

## Sector: Infrastructure

## Result Update

	Change
Reco: <b>Buy</b>	↔
CMP: <b>Rs. 50</b>	
Price Target: <b>Rs. 75</b>	↔
↑ Upgrade   ↔ No change   ↓ Downgrade	

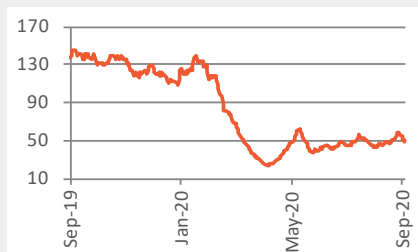
## Company details

Market cap:	Rs. 855 cr
52-week high/low:	Rs. 148/23
NSE volume: (No of shares)	17.2 lakh
BSE code:	532710
NSE code:	SADBHAV
Sharekhan code:	SADBHAV
Free float: (No of shares)	14.4 cr

## Shareholding (%)

Promoters	47
FII	8
DII	29
Others	16

## Price chart



## Price performance

(%)	1m	3m	6m	12m
Absolute	12.5	21.0	-23.0	-63.7
Relative to Sensex	9.1	6.3	-24.5	-69.9

Sharekhan Research, Bloomberg

Sadbhav Engineering Limited (SEL) yet again disappointed on execution front during Q1FY2021 with standalone revenues declining by 73% y-o-y to Rs. 230 crore. However, OPM beat expectations (although falling 402 bps y-o-y to 8.5%) as gross margins improved. Lower revenue affected by COVID-19 led challenges and a dip in OPM led to a standalone net loss of Rs. 26.6 crore (higher than our expectation of a net loss of Rs. 22 crore). However, post Q1FY2021, SEL has seen labour availability and execution run-rate improving to 70-80% and 60-70%, respectively, from July 2020. It expects to achieve labour availability of 90-100% and normalized execution run-rate from October 2020 onwards. Hence, the company broadly maintained its standalone revenue guidance for FY2021 and FY2022. SEL bagged two EPC projects totaling Rs. 1572 crore during Q2FY2021 till date and expects to bag another Rs. 3,000-3500 crore of orders for the remainder of FY2021. The company's order book adding the recently bagged projects stood strong at Rs. 9753 crore, translating to over 4x FY2020 standalone revenues. The company expects to receive Rs. 340 crore proceeds from Ahmedabad ring road sale by Q3FY2021 end, of which Rs. 220-230 crore would be utilized in reducing debt. The company's outstanding receivables has come down to Rs. 1,743 crore from Rs. 1,930 crore in FY2020 and expects further reduction of Rs. 400 crore (factoring Rs. 300 crore from two hybrid-annuity model (HAM) projects and Rs. 98 crore from GST refunds). The management is confident of promoters releasing their entire pledged shares within three months, which would remove a key hangover on the stock. SEL expects merger of Sadbhav Infrastructure Projects Limited (SIPL) with itself to be completed before March 2021. Overall, we expect the company to gradually return back to track with execution of projects at advanced stage and reduction in leverage. We have maintained our FY2021 and FY2022 estimates. Considering attractive valuation and improving fundamentals, we have maintained our Buy rating on the stock with unchanged price target (PT) of Rs. 75.

## Key positives

- Revenue guidance for FY2021 and FY2022 intact on improving execution and labour availability.
- Expect promoters to release pledged shares within three months time period.

## Key negatives

- Disappointment on execution front due to COVID-19 related challenges.
- Outstanding receivables at elevated levels. However, they are expected to gradually tread lower.

## Our Call

**Valuation – Maintain Buy with an unchanged PT of Rs. 75:** SEL has disappointed on execution front, over the trailing two quarters, as it was severely affected by COVID-19 related challenges. However, the company maintained its revenue guidance for FY2021 and FY2022 factoring improving labour availability and ramp-up in execution in three EPC projects post the monsoons. SEL has strong order book of over 4x TTM standalone revenue. It would be focusing majorly on EPC project tenders, thus limiting leverage. We expect the company to gradually return back to track with the execution of projects at an advanced stage and reduction in leverage. The release of promoters' pledged shares within three months would be a key positive trigger. We have maintained our FY2021 and FY2022 earnings estimates. Considering attractive valuation and improving fundamentals, we have maintained our Buy rating on the stock with unchanged price target (PT) of Rs. 75.

## Key Risks

Further delay in execution of projects is a key risk to our call.

## Valuation (Standalone)

	Rs cr			
Particulars	FY19	FY20	FY21E	FY22E
Revenue	3,549.2	2,251.7	2,378.4	3,208.0
OPM (%)	12.1	12.4	10.9	11.9
Adjusted PAT	186.1	68.1	63.2	152.3
% y-o-y growth	(15.7)	(63.4)	(7.3)	141.1
Adjusted EPS (Rs.)	10.8	4.0	3.7	8.9
P/E (x)	4.6	12.6	13.6	5.6
P/B (x)	0.4	0.4	0.4	0.4
EV/EBITDA (x)	4.2	6.5	7.0	4.7
RoNW (%)	9.5	3.3	3.0	6.9
RoCE (%)	8.8	4.8	4.7	7.1

Source: Company; Sharekhan estimates

**Execution continues to disappoint leading to lower than expected performance:** SEL reported lower-than-expected execution in Q1FY2021 with standalone revenue declining by 73% y-o-y to Rs. 230 crore. The company had been affected by COVID-19 led lockdown which had significantly hampered its supply chain and labour availability. During March-June 2020, availability of workforce was at 30-40%, supply of raw material at 10-20% and execution run-rate at 25%. Although the company reported a 402 bps y-o-y dip in OPM at 8.5%, it was higher than our expectation. It reported strong improvement in gross margins by 451 bps y-o-y partially offsetting fixed cost expenditure. A decline in revenues and OPM led to operating profit dip of 81% y-o-y to Rs. 19.5 crore and net standalone loss of Rs. 26.6 crore (higher than our expectation of a net loss of Rs. 22 crore).

**Revenue guidance broadly intact:** SEL has seen an improvement in workforce and supply of raw material to 70-80% and 60-80% from July 2020 onwards. Further, the execution run-rate has improved to 60-70% of pre-COVID levels in July 2020. From October onwards, it expects work force availability to improve to 90-100% and execution run-rate getting normalised. Hence, the company broadly maintained its revenue guidance for FY2021 expecting ~Rs. 400 crore of standalone revenue in Q2FY2021 and Rs. 9-10 crore per day revenue run-rate from Q3FY2021 onwards. It also maintained its revenue guidance for FY2022 at Rs. 3,300-3,500 crore. It expects faster execution in its three EPC projects from October onwards which should lead to Rs. 300-350 crore turnover in Q3FY2021. It expects to receive provisional commercial operation date (PCOD) of six HAM projects in FY2021. On the order inflow front, the company post receipt of Rs. 1572 crore projects in Q2FY2021 till date, it expects to bag another Rs. 3,000-3,500 crore of orders for balance FY2021. The company would be focusing majorly on EPC project tenders.

### Key Conference Call Takeaways

- ♦ **Guidance:** The company broadly maintained its revenue guidance for FY2021. It expects ~Rs. 400 crore standalone revenue in Q2FY2021 which is likely to be scaled up to Rs. 9-10 crore per day from Q3FY2021 onwards. For FY2022, it expects to clock standalone revenue of Rs. 3,300-3,500 crore.
- ♦ **Order inflows:** The company bagged Rs. 1,572 crore order inflows during Q2FY2021 and expects to receive Rs. 3000-3500 crore order inflow for the remainder of FY2021. The company has submitted bids for two EPC road projects totalling Rs. 1,652 crore and one metro project worth Rs. 570 crore.
- ♦ **Order book position:** The company's order book at the end of Q1FY2021 stood at Rs. 8181 crore. However it bagged two more EPC projects worth Rs. 1572 crore in Q2FY2021 till date taking its total order book at Rs. 9753 crore, which is 4.3x its FY2020 standalone revenues. Going ahead, the company will focus only on EPC project tenders. At SIPL level, it has an O&M order book of Rs. 4,000 crore which is to be executed over 15 years.
- ♦ **Bidding pipeline:** As per the company, NHAI has lined up 19 EPC projects worth Rs. 14,195 crore and 24 HAM projects worth Rs. 21,000 crore for which bids are to be submitted by September 2020 end and October 2020 end, respectively.
- ♦ **Trade receivables:** The company's total outstanding receivables at the end of Q1 stood at Rs. 1743 crore, which was Rs. 1930 crore on FY2020 end. It expects receivable to further decline by Rs. 400 crore going ahead.
- ♦ **Ahmedabad ring road stake sale:** The company expects AUDA approval for sale of Ahmedabad ring road project by the end of the current month. Post which, by the end of Q3FY2021, it expects to receive Rs. 340 crore proceeds from the sale. Out of the proceeds, Rs. 220-230 crore would be utilised in paying off debt to SEL from SIPL and balance would be utilised in working capital.
- ♦ **Debt profile:** SEL's standalone debt stood at Rs. 1165 crore, while SIPL's standalone debt at Rs. 800 crore as on Q1FY2021. The company expects SIPL's peak debt to be Rs. 7000 crore (Rs. 3103 crore for operational assets, Rs. 2,099 crore for under-construction and further Rs. 2000 crore pending for withdrawal). The company has infused Rs. 705 crore of equity in its projects and balance Rs. 308 crore is required to be infused.
- ♦ **Pledge of shares:** The company is confident of promoters releasing their pledge of shares within three months.

**Financials (Standalone)**

	Rs cr				
Particulars	Q1FY2021	Q1FY2020	y-o-y%	Q4FY2020	q-o-q%
<b>Net sales</b>	<b>229.7</b>	<b>837.6</b>	<b>-72.6%</b>	<b>408.9</b>	<b>-43.8%</b>
Total expenses	210.2	733.1	-71.3%	358.4	-41.3%
<b>Operating profit</b>	<b>19.5</b>	<b>104.6</b>	<b>-81.4%</b>	<b>50.4</b>	<b>-61.4%</b>
other income	1.4	4.1	-66.8%	4.1	-66.5%
Depreciation	24.9	28.0	-10.9%	26.0	-3.9%
Interest	24.0	27.3	-12.2%	29.4	-18.6%
Exceptional items	0.0	0.0		17.0	
Profit Before Tax	-28.1	53.4	-	16.2	-
Taxes	-1.5	13.9	-	8.0	-
PAT	-26.6	39.5	-	8.2	-
<b>Adjusted PAT</b>	<b>-26.6</b>	<b>39.5</b>	<b>-</b>	<b>-8.8</b>	<b>-</b>
No of equity shares	17.2	17.2	0.0%	17.2	0.0%
EPS (Rs.)	-1.5	2.3	-	-0.5	-
			<b>bps</b>		<b>bps</b>
OPM(%)	8.5%	12.5%	-402	12.3%	-387
NPM(%)	-11.6%	4.7%	-	-2.2%	-
Tax rate (%)	5.4%	26.1%	-	49.4%	-

Source: Company; Sharekhan Research

## Outlook

**Expect strong bounce-back in FY2022:** SEL has been disappointing on execution front as the trailing two quarters were severely hit by COVID-19 related challenges. However, the company has seen strong improvement in execution and labour availability from July 2020 onwards and expects normalcy from October 2020 onwards. Further, it expects ramp-up in three EPC projects which would start contributing materially in revenue from Q3FY2021 onwards. Hence, it has broadly maintained its revenue guidance for FY2021 and FY2022. The company's strong order backlog along with healthy order inflows expected during FY2021 is expected to lead to a strong earnings bounce-back in FY2022.

## Valuation

**Maintain Buy with an unchanged PT of Rs. 75:** SEL has disappointed on execution front, over the trailing two quarters, as it was severely affected by COVID-19 related challenges. However, the company maintained its revenue guidance for FY2021 and FY2022 factoring improving labour availability and ramp-up in execution in three EPC projects post the monsoons. SEL has strong order book of over 4x TTM standalone revenue. It would be focusing majorly on EPC project tenders, thus limiting leverage. We expect the company to gradually return back to track with the execution of projects at an advanced stage and reduction in leverage. The release of promoters' pledged shares within three months would be a key positive trigger. We have maintained our FY2021 and FY2022 earnings estimates. Considering attractive valuation and improving fundamentals, we have maintained our Buy rating on the stock with unchanged price target (PT) of Rs. 75.

### Peer Comparison

Particulars	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
PNC Infratech	15.3	12.6	7.2	6.0	1.5	1.4	10.7	11.7
KNR Constructions	18.6	14.4	7.2	6.0	1.9	1.7	11.1	12.7
Sadbhav Engineering	13.6	5.6	7.0	4.7	0.4	0.4	3.0	6.9

Source: Sharekhan Research

## 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. 9,753 crore (4.3x its FY2020 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 past 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 significantly deleverage its balance sheet. 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, improvement in outlook for the Indian roads sector 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 VISHNUBHAI	28.07
2	PATEL SHANTABEN V	28.07
3	SADBHAV FINSTOCK PVT LTD	9.64
4	HDFC Asset Management Co Ltd	9.27
5	ICICI Prudential Life Insurance Co	6.97
6	SBI Funds Management Pvt Ltd	4.13
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	2.67

Source: Bloomberg

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# Sharekhan

by BNP PARIBAS

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