

NAGARJUNA CONSTRUCTION

Interest cost savings aid profitability

India Equity Research | Infrastructure - Construction

Nagarjuna Construction's (NCC) Q4FY17 revenue fell 13% YoY to INR21bn (estimate INR22bn) due to payment delays in a few state projects and demonetisation impact. While EBITDA margin tumbled 38bps YoY, falling interest cost (down 22% YoY) led to adjusted PAT rising 4% YoY to INR1.1bn. We believe, management's plan to bolster order intake by focusing on roads, mining and electrical segments, as highlighted in our report "[Construction - Hyderabad visit takeaways: Revenue visibility improving; sector update](#)" will improve revenue visibility (2.1x currently). Maintain 'BUY' with SOTP-based target price of INR121.

Lower interest cost boost profitability

NCC's Q4FY17 revenue was impacted by: a) delays in payment in electrical projects in UP due to elections; b) demonetisation; and c) payment issues in water projects in Tamil Nadu and Rajasthan. Management has guided for 8-10% revenue growth in FY18. Operating deleverage led to EBITDA margin declining 38bps YoY to 8.1% (guidance: 9.2% in FY17 and 9.5% in FY18). Loan repayment by subsidiaries led to debt declining by ~INR3bn YoY, due to which interest expenses fell 22% YoY, boosting profitability. Management has guided for debt level to remain stable at ~INR18-20bn in subsequent years. We expect NCC's interest cost to decline further led by improvement in its credit rating.

Targeting robust order accretion

The company won ~INR92bn orders in FY17 and is targeting ~INR100bn order intake in FY18. NCC ended FY17 with order book of ~INR181bn. It is L1 in orders worth INR20bn. NCC's top line growth, over the past couple of years, has been muted due to order book constraints. We believe, improving order intake prospects will bolster growth going ahead.

Outlook and valuations: Order inflow key; maintain 'BUY'

Healthy balance sheet, falling interest cost and strong order intake prospects are key positives. We believe, order intake (which will determine revenue visibility) will be a key trigger going ahead. We maintain 'BUY' with SoTP-based target price of INR121 – INR120/share from EPC business (18x FY19E P/E) and balance from BOT projects.

Financials (Standalone)

(INR mn)

Year to March	Q4FY17	Q4FY16	% change	Q3FY17	% change	FY17	FY18E	FY19E
Revenues	21,394	24,522	(12.8)	19,036	12.4	78,921	81,338	93,160
EBITDA	1,742	2,090	(16.7)	1,742	(0.0)	6,852	7,494	8,810
Adj. profit	1,110	1,065	4.2	660	68.1	2,758	2,398	3,574
Dil. EPS (INR)	2.0	1.9	4.2	1.2	68.1	5.0	4.3	6.4
Dil. P/E (x)						18.3	21.1	14.1
EV/EBITDA (x)						9.5	9.0	7.4
ROAE (%)						8.2	6.8	9.4

EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	Growth

MARKET DATA (R: NCCL.BO, B: NJCC IN)

CMP	: INR 95
Target Price	: INR 121
52-week range (INR)	: 104 / 68
Share in issue (mn)	: 555.9
M cap (INR bn/USD mn)	: 53 / 821
Avg. Daily Vol. BSE/NSE ('000)	: 5,231.9

SHARE HOLDING PATTERN (%)

	Current	Q3FY17	Q2FY17
Promoters *	19.7	19.7	20.1
MF's, FI's & BKs	22.4	22.4	17.7
FII's	23.3	23.0	27.1
Others	34.6	35.0	35.1
* Promoters pledged shares (% of share in issue)	:		9.8

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	3.2	5.4	2.3
3 months	9.9	17.8	7.9
12 months	31.7	29.4	(2.3)

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Other highlights

- For FY17, while revenue dipped 5%, EBITDA margin declined 20bps. However, INR1.1bn reduction in interest cost led to YoY improvement in adjusted profit.
- NCC is L1 in an MDO contract where it is awaiting LoI.
- The company proposes to bid for road EPC and hybrid annuity projects along with water pipeline projects to boost order book.
- NCC Urban repaid ~INR4bn loans to the parent company during the quarter. As a result, NCC's overall exposure to subsidiaries has declined to INR15.9bn (INR20.8bn in FY16).

Chart 1: Order book break-up

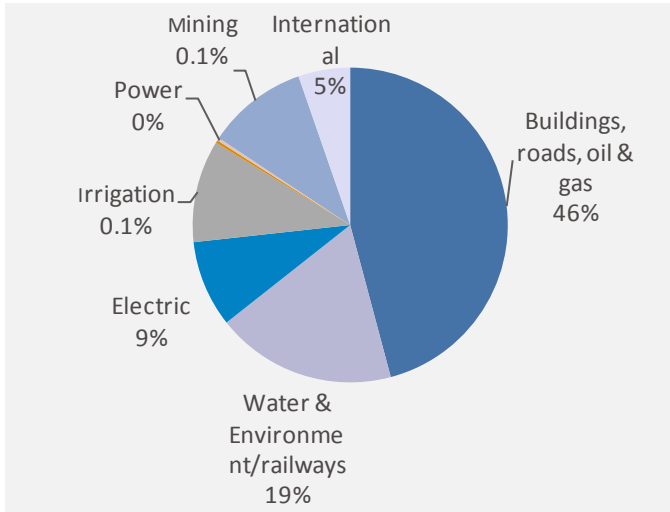


Chart 2: Q4FY17 revenue break-up

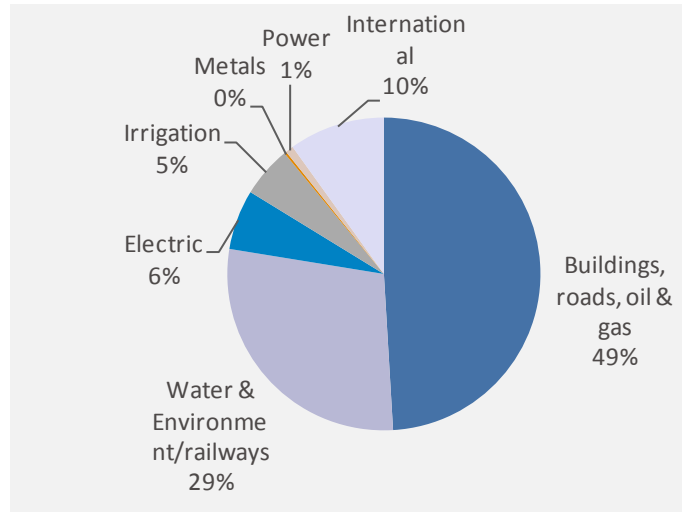
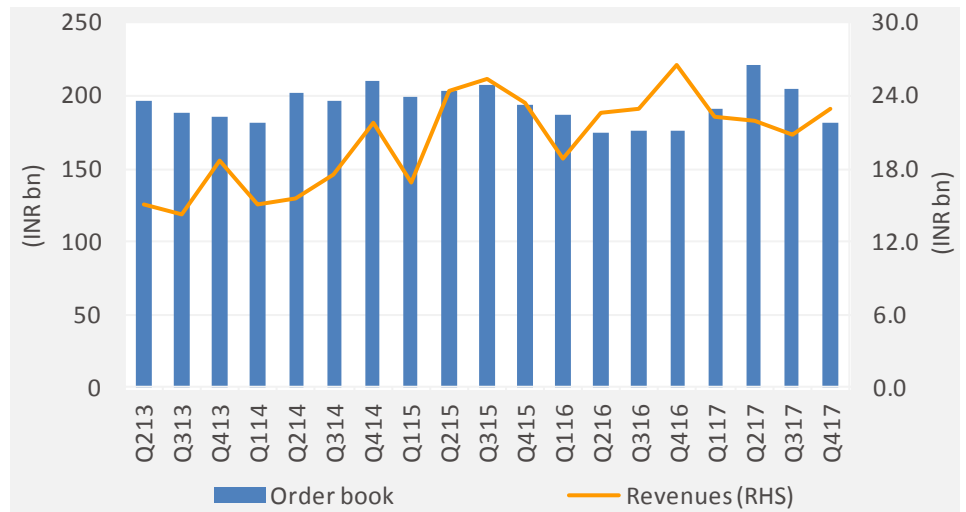


Chart 3: Revenues and order book



Source: Edelweiss research

Table 1: SOTP valuation

Particulars	Basis	Total value (INR mn)	Value per share (INR)
Overall EPC business	18x FY19E EPS	66,693	120
BOT projects	DCF	567	1
Total		67,260	121

Source: Edelweiss research

Financial snapshot

(INR mn)

Year to March	Q4FY17	Q4FY16	% change	Q3FY17	% change	FY17	FY18E	FY19E
Net revenues	21,394	24,522	(12.8)	19,036	12.4	78,921	81,338	93,160
Direct costs	18,284	21,237	(13.9)	16,011	14.2	66,871	68,677	78,432
Staff costs	871	776	12.2	829	5.0	3,316	3,185	3,648
Other expenses	498	419	18.8	454	9.7	1,883	1,981	2,269
Total expenditure	19,653	22,432	(12.4)	17,294	13.6	72,069	73,843	84,350
EBITDA	1,742	2,090	(16.7)	1,742	0.0	6,852	7,494	8,810
Depreciation	276	275	0.6	284	(2.8)	1,121	1,358	1,473
EBIT	1,465	1,815	(19.3)	1,458	0.5	5,731	6,136	7,338
Other income	471	768	(38.7)	393	19.8	1,401	975	1,042
Interest	1,022	1,307	(21.8)	1,009	1.3	3,957	3,532	3,045
Add: Prior period items								
Add: Exceptional items	473	203	132.9	(78)	(708.4)	(503)	-	-
Profit before tax	440	1,072	(58.9)	764	(42.3)	2,671	3,579	5,335
Provision for taxes	(197)	210	NA	181	NA	417	1,181	1,760
Reported profit	637	862	(26.1)	583	9.3	2,255	2,398	3,574
Adjusted profit	1,110	1,065	4.2	660	68.1	2,758	2,398	3,574
Equity capital	1,112	1,112		1,112		1,112	1,112	1,112
Diluted shares (mn)	556	556		556		556	556	556
Adjusted Diluted EPS	2.0	1.9	4.2	1.2	68.1	5.0	4.3	6.4
as % of net revenues								
Direct costs	85.5	86.6		84.1		84.7	84.4	84.2
Other expenses	2.3	1.7		2.4		2.4	2.4	2.4
EBITDA	8.1	8.5		9.2		8.7	9.2	9.5
Tax rate	(44.6)	19.6		23.7		15.6	33.0	33.0

Company Description

NCC is one of the largest construction players in India and undertakes civil construction in segments such as transportation, water & irrigation, buildings, power, transmission and distribution. The company has ventured into railways, oil & gas, and metals and has also entered the Middle East where it currently undertakes works in roads, buildings, and water segments. NCC is also one of the large players in the asset development space, with a portfolio of road and power assets. It also has a land bank of 529 acres spread across Hyderabad, Bangalore and Chennai.

Investment Theme

NCC is a well diversified player in the construction space. Given that NCC has built capabilities across various verticals of infrastructure, a slowdown in one vertical will not deter its growth as it can always take orders in other verticals. NCC also has a portfolio of 6 BOT projects—five roads and one power projects. These projects are expected to be value accretive in the long term. Moreover NCC has a sizeable land bank spread across Hyderabad, Bangalore, Chennai, etc. Even though the company has put on hold its development plans due to soft real estate market, these land holdings are expected to result in significant value accretion as and when the real estate market improves.

Key Risks

The company's venture into the BOT and real estate segments will demand upfront investments with returns being back-ended. Though the company has pruned its real estate plans considerably, its plans to set up BOT projects will need funding in the future, possibly leading to a rise in leverage.

Although we believe the thrust on infrastructure spending by the government will continue, given that public sector finances are getting stretched, any decrease in spending could affect order intake and growth assumptions. Even though NCC is a well-diversified player and is to that extent insulated by order intake risks to any particular vertical, overall decrease in spending could have a bearing on its growth prospects.

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)	74	92	109	148
Y-o-Y growth (%)	0.3	24.7	17.8	36.2
Book-to-bill ratio (x)	1.9	2.1	2.3	2.6
Order backlog (INR bn)	177	181	203	254
Order backlog growth (%)	(8.6)	2.5	12.1	25.1
Revenue growth (% yoy)	1	(3)	(1)	12
Raw Material (% net rev)	46.6	39.7	46.3	46.1
Job work (as % of sales)	28.3	33.2	28.3	28.3
Other mfg(as % of sales)	10.1	11.8	9.8	9.8
Other admin (% net rev)	2.5	2.4	2.4	2.4
Avg. Interest rate (%)	26.2	20.7	21.0	18.3
Depreciation rate (%)	8.8	8.4	9.2	9.2
Tax rate (%)	25.5	15.6	33.0	33.0
Dividend per share	0.6	0.4	0.4	0.4
Inc. in invts (INR mn)	(1,259)	717	(1,080)	-
Capex (INR mn)	659	1,186	1,400	1,080
Debtor days	133	160	166	139
Inventory days	89	87	86	83
Other cur. assets days	59	55	63	55
Payable days	133	157	158	140
Other creditors days	79	60	49	43
Provisions days	1	2	2	2
Loans & adv (% net rev)	13.9	7.4	10.0	12.0
Incremental debt	(1,110)	(3,065)	2,100	(2,367)

Income statement

(INR mn)				
Year to March	FY16	FY17	FY18E	FY19E
Income from operations	83,252	78,921	81,338	93,160
Direct costs	70,756	66,871	68,677	78,432
Employee costs	3,008	3,316	3,185	3,648
Other Expenses	2,111	1,883	1,981	2,269
Total operating expenses	75,875	72,069	73,843	84,350
EBITDA	7,377	6,852	7,494	8,810
Depreciation	1,100	1,121	1,358	1,473
EBIT	6,277	5,731	6,136	7,338
Add: Other income	2,239.8	1,400.8	974.53	1,042.34
Less: Interest Expense	5,089	3,957	3,532	3,045
Add: Exceptional items	(203)	(503)	-	-
Profit Before Tax	3,225	2,672	3,579	5,335
Less: Provision for Tax	823	417	1,181	1,760
Reported Profit	2,402	2,255	2,398	3,574
Exceptional Items	(203)	(503)	-	-
Adjusted Profit	2,605	2,758	2,398	3,574
Shares o /s (mn)	556	556	556	556
Adjusted Basic EPS	4.7	5.0	4.3	6.4
Diluted shares o/s (mn)	556	556	556	556
Adjusted Diluted EPS	4.7	5.0	4.3	6.4
Adjusted Cash EPS	6.2	6.0	6.8	9.1
Dividend per share (DPS)	0.6	0.4	0.4	0.4
Dividend Payout Ratio(%)	16.7	11.8	11.1	7.5

Common size metrics

Year to March	FY16	FY17	FY18E	FY19E
Operating expenses	91.1	91.3	90.8	90.5
EBITDA margins	8.9	8.7	9.2	9.5
Net Profit margins	3.1	3.5	2.9	3.8

Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	0.3	(5.2)	3.1	14.5
EBITDA	13.6	(7.1)	9.4	17.6
PBT	102.8	(17.2)	34.0	49.1
Adjusted Profit	133.0	5.9	(13.1)	49.1
EPS	133.0	5.9	(13.1)	49.1

Balance sheet		(INR mn)			
As on 31st March	FY16	FY17	FY18E	FY19E	
Share capital	1,112	1,112	1,112	1,112	
Reserves & Surplus	31,496	33,311	35,442	38,749	
Shareholders' funds	32,608	34,423	36,554	39,861	
Short term borrowings	17,816	15,679	17,679	12,433	
Long term borrowings	1,019	91	191	3,070	
Total Borrowings	18,835	15,770	17,870	15,503	
Long Term Liabilities	228	268	288	308	
Def. Tax Liability (net)	(810)	(1,342)	(1,342)	(1,342)	
Sources of funds	50,862	49,120	53,370	54,330	
Gross Block	12,551	13,751	15,051	16,101	
Net Block	6,160	6,381	6,227	5,844	
Capital work in progress	76	13	63	63	
Intangible Assets	37	23	79	69	
Total Fixed Assets	6,274	6,416	6,368	5,975	
Non current investments	9,568	10,287	9,207	9,207	
Cash and Equivalents	2,161	1,095	1,035	1,274	
Inventories	16,568	15,258	17,105	18,566	
Sundry Debtors	32,038	37,035	36,949	34,005	
Loans & Advances	11,610	5,861	8,134	11,179	
Other Current Assets	13,529	11,865	13,990	13,974	
Current Assets (ex cash)	73,745	70,019	76,178	77,725	
Trade payable	28,208	29,435	30,024	30,324	
Other Current Liab	12,678	9,262	9,394	9,527	
Total Current Liab	40,886	38,698	39,418	39,851	
Net Curr Assets-ex cash	32,859	31,321	36,760	37,873	
Uses of funds	50,862	49,120	53,370	54,330	
BVPS (INR)	58.7	61.9	65.8	71.7	

Free cash flow		(INR mn)			
Year to March	FY16	FY17	FY18E	FY19E	
Reported Profit	2,402	2,255	2,398	3,574	
Add: Depreciation	1,100	1,121	1,358	1,473	
Interest (Net of Tax)	3,790	3,340	2,367	2,040	
Others	(6,031)	(200)	(13,204)	(4,228)	
Less: Changes in WC	1,093	(1,578)	5,419	1,094	
Operating cash flow	2,353	4,938	(1,663)	3,953	
Less: Capex	659	1,186	1,400	1,080	
Free Cash Flow	1,694	3,751	(3,063)	2,873	

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		P/B (X)		ROAE (%)	
		FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
Nagarjuna Construction Co	821	21.1	14.1	1.4	1.3	6.8	9.4
Hindustan Construction Co.	683	(46.5)	27.1	1.6	1.5	(3.4)	5.7
J Kumar Infraprojects	357	16.1	12.4	1.5	1.3	9.4	11.1
Simplex Infrastructures Ltd	319	25.7	13.6	1.2	1.1	4.8	8.5
Median	-	18.3	14.0	1.4	1.3	5.8	8.7
AVERAGE	-	4.0	16.9	1.4	1.3	4.4	8.6

Source: Edelweiss research

Cash flow metrics		FY16	FY17	FY18E	FY19E
Year to March					
Operating cash flow		2,353	4,938	(1,663)	3,953
Investing cash flow		600	(1,903)	(320)	(1,080)
Financing cash flow		(1,811)	(3,331)	1,833	(2,634)
Net cash Flow		1,142	(297)	(150)	239
Capex		(659)	(1,186)	(1,400)	(1,080)
Dividend paid		(401)	(267)	(267)	(267)

Profitability and efficiency ratios

Year to March	FY16	FY17	FY18E	FY19E
ROAE (%)	8.3	8.2	6.8	9.4
ROACE (%)	16.7	14.0	13.6	15.3
Inventory Days	89	87	86	83
Debtors Days	133	160	166	139
Payable Days	213	217	207	184
Cash Conversion Cycle	10	30	45	38
Current Ratio	1.9	1.8	2.0	2.0
Gross Debt/EBITDA	2.6	2.3	2.4	1.8
Gross Debt/Equity	0.6	0.5	0.5	0.4
Adjusted Debt/Equity	0.6	0.5	0.5	0.4
Net Debt/Equity	0.5	0.4	0.5	0.4
Interest Coverage Ratio	1.2	1.4	1.7	2.4

Operating ratios

Year to March	FY16	FY17	FY18E	FY19E
Total Asset Turnover	1.6	1.6	1.6	1.7
Fixed Asset Turnover	13.3	12.5	12.8	15.2
Equity Turnover	2.6	2.4	2.3	2.4

Valuation parameters

Year to March	FY16	FY17	FY18E	FY19E
Adj. Diluted EPS (INR)	4.7	5.0	4.3	6.4
Y-o-Y growth (%)	133.0	5.9	(13.1)	49.1
Adjusted Cash EPS (INR)	6.2	6.0	6.8	9.1
Diluted P/E (x)	19.4	18.3	21.1	14.1
P/B (x)	1.6	1.5	1.4	1.3
EV / Sales (x)	0.8	0.8	0.8	0.7
EV / EBITDA (x)	9.1	9.5	9.0	7.4
Dividend Yield (%)	0.7	0.4	0.4	0.4

Additional Data

Directors Data

Shri A. S. N. Raju	Promoter/ Executive Director	Shri N. R. Alluri	Promoter/ Non - Executive Director
Shri J. V. Ranga Raju	Promoter/ Executive Director	Shri A. V. N. Raju	Promoter/ Executive Director
Shri A. G. K. Raju	Promoter/ Executive Director	Shri A. A. V. Ranga Raju	Promoter and Managing Director
Shri P. Abraham	Independent Non-Executive Director	Shri R. V. Shastri	Independent Non-Executive Director
Shri Amit Dixit	Non-Independent Non-Executive Director	Shri Utpal Sheth	Non-Independent Non-Executive Director
Smt Renu Challu	Independent Non-Executive Director	Shri Hemant M Nerurkar	Chairman and Independent Director
Shri Neeraj Mohan	Non-Independent Non-Executive Director	Shri S Ravi	Independent Non-Executive Director
Dr. A S Durga Prasad	Independent Non-Executive Director		

Auditors - M/s M. Bhaskara Rao & Co., M/s Deloitte Haskins & Sells

**as per last annual report*

Holding – Top10

	Perc. Holding		Perc. Holding
Rakesh R Jhunjunwala	10.21	UTI Asset Management	4.47
Government Pension Fund Global	4.46	Dimensional Fund Advisors	3.40
Tata Asset Management	3.28	Reliance Capital Trustee	3.07
Prudential ICICI Asset Management Blackstone	2.89	DSP Blackrock Investment Management Beacon India Pvt Equity	2.17
Vanguard Inc	2.06	SBI funds management	1.28

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
21 Oct 2016	Reliance Banking Fund	Buy	13500000	86.00
21 Oct 2016	Blackstone Gpv Capital Partners (Mauritius) Vi Fii Ltd.	Sell	14943404	86.00
20 Jun 2016	A V S R Holdings Pvt Ltd	Buy	500000	74.50
20 Jun 2016	A V S Raju	Sell	500000	74.50
01 Jun 2016	A V S R Holdings Pvt Ltd	Buy	1800000	73.50
01 Jun 2016	A V S Raju	Sell	1250000	73.50
01 Jun 2016	Avathesh Property Developers Pvt Ltd	Sell	550000	73.50

**as per last available data*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
21 Dec 2016	JAMPANA VENKATA RANGA RAJU	Sell	50000.00
19 Dec 2016	J. Sridevi	Sell	50000.00
19 Dec 2016	JAMPANA KRISHNA CHAITANYA VARMA	Sell	50000.00
25 Oct 2016	ALLURI VENKATA SATYANARAYANA RAJU	Sell	1394969.00
07 Oct 2016	ALLURI VENKATA SATYANARAYANAMMA	Sell	500000.00

**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
10-Feb-17	Nagarjuna Construction	Falling interest costs boost profitability; <i>Result Update</i>	87	Buy
02-Feb-17	Hindustan Construction Company	Debt reduction commences; <i>Result Update</i>	41	Buy
01-Feb-17	Construction	Budget FY18: Budgetary support gets enhanced; <i>Sector Update</i>		

Distribution of Ratings / Market Cap

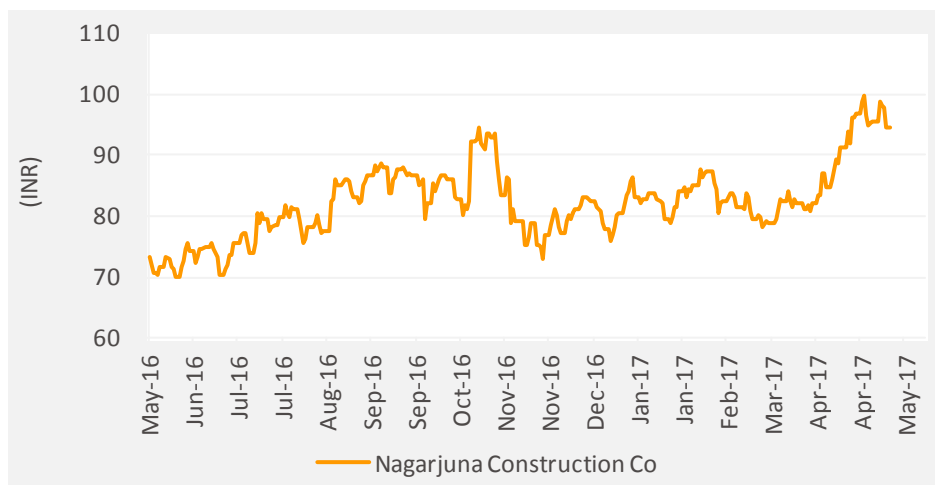
Edelweiss Research Coverage Universe

	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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