

Sector: Infrastructure
Result Update

Change

Reco: Buy



CMP: Rs. 125

Price Target: Rs. 200



Upgrade
 No change
 Downgrade

Company details

Market cap:	Rs. 2143 cr
52-week high/low:	Rs. 306/114
NSE volume: (No of shares)	2.7 lakh
BSE code:	532710
NSE code:	SADBHAV
Sharekhan code:	SADBHAV
Free float: (No of shares)	14.7 cr

Shareholding (%)

Promoters	47
FII	13
DII	26
Others	15

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-28.1	-36.9	-20.6	-50.8
Relative to Sensex	-25.6	-37.3	-24.3	-50.8

Sharekhan Research, Bloomberg

Sadbhav Engineering Limited (SEL) reported weak standalone earnings for Q1FY2020 owing to a delay in receipt of appointed dates for hybrid annuity model (HAM) projects, which dragged down revenue and net profit by 8% and 38% y-o-y, respectively. The management maintained a revenue guidance of Rs. 3,600 crore for FY2020 on back of better execution in H2FY2020 along with receipt of appointed dates for couple of projects at the start of H2FY2020. Post the transfer of nine assets in recently signed deal with the IndInfravit trust, the management is exploring a reverse merger of SIPL with SEL, which should help in aligning all businesses under one roof and also turn SEL into an asset-light entity that focuses solely on EPC and O&M of projects of the IndInfravit trust. We have lowered our estimates for FY2020-FY2021 and reduced EPC valuation multiples, revising our SOTP-based price target (PT) to Rs. 200. We retain a Buy rating, expecting healthy project execution in H2FY2020, clarity from asset sale and reverse merger and an improvement in sectoral outlook.

Key positives

- Management retained Rs. 3,600 crore revenue guidance for FY2020.
- SIPL reverse merger to make business asset light with core focus on EPC and O&M

Key negatives

- Weak earnings on account of delay in receipt of appointed dates for HAM projects.
- Nil order inflows as sector faces tight liquidity and land acquisition issues

Our Call

Valuation – Maintain Buy with revised PT of Rs. 200: We have lowered our net earnings estimates for FY2020-FY2021 by more than 16%, factoring in a delay in receipt of appointed dates for HAM projects. The stock has remained under pressure on account of weakening macro environment affecting traffic growth at toll projects along with drying up of new project tendering since H2FY2019. The reduction of net earnings and a reduced EPC multiple on account of near-term sectoral woes led us to cut our price target to Rs. 200. We believe that execution coming back on track in H2FY2020, clarity emerging out of the asset sale and reverse merger of SIPL and an overall improvement in business outlook, would lead to re-rating of valuation multiple for SEL. Hence, we maintain our Buy rating on the stock.

Key Risks

Delay in receipt of appointed dates for HAM and asset sale deal being called off in the worst case.

Valuation (Standalone)

Particulars	FY17	FY18	FY19	FY20E	FY21E
Revenue	3,320.3	3,505.1	3,549.2	3,587.9	4,138.5
OPM (%)	10.7	11.8	12.1	12.3	12.4
Adjusted PAT	187.8	220.7	186.1	173.6	219.6
% YoY growth	24.0	17.5	(15.7)	(6.7)	26.5
Adjusted EPS (Rs.)	10.9	12.9	10.8	10.1	12.8
P/E (x)	11.4	9.7	11.5	12.3	9.8
P/B (x)	1.3	1.1	1.0	1.0	0.9
EV/EBITDA (x)	8.3	7.1	6.9	6.6	5.8
RoNW (%)	11.9	12.5	9.5	8.2	9.6
RoCE (%)	10.0	10.7	8.8	7.8	8.5

Source: Company; Sharekhan estimates

Delay in getting appointed dates affects Q1FY2020 net earnings

Sadbhav Engineering reported a decline of 8.1% y-o-y in standalone net sales to Rs. 838 crore for Q1FY2020 because of a delay in receipt of appointed date for its HAM projects. Consequently, revenue from the transport vertical declined by 10.7% y-o-y to Rs. 732 crore while the irrigation and mining verticals registered a 29.4% and 7.5% y-o-y growth in revenue to Rs. 48 crore and Rs. 53 crore, respectively. Higher OPM (up 74 bps y-o-y) because of a better revenue mix stemmed the decline in standalone operating profit to 2.3%. Lower other income (down 61.8% y-o-y), higher depreciation (up 16.3% y-o-y) and a higher effective tax rate of 26.1% versus 6.8% in Q1FY2019) dragged down standalone net profit by 37.8% y-o-y to Rs. 39.5 crore.

Revenue guidance maintained but order inflow target reduced

The management retained a revenue guidance of Rs. 3,600 crore for FY2020 building in a Rs. 350 crore contribution for projects, affected by delay in receipt of appointed dates. The projects Kim Ankleshwar (EPC value Rs. 1005 crore) and Gadag Honnali (Rs. 888 crore) are expected to start execution from early Q3FY2020. Hence, the management expects to make up for the shortfall in revenues with better execution in H2FY2020. However, SEL has reduced its order inflow target for FY2020 to Rs. 3000-4000 crore for road EPC while it will focus on completing existing mining projects and eye Jal Shakti tenders in the irrigation vertical.

Contemplation of reverse merger of SIPL

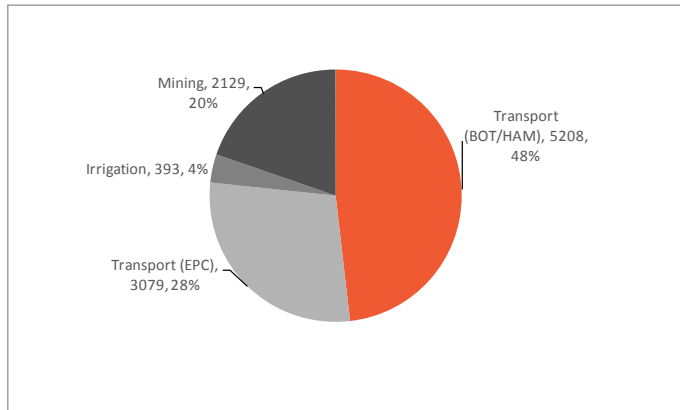
SEL is exploring a reverse merger of SIPL with SEL and has appointed evaluators and other intermediaries for this purpose. After the transfer of nine operational assets held under SIPL to IndInfravit Trust (read our detailed report dated July 3, 2019) for which lenders' NOC is expected by mid-September, SEL wants to bring the remaining three operational BOT projects and 12 HAM assets under one roof. SEL is looking at asset light business model with a focus on EPC and O&M activities of projects held under the said trust. The transaction is likely to help in easing funding issues of SEL and removal of the holding company discount of assets held under SIPL.

Results (Standalone)					Rs cr
Particulars	Q1FY2020	Q1FY2019	y-o-y%	Q4FY2019	q-o-q%
Net sales	837.6	911.4	-8.1%	1021.7	-18.0%
Total expenses	733.1	804.4	-8.9%	894.9	-18.1%
Operating profit	104.6	107.0	-2.3%	126.8	-17.5%
Other income	4.1	10.8	-61.8%	5.5	-24.2%
Depreciation	28.0	24.1	16.3%	23.1	21.1%
Interest	27.3	25.7	6.2%	28.2	-3.2%
Exceptional items	0.0	0.0		0.8	
Profit Before Tax	53.4	68.1	-21.5%	81.6	-34.6%
Taxes	13.9	4.6	200.3%	52.7	-73.6%
PAT	39.5	63.4	-37.8%	28.9	36.6%
Adjusted PAT	39.5	63.4	-37.8%	28.1	40.3%
No of equity shares	17.2	17.2	0.0%	17.2	0.0%
EPS	2.3	3.7	-37.8%	1.6	40.3%
Margins (%)					
OPM(%)	12.5%	11.7%	74 bps	12.4%	8 bps
NPM(%)	4.7%	7.0%	-225 bps	2.8%	196 bps
Tax rate (%)	26.1%	6.8%	1928 bps	64.6%	-3850 bps

Source: Company; Sharekhan Research

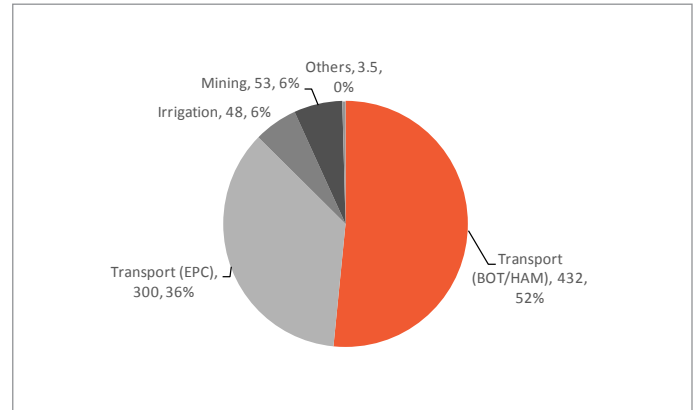
Financials in charts

Order Book Mix



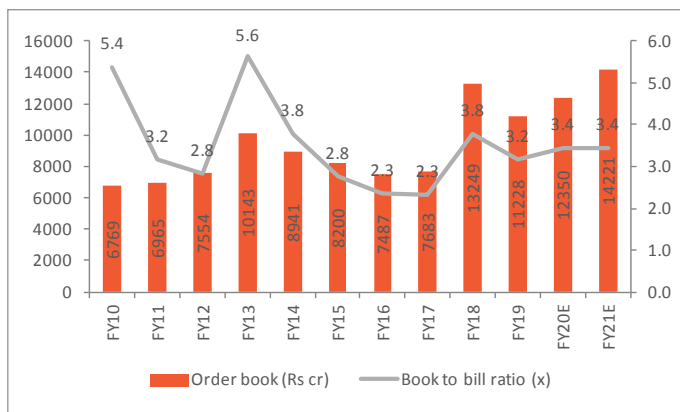
Source: Company, Sharekhan Research

Revenue Mix – Q1FY2020



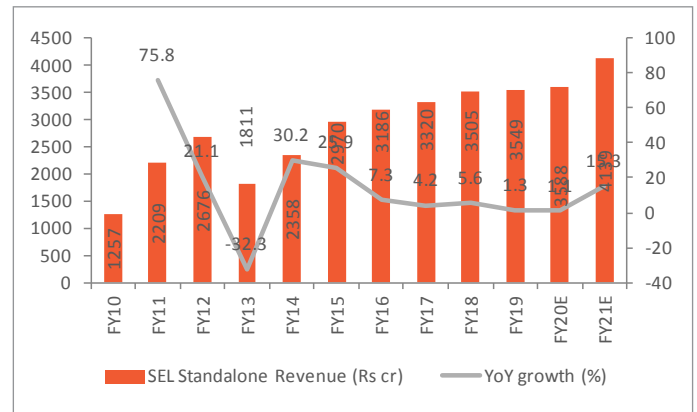
Source: Company, Sharekhan Research

Order book trend



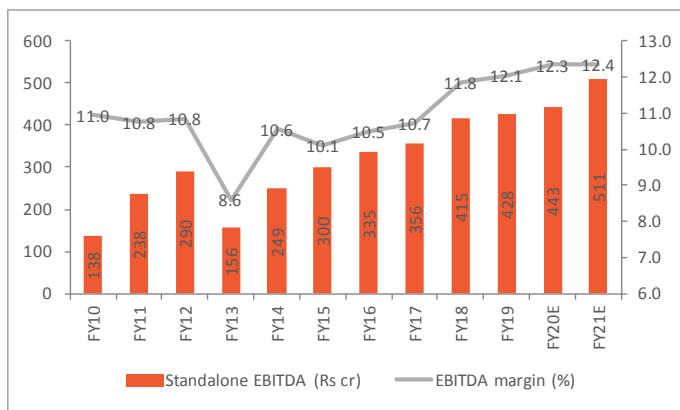
Source: Company, Sharekhan Research

Standalone Revenue trend



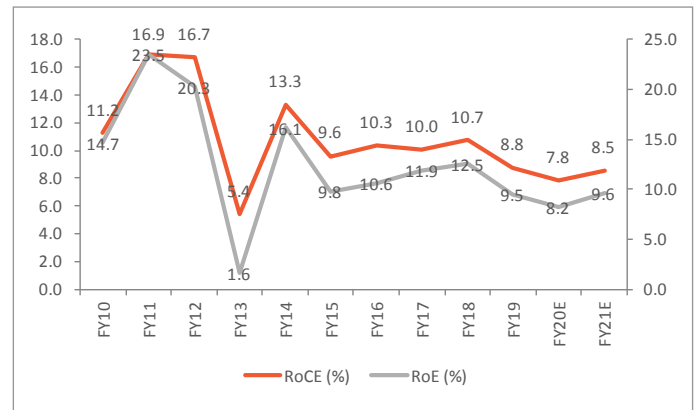
Source: Company, Sharekhan Research

Standalone EBITDA trend



Source: Company, Sharekhan Research

Return Ratios trend



Source: Company, Sharekhan Research

Outlook

Expect project tendering to pick up in H2FY2020: The roads sector has been facing issues of tightening liquidity and delays in land acquisitions, which has affected timely execution of projects. Additionally, project tendering activity has been sluggish since start of H2FY2019, owing to an election-led slowdown and a delay in execution of projects awarded earlier on account of issues mentioned above. However, industry players expect project bidding to start as early as September 2019-end. Companies would prefer receipt of appointed dates after the monsoon and are expected to commence construction as early as possible with most of them having already mobilized equipment. Hence, we believe that H2FY2020 would turn out to be better in terms of project tendering and execution for the sector.

Valuation

Maintain Buy with revised PT of Rs. 200: We have lowered our net earnings estimates for FY2020-FY2021 by more than 16%, factoring in a delay in receipt of appointed dates for HAM projects. The stock has remained under pressure on account of weakening macro environment affecting traffic growth at toll projects along with drying up of new project tendering since H2FY2019. The reduction of net earnings and a reduced EPC multiple on account of near-term sectoral woes led us to cut our price target to Rs. 200. We believe that execution coming back on track in H2FY2020, clarity emerging out of the asset sale and reverse merger of SIPL and an overall improvement in business outlook, would lead to re-rating of valuation multiple for SEL. Hence, we maintain our Buy rating on the stock.

About company

SEL, incorporated in 1988, is engaged in 1) EPC business for transport, mining and irrigation sectors and 2) development of roads and highways on a BOT basis through SIPL. SEL has a healthy order book of Rs. 10,810 crore (3.1x its TTM standalone revenue). The company has robust in-house integrated execution capabilities with qualified human resources and owned equipment. The company has been making profits since its inception in its standalone business and has paid regular dividends for the last 16 years.

Investment theme

We expect SEL to benefit from improved order execution, enhanced order inflows (particularly from the transport segment) and resolution of working capital issues, resulting in a sturdier balance sheet. The company's recent stake sale is likely to halve its leverage. The reverse merger of SIPL with SEL can lead to an asset-light business model with focus on core EPC and O&M execution. Further, expected improvement in outlook for the Indian roads sector from H2FY2020 onwards and limited competitive intensity augur well for SEL as it is present in both the asset creation and EPC verticals.

Key Risks

- ♦ Delay in receipt of appointed dates for HAM projects can lead to lower earnings.
- ♦ Inability to fructify asset sale deal with IndInfraVIT can limit its ability to bid for future projects.
- ♦ Weak macro-economic environment leading to lower traffic at toll projects affects valuation.

Additional Data

Key management personnel

Mr. Vishnubhai M Patel	Chairman Emeritus
Mr. Shashin V. Patel	Chairman and Managing Director
Mr. Nitin R Patel	CFO & Whole time Director
Mr. Tushar D Shah	Company Secretary & Compliance Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	PATEL SHANTABEN V	28.07
2	SADBHAV FINSTOCK PVT LTD	9.64
3	HDFC Asset Management Co Ltd	9.22
4	ICICI Prudential Life Insurance Co	7.75
5	Nomura Holdings Inc	6.34
6	SBI Funds Management Pvt Ltd	4.12
7	PATEL SHASHIN	3.64
8	Reliance Capital Trustee Co Ltd	3.5
9	Patel Vikramkumar R	2.7
10	Aditya Birla Sun Life Asset Manage	2.54

Source: Bloomberg

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