

**MAY 26, 2010**
**UPDATE**

 Coverage view: **Attractive**

 Price (Rs): **145**

 Target price (Rs): **215**

 BSE-30: **16,022**
**Low valuations belie earnings potential from strong order book, provide entry.**

IVRCL is trading at 8XFY2011E P/E, about 30% discount to its five-year average. The stock price may be impacted by perceived overexposure to AP government orders. It does not fully reflect the earnings potential of the strong backlog, which now reflects well diversified incremental order inflows. Core construction returns are reasonable but infra and real estate investments dilute these. Having separated these into a subsidiary would help IVRCL. Maintain estimates; BUY (TP : Rs215).

**Company data and valuation summary**

IVRCL

**Stock data**

52-week range (Rs) (high,low) 213-131

Market Cap. (Rs bn) 38.8

**Shareholding pattern (%)**

Promoters 9.7

FII's 57.4

MFs 9.8

**Price performance (%)**

	1M	3M	12M
Absolute	(17.3)	(9.0)	1.9
Rel. to BSE-30	(8.6)	(7.7)	(11.5)

**Forecasts/Valuations**

	2010	2011E	2012E
EPS (Rs)	7.8	10.3	12.4
EPS growth (%)	(7.7)	32.4	19.7
P/E (X)	18.6	14.0	11.7
Sales (Rs bn)	53.1	66.5	85.2
Net profits (Rs bn)	2.1	2.8	3.3
EBITDA (Rs bn)	5.0	6.3	7.8
EV/EBITDA (X)	10.3	8.5	7.3
ROE (%)	10.9	12.8	13.5
Div. Yield (%)	0.3	0.3	0.3

**QUICK NUMBERS**

- News reports suggest IVRCL may secure a Rs30 bn NHAI project
- High core capital return facilitates about 20% growth without dilution
- Orders worth Rs17 bn for FY2011E, so far

**Low valuations, about 30% discount to five-year average, possibly led by overstated AP concern**

IVRCL is trading at about 30-35% discount to five-year historical average multiple (P/E, EV/EBITDA and EV/Backlog). We believe the low valuation may have been led by (1) concerns over exposure to Andhra Pradesh government projects, and (2) high FII holding leads to underperformance in case of FII outflows. The company has demonstrated its ability to secure orders from agencies other than AP state government, however, we believe the stock price does not fully reflect the earnings potential of the strong order backlog, particularly from recently secured projects.

**Core construction returns reasonable (14% RoCE; 18% RoE), diluted by real estate and infra**

Our analysis of core ROCE and ROE of construction companies—after adjusting the capital employed and net worth for loans to and investments in subsidiaries—shows reasonable adjusted ROCE of about 14% and thus levered ROE of about 18-20% on an FY2009 basis. Reported returns are lower because of investments and loans and advances to real estate and infrastructure subsidiaries. IVRCL's newly separated real estate and infrastructure businesses into a step-down subsidiary is likely to raise its own capital, thus reducing the burden on the parent balance sheet.

**Reasonable 4QFY10E estimates, about 12% yoy revenue growth with slight margin expansion**

We estimate that IVRCL would report 4QFY10E revenues of about Rs18 bn, up 12% yoy with EBITDA margins of about 9.4%, up 70 bps yoy. On an FY2010E basis, we believe revenue would be about Rs53 bn, up 9% yoy. EBITDA margin is expected to be about 9.5%, up 90 bps yoy. PAT is expected at Rs2.1 bn, down about 8% yoy.

**Maintain estimates, revise target price of Rs215 based on Sep-11E; reiterate BUY**

We retain our earnings estimates at Rs7.8 and Rs10.3 for FY2010E and FY2011E. Our SOTP-based TP of Rs215/share comprises (1) core business valuation of Rs148/share (based on 13X Sep-11E P/E), (2) IVRCL Assets' contribution of Rs54/share, and (3) Rs13/share contribution from Hindustan Dorr Oliver. Retain BUY on (1) attractive valuations, (2) strong likely near-term earnings growth, (3) high revenue visibility and (4) long-term outlook for infrastructural investments.

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### Reasonable 4Q estimates –12% yoy revenue growth, slight margin expansion

We estimate that IVRCL would report 4QFY10E revenues of about Rs18 bn, up 12% yoy. EBITDA margins are expected to be 9.4%, up 70 bps yoy. The company is expected to record PAT of Rs0.8 bn, almost flat yoy, as we have built in a full tax rate of 34% for FY2010E. On an FY2010E basis, we believe revenue would be about Rs53 bn, up 9% yoy. EBITDA margin are expected to be about 9.5%, up 90 bps yoy. PAT is expected at Rs2.1 bn, down about 8% yoy, on account of full tax rate assumption.

IVRCL - 4QFY10E estimates - key numbers (Rs mn)

	4QFY10E	4QFY09	3QFY10	% chg.		9MFY10	9MFY09	% chg.	FY2010E	FY2009	% chg.
				4QFY09	3QFY10						
<b>Net Sales</b>	<b>18,225</b>	<b>16,272</b>	<b>11,840</b>	<b>12.0</b>	<b>53.9</b>	<b>34,879</b>	<b>32,546</b>	<b>7.2</b>	<b>53,104</b>	<b>48,819</b>	<b>8.8</b>
Expenditure	(16,503)	(14,853)	(10,685)	11.1	54.5	(31,583)	(29,729)	6.2	(48,086)	(44,601)	7.8
<b>EBITDA</b>	<b>1,722</b>	<b>1,420</b>	<b>1,156</b>	<b>21.3</b>	<b>49.0</b>	<b>3,296</b>	<b>2,817</b>	<b>17.0</b>	<b>5,018</b>	<b>4,218</b>	<b>19.0</b>
Other income	33	87	39	(62.3)	(15.9)	135	212	(36.1)	168	299	(43.8)
Interest	(318)	(392)	(368)	(18.9)	(13.8)	(1,111)	(917)	21.2	(1,429)	(1,306)	9.4
Depreciation	(215)	(134)	(139)	59.8	54.8	(401)	(339)	18.5	(616)	(473)	30.2
<b>Profit before tax</b>	<b>1,222</b>	<b>980</b>	<b>688</b>	<b>24.7</b>	<b>77.8</b>	<b>1,919</b>	<b>1,773</b>	<b>8.2</b>	<b>3,141</b>	<b>2,738</b>	<b>14.7</b>
Tax	(434)	(181)	(229)	138.9	89.0	(622)	(302)	106.0	(1,055)	(478)	120.8
<b>Profit after tax</b>	<b>789</b>	<b>799</b>	<b>458</b>	<b>(1.3)</b>	<b>72.1</b>	<b>1,297</b>	<b>1,471</b>	<b>(11.8)</b>	<b>2,086</b>	<b>2,260</b>	<b>(7.7)</b>
<b>Key ratios (%)</b>											
<b>EBITDA margin</b>	<b>9.4</b>	<b>8.7</b>	<b>9.8</b>	<b>0.7</b>	<b>(0.3)</b>	<b>9.5</b>	<b>8.7</b>	<b>0.8</b>	<b>9.5</b>	<b>8.6</b>	
PBT Margin	6.7	6.0	5.8			5.5	5.4		5.9	5.6	
Net Profit margin	4.3	4.9	3.9			3.7	4.5		3.9	4.6	
Effective tax rate	35.5	18.5	33.4			32.4	17.0		33.6	17.5	

Source: Company, Kotak Institutional Equities estimates

### News run suggest IVRCL may secure a Rs30 bn NHAI project

News run suggest that IVRCL is likely to secure Rs30 bn road BOT project from NHAI which would be the largest toll road contract in India so far. The highway project is for BOT of 123 km highway on NH-17 on Maharashtra-Goa border.

### Core construction return ratios reasonable, diluted by extraneous investments

We have analyzed the core ROCE and ROE of construction companies after adjusting the capital employed and net worth for loans to and investments in subsidiaries respectively. The analysis shows that construction companies, such as IVRCL and Nagarjuna, have reasonable adjusted ROCE of about 14% and thus levered ROE of about 20% on FY2009 basis. Reported returns are lower than this because of investments and loans and advances to real estate and infrastructure subsidiaries.

IVRCL has separated real estate and infrastructure business into a separate step-down subsidiary, which may raise its own growth capital, thus reducing burden on parent balance sheet. We believe that this would help IVRCL parent company to realize full business potential in terms of returns possible from core construction business without the overhang of financing subsidiaries, if the subsidiaries can raise capital depending on market perception and environment. This would also reduce the overhang of equity dilution at the parent company level.

## Key asset efficiency parameters of construction companies, March fiscal year-ends, 2007-11E

	IVRCL			Nagarjuna			L&T (standalone)		
	FY2009	FY2010E	FY2011E	FY2009	FY2010E	FY2011E	FY2009	FY2010E	FY2011E
<b>Key numbers (Rs bn)</b>									
Capital Employed	32.2	34.2	39.3	29.5	36.9	42.5	190.2	254.9	270.0
Net worth	18.1	20.2	22.8	16.9	22.3	24.4	124.4	179.5	209.5
Net fixed assets	5.4	6.1	6.9	4.9	5.5	6.3	50.5	61.1	67.6
<b>Adjustments related to subs/JVs</b>									
Investment in subsidiaries	3.9	4.3	4.6	7.4	8.8	9.0	19.8	50.6	60.6
Loans and Advances to subs	5.2	5.2	4.2	3.1	3.1	3.1	23.6	23.6	23.6
<b>Key ratios (%)</b>									
ROCE	10.5	9.2	10.4	9.7	10.4	10.5	18.3	14.6	14.5
ROCE (adj.)	14.6	12.7	13.9	14.7	15.8	15.0	23.4	19.8	20.8
ROE	13.2	10.9	12.8	9.4	11.3	11.6	24.7	19.2	18.0
ROE (adj.)	21.8	18.2	21.3	22.9	23.9	24.2	31.4	25.5	24.4
Fixed asset turnover ratio (X)	10.7	9.2	10.3	8.1	10.5	11.1	7.9	6.5	6.9
<b>CROCI</b>									
Cash return	2.9	3.6	4.5	2.7	3.6	4.4	26.6	29.2	35.1
Cash Invested	23.0	25.3	31.3	19.4	25.3	30.8	80.5	98.2	134.9
CROCI (%)	12.8	14.1	14.3	13.8	14.4	14.2	33.1	29.8	26.0

Note:

(1) Cash return = EBIT \* (1 - effective tax rate) + depreciation and amortization.

(2) Cash invested = Gross fixed assets (gross block) + net working capital.

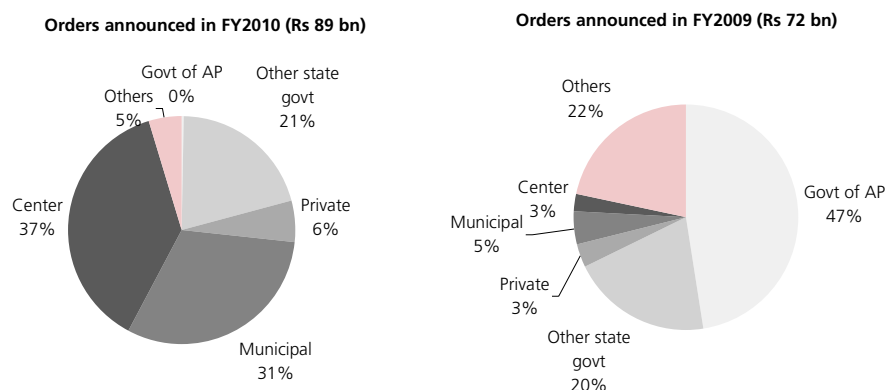
Source: Company, Kotak Institutional Equities estimates

**Strong order inflows; diversified away from Andhra government projects**

IVRCL has been able to successfully diversify away its order inflows from Andhra Pradesh (AP) state government projects while the total value of announced orders in FY2010 have still grown by about 25% yoy. AP state orders, which comprised about 50% of announced orders inflows in FY2009, are virtually non-existent in announced inflows in FY2010. Exposure to AP state government orders has been a big concern as the socio-political instability in the state has led to slow execution not only for IVRCL but for construction peers such as HCC and Patel Engineering. The ability to secure projects from agencies other than AP government demonstrates company's strong execution capabilities and alleviates concerns of AP exposure.

**IVRCL has diversified away from Andhra Pradesh state government orders in FY2010**

Customer-wise mix of orders announced by IVRCL, March fiscal year-ends, 2009-10

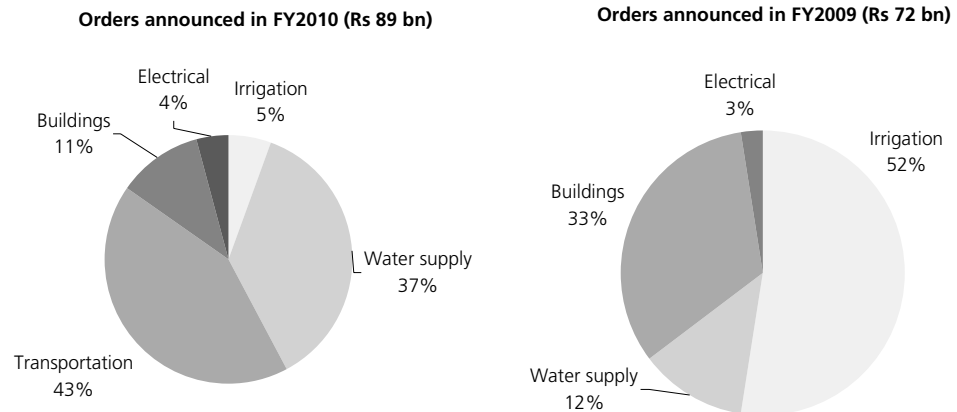


Source: Company, Kotak Institutional Equities

### Segment mix tilts towards roads from water supply and buildings

IVRCL has secured road projects worth Rs38 bn (Rs30 bn from NHA) in FY2010 which form 43% of the announced orders. Large projects wins in transportation segment have more than compensated for slow inflows in water resources (potentially due to lack of ordering activity from AP state government) and in the building segments.

**Road and water supply projects more than compensated for slow inflows in buildings and irrigation**  
Segment-wise mix of orders announced by IVRCL, March fiscal year-ends, 2009-10



Source: Company, Kotak Institutional Equities

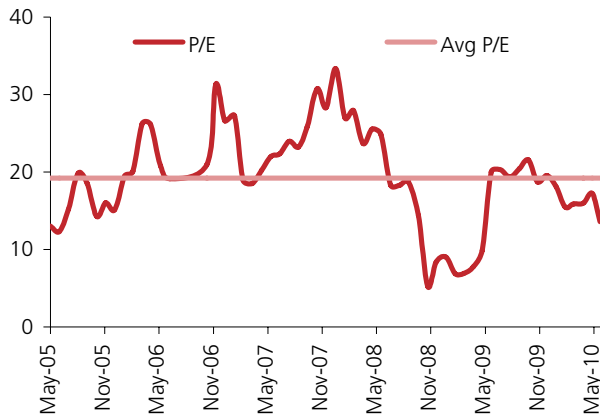
IVRCL has announced total orders worth Rs45 bn in 4QFY10 which include road projects that were earlier declared at L1. The company has also reported orders worth Rs16.6 bn secured for FY2011E so far.

## List of orders announced by IVRCL in FY2010 and FY2011 so far

Date	Nature of Work	Segment	Value (Rs mn)	Agency	Customers
May-10	Construction of automotive test tracks at Pithampur and Chennai	Roads	5,260	Center	National Automotive Testing and R&D Infra Project
May-10	EPC for Ranchi water supply project under JNNURM	Water supply	2,347	State Govt	Drinking Water and Sanitation Dept, Jharkhand
May-10	Residential building works	Buildings	621	Others	IOCL, Paradip
Apr-10	EPC of pump-turbine and generator-motor for Koyna left bank	Water supply	4,600	Municipal	Water Resource Dept, Mumbai
Apr-10	Tower package for Pallantana GBPP and Bongalgaon TPS	Transmission	2,505	Center	Power Grid Corporation of India Ltd
Apr-10	Civil wok for coal handling for Rihand TPS III (2X500 MW)	Buildings	1,220	Private	FLSmith, Tamil Nadu
<b>Total announced in FY2011 so far</b>			<b>16,553</b>		
Mar-10	Eastern Kosi canal system	Irrigation	3,229	State Govt	Water resource department, Birpur, Bihar
Mar-10	Hogenakkal water supply and fluorosis mitigation project	Water supply	2,357	State Govt	Tamil Nadu water supply and drainage board
Mar-10	City water supply and sewerage project II	Water supply	2,106	Municipal	Bangalore water supply and sewerage board
Mar-10	Sewerage system to Bommanahalli areas	Water supply	984	Municipal	Bangalore water supply and sewerage board
Feb-10	BOT project for 55 km Chengapalli - Coimbatore highway	Roads	11,250	Center	NHAI
Jan-10	BOT project for Indore - Gujarat/MP border highway	Roads	15,500	Center	NHAI
Jan-10	Balance work for 4 laning of 44 km Bhogpur-Mukerian	Roads	3,600	Center	NHAI project in Punjab
Jan-10	Distribution system for water supply to Ambattur municipality	Water supply	1,233	Municipal	Chennai Metropolitan Water Supply & Sewage Board
Jan-10	Construction of drinking water supply system for Hemavathy project	Water supply	1,424	State Govt	Cauvery Neeravary Nigam Ltd, Govt. of Karnataka
Jan-10	Civil and EM work for multiple reservoirs in Karnataka	Water supply	1,336	Municipal	Bangalore Water Supply and Sewage Board
Jan-10	Multiple building, power and water supply projects	Buildings	1,989	Others	HPCL, Tata Teleservices, MRPL, PGCIL, Govt. of Jharkhand
Dec-09	Kapurbawadi-Bhandpur tunnel	Water supply	5,730	Municipal	Brihan Mumbai Mahanagar Palika, 50% JV
Nov-09	Construction of tunnel from Kapurbawadi to Bhandup Complex	Water supply	5,729	Municipal	Municipal Corporation of Greater Mumbai
Oct-09	Construction of building towers, hospital and hotel	Buildings	2,363	Private	Kakade Infrastructure, Pune
Oct-09	Sewerage works	Water supply	2,870	Municipal	UP Jal Nigam, Allahabad
Sep-09	Various works	Buildings	1,570	Municipal	NSG Kolkata, CIDCO Navi Mumbai and others
Sep-09	Four laning of Baramati-Phaltan and Phaltan-Lonand to Shirwal	Roads	4,000	State Govt	Govt of Maharashtra
Aug-09	Vallur Thermal power project	Power	572	Center	NTPC Tamil Nadu Energy Company Ltd
Aug-09	Laying and joining MS pipes	Water supply	1,041	Others	Busawath Thermal Power Station
Aug-09	Tansa mains from Tansa to Tarali	Water supply	4,213	Municipal	Municipal Corporation of Greater Mumbai
Aug-09	External coal handling system	Buildings	194	Private	FLSmith Minerals Pvt. Ltd, Tamil Nadu
Aug-09	Various building works	Buildings	765	Others	IOCL, Paradip and AP Medical housing Infrastructure
Aug-09	2,500 MW HVDC terminal stations	Transmission	805	Private	Siemens Ltd, Gurgaon
Aug-09	Construction of mechanized canal lining	Irrigation	1,628	State Govt	Maharashtra Krishna Valley Development Corporation
Aug-09	Upgradation of Darbhanga-Kamtaul-Basaitha-Madhwapur road	Roads	1,570	State Govt	Govt of Bihar
Jun-09	Construction of R.O.B	Roads	176	GoAP	Govt of Andhra Pradesh
Jun-09	Tower package works	Transmission	1,209	Center	Power Grid Corporation of India Ltd
Jun-09	Civil and structural works	Buildings	215	Private	Hindustan Dorr-Oliver Ltd
Jun-09	Construction of buildings	Buildings	235	State Govt	Uttar Pradesh Rajkiya Nirman Nigam
Jun-09	Construction of quarters, office, hospital for refinery township	Buildings	465	Others	Indian Oil Corporation Ltd, New Delhi
Jun-09	Construction of hospital building	Buildings	578	State Govt	Uttar Pradesh Rajkiya Nirman Nigam
Jun-09	External coal handling system for Mundra, Gujarat	Buildings	1,446	Private	Coastal Gujarat Power Ltd, Mumbai
May-09	Water supply scheme	Water supply	2,990	State Govt	Public Health Engg Dept, Govt of Bihar
Apr-09	Rehabilitation of water treatment plant	Water supply	422	Municipal	Project Implementation Unit, Thrissur Corporation
Apr-09	Pump house ducts and cold water channel	Water supply	347	State Govt	UP Rajya Vidyut Utpadan Nigam Ltd
Apr-09	Tower package works	Transmission	298	Center	Power Grid Corporation of India Ltd
Apr-09	Supply of equipment and materials for tower package	Transmission	779	Center	Power Grid Corporation of India Ltd
Apr-09	Construction of Vivekananda road flyover	Roads	1,646	Municipal	Kolkata Metropolitan Development Authority
Apr-09	Construction of R.O.B	Roads	103	GoAP	Govt. of AP, Roads & Buildings Department
<b>Total announced in FY2010</b>			<b>88,965</b>		

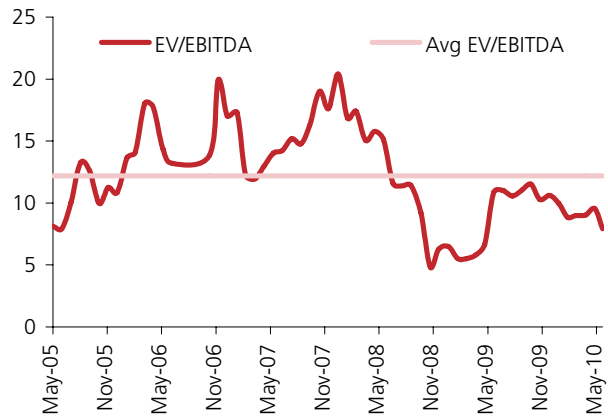
Source: Company, Kotak Institutional Equities

**IVRCL is trading at 30% discount to historical P/E**  
 IVRCL P/E on 12-mth rolling forward EPS, May-05–May-10



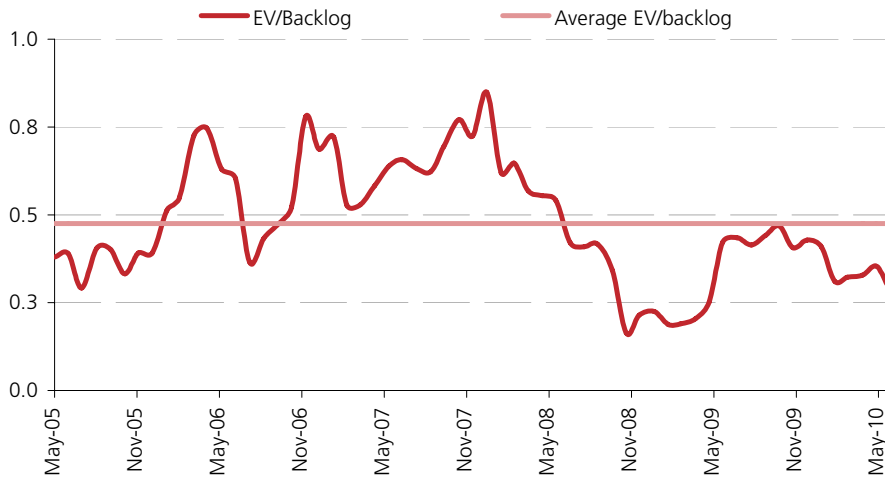
Source: Company, Kotak Institutional Equities estimates

**IVRCL is trading at 35% discount to historical EV/EBITDA**  
 IVRCL EV/EBITDA on 12-mth rolling forward EBITDA, May-05–May-10



Source: Company, Kotak Institutional Equities estimates

**Currently trading at 0.3X EV/Backlog, about 35% discount to last five-year average of 0.47X**  
 EV/Backlog chart for IVRCL based on quarterly order backlog, May-05 to May-10



Source: Company, Factset, Kotak Institutional Equities estimates

Construction stocks currently trade at an average P/E of about 10X and EV/EBITDA of 7.1X based on FY2011E earnings  
Comparison of valuation of various construction companies in India, March fiscal year-ends 2010-12E (Rs bn)

Company	Revenues				EBITDA				EPS (Rs)				P/E (X)			EV/EBITDA (X)		
	2009	2010E	2011E	2012E	2009	2010E	2011E	2012E	2009	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E
Nagarjuna Constrn	42	55	65	79	3.7	5.2	6.2	7.4	6.7	8.6	10.5	12.7	13.3	10.9	9.0 #	7.9	6.6	5.5
Punj Lloyd Ltd.	119	122	140	156	4.4	10.9	12.9	14.4	(7.4)	9.8	14.0	16.6	12.9	9.0	7.6 #	7.2	5.8	5.0
IVRCL Infrastructure	49	53	67	85	4.1	5.0	6.3	7.8	16.9	7.8	10.3	12.4	10.0	7.6	6.3 #	6.7	5.7	5.0
L&T standalone	339	370	458	574	39.2	48.2	56.2	70.1	46.3	52.7	62.6	78.1	22.7	19.1	15.3 #	16.2	13.8	10.9
Sadbhav Engg	11	13	18	25	1.1	1.4	2.0	2.9	50.6	43.1	65.7	94.6	5.9	3.8	2.7 #	5.0	3.5	3.7
<b>Average</b>	<b>112</b>	<b>122</b>	<b>150</b>	<b>184</b>	<b>10.5</b>	<b>14.1</b>	<b>16.7</b>	<b>20.5</b>					<b>12.9</b>	<b>10.1</b>	<b>8.2 #</b>	<b>8.6</b>	<b>7.1</b>	<b>6.0</b>

**Note:**

- (1) For Nagarjuna - adjusted Rs42/share for infrastructural investments (Rs26/share) and book value of real estate investments (Rs16/share).
- (2) For Punj Lloyd estimates are based on consolidated estimates as they do not have any BOT projects.
- (3) For IVRCL - adjusted value of IVR Prime (Rs54/share) and HDO (Rs13/share) for a total adjustment of Rs67/share.
- (4) For L&T - deducted about Rs365/share, our total valuation of the value of subsidiaries/associates/JVs/investments.
- (5) For Sadbhav Engineering - deducted Rs979/share as value of BOT projects.

Source: Bloomberg estimates, Kotak Institutional Equities estimates

Derivation of SOTP based target price for IVRCL

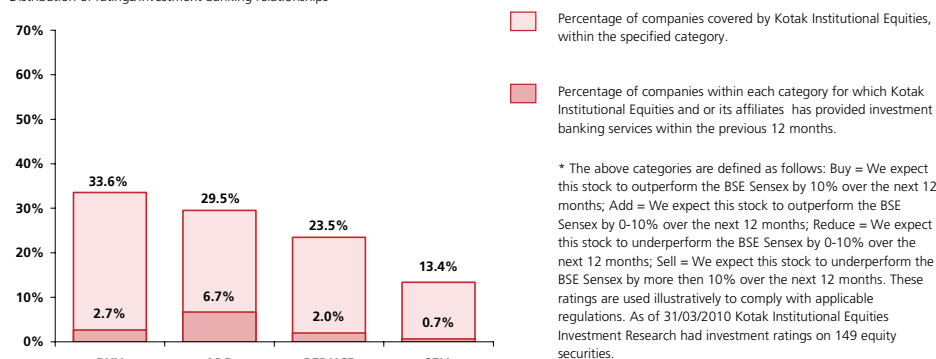
Project/ Business	Valuation		Valuation methodology
	(Rs mn)	Rs/ share	
Value of core construction business	39,885	148	P/E multiple of 13X Sep-11E earnings
Value of Hindustan Dorr Oliver	3,502	13	Discount to market price
Value of IVRCL Prime Developers Ltd	14,610	54	Discount to market price
<b>Total</b>		<b>215</b>	

Source: Kotak Institutional Equities estimates

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Source: Kotak Institutional Equities

As of March 31, 2010

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