Result Update – Q2FY12

Sadbhav Engineering Ltd.

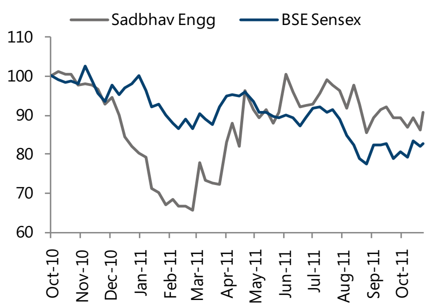
Worst case in the price. Maintain Buy

Buy

Reco	Maintained
CMP	₹ 131
Target Price	₹ 163
Upside Potential	24%

Price Performance

52 wk Hi/Lo	158/91
All time Hi/Lo	164/20
6 mnth Average Vol	67149
Stock Beta	0.49



Valuation

	FY11	FY12P	FY13P
P/E (x)	16.3	13.5	11.9
P/BV (x)	3.1	2.6	2.1
RONW (%)	23.5	20.9	19.6
ROCE (%)	21.7	22.0	21.4

Peer Valuation (FY12P)

	IRB	ITNL
PE	10.9	8.4
P/BV	2.1	1.4

Equity Data

Market Cap. (₹ bln)	20
Face value (₹)	1
No of shares o/s (mln)	150

	Jun'10	Jun'11	Δ%
Promoters	47.55	47.59	0.08
DFI's	18.20	18.01	-1.04
FII's	23.85	23.11	-3.10
Public	10.40	11.29	8.56

Rahul Metkar
rahul.metkar@msflibg.in
(+ 91 22 3094 7115)

Ashish Kumar
ashish.kumar@msflibg.in
(+ 91 22 3094 7116)

November 3, 2011

Sadbhav Engineering continues to outpeform the industry albeit among rising concerns on sustainability of the same due to lack of order inflow (we have been sharing the same concern with investors since Q4FY11). However, the management sounded cautiously optimistic on order intake target to avoid any mis-adventure from the risks of unknown emanating from systemic and/or project specific issues. In our view, although management's strategy of not falling into the growth trap (aggressive order intake->high growth->inc. in working capital requirement->inc. in leverage->erosion in profitablity->poor return ratios) may risk FY13E earnings, going conservative on order bidding in an increasingly competitive environment (particularly in road construction, also media reports suggest some competitively bid road assets are already under the hammer) & deteriorating capex cycle will provide stability to profitability and strengthen its balance sheet for any appropriate opportunities that may come in a stable & better macro environment. We believe, Sadbhav Engineering is well positioned for long term growth opportunities and remains our top pick in the sector. We reiterate our Buy with a PT of ₹ 163

Mgmt. to be conservative on order intake; to focus on EPC orders

The management, rightly so, has decided to go cautious on order intake due to concerns on heightened competition resulting in lower profitability & return on the orders and avoid any significant risks to the balance sheet. Instead the company intends to focus on EPC orders from entities which have won BOT projects and do not have an in-house EPC capability.

Order intake slips; downside risk to our FY13E estimate

While the order intake for H1FY12 has slipped significantly to ₹ 2bln the current order book stands at ₹ 62.5bln which sufficiently ensures double digit growth for FY12E and H1FY13E. Although we remain confident of Sadbhav adding atleast ₹ 22bln orders in H2FY12E, the timing of the same may delay execution & revenue recognition in FY13 posing a downside risk to our FY13E estimates.

Scenario Analysis: Worst case scenario already factored in

Our scenario analysis results indicate worst case scenario of no incremental order inflow in H2FY12 already being factored by the market. We believe investors should not be overwhelmed by 6 months delay in order intake and remain confident of the ability of the management to secure orders while maintaining profitability & return on investments

Execution of on track, early completion bonus a potential trigger; maintain Buy

Potential early completion bonus on 3 out of 5 BOT projects under construction, commencement of tolling in FY13 and growth prospects in a well-managed EPC arm underlies our investment thesis. We reiterate our Buy with a price target of ₹ 163.

Summary Financials

₹ in Mln	FY10	FY11	FY12P	FY13P
Net Sales	12,569	22092	27929	31922
OPBDIT	1,377	2258	2910	3383
Net Profit	538	1196	1444	1640
EPS	3.6	8.0	9.6	10.9
Net Worth	3,915	6257	7598	9133
Debt	4,242	3961	5961	5961
Fixed Assets	2,101	2298	2408	2587
Net Current Assets	4,756	4817	6710	8067

Exhibit 1: Quarterly Financials

(Figures in ₹ mln)	Q2FY12	Q2FY11	% chg	H1FY12	H1FY11	% chg
Net Sales	**4304**	**2609**	**65.0%**	**10433**	**6862**	**52.0%**
Total Expenditure	3851	2295	67.8%	9302	6042	54.0%
Construction Exp's	3468	2025	71.3%	8621	5576	54.6%
(% of sales)	80.5	77.6		82.6	81.3	
Staff Cost	91	49	87.7%	184	118	55.9%
(% of sales)	2.1	1.9		1.8	1.7	
Other Expenditure	292	221	31.9%	497	348	43.1%
(% of sales)	6.8	8.5		4.8	5.1	
EBIDTA	**453**	**314**	**44.1%**	**1131**	**821**	**37.8%**
EBIDTA Margin	10.5	12.0		10.8	12.0	
Interest	154	90	70.9%	279	206	35.8%
Depreciation	70	67	5.2%	139	131	6.2%
PBT From Operations	229	158	44.9%	712	484	47.1%
Other Income	52	51	3.5%	68	108	-36.6%
PBT after Extra items	**281**	**208**	**35.1%**	**780**	**592**	**31.9%**
Taxation	100	71	40.8%	260	199	31.0%
PAT	**181**	**137**	**32.2%**	**520**	**393**	**32.4%**
PAT Margin	4.2	5.3		5.0	5.7	

Source: Company, MSFL Research

Exhibit 2: Revenue Break up trend

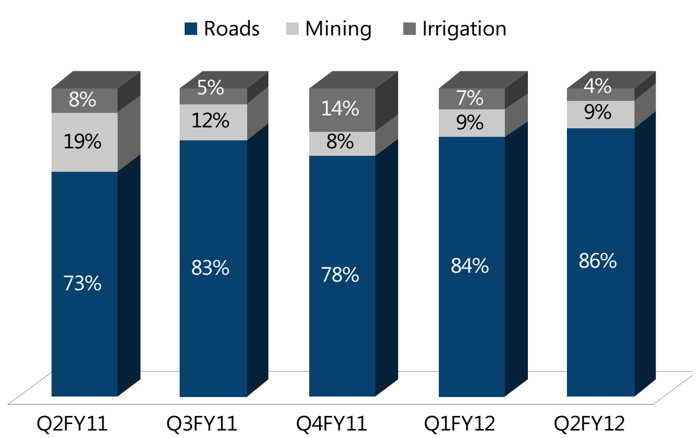
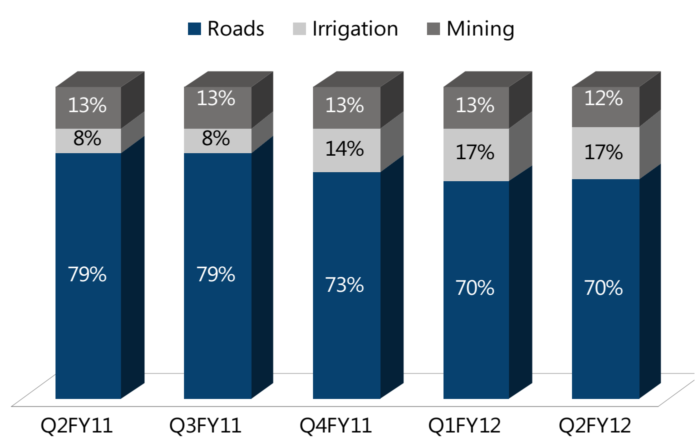


Exhibit 3: Order book Break up



Source: Company, MSFL Research

Order book comfortable for FY12 growth; inflow the key concern

The company's order book stands at ₹ 62.5bln as on Sep 30, 2011. The order book is dominated by roads (70%), followed by Irrigation (17%) and Mining (12%). Captive road BOT's order contribute 40% of the total order book.

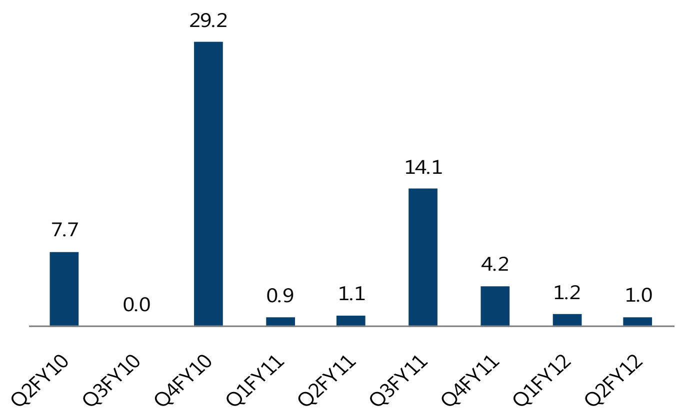
Exhibit 4: Segmental order book as on Sep 30, 2011

Sector	Value (₹ bln)
Road	43.6
Mining	7.8
Irrigation	11.3
Total	**62.5**

Source: Company

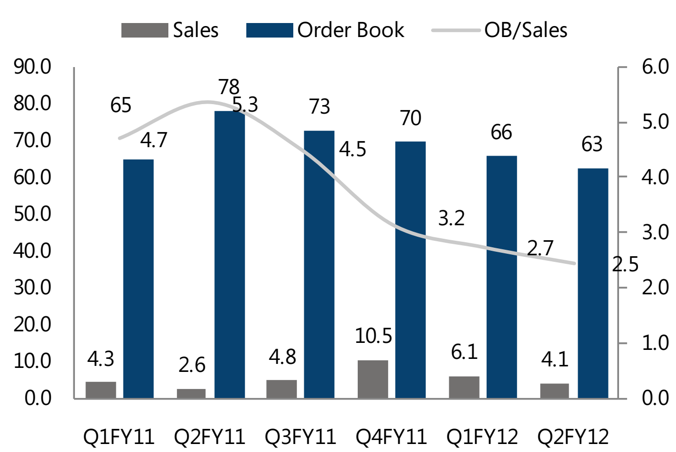
Order inflow has continued to be dismal in Q2FY12. Company bagged a single order worth ₹ 1.01bln in the road segment in Bihar. However, company remains hopeful of order inflow in H2FY12 as it has submitted bids worth ₹ 90.2bln across the three segments wherein road remains the key focus area.

Exhibit 5: Order inflow trend in ₹ bln



Source: Company, MSFL Research

Exhibit 6: Traling OB/Sales trend



Source: Company, MSFL Research

Exhibit 7: Segmental RFP stage as on Sep 30, 2011

Sector	No of Projects	Value (₹ bln)
Road	6	72.5
Mining	4	12.5
Irrigation	3	5.2
Total		**90.2**

Source: Company, MSFL Research

Working capital deteriorates but remains under control

Unlike its peers Sadbhav's working capital cycle remains at 75days, which has slightly deteriorated by 9days as compared to that on Mar'11 due to decline in current liabilities. The current liabilities levels has reduced sequentially from 137days as on Mar'11 to 77days on account of decline in mobilization advance received from the clients.

Exhibit 8: Working Capital Analysis

Working Capital Analysis (Days)	Sep-11	Sep-10	Mar-11
Current Assets	**174**	**301**	**223**
Inventory	12	13	11
Sundry Debtors	79	129	113
Other Current Assets	3	1	1
Loans & Advances	80	159	97
Current Liabilities	**98**	**224**	**157**
Liabilities	77	219	137
Provisions	22	5	21
Net Current Assets	**75**	**77**	**66**
Leverage	**0.7**	**0.9**	**0.6**

Source: Company, MSFL Research

Key takeaways from Concall

- Sadbhav Engg has continued its strong revenue growth momentum in Q2FY12 on the back of higher execution on its captive BOT road projects. During the quarter road segment contributed ₹ 3735mln while mining and irrigation contributed ₹ 399mln and ₹ 169mln respectively.
- Road segment: Order inflow during this quarter remain muted in the road segment and bagged one road project worth ₹ 1.01bln in Bihar. However, company expects order inflow to pick up in H2FY12 as it has already submitted bids for 6 projects worth ₹ 72.5bln in the BOT road segment. Apart from BOT projects, company is hopeful of bagging EPC contracts from the BOT asset developers and is in talks with them.
- Company has no significant capex plan across the segment in FY12. However any major order inflow in mining segment may lead to a significant capex in mining segment.
- Company has already infused ₹ 5.75bln as equity for its BOT projects and requires additional ₹ 2.72bln over next two years.

BOT projects – Growth momentum continues

- o Aurangabad-Jalna: Toll collection for Q2FY12 stood at ₹ 61.6mln or ₹ 0.67mln per day. The road project recorded 15.08% y-o-y PCU growth.
- o Ahmedabad Ring Road: Toll collection for Q1FY12 increased by 21.9% and stood at ₹ 182.5mln or ₹ 2.01mln per day.

Exhibit 9: Toll collection trend of Aurangabad-Jalna

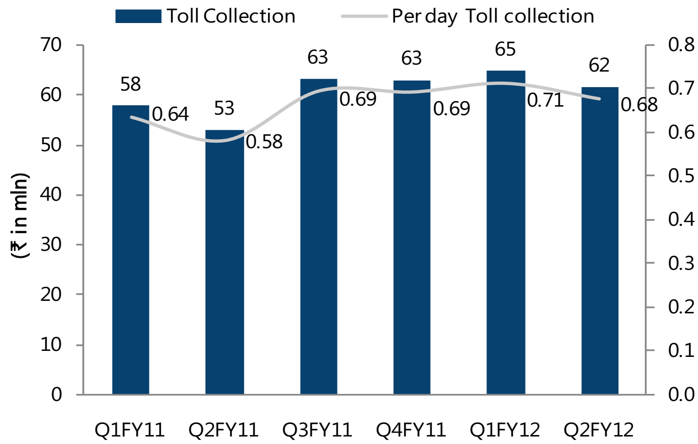
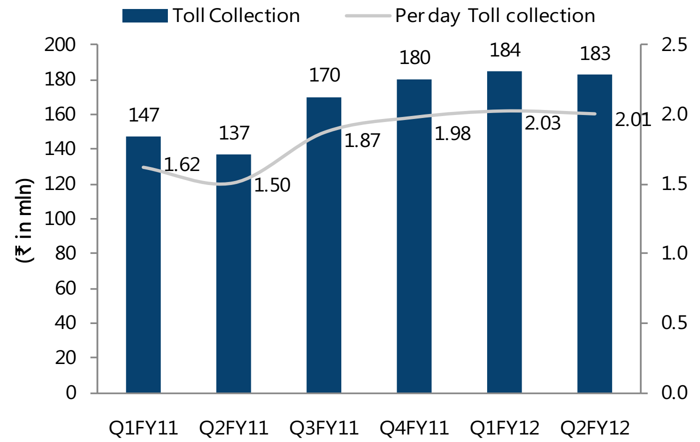


Exhibit 10: Toll collection trend of Ahmedabad Ring Road



Source: Company, MSFL Research

- Mumbai - Nashik: Work related to ROB is still pending since the company has still not received clearance from the railway authorities. Currently, the SPV is collecting an average of ₹ 3.1mln on a daily basis which it expects to increase upto ₹ 3.4mln by next year.
- Dhule – Palasner: The company has completed work amounting to 79% of the total project cost and expects to achieve COD by March 2012. Management is expecting to start toll collection on 75% of the stretch by Dec 2011. The outstanding receivable from this project stands at ₹ 3.0bln.
- Maharashtra Border Checkpost: The company has started work on 12 out of the 22 checkposts for which the company has received possession. Management expects construction work for 4 out of 12 check post to be completed by March 2012 and work on remaining 8 is expected to be completed by June 2012.
- Hyderabad – Yadigiri: The company has completed work amounting to ₹ 2.42bln of the total project cost and expects to achieve COD by March 2012 which is 3 month ahead of schedule. Management is expecting a toll collection of ₹ 0.61bln for FY13. We estimate a delay of 3 months due to non possession of 3.5km of land
- Bijapur - Hungud: The company has 100% of the required land in possession and has completed work amounting to ₹ 7.6bln (~75% of the total project cost). While the scheduled completion date is Mar'13 the company expects to achieve COD 3 months ahead of schedule.
- Rohtak - Panipat: The company has completed work worth ₹ 1785mln. Management indicated that project is ahead of schedule and is expected to achieve COD by March 2013.

Exhibit 11: Construction progress - Hyd-Yadigiri

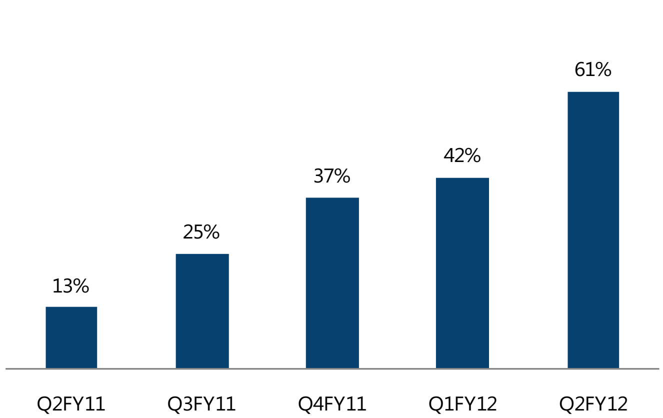


Exhibit 12: Construction progress - Bijapur-Hungud

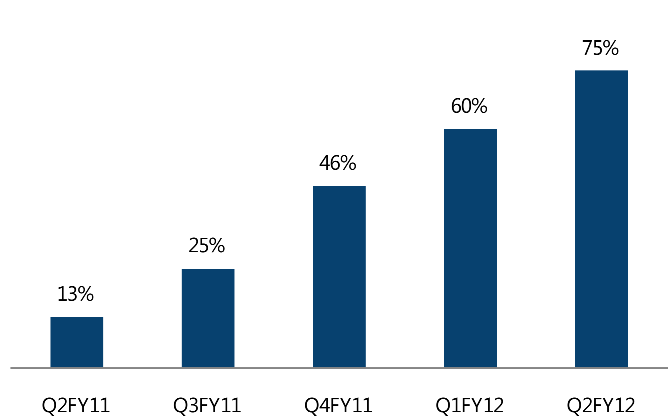


Exhibit 13: Construction progress - Dhule Palasner

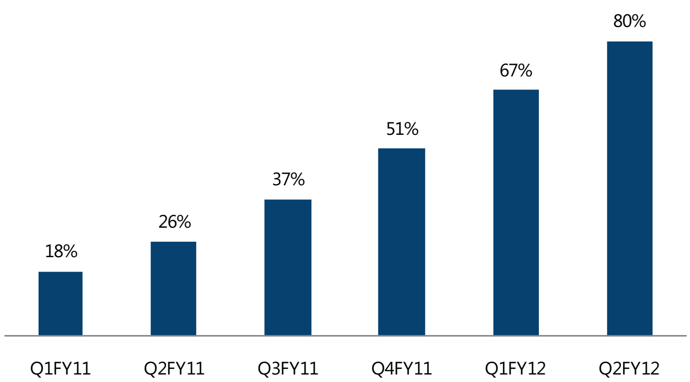
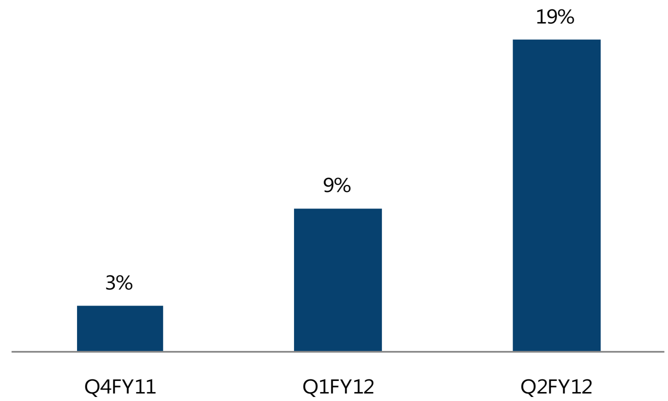


Exhibit 14: Construction progress - Rohtak Panipat



Source: Company, MSFL Research

Scenario Analysis – Markets already factoring in worst case scenario

We present below the sensitivity of our price target to order inflow and P/E multiple to the standalone earnings.

Base case – In our base case we have assumed an order inflow of ₹ 25bln in H2FY12 which translates into a target price of ₹ 163 based on 10x multiple for FY12E earnings of the EPC business & BOT valuation of ₹ 67. On discounting FY13E earnings for the EPC business, the target price increases to ₹ 174.

Worst case – We believe the market has become increasingly concerned about lack of significant order inflow and dependence on captive orders. To put to rest these concerns, we have assumed a worst case scenario of no incremental order inflow in H2FY12 and its effect thereof on earnings in FY12E/FY13E and valuations.

Exhibit 15: Financial performance in worst-case scenario

	Base case	Worst case		Base case	Worst case	
	FY12E	FY12E	% chg	FY13E	FY13E	% chg
Sales	27929	26640	-4.6%	31922	24572	-23.0%
EBITDA	2910	2777	-4.6%	3383	2612	-22.8%
PAT	1444	1371	-5.0%	1640	1197	-27.0%
EPS	9.6	9.2		10.9	8.0	

Source: MSFL Research

Although lack of any order inflow does not materially impact FY12E earnings, there is a siginificant decline of ~27% in FY13E should this scenario play out. However, we take comfort from the fact that the company is an established player, has showcased its capability in execution of large scale projects, has a conservative management & limited downside valuation support.

To prove our point on limited downside valuation support we have arrived at multiple target price & an implied EV/EBIDTA based on a range of P/E levels from 20% discount to 50% discount to its long term multiple for its EPC business. Considering, its peer viz. IVRCL Infra & NCC are currently trading in the range of 5.5-6.0x FY13E EV/EBIDTA we believe Sadbhav Engineering should atleast trade in a similar range if not higher since it's margins are higher & stable as compared to these players and is present in high margin Mining business which translates into a target price of ₹ 131 and a support P/E multiple of 8x. Hence, we believe the CMP of ₹ 131 is already factoring in the worst case scenario and investors should not be overwhelmed by 6 months delay in order intake.

Base case: ₹ 25bln order inflow in H2FY12

	Price Target (₹)		Implied EV/EBITDA	
P/E Multiple	FY12E	FY13E	FY12E	FY13E
10x	163	176	6.8	6.4
8x	144	154	5.8	5.4
6x	125	131	4.8	4.5

Worst case: Nil order inflow in H2FY12

	Price Target (₹)		Implied EV/EBITDA	
P/E Multiple	FY12E	FY13E	FY12E	FY13E
10x	158	147	6.8	6.6
8x	140	$\boxed{131}$	5.8	5.7
6x	122	115	4.9	4.8

Source: MSFL Research

Valuation – Maintain Buy

With strong EPC capability across multiple sectors & scale, entry in railway EPC works, higher capital efficiency and timely completion of its BOT assets Sadbhav Engineering remains our top pick in the sector. We maintain Buy with a PT of ₹ 163. We have valued the EPC entity at ₹ 96.4/share on the basis of 10x FY12P earnings. Factoring in Sadbhav Engineering's 20% stake dilution in SIPL, the road BOT projects contribute ₹ 66.9/share (41%) to the TP based on a DCF-FCFE approach.

At CMP of ₹ 131 the stock is trading at 13.5x & 11.9x FY12E & FY13E standalone earnings respectively and 2.6x & 2.1x FY12E & FY13E standalone BV respectively while adjusting to its BOT value it is trading at 6.5x FY12E & 5.7x FY13E standalone earnings.

Risk: As explained earlier, the worst-case scenario of no incremental order in H2FY12 remains a risk to our recommendation and price target.

Exhibit 16: SOTP - based valuation

Component	Method	Value per Share (₹)
Core entity	10x FY12P EPS	96.4
Road BOTs	DCF	66.9
Total		**163.3**

Source: MSFL Research

Financial Summary

Profit & Loss

Particulars (₹ in mln)	2009	2010	2011	2012P	2013P
Sales	**10,625**	**12,569**	**22,092**	**27,929**	**31,922**
Total Expenditure	9,542	11,193	19,834	25,019	28,540
EBIDTA	**1,083**	**1,377**	**2,258**	**2,910**	**3,383**
EBIDTA Margin (%)	10.2%	11.0%	10.2%	10.4%	10.6%
Depreciation	139	157	233	269	289
EBIT	944	1,220	2,025	2,642	3,093
Interest Cost	214	331	427	558	671
Operating Profit	730	889	1,598	2,084	2,423
Other Income	117	166	195	97	64
Extraordinary Items	-	-	-	-	-
PBT	**829**	**980**	**1,757**	**2,161**	**2,454**
Tax	192	328	562	716	813
PAT	**633**	**538**	**1,196**	**1,444**	**1,640**
PAT Margin (%)	6%	4%	5.4%	5.2%	5.1%
EPS	4.2	3.6	8.0	9.6	10.9
Sales Growth (%)	21%	18%	75.8%	26.4%	14.3%
EBITDA Growth (%)	6%	27%	64%	28.9%	16.2%
PAT Growth (%)	21%	-15%	122%	20.8%	13.6%

Balance Sheet

Particulars (₹ in mln)	2009	2010	2011	2012P	2013P
Sources of Funds					
Share Capital	125	125	150	150	150
Reserves & Surplus	3,310	3,790	6,107	7,448	8,983
Net Worth	**3,435**	**3,915**	**6,257**	**7,598**	**9,133**
Secured Loans	2,111	2,740	3,961	5,961	5,961
Unsecured Loans	-	1,502	-	-	-
Total Loans	**2,111**	**4,242**	**3,961**	**5,961**	**5,961**
TOTAL	**5,546**	**8,157**	**10,218**	**13,558**	**15,094**
Application of Funds					
Net Fixed Assets	**1,545**	**2,101**	**2,298**	**2,408**	**2,587**
Investments	1,246	1,441	3,264	4,601	4,601
Current Assets	5,920	10,092	14,341	15,892	17,688
Current Liabilities	3,064	5,336	9,524	9,182	9,620
Net Current Assets	**2,856**	**4,756**	**4,817**	**6,710**	**8,067**
Deferred Tax Asset (Net)	(110)	(141)	(161)	(161)	(161)
Misc Expense not w/o	8	-	-	-	-
TOTAL	**5,546**	**8,157**	**10,218**	**13,558**	**15,094**

Cash Flows

Particulars (₹ in mln)	2009	2010	2011	2012P	2013P
Internal accruals	807	884	1,464	1,734	1,962
Other adjustments	673	1,531	19	-	-
(Inc)/Dec in Net Current Assets	(1,050)	(1,552)	336	(2,609)	(766)
Cash flow from Operations	**430**	**863**	**1,820**	**(876)**	**1,196**
Inc/(Dec) in Debt	394	1,803	(282)	2,000	-
Inc/(Dec) in Equity	-	-	1,252	-	-
Dividend & Tax	(58)	(58)	(105)	(105)	(105)
Cash flow from Financing	**335**	**1,744**	**866**	**1,895**	**(105)**
Fixed Asset formation	(193)	(716)	(465)	(400)	(500)
(Inc)/Dec in Investment	(568)	(1,551)	(1,823)	(1,337)	-
Cash flow from Investment	**(760)**	**(2,267)**	**(2,288)**	**(1,737)**	**(500)**
Net Change in Cash	**5**	**341**	**397**	**(717)**	**592**

Ratios

Valuation Ratio	2009	2010	2011	2012P	2013P
P/E	30.8	36.2	16.3	13.5	11.9
P/BV	5.7	5.0	3.1	2.6	2.1
EV/EBIDTA	16.9	14.6	10.0	8.7	7.3
EV/Sales	1.7	1.6	1.0	0.9	0.8
Dividend Yield (%)	0.3%	0.3%	0.5%	0.5%	0.5%
EPS	4.2	3.6	8.0	9.6	10.9
DPS	0.4	0.4	0.6	0.6	0.6
Book Value	22.9	26.1	41.8	50.7	60.9
Adj. ROE	20.1	14.7	23.5	20.9	19.6
Adj. ROCE	18.7	16.7	21.7	22.0	21.4
Solvency Ratio (x)					
Debt/Equity	0.6	1.1	0.6	0.8	0.7
Debt/EBIDTA	1.9	3.1	1.8	2.0	1.8
Turnover Ratio (x)					
Asset Turnover	2.1	1.8	2.4	2.3	2.2
Fixed Asset Turnover	7.1	6.9	10.0	11.9	12.8
Current Ratio	1.9	1.9	1.5	1.7	1.8
Inventory (days)	9.5	15.7	11.4	15.0	15.0
Debtors (days)	95.6	128.0	113.5	100.0	88.0
Creditors (days)	18.7	41.6	43.0	41.0	42.0

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Key ratings:

Rating	Expected Return
Buy	> 15%
Accumulate	5 to 15%
Hold	-5 to 5%
Sell	< -5%
Not Rated	-

Marwadi Shares & Finance Limited

Institutional Business Group, *MSFL*
@p-sec, 306, Gresham Assurance House
132, Mint Road, Fort, Mumbai - 400 001
Tel : + 91 22 30947100 / 102 Fax : +91 22 2269 0478

Registered Office
Marwadi Financial Plaza, Nava Mava Main Road,
Off 150 FT. Ring Road, Rajkot - 360 005
Tel : + 91 281 2481313 / 3011000