30 May 2020

NCC

Rating: **Buy**
Target Price: ₹57
Share Price: ₹23

Q4 de-levering renders it future ready; raising to a Buy

For NCC, the Covid-19-induced disruption has come as a setback in its efforts to recover from the issues it faced with its AP exposure. Though revenue guidance was missed because of Covid-19, not all was bad as healthy Q4 inflows turned revenue assurance better, and the meaningfully de-levered balance sheet renders it future-ready for any revival in economic activity. We see NCC's multi-sector execution capabilities to come to its rescue in the immediate future, and set the stage for it to emerge as one of the beneficiaries of the unaltered long-term growth prospects. Valuations, too, have turned appealing, after the recent steep fall, and prod us to change our long-held cautious stance. Consequently, we raise our recommendation to a Buy.

Unprecedented times, no guidance. With the Covid-19 situation yet evolving, management refrained from "guidance". Nevertheless, it sees the present ~50% operating efficiency to rise with each passing day, and healthy awarding by the government in an effort to revive the economy.

Meaningful de-levering, quality more inspiring. To us, the quality is more important than the quantum (~₹5.7bn lower q/q to ~₹15.9bn). What makes Q4 de-levering inspiring is the fact that it was driven by recoveries, not by higher mobilisation advances. Promoter infusion (~₹0.8bn), too, helped.

Inflows, FY20 turns respectable on healthy Q4. The Q4 ~₹38bn inflows substantially exceeding Q4 revenues mean the first nine months' sluggishness is mostly covered (inflows lagged revenues by ~₹27bn), and make FY20 additions (at ~₹72bn) look respectable. Revenue assurance is healthy (standalone OB of ~₹250bn; implied BtB of 3x), and execution holds the key.

Valuation. Adjusting for the Covid-impact, we slash FY21e earnings ~48% (and ~0.2% for FY22). At the CMP, the stock (excl. investments) quotes at EV/EBITDA of 2.6x FY22e, against the TP implied 4x. **Risk.** Prolonged Covid-19 impact.

Key financials (YE Mar)	FY18	FY19	FY20P	FY21e	FY22e
Sales (₹ m)	75,593	1,20,798	82,188	72,283	94,626
Net profit (₹ m)	3,934	6,228	4,147	1,617	3,759
EPS (₹)	6.5	10.4	6.8	2.7	6.2
Growth (%)	32.0	58.3	-34.4	-61.0	132.5
PE (x)	18.0	10.9	2.8	8.7	3.7
EV / EBITDA (x)	9.7	5.9	2.7	3.9	2.9
PBV (x)	1.7	1.4	0.2	0.3	0.3
RoE (%)	10.2	13.8	8.4	3.1	7.0
RoCE (%)	16.3	22.8	14.8	10.5	14.1
Net debt / equity (x)	0.3	0.4	0.3	0.3	0.3

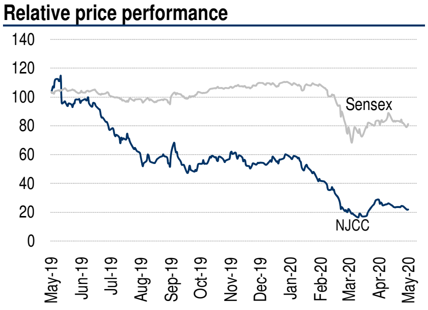
Source: Company, Anand Rathi Research *Note: P - Provisional*

Key data	NJCC IN / NJCC.BO
52-week high / low	₹118 / 16
Sensex / Nifty	32424 / 9580
3-m average volume	$9.8m
Market cap	₹14bn / $185m
Shares outstanding	610m

Shareholding pattern (%)	Mar'20	Dec'19	Sep'19
Promoters	19.6	18.1	18.1
- of which, Pledged	6.7	6.6	6.6
Free float	80.4	81.9	81.9
- Foreign institutions	14.7	17.7	17.4
- Domestic institutions	20.2	27.0	31.7
- Public	45.6	37.2	32.9

Estimates revision (%)	FY21e	FY22e
Sales	-24.5	-9.6
EBITDA	-30.3	-10.1
Adj. PAT	-48.1	-0.2

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations (standalone)

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY18	FY19	FY20P	FY21e	FY22e
Order backlog	3,29,538	4,11,978	2,65,720	2,70,494	2,89,390
Order inflows	2,31,893	2,56,120	72,030	79,356	1,13,372
Net revenues	**75,593**	**1,20,798**	**82,188**	**72,283**	**94,626**
Growth (%)	*-4.2*	*59.8*	*-32.0*	*-12.1*	*30.9*
Direct costs	64,830	1,03,532	69,234	62,165	80,995
SG&A	2,215	3,035	2,653	2,376	2,775
EBITDA	**8,549**	**14,230**	**10,302**	**7,743**	**10,856**
EBITDA margins (%)	*11.3*	*11.8*	*12.5*	*10.7*	*11.5*
Depreciation	1,175	1,494	1,775	1,720	1,878
Other income	1,158	1,183	1,513	1,290	1,253
Interest expenses	3,789	4,513	5,179	4,873	5,176
PBT	4,743	9,406	4,860	2,440	5,054
Effective tax rate (%)	*17.1*	*33.8*	*14.7*	*33.7*	*25.6*
+ Associates / (Minorities)	-	-	-	-	-
Net income	2,868	5,639	3,820	1,617	3,759
Adjusted income	3,934	6,228	4,147	1,617	3,759
WANS	601	601	610	610	610
FDEPS (₹ / sh)	6.5	10.4	6.8	2.7	6.2

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY18	FY19	FY20P	FY21e	FY22e
Share capital	1,201	1,201	1,220	1,220	1,220
Net worth	42,417	47,568	51,056	52,526	55,550
Debt	13,001	19,933	19,101	18,832	19,931
Minority interest	-	-	-	-	-
DTL / (Assets)	-1,793	-1,726	-2,055	-2,055	-2,055
Capital employed	**53,624**	**65,774**	**68,102**	**69,303**	**73,427**
Net tangible assets	8,065	11,725	11,226	10,984	11,484
Net intangible assets	16	692	689	686	685
Goodwill	-	-	-	-	-
CWIP (tang. & intang.)	229	813	829	811	852
Investments (strategic)	10,237	9,193	8,887	9,142	9,397
Investments (financial)	0	-	-	-	-
Current assets (ex cash)	87,007	1,04,448	1,00,849	96,856	1,13,360
Cash	659	2,990	3,169	2,423	2,385
Current liabilities	52,589	64,085	57,547	51,600	64,736
Working capital	34,418	40,363	43,302	45,256	48,624
Capital deployed	**53,624**	**65,774**	**68,102**	**69,303**	**73,427**
Contingent liabilities	12,047	10,657	-	-	-

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY18	FY19	FY20P	FY21e	FY22e
PBT + Net interest expense	7,374	12,736	8,526	6,023	8,977
+ Non-cash items	1,175	1,494	1,775	1,720	1,878
Oper. prof. before WC	8,549	14,230	10,302	7,743	10,856
- Incr. / (decr.) in WC	3,381	5,945	2,940	1,953	3,368
Others incl. taxes	969	3,087	1,001	823	1,295
Operating cash-flow	4,200	5,198	6,361	4,966	6,193
- Capex (tang. + intang.)	3,069	6,413	1,290	1,458	2,417
Free cash-flow	1,131	-1,215	5,071	3,508	3,776
Acquisitions	-	-	-	-	-
- Div.(incl. buyback & taxes)	268	724	1,086	147	735
+ Equity raised	5,500	275	826	-	-
+ Debt raised	-3,205	6,998	-1,160	-269	1,099
- Fin investments	-50	-1,045	-306	255	255
- Net interest expense + misc.	3,644	4,048	3,777	3,583	3,923
Net cash-flow	-436	2,331	179	-746	-38

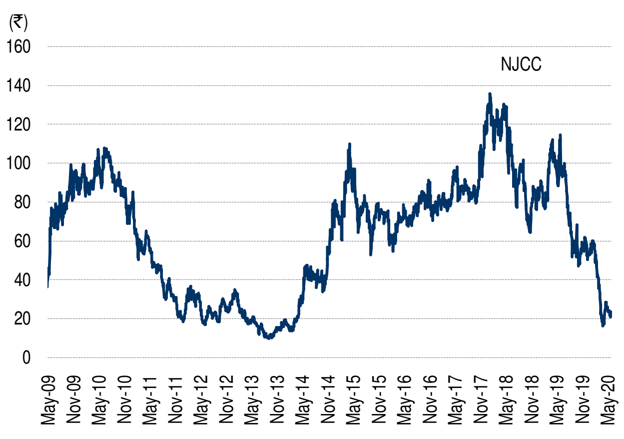
Source: Company, Anand Rathi Research Note: P- Provisional

Fig 4 – Ratio analysis

Year-end: Mar	FY18	FY19	FY20P	FY21e	FY22e
P/E (x)	18.0	10.9	2.8	8.7	3.7
EV / EBITDA (x)	9.7	5.9	2.7	3.9	2.9
EV / Sales (x)	1.1	0.7	0.3	0.4	0.3
P/B (x)	1.7	1.4	0.2	0.3	0.3
RoE (%)	10.2	13.8	8.4	3.1	7.0
RoCE (%)	16.3	22.8	14.8	10.5	14.1
RoIC (%)	15.8	18.1	15.0	8.4	12.5
DPS (₹ / sh)	0.4	1.0	1.5	0.2	1.0
Dividend yield (%)	0.3	0.9	7.9	0.9	4.4
Dividend payout (%) - incl. DDT	6.8	11.6	26.2	9.1	19.6
Net debt / equity (x)	0.3	0.4	0.3	0.3	0.3
Receivables (days)	218	92	107	130	110
Inventory (days)	82	15	23	17	17
Payables (days)	164	132	175	168	174
CFO : PAT %	106.8	83.5	153.4	307.2	164.7

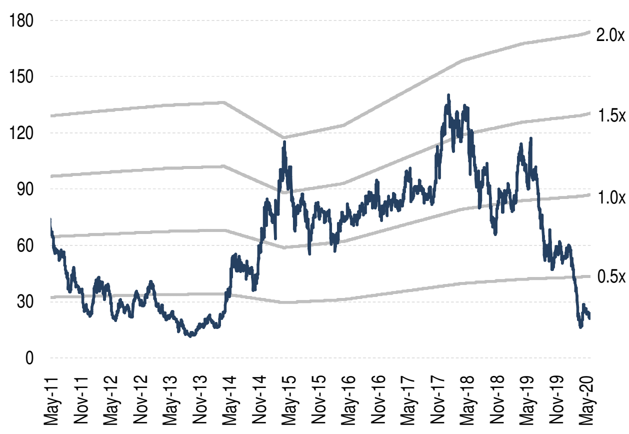
Source: Company, Anand Rathi Research Note: P- Provisional

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – PBV band



Source: Company

Result / Concall Highlights

Result highlights

- **Revenue from operations understandably low.** Besides the y/y lower effectively under-execution order backlog (on removing the AP exposure and on slow additions), Covid-19 also led to NCC missing out on some precious execution-heavy days in Q4. Consequently, revenue from operations was down a sharp ~36% y/y to ~₹21bn, and led to ~32% lower revenues y/y for the year.
  - The reason for the lower y/y full-year revenues was the removal of ~₹132bn non-moving/due-for-termination Andhra Pradesh exposure from its order backlog earlier in the year.
  - Besides, inflows in the first nine months lagged orders executed (by ~₹27bn), consequently, leaving NCC with a lower OB to work with.
- **EBITDA margin, positively surprising.** The Q4 ~12.9% EBITDA margin (up ~112bps y/y) is indeed strong, and was largely powered by a favourable project mix and an arbitration claim. For the year, too, the EBITDA margin was an inspiring ~12.5%, assisted by a favourable mix, settlement of dues and approvals for variations.
  - The greater contribution from the better-margin segments such as Roads, Water and mining boosted margins for the quarter as well as for the year.
  - Settlement and arbitration claims (estimated at ~₹0.9bn during the year) also aided margins. Even adjusted, margins more than met expectations.

Fig 7 – Financial highlights

(₹m)	Q4 FY18	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	Q2 FY20	Q3 FY20	Q4 FY20	% Y/Y	% Q/Q	FY19	FY20	% Y/Y
Sales	23,948	23,596	31,048	32,265	33,889	21,877	17,320	21,172	21,820	*-35.6*	*3.1*	1,20,798	82,188	*-32.0*
EBITDA	3,044	2,678	3,651	3,925	3,977	2,666	2,330	2,500	2,805	*-29.5*	*12.2*	14,230	10,302	*-27.6*
EBITDA margins (%)	*12.7*	*11.3*	*11.8*	*12.2*	*11.7*	*12.2*	*13.5*	*11.8*	*12.9*	*112bps*	*105bps*	*11.8*	*12.5*	*75bps*
Finance costs	997	1,016	1,082	1,245	1,170	1,259	1,308	1,418	1,195	*2.1*	*-15.7*	4,513	5,179	*14.8*
Depreciation	311	343	357	390	404	437	449	450	439	*8.8*	*-2.4*	1,494	1,775	*18.8*
Other income	246	295	331	196	360	250	703	319	241	*-33.2*	*-24.5*	1,183	1,513	*27.9*
Exceptional items	-300	-	-475	-	-114	-	-165	-229	67	-	-	-589	-327	-
PBT	1,682	1,614	2,068	2,486	2,649	1,221	1,112	722	1,479	*-44.2*	*104.7*	8,817	4,534	*-48.6*
Tax	655	577	811	884	906	407	312	-381	375	*-58.6*	*-198.5*	3,178	713	*-77.6*
PAT	1,027	1,037	1,257	1,602	1,744	813	800	1,103	1,104	*-36.7*	*0.1*	5,639	3,820	*-32.3*
Adj. PAT	1,327	1,037	1,732	1,602	1,858	813	965	1,332	1,037	*-44.2*	*-22.2*	6,228	4,147	*-33.4*

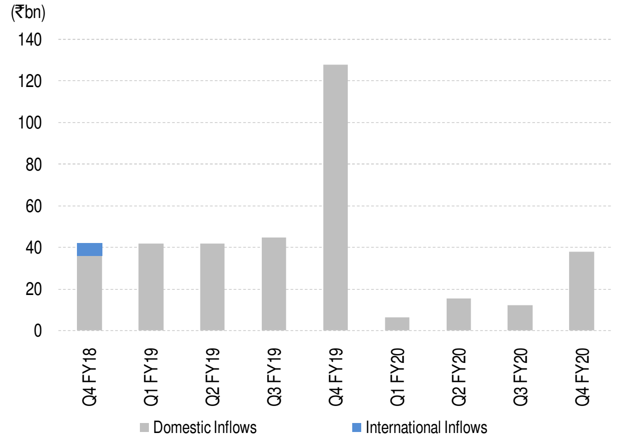
Source: Company

- **Lower scale takes earnings down.** Lower operating profitability and other income together with higher depreciation made adj. PAT plunge ~44% y/y to ~₹1bn. Had it not been for the lower effective tax rate, the cut could have been even steeper. For FY20, adj. PAT was down ~33% y/y, largely in line with ~32% y/y lower revenue.
  - The Q4 effective tax rate (~25%, against ~34% a year earlier) was largely the result of a net tax credit of ~₹135m on receipt of assessment orders of previous years.
  - For the year, net tax credit on favourable assessments was ~₹865m. The ~₹0.4bn profit on sale of land (in Q2) also helped.

Order inflows / backlog

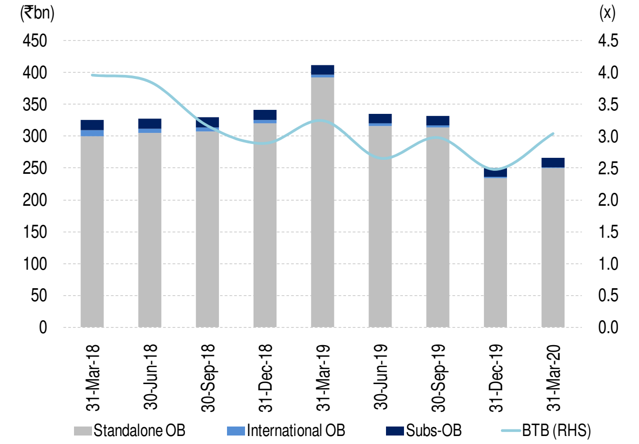
- Helped by the re-instatement of its ~₹15.6bn Nauroji Nagar order from NBCC and the firming up of most of its end-Q3 L1 positions (pegged at ~₹20bn), NCC registered healthy inflows of ~₹38bn in Q4. The healthy Q4 takes the full-year additions to a respectable ~₹72bn.
  - While the FY20 inflows pale in comparison to the previous three years' average inflows (~₹193bn), it is still slightly higher than management's guidance (already lowered in Q3) of ~₹65bn-70bn.
- With Q4 inflows exceeding the quarter's execution, the OB grew sequentially for the first time in the past four quarters. Accordingly, the end-FY20 group OB was ~₹266bn (up ~₹15bn q/q). Of this, the OB attributable to the standalone entity was ~₹250bn. On TTM standalone revenues, this implies a revenue assurance of ~3x.
  - The end-Q4 order backlog includes ~₹45bn of the AP exposure. This is after the removal of orders of ~₹61bn in Q1 (as conforming to conditions laid down for termination in the government notification), and another ~₹71bn of orders in Q3.

Fig 8 – Q4 inflows at ~₹38bn; FY20 respectable, at ~₹72bn



Source: Company

Fig 9 – OB for standalone operations: ~₹250bn; BtB at 3x



Source: Company, Anand Rathi Research

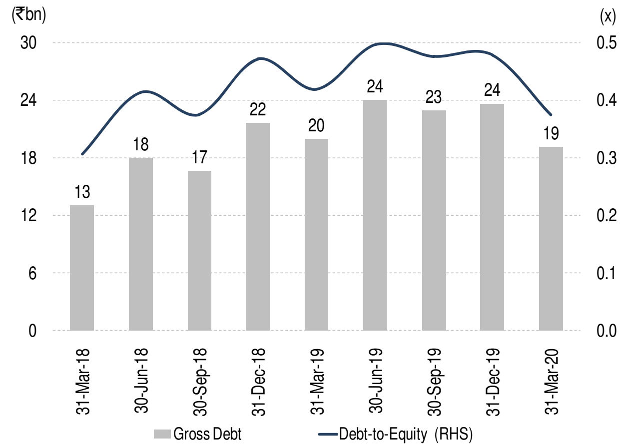
  - The proportion of projects with margins better than the blended average was pegged at ~30%. Management expects these to help offset any potential higher costs on account of Covid-19, thereby keeping the margin profile steady.

Balance sheet

- Lower working-capital needs (on the lower scale of operations) and concerted efforts to realise payments paid dividends during the quarter as well as the year. These were further aided by promoter-equity infusion on warrant conversions. All combined helped net debt decline ~₹5.7bn q/q to ~₹15.9bn (at 31st Mar'20). Resultantly, net debt-to-equity improved to ~0.3x, from ~0.4x a quarter ago.
  - The quality of reduction is all the more inspiring as it appears to have been assisted by dues recovered, and not by more mobilisation advances.
  - Sequentially, receivables were down ~₹4.3bn to ~₹26.2bn, and retention monies by ~₹2bn to ~₹21.4bn. Mobilisation advances over the same period, in fact, were down ~₹3.2bn to ~₹13bn.

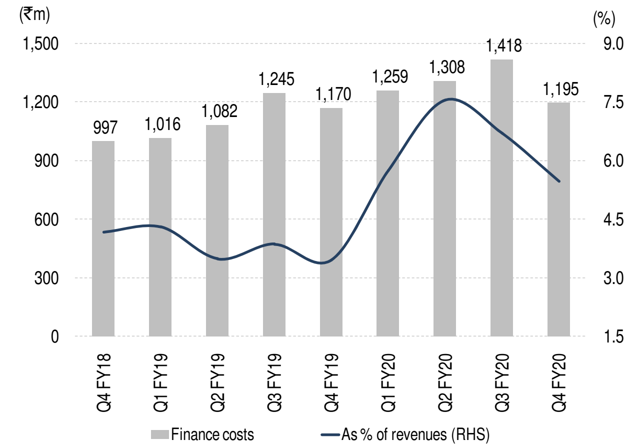
- Warrant-conversion receipts of ~₹0.8bn, too, aided the de-levering but this was partly off-set by ~₹0.2bn extended to support related parties.
- For FY20, net debt declined ~₹1bn, yet again aided by ~₹4.3bn lower receivables. Retention was ~₹1bn more, and mobilisation advances were down ~₹2.2bn for the period under review.
- Although Central and state governments are busy with relief measures, management has not experienced any issues with recoveries,
- While the company did not avail of the moratorium for its loan facilities during the scheme's first round (Mar-May'20), it seeks to avail of them in the second round (Jun-Aug'20) as there is now an option to convert deferred-interest payments into funded-interest term-loans.

Fig 10 – Gross debt down q/q on repayments led by recoveries of receivables than drawing of mob. advances



Source: Company

Fig 11 – Finance cost: Q4 incidence up ~202bps y/y on lower scale of operations



Source: Company

- The company is also in discussions with its consortium to avail of additional working-capital loans termed "Covid-19 loans". Under this, banks are allowed to extend an additional 10% of existing working-capital limits at attractive interest rates. If the consortium members agree, the company would gain access to additional loans of ~₹2bn.
- Despite the rate cuts by the RBI, the company has hardly seen a ~10bp reduction in its blended cost of borrowing, from ~9.9% to ~9.8%.

■ Its NWC cycle jumped ~70 days y/y, to ~192 at end-FY20, despite only ~₹3bn y/y change in absolute working capital. The jump, thus, is largely attributable to the lower FY20 revenues.

- Adjusted for the loans and advances extended to its subsidiaries and Associates, the core-working capital cycle lengthened by ~58 days, to ~165 at end-FY20, with an absolute increase of ~₹2bn in the core working-capital cycle.
- Working capital still looks elevated. It includes the stuck Sembcorp exposure, and the exposure to gradually re-starting AP orders.

- On 31st Mar'20, NCC's net exposure to subsidiaries and Associates rose ~₹0.2bn sequentially and ~₹0.7bn from a year ago, taking its related-party exposure to ~₹14.6bn. Recoveries during the year (of ~₹0.6bn) were over-shadowed by the additional support extended during the year.
  - The exposure comprises loans and advances of ~₹5.7bn (~₹5.5bn at end-Q3, and ~₹4.7bn a year ago) and investments of ~₹8.9bn (down ~₹0.04bn q/q, ~₹0.3bn y/y).
  - Management had earlier indicated that recovery hinges on its subsidiaries being able to raise debt against completed inventory.
- The company has ~₹121bn of fund- and nonfund-based facilities. Of its ~₹21bn fund-based facilities, utilisation ranges between ~75% and 95%. NCC has converted ~60% of these limits into working-capital limits (with a 90-day lock-in); thus, utilisation variation for fund-based limits depends on cash-flow utilisation on the balance ~40%.
  - Of its nonfund-based limits, it has ~₹90bn in the form of a bank guarantee facility (utilisation at ~90%) and ~₹10bn in the form of a Letter of Credit (utilisation at ~75%).

Others highlights

- **Execution in the Covid-19 environment.** Execution at all its sites was impacted in Apr'20 by the lockdown. Subsequently, as relief measures were announced by the government, NCC with the authorities' providing necessary approvals and aid, resumed construction at ~90-95% of its project sites, with varying capacities and available man-power.
  - Barring a few projects which have yet to start, work has begun at other work sites with capacities ranging anywhere between ~20% and 80% (averaging ~50%).
  - With inter-state goods movement now allowed, raw material is no more a huge challenge (it was in the initial stage) but labour availability is an area of concern.
  - For FY21, keeping the current environment in mind, NCC has shied away from "guidance", but said it looks at strong revenues from its Nagpur-Mumbai expressway project, three AIIMS projects, two airport projects (Patna and Lucknow), the Seabird Karwar project and its mining segment, among others.
  - Management said that relief measures are eating into the bulk of state government payments currently; however, it expects the states to honour bills raised by contractors and follow guidelines announced by the Finance Minister. Till now, it has not seen any out-of-ordinary delays in payments.
  - The company looks to ramp up works at those projects which have been financially tied up and where bill certification and clearance are faster as is the case at its Nagpur-Mumbai expressway project. Also, at projects of Central authorities, which have sound financial backing (AAA rated) such as the NHAI, AAI and AIIMS, among others.
- **AP orders' details.** Following the removal of orders of ~₹61bn from the order backlog in Q1 and de-scoping another ~₹71bn of non-moving AP exposure in Q3, the net AP exposure is ~₹45bn.

- Discussions are underway for settlement and release of payments for projects and returning of bank guarantees for the de-scoped works. Management has asked the authorities to set off mobilisation advances drawn against dues outstanding. It expects more clarity in the coming 4-5 months.
- It said that the AP state government has recently been pushing to commence execution in order to generate employment in the state.
- It recently received payments of ~₹1bn for its affordable-housing projects (during Mar'20) and seeks to commence work on such projects wherever payments are likely to be received.
- On the Amravati capital city orders, it is implementing some important works such as quarters for MLAs and IAS officers. Execution at these projects is on and expected to be completed shortly. Besides, it had an order for the Secretariat building. Management expects this order to be cancelled (has already de-scoped it), as the capital is likely to be shifted to Vishakhapatnam.

- **Sembcorp expected by Sep'20.** Management said that arguments have been presented by both parties, and only a decision by the arbitration panel is pending. It expects the arbitration outcome by Sep'20.
  - We estimate that NCC has ~₹9bn exposure, including ~₹3bn of bank guarantees encashed, ~₹1bn of pending dues, and ~₹3bn of retention money and interest accrued.
  - Management had earlier estimated penalties not to exceed ~₹1.5bn, and suggested that, even going by the contours of the agreement, penalties should not exceed ~₹2bn.
- **The Taqa Group.** Management is looking to settle the matter out of court and has already held discussions with the Taqa Group. It had earlier envisaged a potential settlement of ~₹0.7bn-1bn. No discussions have been held in the past month or two on account of the current Covid-induced environment.

Earnings revision, Valuation

On the Covid disruption, we anticipate the company to suffer man-days loss in FY21; and inflows, too, to lag our earlier expectations. We see a part of disruption in FY21 to stretch to FY22. On accounting for this, our revised FY21e and FY22e revenues fall respectively ~25% and ~10% shorter than we earlier expected.

Lower revenues leading to negative operating and financial leverages would lead to earnings plunging ~48% in FY21. For FY22, lower net debt and restrained capex, we believe, would make good the lower operating profitability, and there is an insignificant change in earnings estimates.

Mindful of the altered risk profile, we lower the EV/EBITD multiple for the EPC business, and raise the holding company discount for the assets owned through subsidiaries/JVs.

Our sum-of-parts-based target is now derived using a 4x EV/EBITDA multiple on FY22e EBITDA (lowered from 5x earlier), the real-estate exposure at a 50% discount to the invested value (for both domestic as well as the Dubai exposure) and the estimated MDO investment at 0.8x (earlier 1x).

Consequently, our target price works out to ₹57 a share (against ₹75 earlier). The construction business contributes ₹42 a share to the target price; the balance is attributable to exposure to subsidiaries and Associates.

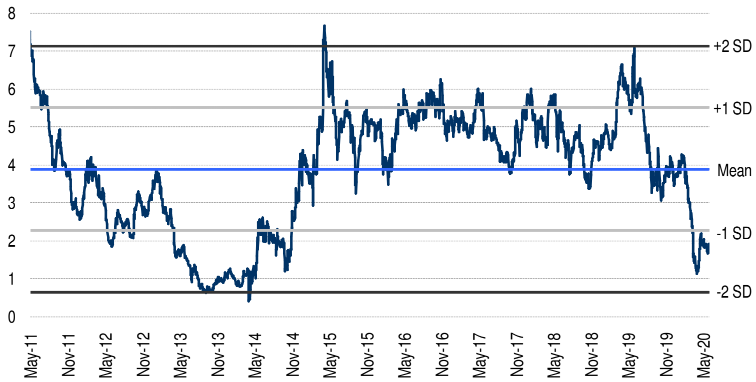
Fig 12 – Estimates revision

(₹ m)	Original estimates		Revised estimates		Change (%)	
	FY21e	FY22e	FY21e	FY22e	FY21e	FY22e
Revenue	95,738	1,04,697	72,283	94,626	-24.5	-9.6
EBITDA	11,110	12,070	7,743	10,856	-30.3	-10.1
Adj. PAT	3,112	3,766	1,617	3,759	-48.1	-0.2

Source: Anand Rathi Research

At the ruling price (excl. investments), the stock trades at EV/EBITDA of 3.5x FY21e and 2.6x FY22e.

Fig 13 – EV / EBIDTA band



Source: Company, Bloomberg, Anand Rathi Research

Risks

- Prolonged impact of Covid-19, leading to a slower-than-expected pace of execution.
- Any significant delay in re-starting the AP orders.

Appendix

Analyst Certification

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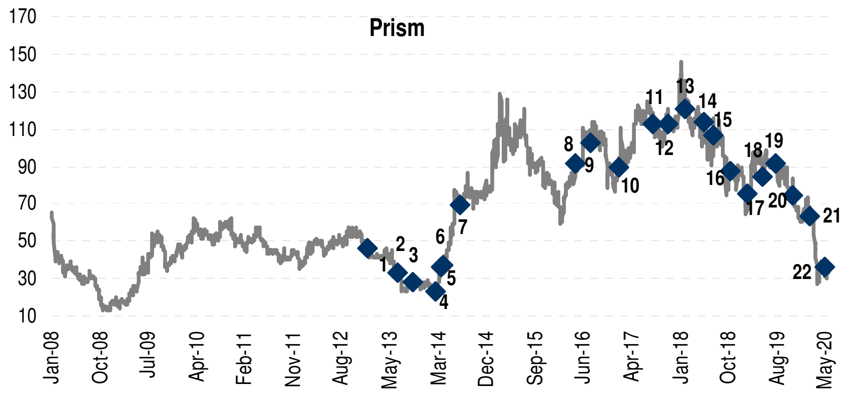
Rating and Target Price History (as of 30 May 2020)



	Date	Rating	TP (₹)	Share Price (₹)
1	21-Jan-13	Hold	55	48
2	10-Jul-13	Buy	50	34
3	09-Oct-13	Buy	40	28
4	12-Feb-14	Buy	32	23
5	21-Mar-14	Hold	32	34
6	04-Apr-14	Hold	35	38
7	09-Jul-14	Buy	90	73
8	16-May-16	Buy	105	88
9	12-Aug-16	Buy	128	105
10	18-Jan-17	Buy	113	91
11	10-Aug-17	Hold	107	113
12	09-Nov-17	Hold	113	110
13	16-Feb-18	Hold	133	126
14	31-May-18	Hold	136	118
15	31-Jul-18	Hold	140	115
16	02-Nov-18	Hold	105	87
17	08-Feb-19	Hold	95	77
18	14-May-19	Hold	102	86
19	30-Jul-19	Hold	99	92
20	07-Nov-19	Hold	81	72
21	14-Feb-20	Hold	75	63
22	04-May-20	Hold	48	38

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