEP - 10.5% and Electricals - 7.3%. In addition, the company has emerged as the lowest cost bidder for projects worth Rs2.5-3.0b, resulting in an effective order book of Rs73b. The execution period of the current order book stands at 2.5 years.

TREND IN ORDER BACKLOG (RS M)

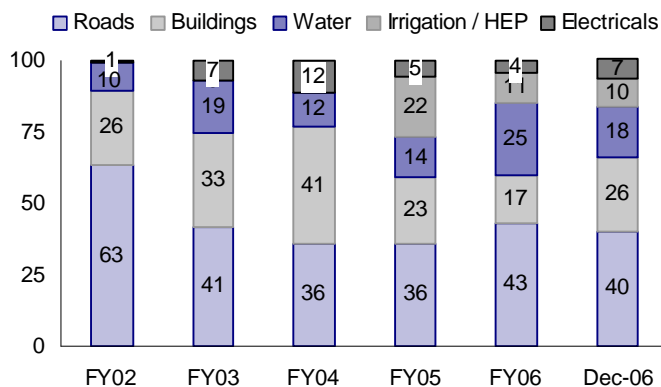


Source: Company

During 3QFY07, the order intake for company stood at Rs9.8b comprising of Buildings of Rs2.8b, Water Rs3.7b, Irrigation Rs1.3b, Roads Rs338m and Rs1.8b from Electricals. Share of roads in order backlog stood at 40% in 3QFY07, vs 38% in 3QFY06; while the share of buildings has increased to 26% in 3QFY07, vs 15% in 3QFY06. Share

of water segment has declined to 18% in 3QFY07, vs 29.2% in 3QFY06, due to ramp up in execution of Devadula Irrigation project.

ORDER BOOK COMPOSITION (%)



Note: Dec-06 denotes as of December, 2006. Source: Company

Fund raising plans of upto US\$180m

Nagarjuna has announced fund raising of Rs8.1b (US\$180m) through a QIP offering. The funds raised would be utilized for enhancing its net worth to qualify for bidding of large projects and to fund its investment in proposed BOT projects. The company has clarified that the proceeds of this issue would not be utilized to fund the land acquisition plans of NCC Urban Infrastructure Limited.

The promoters stake in the company is expected to come down to ~21%, vs current levels of 27% post the QIP offering. The Board has also approved issue of 2.5m warrants to the promoters, which would hike promoter’s stake to ~22-23%.

Key takeaways from conference call

Management Guidance maintained

- Revenues Rs30b in FY07, vs Rs18.4b in FY06 (up 63% YoY)

- Order Intake of Rs43b in FY07, v/s Rs36b in FY06 (up 19% YoY)
- Order backlog of Rs68-70b in March 2007, v/s Rs54b in March 2006
- Tax rates of 17-18% during FY07

Nagarjuna consortium emerges L1 in Machilipatnam Sea port project

The consortium comprising of Nagarjuna Construction (25%), Maytas Infrastructure (26%), Port Operator company (11%) and SREI Finance (38%) has emerged as the lowest cost bidder for the Machilipatnam sea port project in Andhra Pradesh. The total project development cost is estimated at ~Rs12-13b. The project is likely to be funded through a Debt-Equity ratio of 3:1.

The project also entails transfer of 8,000 acres of land to the consortium, on a 99 years lease by the government. The land is currently entirely in possession of the government and the consortium has an option to develop an Export Zone, SEZ or Port related operating facility. The Letter of Intent has already been issued to the consortium.

Sizeable progress in NCC Urban Infrastructure

NCC Urban Infrastructure (80% subsidiary) has a land bank of 530 acre, of which 132 acres is contributed by NCC and 140 acres is from Ranchi and Vizag project (provided by the government). NCC Urban Infrastructure has finalized development plans for 267 acres, entailing development area of 13.4m sq ft to be developed over a 3-4 year period, and possible revenues of Rs22b. On the remaining 263 acres, the company intends to finalize development plans over the next 12 months. The management also stated that all amounts pertaining to land acquisitions have already been paid for. The management has guided for revenues of: FY08 Rs4b (development of 1.2m sq ft), FY08 Rs8b (2.5m sq ft) and FY10 Rs10b (4.0m sq ft).

NCC URBAN INFRASTRUCTURE (PROJECTS UNDER DEVELOPMENT)

	LAND (ACRES)	DEV AREA (M SQ/FT)	FLATS/ VILLA (NOS)	REALI- ZATION (RS M)
SPVs				
Ranchi Project	55.0	2.5	1,800	3,300
NCC Vizag	85.0	3.0	0	4,000
Total (A)	140	5.5		7,300
NCC Urban Infra				
Tulip Tower	8.0	0.9	512	1,460
Symphony Chennai	9.3	0.7	400	1,320
Gachibowli, Hyderabad	9.0	1.0	192	3,080
Bachupalli, Hyderabad	25.0	0.7	225	4,000
Puppala Guda, Hyderabad	14.0	1.6	560	3,500
Others (Bangalore/ Cochin)	23.8	1.6	703	2,320
Group, Hyderabad	38.0	1.5	250	4,430
Total (B)	127	7.9		20,110
Total (A + B)	267	13.4	4,642	27,410

Source: Company

Capex

The management indicated that capex during FY07 would stand at Rs2.2b, of which Rs1.5b has already been spent till Dec 2006. Further, the management has guided for a capex of Rs1.5b in FY08 and Rs1.0b in FY09. This is largely towards procurement of plant and machinery.

Valuation and view

We expect Nagarjuna Constructions to report net profit of Rs1.8b during FY07 (up 72.1% YoY), Rs2.7b in FY08 (up 51.7% YoY) and Rs3.2b in FY09 (up 16.6% YoY). At the CMP of Rs210, the stock trades at reported PER of 24x FY07, 15.9x FY08E and 13.6x FY09E. Adjusted for the value of BOT projects (Rs6.3/sh), Real Estate (Rs31/sh) and Investments (Rs7/sh), the stock trades at PER of 19x FY07E, 12.5x FY08E and 10.8x FY09E. Maintain **Buy**.

SUM OF PARTS VALUE

	BUSINESS SEGMENT	METHOD	VALUATION (X)	VALUE (RS M)	VALUE (RS/SH)	RATIONALE
NCC Standalone	Construction	FY09E PER (x)	12	38,340	186	At par with industry average
BOT Portfolio						
A) Operational Projects						
Bangalore Mysore Annuity	BOT Road	DCF, Cost of Equity: 10%		196	0.9	Based on NPV of cash flows
B) Projects under Construction Phase						
Meerut Muzzafarpur Toll Project	BOT Road	Book Value		140	0.7	Book Value of investments till Mar 07
Orai - Bhognipur and Bhognipur - Barah Annuity Project	BOT Road	Book Value		468	2.3	Book Value of investments till Mar 07
Banglore Elevated Highway Project	BOT Road	Book Value		500	2.4	Book Value of investments till Mar 07
C) Projects yet to achieve Financial Closure						
Sorang HEP (100MW)	BOT Hydro Power	Book Value		-	0.0	Project is yet to achieve financial closure
Himalayan Green HEP (280MW)	BOT Hydro Power	Book Value		-	0.0	Project under DPR phase
Real Estate						
NCC Urban Infra (Land Bank)	Real Estate	NPV, Cost of Equity: 15%		5,204	25.2	Based on NPV of cash flows
National Games Village (Ranchi)	Real Estate	NPV, Cost of Equity: 15%		436	2.1	Based on NPV of cash flows
Jubilee Hills (Hyderabad)	Real Estate	NPV, Cost of Equity: 15%		330	1.6	Based on NPV of cash flows
Madhudwada (AP)	Real Estate	NPV, Cost of Equity: 15%		420	2.0	Based on NPV of cash flows
Investments (at Book Value)				1,449	7.0	Shares of Gautami Power (Rs380m), etc
Total				46,034	230	

Nagarjuna Construction: an investment profile

Company description

Nagarjuna Construction Company is a Hyderabad-based construction company, and has its origins in the partnership business Nagarjuna Construction Corporation established in 1978. It is promoted by Mr. A.V.S. Raju. The company has a fairly diversified business mix with a presence across roads, buildings, water, irrigation, hydropower etc.

Key investment arguments

- Effective current order book (including L1 projects and cash EPC contracts from own BOT portfolio) stand at Rs70b, 3.8x FY06 revenues
- Post fund raising, NCC has net worth of Rs9.4b in March 2006 (v/s Rs3.2b in March 2005) enabling it to bid for bigger ticket-sized projects and also build a BOT portfolio
- NCC is focusing on several new verticals like gas pipelines, real estate development etc.

Key investment risks

- BOT projects depress initial RoE.
- Retention of experienced personnel is a challenge
- Infrastructure capex is highly cyclical and dependent on government policies

Recent developments

- Real estate activities consolidated in NCC Urban Infrastructure
- NCC announced fund raising of upto US\$180m (Rs8.1b).

Valuations and view

- Based on SOTP methodology, we arrive at our PT of Rs230/sh.
- At the CMP of Rs210, the stock quotes at reported PER of 24x FY07, 15.8x FY08E and 13.6x FY09E.

Sector view

- Increased government commitment towards infrastructure projects has led to several large projects taking off the ground
- We notice a trend of margin expansion, driven by changing composition of order book and higher margins at bidding stage
- BOT ventures could unlock sizable value

COMPARATIVE VALUATIONS

		NCC	IVRCL	HCC
P/E (x)	FY07E	24.0	39.1	31.8
	FY08E	15.8	23.5	18.8
P/BV (x)	FY07E	2.0	3.8	2.8
	FY08E	1.7	3.3	2.5
EV/Sales (x)	FY07E	1.8	2.3	1.7
	FY08E	1.2	1.6	1.2
EV/EBITDA (x)	FY07E	17.8	23.6	17.6
	FY08E	12.1	15.4	12.1

SHAREHOLDING PATTERN (%)

	DEC.06	SEP.06	DEC.05
Promoter	25.0	25.5	26.7
Domestic Inst	13.6	10.6	7.7
Foreign	32.2	32.0	25.6
Others	29.2	31.9	40.1

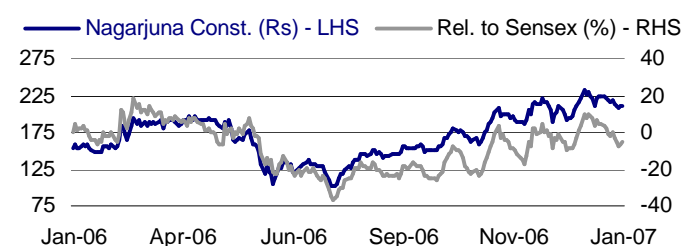
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	8.7	8.6	0.9
FY08	13.3	12.2	9.3

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
210	230	9.5	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)			
Y/E MARCH	2006	2007E	2008E	2009E	
Net Sales	18,404	29,498	47,000	60,000	
Change (%)	54.9	60.3	59.3	27.7	
Construction Expenses	15,803	25,295	40,188	51,334	
Staff Cost	473	710	1,314	1,642	
Office and Site Establish. Exps	487	577	662	802	
EBITDA	1,641	2,916	4,837	6,222	
% of Net Sales	8.9	9.9	10.3	10.4	
Depreciation	182	293	426	531	
Interest	217	489	1,028	1,473	
Other Income	20	41	42	42	
PBT	1,262	2,175	3,424	4,260	
Tax	223	370	685	1,065	
Rate (%)	17.7	17.0	20.0	25.0	
Reported PAT	1,039	1,805	2,739	3,195	
Extra-ordinary Expenses	10	0	0	0	
Adjusted PAT	1,049	1,805	2,739	3,195	
Change (%)	76.3	72.1	51.7	16.6	

BALANCE SHEET		(Rs Million)			
Y/E MARCH	2006	2007E	2008E	2009E	
Share Capital	207	207	207	207	
Reserves	9,212	10,605	12,697	15,138	
Net Worth	9,450	10,812	12,904	15,345	
Loans	4,629	9,700	16,800	20,500	
Deferred Tax Liability	66	66	66	66	
Capital Employed	14,145	20,578	29,770	35,911	

BALANCE SHEET		(Rs Million)			
Y/E MARCH	2006	2007E	2008E	2009E	
Gross Fixed Assets	2,569	4,886	6,086	7,586	
Less: Depreciation	720	1,013	1,439	1,970	
Net Fixed Assets	1,849	3,873	4,647	5,616	
Capital WIP	67	0	0	0	
Investments	877	3,807	5,222	5,222	
Curr. Assets	15,699	18,163	27,906	35,305	
Inventory	3,893	4,849	7,726	9,863	
Debtors	3,017	4,841	7,718	9,855	
Cash & Bank Balance	2,809	1,291	1,475	1,718	
Loans & Advances	5,942	7,144	10,949	13,831	
Other Current Assets	39	39	39	39	
Current Liab. & Prov.	4,368	5,265	8,005	10,232	
Creditors	3,107	3,465	5,505	7,032	
Other Liabilities	803	1,100	1,500	1,800	
Provisions	457	700	1,000	1,400	
Net Current Assets	11,331	12,898	19,901	25,073	
Misc. Expenses	22	0	0	0	
Application of Funds	14,146	20,578	29,770	35,911	

E: M0St Estimates

RATIOS		(Rs Million)			
Y/E MARCH	2006	2007E	2008E	2009E	
Basic (Rs)					
Adjusted EPS	5.1	8.7	13.3	15.5	
Growth (%)	35.7	72.1	51.7	16.6	
Cash EPS	6.0	10.2	15.3	18.0	
Book Value	91.3	104.7	124.9	148.5	
DPS	0.8	1.8	2.8	3.2	
Payout (incl. Div. Tax.)	18.1	22.8	23.6	23.6	
Valuation					
P/E (standalone)	41.4	24.0	15.8	13.6	
Cash P/E	35.3	20.7	13.7	11.6	
EV/EBITDA	27.5	17.8	12.1	10.0	
EV/Sales	2.5	1.8	1.2	1.0	
Price/Book Value	2.3	2.0	1.7	1.4	
Dividend Yield (%)	0.4	0.8	1.3	1.5	
Profitability Ratios (%)					
RoE	16.6	17.8	23.1	22.6	
RoCE	14.7	15.3	17.7	17.5	
Turnover Ratios					
Debtors (Days)	60	60	60	60	
Inventory (Days)	77	60	60	60	
Creditors. (Days)	72	50	50	50	
Asset Turnover (x)	1.8	1.7	1.9	1.8	
Leverage Ratio					
Debt/Equity (x)	0.5	0.9	1.3	1.3	

CASH FLOW STATEMENT		(Rs Million)			
Y/E MARCH	2006	2007E	2008E	2009E	
PBT before Extraordinary Items	1,262	2,175	3,424	4,260	
Add : Depreciation	182	293	426	531	
Interest	217	489	1,028	1,473	
Less : Direct Taxes Paid	223	370	685	1,065	
(Inc)/Dec in WC	-5,519	-3,085	-6,819	-4,929	
CF from Operations	-4,082	-497	-2,626	269	
(Inc)/Dec in FA	-999	-2,250	-1,200	-1,500	
(Pur)/Sale of Investments	-415	-2,930	-1,415	0	
CF from Investments	-1,414	-5,180	-2,615	-1,500	
(Inc)/Dec in Network	5,357	-11	0	0	
(Inc)/Dec in Debt	1,981	5,071	7,100	3,700	
Less : Interest Paid	217	489	1,028	1,473	
Dividend Paid	188	412	648	754	
CF from Fin. Activity	6,933	4,159	5,424	1,474	
Inc/Dec of Cash	1,437	-1,518	184	243	
Add: Beginning Balance	1,372	2,809	1,291	1,475	
Closing Balance	2,809	1,291	1,475	1,718	

N O T E S



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Disclosure of Interest Statement	Nagarjuna Construction
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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