

SADBHAV ENGINEERING

Execution improvement in sight

India Equity Research | Construction



Delays in securing clearances for road projects once again hurt Sadbhav Engineering (SEL) earnings. Q3FY13 revenues, at INR3.5bn were down 51% YoY as execution on projects won last year remained a non-starter. While operating margins were flat sequentially, surging debt levels (INR6.1bn against INR4.9bn at FY12 end), due to mobilisation on BOT projects, led to rising interest costs impacting PAT, which at INR37mn, was down 91% YoY. On the positive side, the order intake which was a concern has improved (order book up 10% QoQ); also receipt of clearance on road projects is likely to speed up execution in FY14E. We believe the stock performance will be determined by the execution of the new projects. We maintain 'BUY' with a revised SOTP-based TP of INR142/share (earlier at INR161).

Profitability hit by muted revenues, interest costs

Delay in commencement of execution on the three road BOT projects won last year, led to revenue disappointment. EBITDA margins at 9.4% were flat QoQ but declined 200bps YoY due to operating de-leverage. Ballooning debt levels due to worsening working capital led to PAT declining 91% YoY to INR37mn.

BOT portfolio on track

Tolling started on the Hyderabad Yadgiri project during Q3, taking the number of operational BOT projects to seven. The work on the under development Rohtak project is ahead of schedule. For the three projects where clearances are pending, financial closure has been achieved for the Gomti-Udaipur and Bijapur-Solapur projects while that for Rajsamand-Bhilwara project is expected over the next month. SEL expects to start execution on Gomti-Udaipur project by March and Bijapur-Solapur project by May 2013 and has guided for ~INR28-29bn of EPC revenues in FY14E.

Outlook and valuations: Execution the key; maintain 'BUY'

While revenues are expected to recover in FY14E driven by execution processes, worsening working capital situation is hurting profits, thus leading us to cut earnings by 18%/29% for FY13E/FY14E. Commencing execution on new projects remains the key driver. Maintain 'BUY' with revised SOTP-based target price of INR142 per share (INR47 from EPC business and INR94 from BOT projects).

Financials

(INR mn)

Year to March	Q3FY13	Q3FY12	% change	Q2FY13	% change	FY12	FY13E	FY14E
Revenues	3,534	7,250	(51.3)	3,345	5.6	26,755	15,678	26,519
EBITDA	331	824	(59.8)	314	5.4	2,903	1,458	2,493
Net profit	37	417	(91.1)	64	(41.5)	1,406	670	891
Dilu.EPS (INR)	0.2	2.8	(91.1)	0.4	(41.5)	9.3	4.5	5.9
Dilu.P/E (x)*						2.1	4.3	3.3
EV/EBITDA (x)*						2.2	5.5	3.3
ROAE (%)						20.2	8.5	10.4

* For implied construction business.

EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	Growth

MARKET DATA (R: SADE.BO, B: SADE IN)

CMP	: INR 114
Target Price	: INR 142
52-week range (INR)	: 165 / 106
Share in issue (mn)	: 150.9
M cap (INR bn/USD mn)	: 17 / 320
Avg. Daily Vol. BSE/NSE ('000)	: 163.0

SHARE HOLDING PATTERN (%)

	Current	Q2FY13	Q1FY13
Promoters *	47.3	47.4	47.4
MF's, FI's & BKs	23.0	22.8	24.1
FII's	19.7	18.1	15.6
others	10.0	11.7	12.8
* Promoters pledged shares (% of share in issue)	:		NIL

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	(7.9)	(10.9)	(3.0)
3 months	0.4	(13.8)	(14.2)
12 months	9.7	(14.6)	(24.3)

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Other highlights

- Current order book of SEL stands at INR87.5bn (4.3x TTM revenues). This includes the INR6.1bn EPC work for the Karnataka annuity project where the Letter of Award has not been received. SEL will do the entire EPC work for this project which was won by a 50:50 consortium of Sadbhav and GKC.
- Order book break-up: Transport projects account for 68.2% of the order book (captive BOT projects are 43.1% of the order book); irrigation and mining segments contribute 16.3% and 15.5% respectively.
- Dhule project: COD for the entire stretch has been achieved though fee notification for the developed section and 25% of the project stretch has not been issued. As a result, the company is collecting toll on only 75% of the stretch. Current daily toll collection is INR2mn which the company expects to go up to INR3.6mn once the entire stretch becomes operational.
- Bijapur project: The project had started tolling from May 2, 2012. Daily toll collection during the quarter has gone up to INR2.8mn from ~INR2.5mn in Q2FY13.
- Ahmedabad Ring Road project: Total income was INR191mn in Q3FY13 (INR205mn in Q3FY12). Traffic during the quarter had declined 9% YoY; however, the management has stated that traffic has recovered in January and is currently as per expectation.
- Aurangabad Jalna project: Total income was INR70mn in Q3FY13 (INR73mn in Q3FY12). Daily toll collection is ~INR0.8mn.
- Hyderabad Yadgiri project: The project achieved COD on Dec 10, 2012. Tolling has started and daily toll collection is INR1.1mn (lower than the INR1.4mn expectation). The company is confident that toll collection will rise to expected levels in 2-3 quarters.
- Rohtak Panipat project: The project is ~74% complete and expected to start tolling by July 2013 (ahead of its scheduled COD of October 2013).
- Nagpur Seoni project: NHAI has recognised COD from March 2010 against the earlier date of October 2010. SEL expects that annuity amount will be revised upwards to ~INR200mn from the current ~INR175mn.
- Maharashtra border check-post project: Of the 22 check- posts, three have achieved COD and the company is expecting fee notification for the same. SEL expects to complete execution on six more check-posts by March 2013, an additional three posts by June 2013 and a further five check-posts by March 2014. It expects to collect INR4.5-4.7mn of daily toll on these 14 check-posts in FY15E.
Execution on the balance 8 check- posts will be completed in FY15E. Toll collection from the entire set of 22 check-posts in FY16E is expected to be INR5.5-6mn per day.
- Total equity yet to be invested for SEL's BOT projects is INR10.2bn – of this, INR1.2bn is to be infused in Q4FY13 and the balance in 4 years. With regards to individual projects, the equity required is Rohtak Panipat - INR790mn, Dhule – INR 170mn, Maharashtra Border Check -Post – INR 540mn, Hyderabad Yadgiri – INR60mn, Gomti Udaipur – INR3.7bn, Sholapur Bijapur - INR3.6bn and Rajsamand-Bhilwara – INR 1.3bn.
- SEL is looking at generating INR3.8bn from the securitisation of Ahmedabad Ring road and Nagpur Seoni projects to meet this equity commitment. Also, INR3.2bn funds are lying in the Debt Service Reserve Accounts (DSRA) and contingency funds of four BOT projects; SEL expects INR2-2.2bn of funds from these to be released over the next two years. The road holding company, Sadbhav Infrastructure (SIPL) also has INR1.8bn of debt sanctioned from ICICI Bank which can be used to meet the equity commitment.

Financial snapshot
(INR mn)

Year to March	Q3FY13	Q3FY12	% change	Q2FY13	% change	YTD13	FY13E	FY14E
Net revenues	3,534	7,250	(51.3)	3,345	5.6	11,094	15,678	26,519
Direct costs	2,867	6,141	(53.3)	2,773	3.4	9,171	13,263	22,434
Staff costs	100	97	3.8	114	(11.7)	301	297	503
Other expenses	236	188	25.4	145	62.9	586	660	1,090
Total expenditure	3,203	6,426	(50.1)	3,031	5.7	10,058	14,220	24,027
EBITDA	331	824	(59.8)	314	5.4	1,036	1,458	2,493
Depreciation	85	69	24.1	76	11.7	239	328	363
EBIT	246	756	(67.4)	238	3.4	797	1,130	2,130
Other income	17	28	(40.5)	25	(33.0)	679	702	116
Interest	205	160	28.2	175	17.1	551	837	923
Profit before tax	57	624	(90.8)	88	(34.5)	926	995	1,323
Tax	20	206	(90.2)	24	(15.7)	300	325	432
Reported net profit	37	417	(91.1)	64	(41.5)	625	670	891
Equity capital	150	150		150		150	150	150
No. of shares (mn)	150	150		150		150	150	150
Diluted EPS (INR)	0.2	2.8	(91.1)	0.4	(41.5)	1.4	4.5	5.9

as a % of net revenues

Direct costs	81.1	84.7		82.9		82.7	84.6	84.6
Other expenses	6.7	2.6		4.3		5.3	4.2	4.1
EBITDA	9.4	11.4		9.4		9.3	9.3	9.4
Reported net profit	1.1	5.8		1.9		5.6	4.3	3.4
Tax rate	35.2	33.1		27.3		32.5	32.6	32.7

Change in estimates

	FY13E			FY14E			Comments
	New	Old	% change	New	Old	% change	
Net revenues	15,678	22,999	(31.8)	26,519	28,930	(8.3)	Delay in receipt of clearances for road projects
EBITDA	1,458	2,162	(32.6)	2,493	2,835	(12.1)	
EBITDA Margin	9.3	9.4		9.4	9.8		
Core profit	670	818	(18.0)	891	1,254	(29.0)	Deterioration in working capital cycle has hurt earnings
PAT Margin	4.3	3.6		3.4	4.3		

Company Description

Founded in 1988, SEL is an infrastructure development and construction company focusing on roads and highways, irrigation and mining operations. SEL's expertise includes rehabilitating, upgrading, widening and strengthening roads and highways, construction of earthen dams, etc. The company is reputed for completing projects ahead of schedule and excellent quality of projects.

Investment Rationale

Superior execution paving way for exemplary performance

SEL's revenue has grown at one of the fastest rates in the last five years in the construction space. It has been able to achieve this feat on back of: (1) its focus on roads, which is one of the fastest growing segments in construction space; (2) ownership of road projects via BOT route, enabling greater control; and (3) consistently completing work ahead of schedule.

BOT assets on track; funding in place

Of SEL's twelve BOT road projects, seven are already operational. The company has raised INR 4 bn by divesting 22.22% stake in Sadbhav Infrastructure Projects, the holding company for its BOT assets to PE investors. This would take care of its equity requirements of the ongoing projects.

Key Risks

Equity dilution in SIPL

SEL has exposure to the road BOT space, which entails upfront investments with returns generally being back-ended. While the company is currently well funded, it needs to win large amount of BOT projects to maintain its current growth momentum. This is likely to stretch SIPL's balance sheet and may lead to equity dilution.

Inherent risk associated with BOT-toll projects

With the company focusing on PPP projects, it is exposed to risks associated with gaining right-of-way on land stretches, execution risk, 'force majeure' risk, etc. Also, the focus on toll projects exposes it to the unpredictability of traffic growth.

Financial Statements

Key Assumptions

Year to March	FY12	FY13E	FY14E	FY15E
Macro				
GDP(Y-o-Y %)	6.5	5.5	6.5	7.0
Inflation (Avg)	8.8	7.8	6.0	6.0
Repo rate (exit rate)	8.5	7.5	6.8	6.0
USD/INR (Avg)	47.9	54.5	54.0	52.0
Company				
Order intake (INR bn)	33	24	34	39
Y-o-Y growth (%) (assumption)	35.7	(26.5)	41.7	14.7
Book-to-bill ratio (x)	2.8	5.3	3.4	3.3
Order backlog (INR bn)	76	84	91	100
Order backlog growth (%)	8.5	11.0	8.9	9.9
Revenue growth (% yoy)	21	(41)	69	13
Raw Material Cost as % of net revenues	12.3	12.8	12.8	12.8
Employee as % of net revenues	1.5	1.9	1.9	1.9
Job work costs (as % of sales)	71.6	71.8	71.8	71.8
Other admin costs (as % of sales)	3.7	4.2	4.1	4.0
Average Interest rate (%)	15.3	15.4	14.4	13.9
Average Depreciation rate (%)	6.7	7.0	7.0	7.0
Tax rate (%)	32.7	32.6	32.6	32.6
Dividend per share	0.6	0.6	0.6	0.6
Increase in investments (INR mn)	(7)	2,250	-	-
Capex (INR mn)	863	500	500	500
Debtor days	108	118	108	108
Inventory days	12	20	20	20
Other current assets days	2	13	8	7
Payable days	26	15	74	92
Other creditors days	72	99	44	26
Provisions days	26	52	37	39
Loans and advances as % of net revenues (%)	21.1	38.6	28.6	28.6
Incremental debt (INR mn)	400	1,900	55	55

Income statement

(INR mn)

Year to March	FY12	FY13E	FY14E	FY15E
Income from operations	26,755	15,678	26,519	29,979
Direct costs	22,460	13,263	22,434	25,361
Employee costs	400	297	503	568
Other Expenses	993	660	1,090	1,202
Total operating expenses	23,853	14,220	24,027	27,131
EBITDA	2,903	1,458	2,493	2,848
Depreciation & Amortization	274	328	363	398
EBIT	2,629	1,130	2,130	2,450
Other income	108	702	116	114
Interest expenses	651	837	923	908
Profit before tax	2,086	995	1,323	1,656
Provision for tax	681	325	432	541
Net profit	1,405	670	891	1,115
Prior period adjustments (net)	(1)	-	-	-
Profit After Tax	1,406	670	891	1,115
Basic EPS (INR)	9.3	4.5	5.9	7.4
Shares outstanding (mn)	150	150	150	150
Diluted EPS (INR)	9.3	4.5	5.9	7.4
Dividend per share (INR)	0.6	0.6	0.6	0.6
Dividend payout (%)	6.4	13.4	10.1	8.1

Common size metrics

Year to March	FY12	FY13E	FY14E	FY15E
Operating expenses	89.1	90.7	90.6	90.5
Depreciation	1.0	2.1	1.4	1.3
Interest expenditure	2.4	5.3	3.5	3.0
EBITDA margins	10.9	9.3	9.4	9.5
Other income	0.4	4.5	0.4	0.4
Tax	2.5	2.1	1.6	1.8
EBIT margins	9.8	7.2	8.0	8.2
Net profit margins	5.3	4.3	3.4	3.7

Growth ratios (%)

Year to March	FY12	FY13E	FY14E	FY15E
Revenues	21.1	(41.4)	69.2	13.0
EBITDA	22.1	(49.8)	71.0	14.2
Net profit	20.9	(52.3)	32.9	25.2
EPS	17.2	(52.3)	32.9	25.2

Balance sheet		(INR mn)			
As on 31st March	FY12	FY13E	FY14E	FY15E	
Equity capital	150	150	150	150	
Reserves & surplus	7,473	8,039	8,825	9,836	
Shareholders' funds	7,623	8,189	8,975	9,986	
Short term debt	3,182	4,882	4,937	4,992	
Long term debt	1,306	1,506	1,506	1,506	
Borrowings	4,488	6,388	6,443	6,498	
Deferred tax liability	235	235	235	235	
Sources of funds	12,346	14,812	15,653	16,718	
Tangible assets	2,878	3,045	3,178	3,276	
Intangible assets	2	8	12	16	
Total net fixed assets	2,881	3,053	3,190	3,292	
Non current investments	3,287	5,537	5,537	5,537	
Current Investments	35	35	35	35	
Cash and equivalents	563	769	691	1,109	
Inventories	884	862	1,457	1,648	
Sundry debtors	7,911	5,065	7,841	8,864	
Loans and advances	5,653	6,052	7,585	8,574	
Other current assets	179	579	579	579	
Total current assets (ex cash)	15,226	13,361	18,188	20,809	
Trade payable	1,874	640	5,363	7,531	
Others current liabilities	7,175	6,500	5,899	5,389	
Total current liabilities &	9,048	7,140	11,263	12,920	
Net current assets (ex cash)	6,178	6,222	6,926	7,889	
Uses of funds	12,346	14,812	15,653	16,718	
Book value per share (INR)	50.7	54.5	59.7	66.4	

Free cash flow		(INR mn)			
Year to March	FY12	FY13E	FY14E	FY15E	
Net profit	1,406	670	891	1,115	
Depreciation	274	328	363	398	
Others	883	(105)	(105)	(105)	
Gross cash flow	2,563	894	1,149	1,408	
Less: Changes in WC	1,524	(162)	782	546	
Operating cash flow	1,040	1,055	367	863	
Less: Capex	863	500	500	500	
Free cash flow	177	555	(133)	363	

Cash flow metrics		FY12	FY13E	FY14E	FY15E
Year to March					
Operating cash flow		1,040	1,055	367	863
Investing cash flow		(1,010)	(2,750)	(500)	(500)
Financing cash flow		(312)	1,900	55	55
Net cash flow		(282)	205	(78)	418
Capex		(863)	(500)	(500)	(500)
Dividends paid		(105)	(105)	(105)	(105)
Share issuance/(buyback)		25	-	-	-

Profitability & efficiency ratios		FY12	FY13E	FY14E	FY15E
Year to March					
ROAE (%)		20.2	8.5	10.4	11.8
ROACE (%)		23.1	8.3	14.0	15.1
Inventory day		13	24	19	22
Debtors days		101	151	89	102
Payable days		151	223	150	174
Cash conversion cycle (days)		(37)	(48)	(42)	(50)
Current ratio		1.7	2.0	1.7	1.7
Debt/Equity		0.6	0.8	0.7	0.6
Interest coverage		4.0	1.4	2.3	2.7

Operating ratios		FY12	FY13E	FY14E	FY15E
Year to March					
Total asset turnover		2.4	1.2	1.7	1.9
Fixed asset turnover		10.3	5.3	8.5	9.3
Equity turnover		3.9	2.0	3.1	3.2

Valuation parameters		FY12	FY13E	FY14E	FY15E
Year to March					
Diluted EPS (INR)		9.3	4.5	5.9	7.4
Y-o-Y growth (%)		17.2	(52.3)	32.9	25.2
CEPS (INR)		11.2	6.6	8.3	10.1
Diluted P/E (x) *		2.1	4.3	3.3	2.6
Price/BV (x)		2.2	2.1	1.9	1.7
EV/Sales (x) *		0.2	0.5	0.3	0.3
EV/EBITDA (x) *		2.2	5.5	3.3	2.7
Dividend yield (%)		0.5	0.5	0.5	0.5

* For implied construction business.

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		Price/BV (X)		ROAE (%)	
		FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
Sadbhav Engineering	344	2.1	4.3	2.1	1.9	5.5	3.3
IVRCL Infra	180	NA	17.9	0.4	0.4	NA	2.4
Nagarjuna Construction Co	196	10.2	6.7	0.4	0.4	4.2	6.1
Ramky Infrastructure	91	3.9	3.1	0.4	0.4	12.3	13.3
Simplex Infrastructures Ltd	157	11.1	8.9	0.7	0.6	6.2	7.3
Median	-	10.2	8.9	0.4	0.4	6.2	7.3
AVERAGE	-	6.8	10.3	0.8	0.8	5.9	8.6

Source: Edelweiss research

Additional Data

Directors Data

Shri Vishnubhai M. Patel	Chairman and Managing Director	Shri Shashin V. Patel	Joint Managing Director
Shri Vikramkumar R. Patel	Executive Director	Shri Vasistha C. Patel	Executive Director
Shri Girish N. Patel	Executive Director	Shri Nitin R. Patel	Executive Director
Shri Pravinkumar M. Ganatra	Independent and Non-Executive Director	Shri Amarsinh J. Vaghela	Independent and Non-Executive Director
Shri Sandip V. Patel	Independent and Non-Executive Director	Shri Atul N. Ruparel	Independent and Non-Executive Director

Auditors - Shashikant Patel Associates

**as per last annual report*

Holding – Top10

	Perc. Holding		Perc. Holding
Nomura Asset Management	5.47	DSP Blackrock Investment	4.81
HDFC Asset Management	4.49	Tata Asset Managemen	3.2
Govt Pension Funds Global	2.97	Birla Sunlife Asset Management	2.66
SBI Asset Management	2.65	Prudential ICICI Asset Manegement	2.25
Eastspring Investor India	2.02	SBI Life Insurance	1.52

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
05 Jun 2012	Wellington Management Company Llp Ac Bay Pond Mb	Sell	904860	120.00
02 Jul 2012	Brij Real Estate & Property Pvt Ltd	Sell	780000	148.00
26 Sep 2012	Idfc Premier Equity Fund	Sell	3014691	143.00

**as per last available data*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
09 Feb 2012	Nitin R. Patel	Sell	45000.00
27 Jun 2012	Tosha A Patel	Buy	500000.00
27 Jun 2012	Girish N Patel	Sell	500000.00
26 Oct 2012	Amarsinh J Vaghela	Sell	25000.00

**as per last available data*

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Coverage group(s) of stocks by primary analyst(s):

Consolidated Construction Co., Hindustan Construction Co., IL&FS Transportation Networks, IRB Infrastructure, IVRCL Infra, Jaiprakash Associates, BL Kashyap & Sons Ltd, Nagarjuna Construction Co, Ramky Infrastructure, Sadbhav Engineering, Simplex Infrastructures Ltd

Recent Research

Date	Company	Title	Price (INR)	Recos
18-Feb-13	Simplex Infra.	Balance sheet concerns intensify; <i>Result Update</i>	164	Hold
18-Feb-13	B L Kashyap & Sons	Margins surprise positively; <i>Result Update</i>	9	Buy
15-Feb-13	IVRCL Infra	Execution improves, but margin disappoints; <i>Result Update</i>	29	Hold

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	118	46	17	181
* - stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	117	57	7	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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