

SADBHAV ENGINEERING

Steady performance

India Equity Research | Infrastructure - Construction



Sadbhav Engineering's (SEL) top line grew 17% YoY in Q1FY18 driven by commencement of work on hybrid annuity (HAM) projects and pick up in execution on EPC projects. While interest cost catapulted 87% YoY, MAT credit led to PAT jumping 14% YoY to INR555mn. Traffic on BOT projects grew ~2% YoY. While we envisage execution of HAM projects to boost FY18 top line, order inflows remain critical to improve revenue visibility (book-to-bill at 2.4x) and will determine stock performance. Maintain 'BUY' with SOTP-based target price of INR388.

Execution remains robust; order intake key

Commencement of work on 3 HAM projects along with sustained traction in EPC projects led to revenue at INR9.4bn rising 17% YoY. Increased revenue contribution from high-margin HAM projects at the expense of low-margin irrigation projects led to EBITDA margin jumping 54bps YoY to 11.3%. The company ended Q1FY18 with an order book of ~INR84bn, 2.4x TTM revenue. While FY18 revenue guidance of INR38bn plus is not at risk, we believe fresh order inflows are required to achieve the target of 15-18% top line growth in FY19.

Subdued traffic on BOT projects

Traffic on BOT projects grew ~2% YoY during Q1FY18, though management indicated that growth has picked up in August (up 5.0-5.5% YoY). Work has commenced on 3 HAM projects; we expect SEL to receive 'appointed date' for 1 HAM project in the current quarter and 3 more HAM projects over Q3/Q4FY18. It is in the process of refinancing 4 operational BOT projects, which will further improve the BOT arm's cash flows.

Outlook and valuations: Attractive; maintain 'BUY'

With a strong bid pipeline, robust BOT portfolio and best-in-class execution skill, we expect SEL to perform well going ahead. We expect higher revenue visibility in the EPC arm and better cash flow generation in the BOT subsidiary to trigger re-rating going ahead. 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).

EDELWEISS RATINGS

Absolute Rating	BUY
Investment Characteristics	Growth

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

CMP	: INR 267
Target Price	: INR 388
52-week range (INR)	: 351 / 220
Share in issue (mn)	: 171.6
M cap (INR bn/USD mn)	: 46 / 713
Avg. Daily Vol. BSE/NSE ('000)	: 138.4

SHARE HOLDING PATTERN (%)

	Current	Q4FY17	Q3FY17
Promoters *	46.8	46.8	46.8
MF's, FI's & BKs	25.3	26.3	26.1
FII's	18.2	17.2	16.9
Others	9.7	9.8	10.2
* Promoters pledged shares (% of share in issue)	:	15.63	

PRICE PERFORMANCE (%)

	BSE Midcap Index	Stock	Stock over Index
1 month	0.6	(7.9)	(8.5)
3 months	1.6	(21.4)	(23.0)
12 months	19.8	(5.1)	(25.0)

Financials

(INR mn)

Year to March	Q1FY18	Q1FY17	% change	Q4FY17	% change	FY17	FY18E	FY19E
Revenues	9,444	8,070	17.0	10,329	(8.6)	33,203	37,770	42,084
EBITDA	1,068	868	23.0	1,096	(2.6)	3,556	4,159	4,634
Adj. profit	555	487	14.0	682	(18.7)	1,878	2,003	1,721
Dilu.EPS (INR)	3.2	2.8	14.0	4.0	(18.7)	11.0	11.7	10.0
Dilu.P/E (x) *						3.5	3.3	3.9
EV/EBITDA (x) *						6.5	5.0	4.5
ROAE (%)						11.9	11.4	8.9

* for implied construction business

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August 16, 2017

Concall highlights

- **Order intake:** Bidding activity was muted in Q1FY18 due to GST impact. However, it has now picked up. With NHAI looking to award projects spanning 6,500km and worth ~INR750bn, SEL expects to win ~INR60-70bn of fresh orders in the road segment alone. In addition, the company is also targeting orders in mining, irrigation and metro rail.
- **FY18 guidance: Revenue** - INR38-39bn, of which HAM projects will contribute ~INR14-15bn; Road EPC – INR17bn; Mining – INR3bn; and Irrigation – INR4.25-4.5bn. **Operating margin** – 11.25-12.0%.
- **Q1FY18 order book break-up:** Transport projects account for 69% of order book (captive BOT projects 55%); irrigation and mining contribute 11% and 20%, respectively.
- **Debt:** As at Q1FY18 end, SEL's gross debt (standalone) stood at INR14.5bn (INR16.6bn at FY17 end). Management expects FY18 end debt to be ~INR12bn driven by: a) receipt of mobilisation advance on new HAM projects; b) reduction in JV work from GKC and DMRC, which requires higher funding support; and c) lower working capital requirement in HAM projects compared to EPC projects.
- **Loans given by SEL to SIPL** are at INR4.4bn (INR4.3bn at FY17 end).
- **Tax rate:** Management has guided for nil tax in FY18 since it still has unclaimed MAT credit of previous years available worth ~INR1.2bn. SEL expects full tax rate in FY19 as the proportion of HAM projects, which do not avail 80 (IA) benefits, will increase in the top line.
- **HAM projects:** SEL has already started work on the Rampur Kathgodam Pkg 1, Una Kodinar and Bhavnagar Talaja projects. It expects to receive 'appointed date' for Rampur Kathgodam Pkg 2 in Q3FY18 and BRT Tiger reserve boundary project in Q2FY18. It expects to achieve financial closure and commence work on the Udaipur bypass and Waranga-Mahagaon (Pkg-I) projects by Q3/Q4FY18.

Financial snapshot

(INR mn)

Year to March	Q1FY18	Q1FY17	% change	Q4FY17	% change	FY17	FY18E	FY19E
Net revenues	9,444	8,070	17.0	10,329	(8.6)	33,203	37,770	42,084
Direct costs	7,436	6,621	12.3	8,106	(8.3)	26,552	30,091	33,528
Staff costs	309	315	(1.8)	379	(18.4)	1,366	1,554	1,732
Other expenses	631	266	137.5	748	(15.7)	1,729	1,967	2,191
Total expenditure	8,376	7,201	16.3	9,233	(9.3)	29,647	33,612	37,451
EBITDA	1,068	868	23.0	1,096	(2.6)	3,556	4,159	4,634
Depreciation	245	254	(3.6)	243	1.0	1,000	1,082	1,170
EBIT	822	614	34.0	853	(3.6)	2,556	3,077	3,464
Other income	39	48	(17.7)	218	(82.0)	333	273	250
Interest	322	172	86.9	355	(9.4)	992	1,347	1,146
Profit before tax	540	489	10.3	716	(24.6)	1,897	2,003	2,568
Provision for taxes	(15)	2	NA	33	NA	18	-	848
Reported profit	555	487	14.0	682	(18.7)	1,878	2,003	1,721
Adjusted profit	555	487	14.0	682	(18.7)	1,878	2,003	1,721
Equity capital	172	172		172		172	172	172
Diluted shares (mn)	172	172		172		172	172	172
Adjusted Diluted EPS	3.2	2.8	14.0	4.0	(18.7)	11.0	11.7	10.0
as % of net revenues								
Direct costs	78.7	82.0		78.5		80.0	79.7	79.7
Other expenses	6.7	3.3		7.2		5.2	5.2	5.2
EBITDA	11.3	10.8		10.6		10.7	11.0	11.0
Reported profit	5.9	6.0		6.6		5.7	5.3	4.1
Tax rate	(2.8)	0.5		4.7		1.0	-	33.0

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	4.5	4.0	4.5
Repo rate (exit rate)	6.8	6.3	5.8	5.8
USD/INR (Avg)	65.0	67.5	66.0	66.0
Company				
Order intake (INR bn)	25	35	63	70
Y-o-Y growth (%)	11.0	42.1	79.4	11.1
Book-to-bill ratio (x)	2.3	2.3	2.7	3.1
Order backlog (INR bn)	75	77	102	130
Order backlog growth (%)	(8.7)	2.6	32.9	27.4
Revenue growth (% yoy)	7	4	14	11
Raw Material (% net rev)	81.0	80.0	79.7	79.7
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	7.4	7.2
Depreciation rate (%)	9.5	9.5	10.0	10.0
Tax rate (%)	28.4	1.0	-	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	52	51
Payable days	58	59	77	83
Other creditors days	60	42	27	27
Provisions days	12	-	-	-
Loans & adv (% net rev)	18.3	16.2	15.7	16.6
Incremental debt	766	(4,396)	2,150	(200)

Income statement

(INR mn)

Year to March	FY16	FY17	FY18E	FY19E
Income from operations	31,863	33,203	37,770	42,084
Direct costs	25,805	26,552	30,091	33,528
Employee costs	1,228	1,366	1,554	1,732
Other Expenses	1,482	1,729	1,967	2,191
Total operating expenses	28,515	29,647	33,612	37,451
EBITDA	3,348	3,556	4,159	4,634
Depreciation	971	1,000	1,082	1,170
EBIT	2,377	2,556	3,077	3,464
Add: Other income	317.85	332.98	273.19	250.37
Less: Interest Expense	855	992	1,347	1,146
Add: Prior period items	141	-	-	-
Add: Exceptional items	(194)	-	-	-
Profit Before Tax	1,787	1,897	2,003	2,568
Less: Provision for Tax	467	18	-	848
Prior Period(Net of Tax)	141	-	-	-
Reported profit	1,320	1,878	2,003	1,721
Exceptional Items	(194)	-	-	-
Adjusted profit	1,373	1,878	2,003	1,721
Shares o/s (mn)	172	172	172	172
Adjusted Basic EPS	8.0	11.0	11.7	10.0
Diluted shares o/s (mn)	172	172	172	172
Adjusted Diluted EPS	8.0	11.0	11.7	10.0
Adjusted Cash EPS	13.7	16.8	18.0	16.9
Dividend per share (DPS)	0.7	0.7	0.7	0.7
Dividend Payout Ratio (%)	10.9	7.7	7.2	8.4

Common size metrics

Year to March	FY16	FY17	FY18E	FY19E
Operating expenses	89.5	89.3	89.0	89.0
EBITDA margins	10.5	10.7	11.0	11.0
Adj. profit margins	4.3	5.7	5.3	4.1

Growth ratios (%)

Year to March	FY16	FY17	FY18E	FY19E
Revenues	7.3	4.2	13.8	11.4
EBITDA	11.5	6.2	16.9	11.4
PBT	20.5	6.2	5.6	28.2
Adjusted profit	23.4	36.8	6.6	(14.1)
EPS	23.4	36.8	6.6	(14.1)

Infrastructure - Construction

Balance sheet (INR mn)				
As on 31st March	FY16	FY17	FY18E	FY19E
Share capital	172	172	172	172
Reserves & Surplus	14,721	16,437	18,296	19,872
Shareholders' funds	14,892	16,609	18,468	20,044
Short term borrowings	7,275	13,541	12,641	12,641
Long term borrowings	4,932	3,062	1,812	2,012
Total Borrowings	12,207	16,603	14,453	14,653
Long Term Liabilities	32	98	98	98
Def. Tax Liability (net)	(90)	(477)	(477)	(477)
Sources of funds	27,041	32,834	32,543	34,319
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	346	325
Inventories	1,406	1,234	1,735	2,123
Sundry Debtors	10,372	17,010	18,174	18,030
Loans & Advances	5,832	5,381	5,932	6,989
Other Current Assets	5,524	4,950	5,417	5,932
Current Assets (ex cash)	23,135	28,574	31,258	33,074
Trade payable	3,703	4,910	7,723	7,578
Other Current Liab	4,116	1,983	2,380	2,384
Total Current Liab	7,819	6,893	10,103	9,962
Net Curr Assets-ex cash	15,316	21,681	21,155	23,112
Uses of funds	27,041	32,834	32,543	34,319
BVPS (INR)	86.8	96.8	107.7	116.9

Free cash flow (INR mn)				
Year to March	FY16	FY17	FY18E	FY19E
Reported Profit	1,125	1,878	2,003	1,721
Add: Depreciation	971	1,000	1,082	1,170
Interest (Net of Tax)	632	982	1,347	768
Others	(764)	(1,604)	(1,968)	(1,389)
Less: Changes in WC	3,612	4,578	5,894	1,676
Operating cash flow	(1,647)	(2,321)	(3,430)	593
Less: Capex	(881)	(1,060)	(760)	(1,010)
Free Cash Flow	(767)	(1,261)	(2,670)	1,603

Cash flow metrics				
Year to March	FY16	FY17	FY18E	FY19E
Operating cash flow	(1,647)	(2,321)	(3,430)	593
Investing cash flow	1,108	3,399	1,408	5,246
Financing cash flow	672	(4,396)	2,150	(200)
Net cash Flow	132	(3,318)	128	5,640
Capex	881	1,060	760	1,010
Dividend paid	(145)	(145)	(145)	(145)

Profitability and efficiency ratios				
Year to March	FY16	FY17	FY18E	FY19E
ROAE (%)	9.7	11.9	11.4	8.9
ROACE (%)	10.4	9.6	10.1	11.0
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	3.4
Gross Debt/EBITDA	3.6	4.7	3.5	3.2
Gross Debt/Equity	0.8	1.0	0.8	0.7
Adjusted Debt/Equity	0.8	1.0	0.8	0.7
Net Debt/Equity	0.8	1.0	0.8	0.7
Interest Coverage Ratio	2.8	2.6	2.3	3.0

Operating ratios				
Year to March	FY16	FY17	FY18E	FY19E
Total Asset Turnover	1.2	1.1	1.2	1.3
Fixed Asset Turnover	5.6	6.0	7.1	8.0
Equity Turnover	2.2	2.1	2.2	2.2

Valuation parameters				
Year to March	FY16	FY17	FY18E	FY19E
Adj. Diluted EPS (INR)	8.0	11.0	11.7	10.0
Y-o-Y growth (%)	23.4	36.8	6.6	(14.1)
Adjusted Cash EPS (INR)	13.7	16.8	18.0	16.9
Diluted P/E (x)*	4.8	3.5	3.3	3.9
P/B (x)	3.1	2.8	2.5	2.3
EV / Sales (x)*	0.6	0.7	0.5	0.5
EV / EBITDA (x)*	5.6	6.5	5.0	4.5
Dividend Yield (%)	0.3	0.3	0.3	0.3

* 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	713	22.8	26.6	2.5	2.3	11.4	8.9
Ashoka Buildcon	556	69.3	27.9	2.1	2.0	0.9	5.1
Nagarjuna Construction Co	759	20.1	13.6	1.3	1.2	6.8	9.4
Simplex Infrastructures Ltd	363	29.0	13.3	1.5	1.3	5.1	10.4
Median	-	25.9	20.1	1.8	1.6	6.0	9.2
AVERAGE	-	35.3	20.3	1.8	1.7	6.1	8.4

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 – Top10

	Perc. Holding		Perc. Holding
HDFC Asset Management	5.74	Prudential ICICI Asset Management	5.51
SBI Fund Management	4.70	Tata Asset Management	3.84
Nomura	3.64	DSP Blackrock Investment	3.15
Abu Dhabi Investment Authority	1.72	Government Pension Fund - Global	1.52
Prudential PLC	1.35	Vanguard Group	1.27

**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	Shashin Vishnubhai Patel	Sell	650000.00
30 Mar 2017	Rekhaben Vasisthakumar Patel	Buy	650000.00
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

**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
16-Aug-17	KNR Constructions	Robust performance; order inflows critical; <i>Result Update</i>	221	Buy
16-Aug-17	J Kumar Infraprojects	A 'trading' challenge; <i>Result Update</i>	206	Buy
11-Aug-17	Nagarjuna Construction	Order inflows perk up ; <i>Result Update</i>	176	Buy

Distribution of Ratings / Market Cap

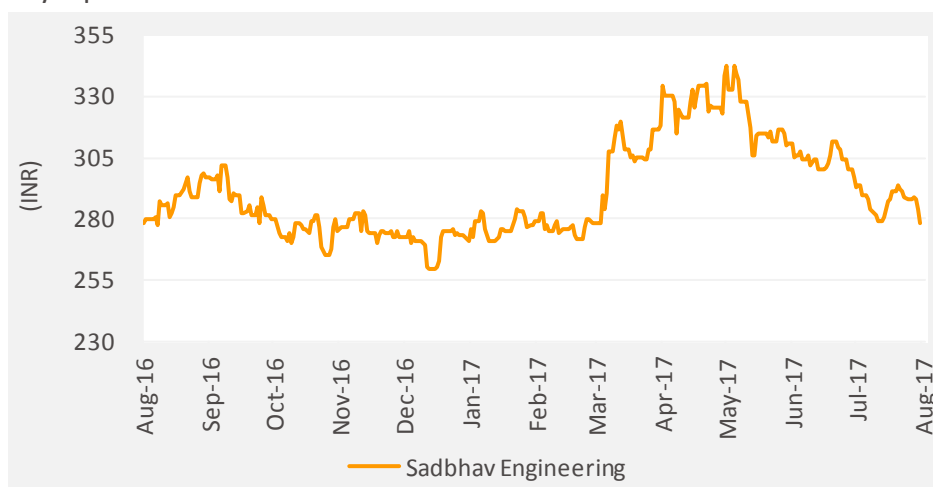
Edelweiss Research Coverage Universe

	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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