

September 12, 2018

Ircon International Ltd

Price band ₹ 470-475

Rating matrix

Rating : Subscribe

Issue Details

Issue Opens	17-Sep-18
Issue Closes	19-Sep-18
Issue Size (₹ Crore)	470
Price Band (₹)	470-475*
No of Shares on Offer (crore)	0.99
QIB (%)	47%
Non-Institutional (%)	14%
Retail (%)	33%
Employee Reservation (%)	5%
Minimum lot size (No. of shares)	30
*₹10 discount for retail category	

Objects of the Issue

Objects of the Issue	
To carry out disinvestment of up to 0.99 crore equity shares (10.5% stake)	
To gain benefits of listing of equity shares	▲

Shareholding Pattern

	Pre-Issue	Post-Issue
Promoter & promoter group	99.7%	89.2%
Public	0.3%	10.8%

Financial Summary

₹ Crore	FY14	FY15	FY16	FY17	FY18
Total Revenue	3897.3	2886.5	2388.8	2977.4	4001.2
EBITDA	916.7	635.8	264.4	327.5	449.3
EBITDA Margin (%)	23.5	22.0	11.1	11.0	11.2
Adjusted PAT	747.0	563.0	393.1	384.0	411.6

Valuation Summary (at ₹ 475 ;upper price band)

(x)	FY13	FY14	FY15	FY16	FY17	FY18
EV/EBITDA	3.8	3.7	5.3	12.7	10.3	14.6
P/E	5.6	6.0	7.9	11.4	11.6	10.9

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Established in 1976 by the Government of India, Ircon International Ltd is a Miniratna (Category-I) Schedule 'A' public sector enterprise. The company is an integrated engineering and construction company, specialising in major infrastructure projects, including, railways, highways, flyovers, tunnels, aircraft maintenance hangars, commercial & residential properties, EHV-sub stations, etc. It provides EPC services on a fixed-sum turnkey basis and also executes several BOT projects. However, the company's primary focus and strength remain in the railway sector since inception. It reported revenue, adjusted PAT CAGR of 29.4%, 2.3% in FY16-18 to ₹ 4001.2 crore, ₹ 411.6 crore, respectively. Ircon's IPO consists of offer for sale of 0.99 crore shares at a price band of ₹ 470-475/share. Post IPO, the government's stake would reduce to 89.2%.

Investment Rationale

Big ticket orders with diversified clientele base across sectors...

Ircon's order book grew at a robust 12.9% CAGR to ~₹ 22400 crore in FY16-18 wherein ~20 orders have an average ticket size exceeding ₹ 500 crore. Such a large order book comes from a diversified clientele base across sectors. Of the total, Railway projects comprise 86.7%, highway sector ~5.6%, electrical works ~5.4% while remainder ~2.2% is from the building sector. The current order book implies an order book to bill ratio of 5.6x on FY18 numbers, indicating it could see better revenue growth over the next couple of years. Major domestic clients for the company include Northern Railways, Dedicated Freight Corridor Corporation of India, National Institute of Technology (Mizoram), NHAI, etc. Foreign clients include orders from Eskom Holdings SOC Ltd (South Africa).

Strong balance sheet position...

Ircon has generated healthy profitability margins and a comfortable liquidity position. Since inception, it has not defaulted in repayment of its borrowings, which has helped the company present a strong credit profile to potential lenders and avail alternatives sources of financing when necessary. The company receives 30% advances from its clients through which, it principally meets its working capital requirement. Furthermore, Ircon is a net debt-free & cash-positive company and receives 75% of orders from the government on a nomination basis.

Key risks and concerns

- High portfolio concentration on railway sector & government projects
- Vigilance issues raised by statutory auditors
- Materialisation of contingent liabilities can impact financials
- Pending legal proceedings, which, if determined against the company, may have a material adverse impact on business operations & financials
- Ircon's subsidiaries are currently not compliant with DPE guidelines on corporate governance for central public sector enterprises

Priced at 10.9x FY18 EPS on higher band

Ircon's revenues grew at 29.4% CAGR to ₹ 4001.2 crore in FY16-18. The order book was at a robust ₹ 22407 crore, which implies an order book to bill ratio of 5.6x on FY18 numbers, indicating revenue growth getting better ahead. At the IPO price band of ₹ 470-475, the stock is available at 10.7-10.9x FY18 EPS. Adjusting for subsidiary investments worth ~₹ 700 crore, the issue is available at 9.2x FY18 EPS on higher band, which is attractive valuation vis-à-vis its peer companies. Hence, we have a **SUBSCRIBE** recommendation on the issue at the offer price only for listing gains.

Company Background

Established in 1976 by the Government of India, Ircon International is a Miniratna (Category-I) Schedule 'A' Public Sector Enterprise. It specialises in major infrastructure projects, both domestically and internationally, with primary focus on the railways segment. Others segments that the company caters to include highways, flyovers, tunnels, aircraft maintenance hangars, commercial & residential properties, EHV-sub stations etc. Ircon provides EPC services on a fixed-sum turnkey basis as well as on an item-rate basis for various infrastructure projects and also executes on BOT mode in various projects. In 2016, it was ranked 248 in the list of the top 250 international contractors by Engineering News Record (ENR) of the US

Ircon's core business is classified into two broad categories,

- Construction
- Infrastructure development

On the financial front, Ircon's consolidated operating revenues grew strongly at 29.4% CAGR to ₹ 4001.2 crore while adjusted PAT grew at 2.3% CAGR to ₹ 411.6 crore in FY16-18. The segment wise revenue break-up of the company is as follows:

Exhibit 1: Revenue break-up segment wise

Geographical Segment Revenues	FY15 ₹ crore	FY16 ₹ crore	FY17 ₹ crore	FY18 ₹ crore
Domestic				
Revenue from External Customers	2,069.8	2,051.1	2,694.3	3,412.7
Revenue share in integrated Joint Ops	41.6	20.3	1.6	0.3
Interest Income	207.8	238.8	201.3	135.9
Other Income	29.9	115.9	49.7	27.6
International				
Revenue from External Customers	806.4	325.9	253.8	588.5
Revenue share in integrated Joint Ops	47.1	83.6	88.3	26.1
Interest Income	9.9	5.6	7.0	6.0
Other Income	20.2	67.4	5.5	15.4
Total	3,232.5	2,908.6	3,301.3	4,212.4

Source: RHP, ICICI Direct Research

Ircon's services primarily includes design and engineering of the project, procurement of equipment & packages, project management and commissioning. Though the company executes projects independently, it also forms project-specific joint ventures (JVs) and consortia with other infrastructure and construction companies, in particular, when a project requires Ircon as partner to meet specific eligibility requirements in relation to certain large projects, including requirements of particular types of experience and financial resources. As of March 31, 2018, the company has a total order book of ₹ 22407 crore.

Exhibit 2: Orderbook break-up

	Value (₹ crore)	% of Order Book
Railway Projects	19426	86.7%
Hoghways Projects	1278	5.7%
Electrical works	1208	5.4%
Building Projects	495	2.2%
Total	22407	100.0%

Source: RHP, ICICI Direct Research

Exhibit 3: Ircon Corporate Structure



Source: Company, ICICI Direct Research

Key strengths

Big ticket orders with diversified clientele base across sectors...

Ircon's order book was at ~₹ 22400 crore as on March 31, 2018, wherein ~20 orders have an average ticket size exceeding ₹ 500 crore. Such a large order book comes from a diversified clientele base across sectors. Of the total, railway projects comprise 86.7%, highway sector ~5.6%, electrical works ~5.4% while the remainder ~2.2% is from the building sector. The current order book has a completion timeline of ~three to four years, which would ensure strong revenue visibility in the next couple of years.

Approximately 99.58% of Ircon's order book is related to projects sponsored by the government or governmental agencies, including the Government of India, states and municipalities, while the remainder of the order book is attributable to private sector clients. Major domestic clients for the company include Northern Railways, Dedicated Freight Corridor Corporation of India, Chhattisgarh East Railway, NHAI, National Institute of Technology (Mizoram), etc. Foreign clients for the company include orders from Eskom Holdings SOC Ltd (South Africa).

Diversified business operations in various sectors and geographies...

Ircon has completed more than 127 projects in more than 24 countries and 380 projects in various states in India in its four decades of operational experience. Additionally, it has a broad range of clients within the Government of India and private sectors (both domestic and international). Since inception, the company's core focus has been railways projects. The segment contributes 86.7% of the order book currently. However, Ircon also caters to several other business segments such as construction of commercial and residential complexes, power transmission lines, industrial lighting, bridge/flyovers, tunnels, electrical and mechanical work, signalling/telecom, coach factory, station building and aviation.

Excellent execution track record...

The company has robust contract management and uses innovation and advanced technology to meet its deliverables, which has enabled Ircon develop strong project management and execution expertise for both domestic and international projects. From April 1, 2015 to March 31, 2018, the company completed seven railway projects with an aggregate value of ₹ 2869 crore, and is currently undertaking 33 railways projects and five highways projects with an aggregate value of ₹ 36618.3 crore.

Experienced management personnel, technically qualified team

Ircon's leadership management team is experienced and well qualified, with the senior members having average experience of 27 years. They have been associated with the company for an average of nine years. On account of the diverse skill sets of its employees, the company enjoys flexibility to adapt to the needs of its clients across sectors and technical expertise of the projects that it undertakes.

Key Strategies

Expand geographical footprint within and beyond India...

Ircon plans to continue its strategy of diversifying across industry segments and increasing orders from foreign countries to capture better profit margins offered by these projects compared to domestic projects. Furthermore, apart from foreign expansion plans, the company intends to expand its operations domestically across India so as to be able to take on more projects proposed by the Government of India and further consolidate its position in the infrastructure sector. Also, while the company's focus remains on the railways sector, it plans to hedge against risks in specific areas & projects through portfolio diversification in other industry sectors.

Bid for high value projects in construction business...

In the construction business, the company intends to focus on undertaking projects with an order value above ₹ 500 crore with the aim of benefiting from economies of scale. As of March 31, 2018, Ircon had 20 projects in its order book that exceed this value. The increasingly stringent pre-qualification requirements for pursuing such projects have resulted in a limited number of 163 competitors being able to bid for such projects, which make such type of projects an attractive sector for the company to participate. Furthermore, Ircon aims to firmly establish itself as a player in the market for high value projects by successfully executing the high order value projects, which are currently in its order book.

Explore different execution models to optimise project portfolio...

A fundamental aspect of the company's business strategy is to gradually transform from a construction company to a diversified company having a portfolio of BOT/DBFOT/EPC/HAM and other contracts as well as project development and operation through JVs/SPVs. To achieve this objective, Ircon plans to secure and is well positioned to take up projects under these new modes due to its ability to meet the technological and financial requirements

Paradigm shift in revenue generation...

Ircon is moving from generating income only through individual projects to regularly generating revenue & profits through its subsidiaries and joint venture companies from continued operation of existing projects and new projects. The company expects projects with an approximate capex of ₹ 17200 crore to be executed by these affiliate companies in the next five years. Through such projects, the company plans to complete 1232 km of toll road and 1000 km of railway tracks for coal and iron ore connectivity. Furthermore, as these projects require regular maintenance, it gives opportunity to generate revenue from this maintenance work.

Key risks and concerns

High portfolio concentration on railway sector & government projects...

Railway projects comprise 86.7% of Ircon's order book. Due to such high order book concentration, any decline in client demands, increase in quality standards and any change in requirements of services for railway projects may adversely affect Ircon's ability to retain its current revenue and profitability level. Furthermore, the company gets ~75% orders on nomination basis from the government. Ircon expects such contracts to continue to account for a high percentage of its total consolidated income in future. Any adverse change in the policies adopted by the government regarding award of its projects such as pre-qualification criteria or incentives granted for infrastructure developments could adversely affect the company's ability to bid for and/ or win such projects.

Vigilance issues raised by statutory auditors...

Statutory auditors to the company had raised an issue of irregular payments worth ₹ 422.4 crore made by Ircon for securing/ execution of overseas projects to foreign agencies. On this basis, Railway Board had forwarded the matter for investigation to the vigilance department of Ircon. The company sent a detailed investigation report on the matter to the Railway Board on February 13, 2018. The matter is pending with the Railway Board for final decision. However, the audit observation on the above mentioned matter was dropped by the CAG of India. Also, the auditors had raised concern over non-provision of ₹ 4.96 crore towards foreign agency commission/consultancy charges with respect to projects in three foreign countries. Failure or inability to address these comments by the auditors may adversely affect Ircon's business operations.

Pending legal proceedings against company...

Certain legal proceedings are pending against Ircon and its subsidiaries at different levels of adjudication before various courts, tribunals, enquiry officers, appellate tribunals and other adjudicatory authorities. Any adverse decision may have a significant effect on its business including financial condition and operations. Furthermore, if the company is unable to neutralise the impact of these proceedings effectively or efficiently, it may suffer damage to reputation and relationships with its clients, lenders & suppliers and experience significant project delays or cost overruns, which would adversely impact its operations & financials.

Exhibit 4: Litigation details

Nature of Cases	No. of cases outstanding	Amount Involved (₹ crore)
Against the Company		
a) Criminal Cases	1	0.5
b) Civil Cases		
Suits and Petitions	3	209.8
Arbitration Cases	4	565.4
Material Conciliation	2	711.8
Direct Tax Matters	17	516.1
Against subsidiaries		
a) Criminal Cases	0	0.0
b) Civil Cases	5	2.8
c) Direct Tax Matters	4	Not quantifiable

Source: Company, ICICI Direct Research

Materialisation of contingent liabilities may impact financials...

Ircon is usually required to have letters of credit (LoC) issued in favour of its suppliers and other vendors. As a result, the company carries substantial contingent liabilities for the project it undertakes. In case its clients invoke any of the guarantees or LoC, it can have a substantial material adverse impact on the financials of Ircon. Listed below are some of the contingent liabilities: -

Exhibit 5: Contingent liabilities details

Particulars*	Amount (₹ crore)
a) Claims against the Company	
Claims (net pf provisions of ₹ 69.4 crore)	421.1
Direct Tax	307.6
Indirect Tax	327.4
b) Guarantees (excluding financial gurantee)	
In respect of Joint Ventures	
Sales Tax	4.3
Service Tax	1.0
Bank Guarantee	1.4
Income Tax	0.0
Recovery Claim	0.0
Bank Guarantee (for Ircon-Afcon JV)	14.3
c) Other	
Liquidation Damages	9.7

Source: RHP, ICICI Direct Research

Valuation

Ircon's revenues grew at 29.4% CAGR to ₹ 4001.2 crore in FY16-18. The order book was at a robust ₹ 22407 crore, which implies an order book to bill ratio of 5.6x on FY18 numbers, indicating revenue growth getting better ahead. At the IPO price band of ₹ 470-475, the stock is available at 10.7-10.9x FY18 EPS. Adjusting for subsidiary investments worth ~₹ 700 crore, the issue is available at 9.2x FY18 EPS on higher band, which is an attractive valuation vis-à-vis its peer companies. Hence, we have a **SUBSCRIBE** recommendation on the issue at the offer price only for listing gains.

Exhibit 6: Valuations vs. Peers

Company	M Cap (₹ Cr)	EPS (₹)			P/E (x)			EV/EBITDA (x)			P/B (x)			RoE(%)		
		FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18	FY16	FY17	FY18
Ircon (Lower price band @₹ 470)	4,420	41.8	40.8	43.8	11.2	11.5	10.7	12.6	10.1	14.5	1.2	1.2	1.2	10.8	10.1	10.9
Ircon (Upper price band @₹ 475)	4,467	41.8	40.8	43.8	11.4	11.6	10.9*	12.7	10.3	14.6	1.2	1.2	1.2	10.8	10.1	10.9
RITES	5,320	14.2	18.1	18.2	18.8	14.7	14.6	13.2	12.6	9.6	2.9	2.6	2.4	15.2	17.7	16.5
NBCC	12,240	1.6	2.0	1.9	42.9	35.1	36.9	35.5	26.4	26.4	8.0	7.3	6.7	18.8	21.0	18.3
Engineers India	7,865	4.1	4.8	6.0	30.1	25.8	20.8	33.1	20.7	13.4	3.2	3.1	3.5	10.4	11.7	16.7

*Adjusted PE after subsidiary investment: 9.2

Source: Company, ICICI Direct Research

Financial Summary

Exhibit 7: Profit and Loss Statement

(₹ Crore)	FY13	FY14	FY15	FY16	FY17	FY18
Revenue from operations	4,293.9	3,897.3	2,886.5	2,388.8	2,977.4	4,001.2
Company's Share of Turnover in Intergear	-	-	88.6	103.9	89.9	26.3
Other Income	249.2	253.4	257.4	415.9	234.0	184.9
Total Revenue	4,543.2	4,150.8	3,232.5	2,908.6	3,301.3	4,212.4
Operating Expense	3,175.0	2,710.8	2,027.9	1,923.6	2,490.7	3,288.0
Employee Benefits Expense	200.2	232.1	194.4	180.7	156.1	238.9
Proportionate Share of expense in Intergear	-	-	86.2	97.2	56.4	9.4
Other expenses	-	-	30.8	26.8	36.7	42.0
Total Operating Expenditure	3,399.3	2,980.6	2,339.3	2,228.3	2,739.8	3,578.2
EBITDA	894.6	916.7	635.8	264.4	327.5	449.3
EBITDA Margin (%)	20.8%	23.5%	22.0%	11.1%	11.0%	11.2%
Interest	10.9	38.5	28.7	43.3	58.7	64.6
Depreciation	43.0	34.3	22.0	30.9	26.7	16.4
Exceptional Items	-	-	-	-	73.7	-
Share in Profit/(Loss) of JV	-	-	(7.9)	5.5	5.6	5.2
PBT	1,090.0	1,097.4	834.6	611.6	555.5	558.4
Total Tax	285.6	349.1	271.6	218.5	171.5	146.8
Minority Interest	0.5	(1.2)	-	-	-	-
Net Profit / (Loss) for the year	804.9	747.0	563.0	393.1	384.0	411.6
Adjusted PAT	804.9	747.0	563.0	393.1	384.0	411.6
Adjusted PAT Margin (%)	18.7%	19.2%	19.5%	16.5%	12.9%	10.3%

Source: RHP, ICICI Direct Research

Exhibit 8: Balance Sheet

(₹ Crore)	FY13	FY14	FY15	FY16	FY17	FY18
Equity Capital	19.8	19.8	19.8	19.8	99.0	94.1
Reserve and Surplus	2,462.2	2,996.5	3,433.6	3,619.2	3,717.9	3,667.7
Total Shareholders funds	2,482.0	3,016.3	3,453.3	3,639.0	3,816.9	3,761.8
Long term borrowings	-	-	-	-	-	3,203.1
Total Debt	-	-	-	-	-	3,203.1
Minority Interest	9.3	20.3	21.3	21.8	19.6	-
Other long term liabilities	810.4	600.3	518.3	1,225.4	2,031.8	1,311.7
Liability side total	3,301.7	3,636.9	3,992.9	4,886.3	5,868.4	8,276.6
Tangible Assets	178.1	165.3	162.0	156.4	145.6	140.6
Intangible Assets	0.8	61.5	87.2	145.8	618.1	1,029.7
Capital WIP	69.2	37.7	1.1	1.5	2.0	3.2
Long term L & A	387.2	650.7	128.6	60.6	78.9	39.7
Non-current Investments	180.1	257.8	444.0	627.7	838.3	926.5
Deferred Tax asset	269.0	300.7	267.5	211.6	145.0	133.9
Other non-current assets	83.9	5.1	298.4	299.3	505.0	2,877.7
Inventories	124.6	124.2	114.4	140.6	139.3	140.7
Debtors	926.4	652.6	471.7	510.0	472.9	693.8
Cash & cash equivalents	3,116.5	2,737.7	3,379.0	4,722.0	4,753.1	4,690.6
Current investments	65.0	176.0	68.4	138.0	249.9	216.2
Short term L & A	435.1	549.9	20.5	1.7	80.2	1.9
Other Current Assets	403.1	494.2	1,078.2	1,124.3	1,203.0	1,883.9
Total Current Assets	5,070.6	4,734.7	5,132.3	6,636.6	6,898.5	7,627.1
Creditors	637.4	590.6	450.8	406.0	361.1	510.5
Provisions	692.3	820.3	327.7	354.3	298.0	265.4
Other Current Liabilities	1,607.5	1,165.7	1,749.7	2,492.9	2,703.9	3,725.7
Total Current Liabilities	2,937.2	2,576.6	2,528.1	3,253.1	3,363.1	4,501.7
Net Current Assets	2,133.4	2,158.1	2,604.2	3,383.5	3,535.4	3,125.4
Assets side total	3,301.7	3,636.9	3,993.0	4,886.3	5,868.4	8,276.6

Source: RHP, ICICI Direct Research

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