Sharekhan by BNP PARIBAS

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Sadbhav Engineering Limited

Expect gradual improvement

Infrastructure	Sharekhan code: SADBHAV	Result Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)		✓	
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 48**	
Price Target: **Rs. 75**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

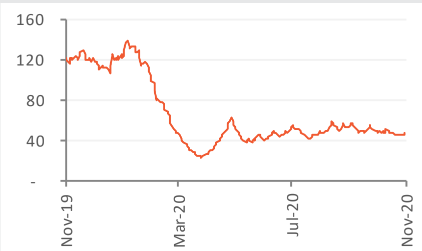
Company details

Market cap:	Rs. 830 cr
52-week high/low:	Rs. 142/23
NSE volume: (No of shares)	17.2 cr
BSE code:	532710
NSE code:	SADBHAV
Free float: (No of shares)	13.6 cr

Shareholding (%)

Promoters	47
FII	6
DII	26
Others	21

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-2.2	0.8	-10.1	-60.2
Relative to Sensex	-8.7	-13.9	-49.7	-68.1

Sharekhan Research, Bloomberg

Summary

- We maintain a Buy rating on Sadbhav Engineering Limited (SEL) with an unchanged PT of Rs. 75, factoring improving fundamentals and attractive valuation.
- Standalone revenues were in-line while OPM beat estimates, leading to better than-expected net earnings. Labour availability at pre-COVID levels would improve upon execution going ahead.
- Management broadly maintained FY2021 and FY2022 standalone revenue and OPM guidance. Its order book remains strong at over 4x FY2020 standalone revenue.
- Merger of SIPL with SEL is in process with NCLT, the hearing of which will commence post Diwali.

Q2FY21 standalone revenues were in line with estimates while OPM beat estimates, leading to better-than-expected net earnings. Standalone net revenues declined by 27.1% y-o-y to Rs. 412 crore as it saw gradual improvement in execution with rising labour availability, which currently is at pre-COVID level. The company reported better-than-expected OPM at 12.1% (-23 bps y-o-y, +362 bps q-o-q). Operating profit declined by 28.4% y-o-y to Rs. 49.8 crore, but was still higher than our expectation. Further, lower other income (down 24.7% y-o-y) and higher interest expense (up 31.6% y-o-y) led to an 80% y-o-y decline in standalone net profit to Rs. 5.2 crore against our expectation of a net loss for the quarter. The company maintained standalone revenue guidance of Rs. 2,200 crore and Rs. 3,500-3,600 crore for FY2021 and FY2022 with OPM at 12%. The order inflow guidance too remained similar at Rs. 3,000-3,500 crore for the remainder of FY21. It also received AUDA approval for transfer of the Ahmedabad project to the IndInfravit trust, which will be completed by Q3FY2021 end yielding Rs. 340 crore proceeds. However, the receivables continued to remain elevated at Rs. 1,692 crore of which Rs. 328 crore are expected to be received by Q4FY2021 end. The merger of SIPL with SEL is in process with NCLT, the hearing of which is expected to commence post Diwali. SEL would look to divest six HAM projects post receipt of PCoD (as expected by FY2021 end). Overall, we expect the company to gradually return back to track with execution of projects at an advanced stage and gradual reduction in leverage as it receives pending receivables and is able to divest its HAM portfolio. We have maintained our FY2021 and FY2022 estimates and have introduced FY2023 estimates in this note. 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

- Standalone revenue and OPM guidance for FY2021 and FY2022 intact.
- AUDA approval for transfer of Ahmedabad Ring Road project to IndInfravit trust.
- Expect receipt of PCoDs for six HAM projects by FY2021 end.

Key negatives

- Outstanding receivables remain elevated but are expected to gradually tread lower.

Our Call

Valuation –Maintain Buy with an unchanged PT of Rs. 75: SEL is on track on improving its execution after disappointing over the past two quarters, as it was severely affected by COVID-19 related challenges. The company's order book remains strong at Rs. 9,397 crore, translating to 4x FY2020 standalone revenues. The order bidding pipeline is expected to remain positive, benefiting the company. However, high receivables are expected to gradually decline. Overall, we expect the company to gradually return back to track with execution of projects at advanced stage and gradual reduction in leverage as it receives pending receivables and is able to divest its HAM portfolio. We have maintained our FY2021 and FY2022 estimates and have introduced FY2023 estimates in this note. Considering attractive valuation and improving fundamentals, we maintain our Buy rating on the stock with unchanged price target (PT) of Rs. 75.

Key risk

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

Valuation (Standalone) Rs cr

Particulars	FY20	FY21E	FY22E	FY23E
Revenue	2,251.7	2,378.4	3,208.0	3,608.0
OPM (%)	12.4	10.9	11.9	11.8
Adjusted PAT	68.1	63.2	152.3	184.3
% y-o-ygrowth	(63.4)	(7.3)	141.1	21.0
Adjusted EPS (Rs.)	4.0	3.7	8.9	10.7
P/E (x)	12.2	13.1	5.4	4.5
P/B (x)	0.4	0.4	0.4	0.3
EV/EBITDA (x)	6.4	6.9	4.6	4.2
RoNW (%)	3.3	3.0	6.9	7.8
RoCE (%)	4.8	4.7	7.1	7.7

Source: Company; Sharekhan estimates

Execution continues to disappoint leading to lower than expected performance

SEL reported in-line standalone revenues while operating margins came in better-than-expectation leading to better-than-expected beat on net earnings. Standalone revenues declined by 27.1% y-o-y to Rs. 412 crore as it saw gradual improvement in execution with rising labour availability which currently is at pre-COVIDlevel. The company reported better-than-expected OPM at 12.1% (-23 bps y-o-y, +362 bps q-o-q). Operating profit declined by 28.4% y-o-y to Rs. 49.8 crore which was higher than our expectation. Further, lower other income (down 24.7% y-o-y) and higher interest expense (up 31.6% y-o-y) led to 80% y-o-y decline in standalone net profit to Rs. 5.2 crore against our expectation of net loss for the quarter.

Revenue guidance broadly intact but sticky receivables to take time

The company has seen execution ramp up in Q3FY2021 till date with revenue run-rate per day crossing Rs. 7 crore and expects to reach a rate of Rs. 9 crore per day by December 2020. It has started construction work on Gadag and Kim projects and expect to start work on Ahmedabad Dholera project from December 2020 onwards. The company maintained standalone revenue guidance of Rs. 2,200 crore for FY2021 and Rs. 3,500-3,600 crore for FY2022. The OPM guidance for FY2021 and FY2022 remain unchanged at 12%. The company's total outstanding receivables at the end of Q2 stood at Rs. 1,692 crore. It expects to receive Rs. 173 crore in current month and about Rs. 155 crore in Q4FY2021. It expects to receive provisional commercial operation date (PCOD) of six HAM projects in FY2021. It expects to bag another Rs. 3,000-3,500 crore of orders for balance FY2021.

Key Conference call takeaways

- **Guidance:** The company maintained standalone revenue guidance of Rs. 2200 crore for FY2021 and Rs. 3,500-3,600 crore for FY2022. It saw a ramp-up in execution in Q3FY2021 till date with revenue run-rate per day crossing Rs. 7 crore and expects to reach Rs. 9 crore per day by December 2020. It has started construction work on the Gadag and Kim projects and expect to start work on Ahmedabad Dholera project from December 2020 onwards. OPM guidance for FY2021 and FY2022 remain unchanged at 12%.
- **Tolling uptick:** The company saw significant improvement in toll revenues. Toll revenue in its four projects increased by 17% in October 2020.
- **Bidding pipeline:** TheNHAI is expected to invite bids for 22 EPC projects worth Rs. 14,386 crore and 34 HAM projects worth Rs. 31,496 crore before November-December 2020. The company has submitted bids for two road projects worth Rs. 3,120 crore and for Surat Metro project worth Rs. 850 crore. It expects to bag Rs. 3,000-3,500 crore of orders for the remainder of FY21.
- **Order book position:** The company's order book at the end of Q2FY2021 stood at Rs. 9,397 crore, which is 4.2x its FY2020 standalone revenues. At SIPL level, it has an O&M order book of Rs. 4,000 crore, which is to be executed over 15 years.
- **Trade receivables:** Outstanding receivables at the end of Q2 stood at Rs. 1,692 crore. It expects to receive Rs. 173 crore in November and about Rs. 155 crore in Q4FY2021.
- **Ahmedabad ring road stake sale:** The company received AUDA approval for the sale of Ahmedabad ring road project. The company expects transfer of asset to be complete by Q3FY2021 along with 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 the balance would be utilised for working capital needs.
- **Debt profile:** Standalone debt stood at Rs. 1224 crore, while SIPL's standalone debt at Rs. 828 crore as on Q2FY2021. SIPL's debt for operational assets stood at Rs. 3,124 crore while for under-construction assets is at Rs. 2184 crore. The company has infused Rs. 743 crore of equity in its projects and balance Rs. 281 crore is required to be infused.

- **Rohtak-Panipat project:** The company has filed claim of Rs. 1706 crore for the project for which arbitration has started. It expects the process to complete over 1-1.5 years.
- **SIPL merger:** The merger of SIPL and SEL is under NCLT for which the hearing is expected to commence post Diwali.

Results (Standalone) Rs cr

Particulars	Q2FY2021	Q2FY2020	y-o-y%	Q1FY2021	q-o-q%
Net sales	**412.2**	**565.1**	**-27.1%**	**229.7**	**79.5%**
Total expenses	362.4	495.5	-26.9%	210.2	72.4%
Operating profit	**49.8**	**69.6**	**-28.4%**	**19.5**	**156.1%**
other income	4.8	6.4	-24.7%	1.4	247.8%
Depreciation	24.5	27.7	-11.5%	24.9	-1.7%
Interest	27.2	20.7	31.6%	24.0	13.3%
Exceptional items	0.0	0.0		0.0	
Profit Before Tax	2.9	27.6	-89.5%	-28.1	-
Taxes	-2.3	1.7	-	-1.5	-
PAT	5.2	25.9	-79.7%	-26.6	-
Adjusted PAT	**5.2**	**25.9**	**-79.7%**	**-26.6**	**-**
No of equity shares	17.2	17.2	0.0%	17.2	-
EPS (Rs.)	0.3	1.5	-79.7%	-1.5	-
OPM (%)	12.1%	12.3%	-23 bps	8.5%	362 bps
NPM (%)	1.3%	4.6%	-330 bps	-11.6%	-
Tax rate (%)	-	6.2%	-	5.4%	-

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Roads to remain one of key focus areas in government's infrastructure spending

The government's infrastructure investment is pegged at Rs. 111 lakh crore over FY2020-FY2025. The road sector is expected to witness Rs. 20 lakh crore investments during the same period. Hugeinvestments along with favourable government policies is expected to provide strong growth opportunities for industry players. The roads sector is recovering with near pre-COVID level man-power strength and availability of materials post easing of restrictions after the COVID--19-led lockdown in the country. The industry is expected to see strong order inflows and an improvement in execution run-rate from Q3FY2021 onwards. Working capital issues of the companies have been handled by proactive payments from the NHAI.

■ Company Outlook – On right track but would take time to fully recover

SEL has been disappointing on execution front as the past two quarters were severely hit by COVID-19 related challenges. However, the same has started to signs of improvement with labour availability reaching pre-COVIDlevels. The company continues to maintain its standalone revenue and OPM guidance for FY2021 and FY2022. However, pending receivables remain at elevated levels and are expected to gradually come down. The divestment of HAM projects would have to wait for achieving PCoD which is expected by FY2021-end. Althoughwe believe the company is on the right track of improving its business fundamentals, it would take time to fully recover while some peers have been able to strengthen the balance sheet at a much faster rate.

■ Valuation – Maintain Buy with an unchanged PT of Rs. 75

SEL is on track on improving its execution post after disappointing over the trailing past two quarters, as it was severely affected by COVID-19 related challenges. The company's order book remains strong at Rs. 9,397 crore, translating to 4x FY2020 standalone revenues. The order bidding pipeline is expected to remain positive, benefitting the company. However, high receivables are expected to gradually tread decline. Overall, we expect the company to gradually return back to track with execution of projects at advanced stage and gradual reduction in leverage as it receives pending receivables and is able to divest its HAM portfolio. We have maintained our FY2021 and FY2022 estimates and have introduced FY2023 estimates in this note. 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 (%)	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
PNC Infratech	11.8	10.0	5.7	5.0	1.3	1.1	13.3	13.7
KNR Constructions	14.6	12.7	6.1	5.5	1.7	1.5	12.7	12.9
Sadbhav Engineering	5.4	4.5	4.6	4.2	0.4	0.3	6.9	7.8

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	28.61
2	PATEL SHANTABEN V	28.61
3	SADBHAV FINSTOCK PVT LTD	9.64
4	HDFC Asset Management Co Ltd	9.25
5	Reliance Capital Trustee Co Ltd	4.46
6	SBI Funds Management Pvt Ltd	4.11
7	BLUE DIAMOND PROPERTIES	3.98
8	PATEL SHASHIN	3.25
9	MAX NEW YORK LIFE INSUR CO	2.91
10	ICICI Prudential Life Insurance Co	2.82

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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