

SADBHAV ENGINEERING

Gunning for growth

India Equity Research | Infrastructure - Construction

Sadbhav Engineering's (SEL) management, during our recent interaction, reaffirmed focus on bidding for road projects, especially hybrid annuity (HAM), where competition is moderate. Management is confident of healthy revenue traction riding: (a) robust execution pace in already won projects; and (b) work on 2 more HAM projects to start over the next month. Moreover, improvement in the EPC arm's working capital and refinancing of 4 projects in the BOT arm are envisaged to boost profitability. We expect execution to stay strong and believe order inflows remain key catalyst for earnings. Maintain 'BUY' with SOTP-based target price of INR388.

EPC: On a strong footing

With work on projects won in FY16 in full swing, SEL posted strong revenues in H2FY17. With work on 2 more projects expected to commence over the next month, management expects to sustain healthy execution pace and has guided for INR38bn plus top line in FY18. The company is targeting ~INR70-80bn order intake in FY18 (INR40-50bn from roads, balance from mining & irrigation) versus ~INR50bn in FY17, which will boost book-to-bill to ~3x and brighten revenue visibility. SEL is also eyeing the metro rail segment to enhance growth prospects.

BOT: Focus on cash flow generation

Sadbhav Infraprojects (SIPL), the company's BOT arm, has already refinanced 5 projects and is in the process of refinancing 4 more. Ergo, it expects the interest rate on these projects to dip ~200bps. The refinancing of the 9 projects will add ~INR600-650mn to the bottom line. Going ahead, management will be focusing on asset churning to improve cash flow generation.

Outlook and valuations: Attractive; maintain 'BUY'

Improving top line, healthy BOT portfolio and best-in-class execution skills render SEL an attractive bet. We expect: (a) higher order intake in the EPC arm; and (b) better cash flow generation in the BOT subsidiary, to trigger re-rating. We maintain 'BUY' with SOTP-based target price of INR388 (INR161 from EPC business at 16x FY19E P/E and balance from DCF valuation of BOT projects).

Financials	(INR mn)			
Year to March	FY16	FY17	FY18E	FY19E
Revenues	31,863	33,203	37,143	42,971
EBITDA	3,348	3,556	3,978	4,602
Adj. profit	1,373	1,878	1,692	1,712
Dil. EPS (INR)	8.0	11.0	9.9	10.0
Diluted P/E (x) *	9.8	7.1	7.9	7.8
EV/EBITDA (x) *	7.6	8.4	6.9	6.3
ROAE (%)	9.7	11.9	9.7	9.0

* For implied construction business

EDELWEISS RATINGS	
Absolute Rating	BUY
Investment Characteristics	Growth

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

CMP	: INR 304
Target Price	: INR 388
52-week range (INR)	: 351 / 220
Share in issue (mn)	: 171.6
M cap (INR bn/USD mn)	: 52 / 811
Avg. Daily Vol. BSE/NSE ('000)	: 139.4

SHARE HOLDING PATTERN (%)

	Current	Q3FY17	Q2FY17
Promoters *	46.8	46.8	46.8
MF's, FI's & BKs	26.3	26.1	25.3
FII's	17.2	16.9	17.5
Others	9.8	10.2	10.4
* Promoters pledged shares (% of share in issue)	:	16.23	

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	(1.8)	(9.9)	(8.1)
3 months	6.4	5.3	(1.2)
12 months	30.3	9.7	(20.6)

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Concall highlights

- **Road segment in focus:** Road sector will continue to contribute ~75% to the order book. SEL expects 60-65% of incremental order intake from HAM projects where competition is relatively benign compared to road EPC projects. It believes NHAI project mix will be oriented towards HAM projects; this, coupled with relatively large size of upcoming HAM projects (~INR15-17bn) will ensure that bidding remains rational.
- **Eyeing rail projects:** With dip in order intake in mining and irrigation segments, the company is planning to target metro rail as well as railway projects to bolster order book.
- **Working capital improvement expected:** SEL's debt had ballooned to ~INR16.6bn at FY17 end (~INR12.2bn at FY16 end) due to repayment of high-cost mobilisation advance to NHAI and higher working capital requirement in certain projects like Delhi Metro and irrigation projects.

SEL expects debt to decline in FY18 as ~INR3.0-3.5bn working capital funds stuck in the Delhi Metro/irrigation projects will be released post project completion. In addition, the company will receive fresh mobilisation advance for HAM projects. Consequently, it estimates debt:equity to dip from 1.0x at FY17 end to ~0.6x by FY18 end. This, it believes, will boost the EPC arm's profitability.

- **Refinancing to boost SIPL's cash flow:** SIPL has already refinanced 5 BOT projects which helped it generate ~INR1.1bn free cash flow in FY17. The company is in the process of refinancing 4 more BOT projects and estimates a ~200bps reduction in interest rate. Blended interest cost currently stands at 10.2% at the SIPL level. The company expects the re-financing of the 9 BOT projects will add ~INR600-650mn to the bottom line.
- Going ahead, the focus will be on cash flow generation in SIPL through churning of assets. Loans given by SEL to SIPL have reduced to INR4.3bn (INR5.3bn, as at March 2016 end) and the company expects to further pare this down.

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 Theme

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.

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

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.

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	FY16	FY17	FY18E	FY19E
Macro				
GDP(Y-o-Y %)	7.2	6.5	7.1	7.7
Inflation (Avg)	4.9	4.8	5.0	5.2
Repo rate (exit rate)	6.8	6.3	6.3	6.3
USD/INR (Avg)	65.0	67.5	67.0	67.0
Company				
Order intake (INR bn)	25	35	63	73
Y-o-Y growth (%)	11.0	42.1	79.4	15.9
Book-to-bill ratio (x)	2.3	2.3	2.8	3.1
Order backlog (INR bn)	75	77	103	133
Order backlog growth (%)	(8.7)	2.6	33.7	29.3
Revenue growth (% yoy)	7	4	12	16
Raw Material (% net rev)	81.0	80.0	80.0	80.0
Employee (% of net rev)	3.9	4.1	4.1	4.1
Other admin (% net rev)	4.7	5.2	5.2	5.2
Avg. Interest rate (%)	7.4	6.9	6.9	6.9
Depreciation rate (%)	9.5	9.5	10.0	10.0
Tax rate (%)	28.4	1.0	20.0	33.0
Dividend per share	0.7	0.7	0.7	0.7
Inc. in invts (INR mn)	(248)	65	-	-
Capex (INR mn)	(881)	(1,060)	(760)	(1,010)
Debtor days	113	151	170	157
Inventory days	25	18	18	21
Other cur. assets days	63	54	53	50
Payable days	58	59	75	83
Other creditors days	60	43	29	27
Provisions days	12	-	-	-
Loans & adv (% net rev)	18.3	16.2	15.7	15.7
Incremental debt	766	(4,296)	2,050	(1,200)

Income statement

(INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Income from operations	31,863	33,203	37,143	42,971
Direct costs	25,805	26,552	29,702	34,363
Employee costs	1,228	1,366	1,528	1,768
Other Expenses	1,482	1,729	1,934	2,238
Total operating expenses	28,515	29,647	33,165	38,369
EBITDA	3,348	3,556	3,978	4,602
Depreciation	971	1,000	1,082	1,170
EBIT	2,377	2,556	2,897	3,432
Add: Other income	317.85	332.98	487.31	270.18
Less: Interest Expense	855	992	1,269	1,147
Add: Prior period items	141	-	-	-
Add: Exceptional items	(194)	-	-	-
Profit Before Tax	1,787	1,897	2,115	2,556
Less: Provision for Tax	467	18	423	843
Prior Period(Net of Tax)	141	-	-	-
Reported profit	1,320	1,878	1,692	1,712
Exceptional Items	(194)	-	-	-
Adjusted profit	1,373	1,878	1,692	1,712
Shares o /s (mn)	172	172	172	172
Adjusted Basic EPS	8.0	11.0	9.9	10.0
Diluted shares o/s (mn)	172	172	172	172
Adjusted Diluted EPS	8.0	11.0	9.9	10.0
Adjusted Cash EPS	13.7	16.8	16.2	16.8
Dividend per share (DPS)	0.7	0.7	0.7	0.7
Dividend Payout Ratio (%)	10.9	7.7	8.5	8.4

Common size metrics

Year to March	FY16	FY17	FY18E	FY19E
Operating expenses	89.5	89.3	89.3	89.3
EBITDA margins	10.5	10.7	10.7	10.7
Adj. profit margins	4.3	5.7	4.6	4.0

Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	7.3	4.2	11.9	15.7
EBITDA	11.5	6.2	11.9	15.7
PBT	20.5	6.2	11.5	20.9
Adjusted profit	23.4	36.8	(9.9)	1.2
EPS	23.4	36.8	(9.9)	1.2

Balance sheet		(INR mn)			
As on 31st March	FY16	FY17	FY18E	FY19E	
Share capital	172	172	172	172	
Reserves & Surplus	14,721	16,437	17,985	19,552	
Shareholders' funds	14,892	16,609	18,156	19,724	
Short term borrowings	7,275	13,541	12,641	13,941	
Long term borrowings	4,932	3,062	1,812	2,012	
Total Borrowings	12,207	16,603	14,453	15,953	
Long Term Liabilities	32	98	98	98	
Def. Tax Liability (net)	(90)	(477)	(477)	(477)	
Sources of funds	27,041	32,834	32,231	35,299	
Gross Block	9,293	10,343	11,093	12,093	
Net Block	5,918	5,222	5,334	5,176	
Intangible Assets	12	7	13	11	
Total Fixed Assets	5,931	5,229	5,347	5,187	
Non current investments	5,629	5,694	5,694	5,694	
Cash and Equivalents	166	230	535	401	
Inventories	1,406	1,234	1,697	2,258	
Sundry Debtors	10,372	17,010	17,589	19,378	
Loans & Advances	5,832	5,381	5,834	7,136	
Other Current Assets	5,524	4,950	5,417	5,932	
Current Assets (ex cash)	23,135	28,574	30,537	34,703	
Trade payable	3,703	4,910	7,502	8,303	
Other Current Liab	4,116	1,983	2,380	2,384	
Total Current Liab	7,819	6,893	9,881	10,687	
Net Curr Assets-ex cash	15,316	21,681	20,655	24,016	
Uses of funds	27,041	32,834	32,231	35,299	
BVPS (INR)	86.8	96.8	105.8	115.0	

Free cash flow		(INR mn)			
Year to March	FY16	FY17	FY18E	FY19E	
Reported Profit	1,125	1,878	1,692	1,712	
Add: Depreciation	971	1,000	1,082	1,170	
Interest (Net of Tax)	632	982	1,015	768	
Others	(764)	(1,604)	(1,637)	(1,390)	
Less: Changes in WC	3,612	4,578	4,951	4,972	
Operating cash flow	(1,647)	(2,321)	(2,799)	(2,711)	
Less: Capex	(881)	(1,060)	(760)	(1,010)	
Free Cash Flow	(767)	(1,261)	(2,039)	(1,701)	

Cash flow metrics		FY16	FY17	FY18E	FY19E
Year to March					
Operating cash flow		(1,647)	(2,321)	(2,799)	(2,711)
Investing cash flow		1,108	3,399	1,408	5,246
Financing cash flow		672	(4,396)	2,150	(1,500)
Net cash Flow		132	(3,318)	759	1,035
Capex		881	1,060	760	1,010
Dividend paid		(145)	(145)	(145)	(145)

Profitability and efficiency ratios		FY16	FY17	FY18E	FY19E
Year to March					
ROAE (%)		9.7	11.9	9.7	9.0
ROACE (%)		10.4	9.6	10.3	10.8
Inventory Days		25	18	18	21
Debtors Days		113	151	170	157
Payable Days		115	101	103	109
Cash Conversion Cycle		23	68	85	69
Current Ratio		3.0	4.2	3.1	3.3
Gross Debt/EBITDA		3.6	4.7	3.6	3.5
Gross Debt/Equity		0.8	1.0	0.8	0.8
Adjusted Debt/Equity		0.8	1.0	0.8	0.8
Net Debt/Equity		0.8	1.0	0.8	0.8
Interest Coverage Ratio		2.8	2.6	2.3	3.0

Operating ratios		FY16	FY17	FY18E	FY19E
Year to March					
Total Asset Turnover		1.2	1.1	1.1	1.3
Fixed Asset Turnover		5.6	6.0	7.0	8.2
Equity Turnover		2.2	2.1	2.1	2.3

Valuation parameters		FY16	FY17	FY18E	FY19E
Year to March					
Adj. Diluted EPS (INR)		8.0	11.0	9.9	10.0
Y-o-Y growth (%)		23.4	36.8	(9.9)	1.2
Adjusted Cash EPS (INR)		13.7	16.8	16.2	16.8
Diluted P/E (x)*		9.8	7.1	7.9	7.8
P/B (x)		3.5	3.2	2.9	2.7
EV / Sales (x)*		0.8	0.9	0.7	0.7
EV / EBITDA (x)*		7.6	8.4	6.9	6.3
Dividend Yield (%)		0.2	0.2	0.2	0.2

* For implied construction business

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		P/B (X)		ROAE (%)	
		FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Sadbhav Engineering	811	7.9	7.8	2.9	2.7	9.7	9.0
Ashoka Buildcon	561	NA	NA	2.3	2.3	NA	NA
Nagarjuna Construction Co	779	20.9	14.0	1.4	1.3	6.8	9.4
Simplex Infrastructures Ltd	390	31.3	14.3	1.6	1.4	5.1	10.4
Median	-	26.0	22.3	1.9	1.9	5.9	9.2
AVERAGE	-	7.1	513.4	2.0	1.9	4.0	6.8

Source: Edelweiss research

Additional Data

Directors Data

Mr. Vishnubhai M. Patel	Chairman and Managing Director	Mr. Shashin V. Patel	Joint Managing Director
Mr. Vikram R. Patel	Executive Director	Mr. Vasistha C. Patel	Executive Director
Mr. Nitin R. Patel	Executive Director & CFO	Mr. Vipul H. Patel	Executive Director
Mr. Sandip A. Sheth	Independent Non-Executive Director	Mr. Sandip V. Patel	Independent Non-Executive Director
Mr. Atul N. Ruparel	Independent Non-Executive Director	Mr. Mirat N. Bhadlawala	Independent Non-Executive Director
Mrs. Purvi S. Parikh	Independent Non-Executive Director	Mr. Arun S. Patel	Independent Non-Executive Director

Auditors - Surana Maloo & Co.

**as per last annual report*

Holding – Top 10

	Perc. Holding		Perc. Holding
Max New York Life Ins Co	6.32	HDFC Asset Management	5.58
Prudential ICICI Asset Management	5.51	SBI Fund Management	5.27
ICICI Prudential Life Insurance Company	5.03	Tata Asset Management	4.31
Nomura	3.62	DSP Blackrock Investment	2.91
Abu Dhabi Investment Authority	1.72	Government Pension Fund - Global	1.52

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

**as per last available data*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
30 Mar 2017	Truptiben Nileshbhai Patel	Buy	650000.00
30 Mar 2017	Bhavnaben Vikramkumar Patel	Buy	650000.00
30 Mar 2017	Rajshreeben Vishnubhai Patel	Sell	650000.00
30 Mar 2017	Rekhaben Vasisthakumar Patel	Buy	650000.00
30 Mar 2017	Shashin Vishnubhai Patel	Sell	650000.00

**as per last available data*

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Coverage group(s) of stocks by primary analyst(s): Infrastructure - Construction

Ahluwalia Contracts, Ashoka Buildcon, Hindustan Construction Co., J Kumar Infraprojects, KNR Constructions, NBCC, Nagarjuna Construction Co, PNC Infratech, Sadbhav Engineering, Simplex Infrastructures Ltd, Supreme Infrastructure

Recent Research

Date	Company	Title	Price (INR)	Recos
08-Jun-17	Simplex Infra.	Healthy order inflow boosts revenue visibility; <i>Result Update</i>	520	Buy
07-Jun-17	Ashoka Buildcon	Steady performance; <i>Result Update</i>	186	Buy
07-Jun-17	Construction	Mumbai Metro: Opportunities of windfall; <i>Sector Update</i>		

Distribution of Ratings / Market Cap

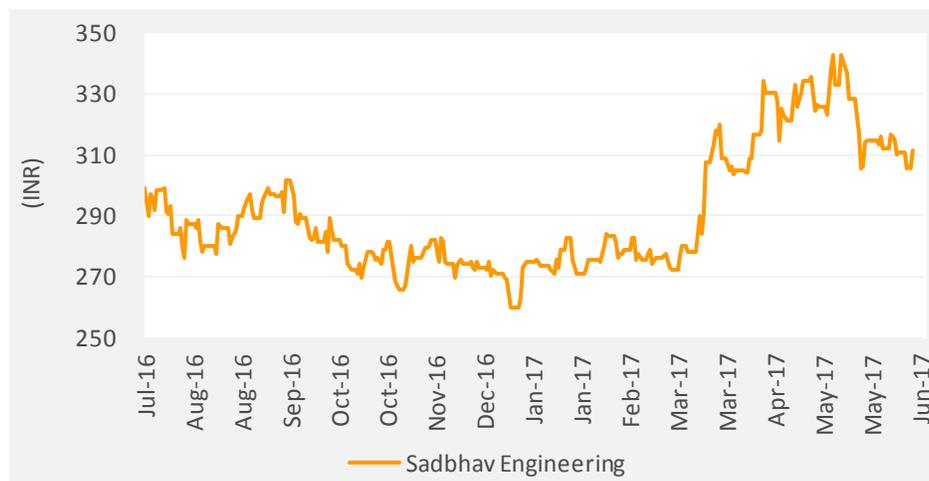
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

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

One year price chart



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