Ahluwalia Contracts India – BUY

CMP Rs173, Target Rs214

Sector: Construction	
Sensex:	16,853
CMP (Rs):	173
Target price (Rs):	214
Upside (%):	23.5
52 Week h/l (Rs):	177 / 25
Market cap (Rscr) :	1,087
6m Avg vol ('000Nos):	197
No of o/s shares (mn):	63
FV (Rs):	2
Bloomberg code:	AHLU IB
Reuters code:	AHLU.BO
BSE code:	532811
NSE code:	-

Prices as on 29 Sep, 2009

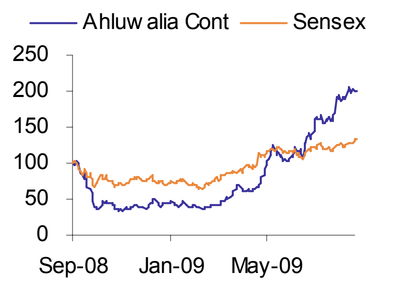
Shareholding pattern

June '09	(%)
Promoters	74.5
Institutions	6.2
Non promoter corp hold	13.8
Public & others	5.6

Performance rel. to sensex

(%)	1m	3m	1yr
Ahluwalia Cont	14.6	86.6	87.6
Simplex Infra	9.0	10.6	7.4
Unity Infra	10.3	8.4	(11.7)
Nagarjuna Const	4.6	(9.4)	22.8

Share price trend



ACIL to enjoy benefits from revival in real estate sector

Ahluwalia Contracts India (ACIL) as a contractor enchases value in a project cycle while maintaining margins with limited risk of asset ownership. With revival in real estate development and new project announcement, ACIL will pose to benefit as it's one of major turnkey contractor player. ACIL enchases value with monthly billing and di-risking itself from long payment cycle.

Robust order backlog provides strong earnings visibility

ACIL's current order backlog of Rs46bn, 3.5x FY09 revenues, provides strong earnings visibility. ACIL's order book historically has been dominated by real estate and allied contracts, which contributed ~90% of the order backlog. With slowdown in real estate business, the company diversified its product portfolio and entered into infrastructure projects business thereby providing cushion to its earnings. Until Q1FY10, Infrastructure space had increased its share to 19% of the order backlog with rest being contributed by real estate and allied segments. We expect the order backlog to grow by 14% CAGR over FY09-11E. Strong execution of the orders should translate into 20% revenue CAGR over FY09-11E.

Diversified client base and venturing into new verticals

ACIL has diversified its client base and has forayed into government contracts to have a good mix of private and public projects to abide slowdown in earnings and order book growth. ~68% of the order book is from the private sector and public sector contributes the rest. The company is foraying into urban infrastructure projects, with expected investment of Rs1271bn through JNNURM program, huge potential to be tapped.

Best play in the contractor space, Initiate with BUY

ACIL's Rs46bn order book provides significant earnings visibility for the next three years. Its well diversified client base reduces riskiness by limiting its exposure to private clients. With change in business mix, order inflow and zero debt levels, we expect margins to contract by 20bps, thus translating into 19% earnings growth. We value the core contracting business at 13x FY11E EPS and BOT project at 15% capitalized rate. Initiate coverage with a BUY rating and a target price of Rs214.

Valuation summary

Y/e 31 Mar (Rs m)	FY08	FY09	FY10E	FY11E
Revenues	8,801	11,916	14,957	20,273
yoy growth (%)	31.5	35.4	25.5	35.5
Operating profit	1,063	1,463	1,810	2,453
OPM (%)	12.1	12.3	12.1	12.1
Reported PAT	517	573	706	996
yoy growth (%)	64.1	10.8	23.2	41.2
EPS (Rs)	8.2	9.1	11.2	15.9
P/E (x)	21.0	19.0	15.4	10.9
EV/EBITDA (x)	9.7	7.4	6.0	4.4
Debt/Equity (x)	0.5	0.5	0.4	0.3
RoE (%)	50.5	37.9	33.6	34.2
RoCE (%)	57.0	49.4	43.5	44.9

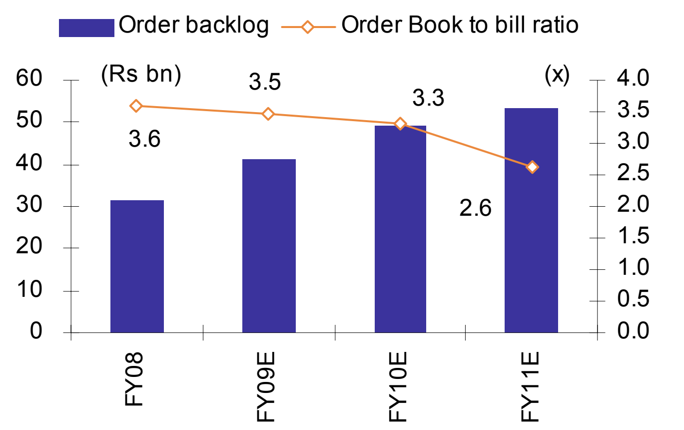
Source: Company, India Infoline Research

Rs46bn order book provides strong earnings comfort

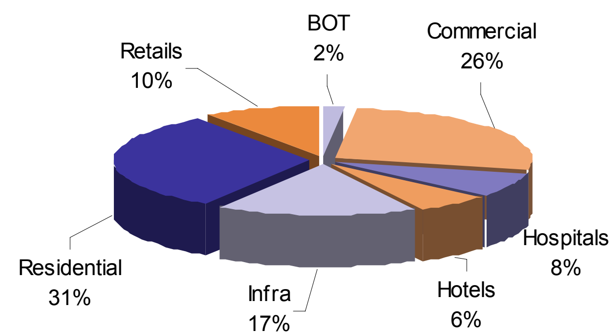
Healthy order book position

ACIL's current order backlog of Rs46bn provides significant earnings visibility for the next three years. ACIL's order book historically was dominated by real estate and allied contracts with a contribution of ~90% to the order backlog. With slowdown in real estate segment, the company started to foray into infrastructure projects to cushion its earning visibility. ~81% of current order backlog accounts for real estate and allied activities which includes residential, commercial, retail, hotels and hospitals. The company is slowly venturing into infrastructure contracts, which has increased from 6% in FY07 to 19% in Q1FY10. The average execution period for this order book is ~28 months, lower than the industry's average of 34 months. This should improve its asset turns and thus its return ratios. ACIL has pending bids of Rs90bn and average ticket size of ~Rs1.4bn.

Declining book to bill ratio



Order book break up



Source: Company, India Infoline Research

Better execution will result in declining book to bill ratio

Better execution will enhance earning visibility

Particulars (Rs mn)	FY08	FY09	FY10E	FY11E
Opening order book	16220	31500	41430	49411
% Growth	-	94.2	31.5	19.3
Order inflow	24081	21846	22938	24085
% Growth	-	(9.3)	5.0	5.0
Revenue	8801	11916	14957	20273
% Growth	-	35.4	25.5	35.5
Order backlog	31500	41430	49411	53223
% Growth	-	31.5	19.3	7.7
Order Book to bill ratio	3.6	3.5	3.3	2.6

Source: Company, India Infoline Research

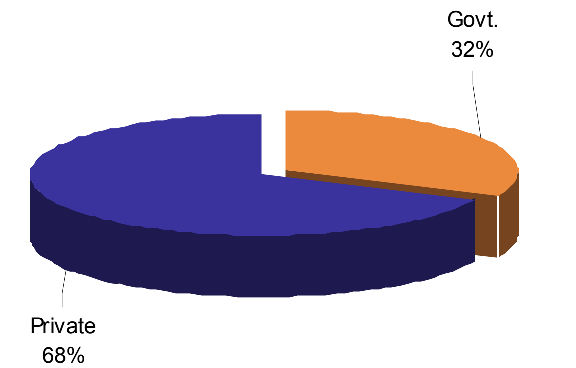
The order book of the Company has grown at a CAGR of 50% over the past five years and is expected to grow 14% over the next 2 years, with significant contribution from the infrastructure segment, which is estimated to increase at a CAGR of ~60%. The Company received its long pending payment from Emaar MGF for Commonwealth Games Village project, helping it address its short-term concerns, thereby infusing sufficient liquidity in the project and ramping up execution.

Government orders will provide cushion against uncertain private orders

Focus on government contracts to abide slowdown

ACIL has diversified its client base and has forayed into government contracts to have a good mix of private and public projects to abide slowdown in earnings and order book growth. The government orders will put pressure on the margins, but at the same time will provide earning visibility in uncertain environment. Historically the company was focused in executing projects for private clients like Mahindra & Mahindra, Asian Development Bank, DLF, SEBI and ITC grand. But to cushion itself from slowdown and order cancellation from private clients, the company has started bidding government projects in school development, hospitals and government institutes. Currently the company is executing commonwealth games project, which is of national importance.

Client-wise order book break-up



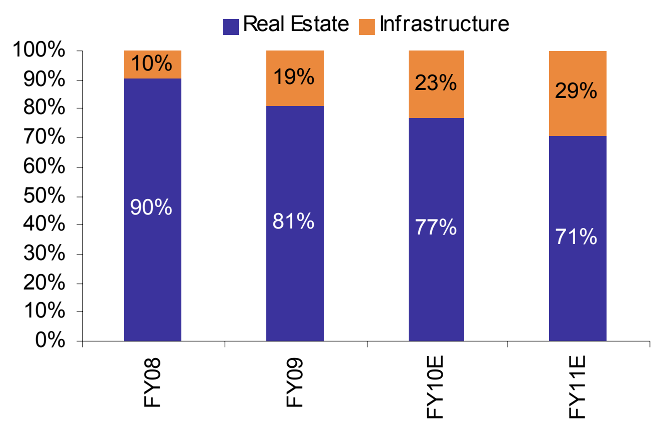
Source: Company, India Infoline Research

Venturing into new verticals of urban infrastruture

Expanding footprint in urban infrastructure projects

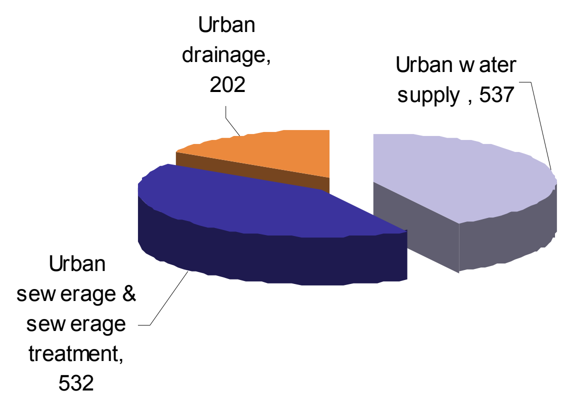
The company has increased focus on infrastructure and Government projects which would perk up the order book quality. ACIL is focus on multilevel car parking, metro railways, airports, power plants, sewage treatment, water treatment etc. The company is actively bidding for urban infrastructure projects (especially projects under the JNNURM scheme) like solid waste management and sewage treatment plants. The expected investment in urban infrastructure under JNNURM program is Rs1271bn. Huge potential for ACIL to increase its order book, the company expects to increase its urban infrastructure order book share to 30% by FY11 from current levels of 19%.

Increase in infrastructure OB



Source: Company, India Infoline Research

Expected investment under JNNURM (Rs bn)



Source: Planning commission

Acquisition or JV to enter into urban infrastructure space

The Company is now looking for technology collaborations and acquisitions in areas of detailed engineering and specific technology requirements in Sewage Water Treatment, Urban Drainage, Water Sanitation, Power Plant and Airports.

Low level of debt

Lowest debt/equity 0.5x

Relatively low debt levels (debt-equity ratio was 0.5 times as of March-09) and positive operating cash flows to leverage further to fund projects. The company is expected to have Rs2bn of capex in plant and machinery over next two years.

Debt/equity levels

	FY07	FY08	FY09	FY10E	FY11E
Debt/Equity	0.7	0.5	0.5	0.4	0.3

Building of bus terminal on BOT basis

Value unlocking through commercial development

ACIL has ventured into BOT space and is currently executing a DBOT project awarded by "Rajasthan State Road Transport Corporation" (RSRTC), to build a bus terminal, along with a commercial complex, at Kota, Rajasthan. After the completion of construction of the above said project, the bus terminal will be rendered to "Rajasthan State Road Transport Corporation" (RSRTC) while the commercial complex will remain in the possession of ACIL for the next 40 years, thereby accruing higher revenues for the Company.

Project details

Particulars	
Cost of project (Rs mn)	720
Funding of project	
Debt	420
lease deposits	100
Equity	200
Area of the project (sqm)	26343
Period for completion (mths)	18
Commercial property development (sqm)	23000
Concession period (years)	40

Source: Company, India Infoline Research

During the concession period the company would benefit from collection of rentals from commercial property, parking revenue and 50% of advertisement revenue. The expected equity IRR of the project is 23%. We have valued commercial project on 15% capitalized rate and arrived at a fair price of Rs7.3 per share.

Concerns

Slowdown in award of contracts

Since ACIL's order inflow is majorily from the private sector, any slowdown in the economic environment will eventually translate into lower order inflow for the company. This will negatively impact the company's earnings. However, we believe order inflow from the public sector will continue to remain robust, given its emphasis on developing infrastructure.

Long working capital cycle

The company operates in a working capital intensive industry. However, against the industry's 180 days of net working capital cycle, ACIL has proven its efficient cash management through a significantly shorter cycle of 74 days. However, this will need to be funded incase the profitability declines.

Small Player in the industry

The Company may face trouble on its commercial and retail project portfolio given that the sector is yet to demonstrate clear signs of a revival. The company may also have to depend on consortiums for the time being to gain a firm foothold in BOT projects in the infrastructure space. This may lead to less lucrative returns until it gains independent qualification.

Best play in the contractor space, Initiate with BUY

ACIL's Rs46bn order book provides significant earnings visibility for the next three years. Its well diversified client base reduces riskiness by limiting its exposure to private clients. The company is placed in a sweet spot as 82% of its order book comes from the real estate sector, which is subject to further growth given revival in real estate sector. With change in business mix, order inflow and zero debt levels, we expect margins to contract by 20bps, thus translating into 19% earnings growth. We value the core contracting business at 13x FY11E EPS and BOT project at 15% capitalized rate. Initiate coverage with a BUY rating and a target price of Rs214.

Valuation Matrix

Particulars	Method	Per share
Core Business-Project Division	13x FY11E EPS	206
BOT- real estate	Cap Rate 15%	7
Target price		**214**

Source: Company, India Infoline Research

Financials

Income statement

Y/e 31 Mar (Rs m)	FY08	FY09	FY10E	FY11E
Revenue	8,801	11,916	14,957	20,273
Operating profit	**1,063**	**1,463**	**1,810**	**2,453**
Depreciation	(228)	(479)	(626)	(830)
Interest expense	(118)	(192)	(205)	(206)
Other income	65	88	90	92
Profit before tax	**781**	**880**	**1,069**	**1,509**
Taxes	(265)	(308)	(364)	(513)
Adj. profit	**517**	**573**	**706**	**996**
Net profit	**517**	**573**	**706**	**996**

Balance sheet

Y/e 31 Mar (Rs m)	FY08	FY09	FY10E	FY11E
Equity capital	126	126	126	126
Reserves	1,124	1,646	2,308	3,260
Net worth	**1,250**	**1,771**	**2,433**	**3,385**
Debt	565	915	976	1,082
Def tax liab (net)	(38)	(121)	(121)	(121)
Total liabilities	**1,778**	**2,565**	**3,288**	**4,347**
Fixed assets	1,208	1,505	2,151	2,944
Investments	42	1	1	1
Net working capital	**(638)**	**159**	**120**	**162**
Inventories	755	1,350	1,710	2,317
Sundry debtors	2,261	3,155	3,961	5,368
Other current assets	330	440	557	755
Sundry creditors	(3,871)	(4,651)	(5,903)	(8,001)
Other current liabilities	(113)	(135)	(205)	(278)
Cash	1,165	901	1,017	1,240
Total assets	**1,778**	**2,565**	**3,288**	**4,347**

Cash flow statement

Y/e 31 Mar (Rs m)	FY08	FY09	FY10E	FY11E
Profit before tax	781	880	1,069	1,509
Depreciation	228	479	626	830
Tax paid	(265)	(308)	(364)	(513)
Working capital Δ	489	(797)	40	(43)
Operating cashflow	1,233	255	1,371	1,784
Capital expenditure	(668)	(776)	(1,272)	(1,623)
Free cash flow	**566**	**(521)**	**99**	**161**
Equity raised	(27)	(15)	(8)	(8)
Investments	0	42	-	-
Debt finag/diposal	(27)	350	61	106
Dividends paid	(36)	(36)	(36)	(36)
Other items	(27)	(83)	-	-
Net Δ in cash	**448**	**(264)**	**116**	**223**

Key ratios

Y/e 31 Mar	FY08	FY09	FY10E	FY11E
Growth matrix (%)				
Revenue growth	31.5	35.4	25.5	35.5
Op profit growth	52.1	37.7	23.7	35.5
EBIT growth	62.5	19.2	18.8	34.6
Net profit growth	64.1	10.8	23.2	41.2
Profitability ratios (%)				
OPM	12.1	12.3	12.1	12.1
EBIT margin	10.2	9.0	8.5	8.5
Net profit margin	5.9	4.8	4.7	4.9
RoCE	57.0	49.4	43.5	44.9
RoNW	50.5	37.9	33.6	34.2
RoA	11.0	8.7	8.4	9.0
Per share ratios				
EPS	8.2	9.1	11.2	15.9
Dividend per share	0.7	0.7	0.7	0.7
Cash EPS	11.9	16.8	21.2	29.1
Book value per share	19.9	28.2	38.8	53.9
Valuation Ratios				
P/E (x)	21.0	19.0	15.4	10.9
price/CEPS	14.6	10.3	8.2	5.9
Price/Book (x)	8.7	6.1	4.5	3.2
EV/EBITDA (x)	9.7	7.4	6.0	4.4
Payout (%)				
Dividend payout	7.0	6.4	5.2	3.7
Tax payout	33.9	34.9	34.0	34.0
Liquidity ratios				
Debtor days	94	97	97	97
Inventory days	31	41	42	42
Creditor days	161	142	144	144

Du-Pont Analysis

Y/e 31 Mar (Rs m)	FY08	FY09	FY10E	FY11E
Tax burden (x)	0.66	0.65	0.66	0.66
Interest burden (x)	0.87	0.82	0.84	0.88
EBIT margin (x)	0.10	0.09	0.09	0.08
Asset turnover (x)	1.88	1.82	1.79	1.84
Financial leverage (x)	4.58	4.34	3.98	3.78
RoE (%)	**50.5**	**37.9**	**33.6**	**34.2**

Recommendation parameters for fundamental reports:

Buy – Absolute return of over +10%

Market Performer – Absolute return between -10% to +10%

Sell – Absolute return below -10%

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