

NBCC

HSCL acquisition to result in synergies

India Equity Research | Infrastructure - Construction

NBCC has acquired 51% stake in Hindustan Steelworks Construction (HSCL) w.e.f., April 1, 2017. HSCL has an order book of ~INR80bn. While HSCL posted negative EBITDA margin in FY16 (-1.5%), we believe there is huge scope for margin improvement via curtailment of establishment/employee costs and operating leverage. Post restructuring, HSCL is now a debt free entity. Ergo, we estimate the acquisition to be EPS accretive for NBCC in FY18 itself. With construction expected to start on NBCC's Delhi redevelopment projects in Q2FY18, we believe execution and margin improvement will gain traction going ahead. Maintain 'HOLD' with a target price of INR223.

HSCL acquisition to expand bouquet of services

NBCC has acquired 51% stake in HSCL after being allotted fresh shares worth INR357mn in the company (balance 49% owned by central government). HSCL (which had posted revenue of ~INR13.5bn and net profit of INR302mn in FY16) undertakes PMC and EPC works in the steel segment. The acquisition will not only augment NBCC's order book by ~INR80bn, but also strengthens its presence in the segment.

Strong possibility of margin expansion

HSCL's operations were earlier chequered due to muted revenue growth, low operating margins and net losses. The company was also burdened by ~INR20bn of debt. However, post restructuring by the Government of India (GoI) and acquisition by NBCC, it is now a debt free company. Through operating leverage and cost control, NBCC management expects significant margin expansion going ahead.

Outlook and valuations: Positive development; maintain 'HOLD'

We believe HSCL's acquisition will add value to NBCC at multiple levels. Not only will it bolster the latter's capabilities in the steel segment, but also add ~INR80bn orders along with the possibility of quick turnaround and consequent strong earnings growth. With the Delhi redevelopment projects getting launched, we expect NBCC's execution to gather pace going ahead. Robust revenue visibility (>8x FY17E revenues), cash-rich balance sheet and healthy return ratios are key positives for NBCC. We maintain 'HOLD' with a target price of INR223, based on 33x FY19E EPS.

Financials

Year to March	FY16	FY17E	FY18E	FY19E
Revenue (INR mn)	58,271	66,041	79,968	108,038
EBITDA (INR mn)	3,462	3,994	4,996	7,290
Adjusted profit (INR mn)	3,088	3,371	4,247	6,070
Shares outstanding (mn)	600	900	900	900
Basic EPS (INR)	5.1	3.7	4.7	6.7
P/E (x)	38.7	53.2	42.2	29.5
ROAE (%)	22.0	21.1	23.1	28.0

EDELWEISS RATINGS

Absolute Rating	HOLD
Investment Characteristics	Growth

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

CMP	: INR 199
Target Price	: INR 223
52-week range (INR)	: 206 / 117
Share in issue (mn)	: 900.0
M cap (INR bn/USD mn)	: 180 / 2,808
Avg. Daily Vol. BSE/NSE ('000)	: 2,064.5

SHARE HOLDING PATTERN (%)

	Current	Q2FY17	Q1FY17
Promoters *	75.0	75.0	90.0
MF's, FI's & BKs	9.0	10.3	0.8
FII's	5.0	4.0	3.0
Others	11.0	10.7	6.3
* Promoters pledged shares (% of share in issue)	:	NIL	

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	6.4	15.8	9.5
3 months	14.1	11.3	(2.8)
12 months	34.3	50.3	16.0

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Other highlights

- HSCL was grappling with muted revenue growth (during FY14-16), low operating margins (-1.5% in FY16, 3% in FY15) and high debt (~INR20bn). Post the restructuring exercise undertaken by GoI, the company was left with ~INR3bn debt. This debt was also repaid using cash available with the company. Thus, HSCL is now a debt free company.

Table 1: HSCL Financial snapshot

Particulars	FY11	FY12	FY13	FY14	FY15	FY16
Revenues (INR mn)	9,749	11,714	12,385	13,599	14,710	13,470
Revenue growth (%)		20.2	5.7	9.8	8.2	(8.4)
EBITDA (INR mn)	374	292	443	205	437	(198)
EBITDA margin (%)	3.8	2.5	3.6	1.5	3.0	(1.5)
Reported profit (INR mn)	(381)	(281)	(198)	(187)	(81)	302
PAT margin (%)	(3.9)	(2.4)	(1.6)	(1.4)	(0.6)	2.2
Net worth (INR mn)	(13,439)	(13,720)	(13,918)	(14,105)	(14,174)	657
Debt (INR mn)	16,142	17,242	18,346	19,355	20,285	5,352
Net Debt/Equity (x)	(1.0)	(1.0)	(1.0)	(1.0)	(1.0)	(2.6)

Source: Edelweiss research

- Post the acquisition, NBCC is targeting 10-15% revenue growth in HSCL's revenues over next 2 years.
- HSCL's operating margins were low due to inefficient operations and huge employee base. Post implementation of the VRS scheme, the employee base now stands reduced. The company is now managing its operations with 40-45 permanent and ~1,000 contractual employees. The company also had offices in ~26 cities, despite small base of operations.

NBCC plans to reduce the number contractual employees and employ its own staff to run HSCL. This, along with lower establishment expenses (in addition to likely revenue growth and operating leverage) could result in significant expansion in margins going ahead.

- **HSCL business mix:** Around 60% of HSCL's business pertains to PMC work with the balance 40% accounted by EPC work at the steel plants. Both nature of PMC work undertaken by HSCL and margins of the segment are similar to that of NBCC. HSCL's main clients are Ministry of Rural Development, Ministry of Sports, paramilitary forces, state governments, etc.

Main clients in EPC segment are PSUs like Rashtriya Ispat Nigam (RINL) and Steel Authority of India (SAIL) which enter into long term contracts with HSCL (90% of EPC revenues).

- HSCL has land parcels/properties in cities like Kolkata, New Delhi, Chennai and Tirupati with estimated market value at INR1.5bn.
- **Future acquisitions:** The GoI is looking to sell 4 more companies (similar to HSCL) with the final decision expected to be taken in next 6 months. NBCC has evinced interest in taking over 2-3 companies depending on their valuations.
- NBCC launched Phase I of the Nauroji Nagar redevelopment project in March 2017. The company is offering 0.25mn sq ft area in this phase at INR37,000/sq ft.

- **Status of NBCC's Delhi projects:** NBCC expects to start construction on the Pragati Maidan and Nauroji Nagar projects in Q2FY18 and on AIIMS and Netaji Nagar projects in Q3FY18. The company has already invited tenders for the Pragati Maidan and Nauroji Nagar projects. It will now invite tenders for other projects in every subsequent month going ahead.

Company Description

NBCC is a 'Navratna' PSU which is mainly present in the following segments:

PMC: NBCC does PMC work for projects awarded by various government arms like the Ministry of Home Affairs, Ministry of Corporate Affairs, Ministry of Urban Development, Ministry of Power and Ministry of External Affairs, among others. The company bags ~80% of the PMC works on a nomination basis, with the balance won on competitive bidding basis. Its competitors in this segment include IRCON, WAPCOS, Engg Projects India (EPI), Hindustan Prefab, etc.

EPC work for infra projects: In this segment, NBCC provides EPC services for power projects. It undertakes design and execution of civil and structural works for power projects, cooling towers and chimneys. Projects in this segment are awarded on competitive bidding basis. Major competitors in this segment are L&T, Gammon, Paharpur Cooling Tower, etc.

Real estate development: Here NBCC develops realty projects on land owned by it. Over the years, surplus cash generated has been invested in buying land from the government agencies. Currently, NBCC has ~130 acres of land in its kitty.

Investment Theme

NBCC is a 'Navratna' public sector undertaking (PSU) in the construction space, which mainly undertakes project management and consultancy (PMC) work for government organisations. The company's PSU status ensures that ~80% of the PMC projects won by it are bagged on nomination basis. NBCC's diversified execution capabilities ensure that it remains the preferred port-of-call for executing large size projects, which various government organisations are unequipped to handle on their own.

NBCC's experience in real estate development space (the only PSU PMC player with this capability) means it enjoys near monopoly position in redevelopment of government colonies/development of government land.

Key Risks

Sub-contractor risk

NBCC sub-contracts actual construction work. Even when work is sub-contracted on a back-to-back basis, the ultimate responsibility for project completion rests with the company. Any issue with the sub-contractor not being able to execute the project efficiently can adversely impact project timelines and hence NBCC's profitability.

Execution risk

Average size of projects being handled by the company is increasing and projects also involve higher level of complexity than what the company has encountered so far. Completion of such projects within the stipulated time and costs will be paramount to maintain profitability.

Rising exposure to real estate development business

NBCC's investment (in terms of land bank acquisition) has been steadily increasing. With the real estate industry currently facing a slowdown in many cities, the company may also have to rework its plan regarding monetisation of this land bank.

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)	174	331	132	156
Y-o-Y growth (%)	143.5	90.0	(60.0)	18.0
Book-to-bill ratio (x)	5.1	8.5	7.7	6.1
Order backlog (INR bn)	298	563	615	664
Order backlog growth (%)	63.8	89.0	9.3	7.8
Revenue growth (% yoy)	32	13	21	35
Raw Material (% net rev)	(1.2)	(1.2)	(1.2)	(1.2)
Other mfg(as % of sales)	90.1	90.5	90.3	89.9
Salary (% of revenues)	3.8	3.3	3.3	3.2
Depreciation rate (%)	5.7	3.2	3.2	5.1
Tax rate (%)	29.2	29.2	29.2	29.2
Dividend per share	2.0	1.7	2.1	3.0
Inc. in invts (INR mn)	789	166	180	194
Capex (INR mn)	378	89	98	128
Debtor days	116	116	116	115
Inventory days	91	92	87	86
Payable days	113	138	128	147
Other creditors days	133	123	123	123
Provisions days	13	12	8	6
Loans & adv (% net rev)	10.6	12.0	12.0	13.0

Income statement

(INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Income from operations	58,271	66,041	79,968	108,038
Direct costs	51,812	58,984	71,263	95,846
Employee costs	2,223	2,189	2,650	3,473
Other Expenses	775	874	1,059	1,430
Total operating expenses	54,809	62,047	74,972	100,749
EBITDA	3,462	3,994	4,996	7,290
Depreciation	22	27	30	53
EBIT	3,439	3,967	4,966	7,236
Add: Other income	1,290	1,397	1,703	2,031
Less: Interest Expense	368	602	669	693
Profit Before Tax	4,362	4,762	6,000	8,574
Less: Provision for Tax	1,274	1,391	1,753	2,505
Reported profit	3,088	3,371	4,247	6,070
Adjusted profit	3,088	3,371	4,247	6,070
Shares o/s (mn)	600	900	900	900
Adjusted Basic EPS	5.1	3.7	4.7	6.7
Diluted shares o/s (mn)	600	900	900	900
Adjusted Diluted EPS	5.1	3.7	4.7	6.7
Adjusted Cash EPS	5.0	3.8	4.8	6.8
Dividend per share (DPS)	2.0	1.1	1.4	2.0
Dividend Payout Ratio (%)	38.9	30.0	30.0	30.0

Common size metrics

Year to March	FY16	FY17	FY18E	FY19E
Operating expenses	94.1	94.0	93.8	93.3
Depreciation	-	-	-	-
Interest Expense	0.6	0.9	0.8	0.6
EBITDA margins	5.9	6.0	6.2	6.7
Other income	2.2	2.1	2.1	1.9
Tax	2.2	2.1	2.2	2.3
EBIT margins	5.9	6.0	6.2	6.7
Adj. profit margins	5.3	5.1	5.3	5.6

Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	32.4	13.3	21.1	35.1
EBITDA	20.6	15.4	25.1	45.9
PBT	11.6	9.2	26.0	42.9
Adjusted profit	11.4	9.2	26.0	42.9
EPS	11.4	(27.2)	26.0	42.9

Balance sheet		(INR mn)			
As on 31st March	FY16	FY17	FY18E	FY19E	
Share capital	1,200	1,800	1,800	1,800	
Reserves & Surplus	13,685	15,239	17,953	21,831	
Shareholders' funds	14,885	17,039	19,753	23,631	
Long Term Liabilities	608	608	608	608	
Def. Tax Liability (net)	(315)	(315)	(315)	(315)	
Sources of funds	15,178	17,332	20,046	23,924	
Gross Block	793	882	980	1,109	
Net Block	620	682	750	825	
Total Fixed Assets	620	682	750	825	
Non current investments	229	229	229	229	
Cash and Equivalents	13,414	17,870	19,732	25,648	
Inventories	14,247	19,045	19,076	31,835	
Sundry Debtors	20,079	21,897	28,932	39,147	
Loans & Advances	6,176	7,925	9,596	14,045	
Other Current Assets	71	102	102	102	
Current Assets (ex cash)	40,572	48,969	57,706	85,128	
Trade payable	18,000	24,965	27,937	43,534	
Other Current Liab	21,657	25,454	30,434	44,372	
Total Current Liab	39,657	50,418	58,371	87,906	
Net Curr Assets-ex cash	915	(1,449)	(666)	(2,778)	
Uses of funds	15,178	17,332	20,046	23,924	
BVPS (INR)	24.8	18.9	21.9	26.3	

Free cash flow		(INR mn)			
Year to March	FY16	FY17	FY18E	FY19E	
Reported Profit	3,088	3,371	4,247	6,070	
Add: Depreciation	22	27	30	53	
Interest (Net of Tax)	260	426	474	490	
Others	(1,705)	(1,643)	(2,007)	(2,682)	
Less: Changes in WC	(364)	(2,364)	784	(2,112)	
Operating cash flow	2,030	4,545	1,960	6,044	
Less: Capex	378	89	98	128	
Free Cash Flow	1,652	4,456	1,862	5,915	

Cash flow metrics		FY16	FY17	FY18E	FY19E
Year to March					
Operating cash flow		2,030	4,545	1,960	6,044
Investing cash flow		(1,167)	(255)	(278)	(322)
Financing cash flow		-	600	-	-
Net cash Flow		862	4,890	1,682	5,721
Capex		(378)	(89)	(98)	(128)
Dividend paid		(1,444)	(1,217)	(1,534)	(2,192)

Profitability and efficiency ratios		FY16	FY17	FY18E	FY19E
Year to March					
ROAE (%)		22.0	21.1	23.1	28.0
ROACE (%)		33.6	33.6	36.3	42.7
Inventory Days		100	98	96	95
Debtors Days		125	123	121	120
Payable Days		116	118	120	120
Cash Conversion Cycle		109	103	97	95
Current Ratio		1.4	1.3	1.3	1.0
Net Debt/Equity		(0.9)	(1.0)	(1.0)	(1.1)
Interest Coverage Ratio		9.4	6.6	7.4	10.4

Operating ratios		FY16	FY17	FY18E	FY19E
Year to March					
Total Asset Turnover		4.1	4.1	4.3	4.9
Fixed Asset Turnover		132.1	101.4	111.7	137.2
Equity Turnover		4.1	4.1	4.3	5.0

Valuation parameters		FY16	FY17	FY18E	FY19E
Year to March					
Adj. Diluted EPS (INR)		5.1	3.7	4.7	6.7
Y-o-Y growth (%)		11.4	(27.2)	26.0	42.9
Adjusted Cash EPS (INR)		5.0	3.8	4.8	6.8
Diluted P/E (x)		38.7	53.2	42.2	29.5
P/B (x)		8.0	10.5	9.1	7.6
EV / Sales (x)		1.8	2.4	2.0	1.4
EV / EBITDA (x)		30.6	40.4	31.9	21.1
Dividend Yield (%)		1.0	0.6	0.7	1.0

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		ROAE (%)	
		FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
NBCC	2,792	42.2	29.5	31.9	21.1	23.1	28.0
Nagarjuna Construction Co	846	23.1	16.6	9.1	7.9	6.4	8.3
Simplex Infrastructures Ltd	321	26.0	13.7	7.6	6.6	4.8	8.5
Median	-	26.0	16.6	9.1	7.9	6.4	8.5
AVERAGE	-	30.4	20.0	16.2	11.9	11.4	15.0

Source: Edelweiss research

Additional Data

Directors Data

Dr. Anoop Kumar Mittal	Chairman and Managing Director	Mr. S.K Pal	Director (Finance)
Mr. S K Chaudhary	Director (Projects)	Mr. Rajendra Chaudhari	Director (Commercial)
Mr. D.S. Mishra	Nominee Director (MoUD)	Ms. Jhanja Tripathy	Nominee Director (MoUD)
Mr. Ashok Khurana	Independent Director	Major General Tajuddin Moulali Mhaisale	Independent Director
Mr. C Subba Reddy	Independent Director	Mr. C. R. Raju	Independent Director
Mr. Rajendrasinh G. Rana	Independent Director	Mr. Sairam Mocheria	Independent Director

Auditors - M/s Jagdish Chand & Co

**as per last annual report*

Holding – Top 10

	Perc. Holding		Perc. Holding
Life Insurance Corp of India	7.28	HSBC	0.42
Credit Agricole SA	0.38	Jupiter Investment Management	0.33
Birla Sun Life Insurance	0.28	Vanguard	0.21
Allianz SE Norges Bank	0.19	Nomura Asset Management	0.17
Tata Asset Management	0.17	JP Morgan Asset Management	0

**as per last available data*

Bulk Deals

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

**as per last available data*

Insider Trades

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

**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
07-Apr-17	Ashoka Buildcon	Diversifies into commercial realty development space; <i>Company Update</i>	212	Buy
05-Apr-17	Infra.	Railways and roads continue stellar run; <i>Sector Update</i>		
16-Feb-17	J Kumar Infraprojects	Execution ramp up begins; <i>Result Update</i>	223	Buy

Distribution of Ratings / Market Cap

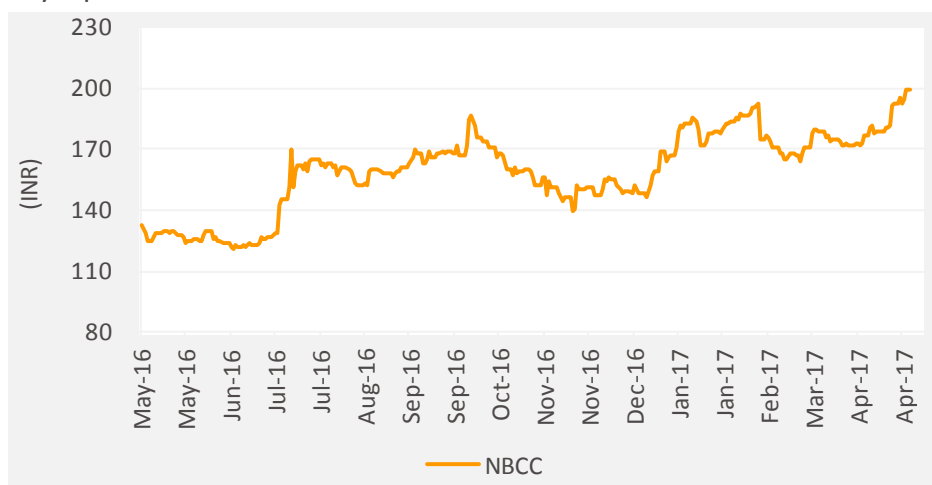
Edelweiss Research Coverage Universe

	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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