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Sadbhav Engineering Limited

Weak execution outlook; Downgrade to Hold

Infrastructure	Sharekhan code: SADBHAV	Result Update

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

+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		↔	
RQ		↔	
RV		↔	

Reco/View	Change
Reco: **Hold**	↓
CMP: **Rs. 87**	
Price Target: **Rs. 97**	↓

↑ Upgrade ↔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 1,484 cr
52-week high/low:	Rs. 96/37
NSE volume: (No of shares)	17.2 lakh
BSE code:	532710
NSE code:	SADBHAV
Free float: (No of shares)	12.8 cr

Shareholding (%)

Promoters	47
FII	4
DII	23
Others	26

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	24.2	37.2	34.2	89.9
Relative to Sensex	23.7	30.4	25.3	44.2

Sharekhan Research, Bloomberg

Summary

- We downgrade Sadbhav Engineering Limited (SEL) to Hold with a revised PT of Rs. 97, factoring downwardly revised estimates, awaiting balance sheet de-leveraging and new order wins.
- The company reported lower-than-expected standalone operational performance for Q4FY2021, led by weak execution while standalone net profit came in higher than estimate on account of tax reversals.
- Management significantly trims standalone revenue guidance for FY2022. Management is focused on conciliation of two large projects, balance sheet de-leveraging by further asset divestments, and bidding for EPC projects.
- Funds raised during April 2021 aided in completing pending equity requirements for HAM projects.

Sadbhav Engineering Limited (SEL) reported lower-than-expected standalone operational performance for Q4FY2021, led by weak execution, while standalone net profit came in higher than estimate on account of tax reversals. SEL's standalone revenue grew by 4.1% y-o-y to Rs. 426 crore, as it could not start the work on three EPC projects due to delay in appointed dates and weak execution in HAM projects, led by pending equity requirements from the company. Standalone OPM was better than estimates at 16.1% (up 374 bps y-o-y, up 283 bps q-o-q), which was led by exceptional items and projects nearing completion. Hence, operating profit rose by 35.7% y-o-y to Rs. 68.5 crore, although it was lower than our estimate. Higher other income (up 8.2x y-o-y, interest received from SIPL, and Rs. 11 crore amount write back) and lower effective tax rate (Rs. 36 crore tax reversals pertaining to earlier period and sale of asset) led to reported net profit of Rs. 47.2 crore (which includes Rs. 20 crore exceptional loss on account of sale of assets) versus Rs. 8.2 crore reported PAT in Q4FY2020. Adjusting for exceptional item, adjusted net profit stood at Rs. 66.8 crore, which was higher than our estimate. SEL raised Rs. 991 crore in April 2021 by way of Rs. 550 crore NCDs and Rs. 441 crore through sale of 7% stake (out of 10% stake) in IndInfravit trust units, which aided in funding its pending equity requirement for nine HAM projects under SIPL. Hence, there is no equity requirement pending for the company. However, management has significantly trimmed down its standalone revenue guidance from Rs. 3,500 crore in FY2022 to just 15-20% minimum y-o-y growth, which we believe is led by delay in receipt of appointed dates for EPC projects and Q1FY2022 getting affected by COVID second wave. Further, OPM is expected to normalise at 12-13% versus 16.1% in Q4FY2021 going ahead. SEL's focus would remain on de-leveraging its balance sheet through asset monetisation (Ahmedabad Ring Road, 3 HAM projects, Maharashtra Border check posts), concluding conciliation of two projects (Rohtak Panipat and Rohtak Hisar, where toll collection has stopped since 180 days led by farmers' agitation invoking force majeure clause), and bidding for EPC projects. We have lowered our estimates for FY2022E-FY2023E, factoring material reduction in EPC revenue led by issues highlighted above. The conclusion of conciliation process of two large projects, fructification of further asset monetisation, and winning projects in a highly competitive EPC segment would be key monitarables going ahead. We downgrade our rating on the stock to Hold with a revised price target (PT) of Rs. 97, led by downwardly revised estimates and awaiting balance sheet de-leveraging and new order wins.

Key positives

- OPM and net profit came in above estimates, led by exceptional items.
- Funds raised during April aided in completing pending equity requirement for HAM projects.

Key negatives

- Significant downward revision in EPC execution for FY2022.
- Delays in conciliation of Rohtak Panipat and Rohtak Hisar projects.
- Delays in receiving appointed dates for EPC projects.

Our Call

Valuation – Downgrade to Hold with a revised PT of Rs. 97: SEL has significantly lowered its standalone revenue guidance affected by delay in receiving appointed dates for EPC projects and impact of COVID second wave on Q1FY2022 earnings. The company's focus during FY2022 would remain on concluding conciliation process related to two large projects, de-leveraging balance sheet through further asset monetisation, and bidding for EPC projects. We have lowered our estimates for FY2022E-FY2023E, factoring lower execution of EPC projects. Further, we have downgraded our rating on the stock to Hold with a revised PT of Rs. 97, led by downwardly revised estimates and awaiting balance sheet de-leveraging and new order wins.

Key Risks

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

Valuation (Standalone) Rs cr

Particulars	FY20	FY21	FY22E	FY23E
Revenue	2,251.7	1,623.6	1,944.1	2,549.2
OPM (%)	12.4	13.0	12.3	12.7
Adjusted PAT	68.1	60.6	16.0	71.0
% y-o-y growth	(63.4)	(11.0)	(73.6)	343.1
Adjusted EPS (Rs.)	4.0	3.5	0.9	4.1
P/E (x)	21.8	24.5	92.6	20.9
P/B (x)	0.7	0.7	0.7	0.7
EV/EBITDA (x)	8.4	11.2	9.9	7.3
RoNW (%)	3.3	2.9	0.7	3.3
RoCE (%)	4.8	83.6	5.0	6.6

Source: Company; Sharekhan estimates

Higher other income and tax reversals lead to higher-than-expected PAT

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Recent fund raised aided in HAM equity funding; FY2022 guidance trimmed down

SEL raised Rs. 991 crore in April 2021 by way of Rs. 550 crore NCDs and Rs. 441 crore through sale of 7% stake (out of 10% stake) in IndInfravit trust units, which aided in funding its pending equity requirement for nine HAM projects under SIPL. Hence, there is no equity requirement pending for the company. However, management has significantly trimmed down its standalone revenue guidance from Rs. 3,500 crore in FY2022 to just 15-20% minimum y-o-y growth, which we believe is led by delay in receipt of appointed dates for EPC projects and Q1FY2022 getting affected by COVID second wave. Further, OPM is expected to normalise at 12-13% versus 16.1% in Q4FY2021 going ahead. SEL's focus would remain on de-leveraging its balance sheet through asset monetisation (Ahmedabad Ring Road, 3 HAM projects, Maharashtra Border check posts), concluding conciliation of two projects (Rohtak Panipat and Rohtak Hisar, where toll collection has stopped since 180 days, led by farmers' agitation invoking force majeure clause), and bidding for EPC projects.

Key Conference Call Takeaways

- **Guidance:** The company targets to achieve 15-20% standalone revenue growth for FY2022. It expects OPM to be 12-13% under normal course. It would be focussing on EPC bidding. It has submitted bids for 6 road EPC projects worth Rs. 11,200 crore.
- **Rohtak Panipat and Rohtak Hisar project:** Tolling at both the projects has stopped since December 2020, led by farmer's agitation. As tolling has stopped for 180 days led by force majeure events, the company has approached NHAI. For Rohtak Panipat, Rs. 115 crore is outstanding arbitration award and Rs. 1,706 crore claim launched due to alternate route. The conciliation process is currently going on, which is expected to conclude in 3 to 4 months. Outstanding debt for Rohtak Panipat and Rohtak Hisar is Rs. 932 crore and Rs. 1,042 crore, respectively, and equity invested is Rs. 240 crore and Rs. 106 crore, respectively.
- **Equity infusion:** The company has completed equity infusion in nine HAM projects under SIPL in April 2021 through Rs. 550 crore NCDs raised and Rs. 441 crore received from monetisation of 7% stake in InvIT assets. Overall, it has infused Rs. 1,070 crore in nine HAM projects.
- **Debtors:** The company has Rs. 414 crore debtors, of which HAM comprises Rs. 270 crore, EPC Rs. 65 crore, mining Rs. 14 crore, irrigation Rs. 38 crore, and others Rs. 27 crore.
- **Work-in-progress:** Work-in-progress stood at Rs. 1,339 crore, comprising HAM Rs. 456 crore, price escalation Rs. 292 crore, GST receivable Rs. 47 crore, EPC Rs. 249 crore, mining Rs. 19 crore, irrigation Rs. 179 crore, and others Rs. 25 crore.
- **Order book:** SEL's order book stood at Rs. 9,328 crore. SIPL order book stands at Rs. 3,990 crore, of which Rs. 59.18 crore is for HAM SPVs O&M.
- **Debt:** SEL's consolidated debt stood at Rs. 1,210 crore, of which it has reduced Rs. 90 crore in April 2021. The debt includes Rs. 419 crore outstanding from SIPL. SIPL's consolidated SPV debt stands at Rs. 3,219 crore, of which Rs. 3,219 crore is for under-construction projects and standalone debt is Rs. 952 crore.
- **SIPL reverse merger:** The matter is pending for hearing at NCLT Ahmedabad for which hearing is expected in July end.

- **PCOD Status:** The company has received PCOD for three HAM projects. It expects to receive PCOD for four HAM projects in H1FY2022 and three HAM projects in FY2023.
- **Industry Update:** NHAI has lined up 23 HAM projects worth Rs. 26,750 crore for which bidding is expected to be completed by August 2021 and 13 EPC projects worth Rs. 11,410 crore for which bidding is expected to be completed by July-August 2021.
- **Asset monetisation:** The company will be undertaking monetisation process for Ahmedabad Ring Road project, three HAM projects where PCOD has been received, and Maharashtra check posts.
- **Weak execution in Q4FY2021:** The company could not start work on three EPC projects viz. Surat Metro and two Dholera projects due to delay in appointed dates. Further, HAM execution was weak as equity commitments were pending, which were completed by April 2021 end. Hence, the quarter witnessed lower execution.
- **Tax credit in Q4FY2021:** In Q4FY2021, it reversed Rs. 19.36 crore tax of earlier year and Rs. 16.33 crore deferred tax reversal on account of sale of assets. The company has Rs. 110 crore MAT credit outstanding.
- **Fund and non-fund based limits:** The company's non-fund based limits is Rs. 2,000 crore, of which it has utilised Rs. 1,680 crore. It has Rs. 45 crore-50 crore fund-based limits available out of Rs. 550 crore.
- **Higher other income:** Higher other income was on account of interest received from SIPL and Rs. 11 crore written back, which was not to be paid.

Result (Standalone) **Rs cr**

Particulars	Q4FY2021	Q4FY2020	y-o-y%	Q3FY2021	q-o-q%
Net sales	425.7	408.9	4.1%	556.0	-23.4%
Total expenses	357.3	358.4	-0.3%	482.4	-25.9%
Operating profit	68.5	50.4	35.7%	73.7	-7.0%
other income	33.7	4.1	722.1%	13.3	154.3%
Depreciation	21.2	26.0	-18.3%	23.5	-9.9%
Interest	49.9	29.4	69.4%	48.2	3.6%
Exceptional items	-19.6	17.0		0.0	
Profit Before Tax	11.5	16.2	-28.7%	15.2	-24.4%
Taxes	-35.7	8.0	-	0.1	-
PAT	47.2	8.2	-	15.2	-
Adjusted PAT	66.8	-8.8	-	15.2	-
No of equity shares	17.2	17.2	0.0%	17.2	0.0%
EPS (Rs.)	3.9	-0.5	-	0.9	-
OPM (%)	16.1%	12.3%	374 bps	13.2%	283 bps
NPM (%)	15.7%	-2.2%	-	2.7%	1296 bps
Tax rate (%)	-	49.4%	-	0.4%	-

Source: Company Data, 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. Huge investments along with favourable government policies are expected to provide strong growth opportunities for industry players. The roads sector is recovering, with near pre-COVID level manpower strength and availability of materials post easing of restrictions after COVID-19-led lockdown in the country. The industry is expected to see strong order inflows and improved in execution run-rate compared to Q3FY2021. Working capital issues of companies have been handled by proactive payments from NHAI.

■ Company outlook - Balance sheet de-leveraging and asset divestment to be focus areas

SEL's performance on the execution front has been disappointing over the trailing year, led by COVID-related challenges, delays in receipt of appointed dates, and liquidity crunch affecting equity requirements in HAM projects. Management has significantly trimmed down its standalone revenue guidance from Rs. 3,500 crore in FY2022 to just 15-20% minimum y-o-y growth, which we believe is led by delay in receipt of appointed dates for EPC projects and Q1FY2022 getting affected by COVID second wave. Further, OPM is expected to normalise at 12-13% versus 16.1% in Q4FY2021 going ahead. SEL's focus would remain on its de-leveraging balance sheet through asset monetisation (Ahmedabad Ring Road, three HAM projects, and Maharashtra Border check posts), concluding conciliation of two projects (Rohtak Panipat and Rohtak Hisar, where toll collection has stopped since 180 days, led by farmers' agitation invoking force majeure clause), and bidding for EPC projects. Although we 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 - Downgrade to Hold with a revised PT of Rs. 97

SEL has significantly lowered its standalone revenue guidance affected by delay in receiving appointed dates for EPC projects and impact of COVID second wave on Q1FY2022 earnings. The company's focus during FY2022 would remain on concluding conciliation process related to two large projects, de-leveraging balance sheet through further asset monetisation, and bidding for EPC projects. We have lowered our estimates for FY2022E-FY2023E, factoring lower execution of EPC projects. Further, we downgrade our rating on the stock to Hold with a revised PT of Rs. 97, led by downwardly revised estimates and awaiting balance sheet de-leveraging and new order wins.

Peer Comparison

Particulars	P/E (x)		EV/EBITDA (x)		P/BV (x)		RoE (%)	
	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E	FY22E	FY23E
PNC Infratech	17.3	14.0	9.3	7.8	2.2	1.9	13.9	15.0
KNR Constructions	21.0	17.2	11.4	9.5	3.0	2.6	15.7	16.5
Sadbhav Engineering	92.6	20.9	9.9	7.3	0.7	0.7	0.7	3.3

Source: Sharekhan Research, Standalone financials

About company

Incorporated in 1988, SEL 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

SEL has been disappointing on the execution front, led by COVID-related challenges, delays in receipt of appointed dates, and liquidity crunch affecting equity requirements in HAM projects. SEL's focus would remain on de-leveraging its balance sheet through asset monetisation, concluding conciliation of projects, and bidding for EPC projects. Although we 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.

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

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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Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

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