INSTITUTIONAL EQUITY RESEARCH

Ashoka Buildcon (ASBL IN)

Business risks increasing; valuations complete

INDIA | INFRASTRUCTURE | Company Update

10 April 2017

Diversifying into unrelated businesses – increasing business risks

Ashoka Buildcon recently announced that it has been declared L1 for a commercial real estate project by MIAL (Mumbai International Airport Ltd) for developing two land parcels on asset-ownership model. This is its second foray into an unrelated business in this model; it won a city-gas distribution project in Ratnagiri, Maharashtra, in September 2016. With a huge pipeline of road projects expected from NHAI over the next three years (especially HAM projects), we see no reason for the company to diversify into these unrelated businesses where capital commitment is significant. These events will lead to a substantial increase in business risks associated with the stock.

We view these unrelated diversifications as signs of the management's growing aspirations, as its EPC/BOT business stabilises. **We note that it was THIS very 'indiscriminate' nature of investments, that led to the downfall of infrastructure companies like IVRCL, Gammon, GMR, GVK and JP Associates in the last cycle**. NCC and HCC are the lone survivors of that cycle; HCC is running on borrowed oxygen. We fear a similar fate for Ashoka if the business cycle turns negative in the near or medium term, making these investments a drag on its balance sheet and profitability. We would have been happy had these diversifications come in the form of EPC projects (rather than BOT), ensuring minimum capital commitment.

MIAL commercial RE project – laden with uncertainties

For the MIAL RE project, the company will be entitled to develop and collect rentals from 1.17mn sq. ft. of commercial space for 49 years (including a construction period of three years). **It expects a total capex of Rs 9bn, with an equity commitment of Rs 2.5bn.** As per the concession agreement, it will be required to deposit Rs 3.2bn (refundable), and share an annual revenue of Rs 152mn from year one, increasing by 15% every three years. The management expects monthly lease rentals of Rs 140-150 psf, construction cost of Rs 3500-4000psf, and healthy +20% IRR from the project.

The project faces multiple hurdles, which could significantly impact its returns profile:

- **The company has to develop a master plan** for the commercial complex and get it approved by the BMC (Bombay Municipal Corporation).
- **Competition** from another land parcel awarded by MIAL and other upcoming commercial real estate projects on the neighboring Andheri-Kurla road.
- **Lack of clarity on the extension of the concession agreement** for Mumbai airport between MIAL and AAI (Airport Authority of India) after 30 years (19 years from today) – which would endanger the 49-year concession period of this real estate project.

Notwithstanding the uncertainties, **the project could generate 20% IRR for Ashoka (17% in 19 years), assuming everything goes as per plan and schedule**. We derive a valuation of Rs 4.6bn (Rs 25/share) using the management's assumptions for the project.

Valuations complete; downgrade to NEUTRAL

Ashoka's stock has run up significantly over the last three months (35%), outperforming its peers. Its valuations, currently at 1.8x P/BV, are in line with our SOTP valuation. We see limited upside in the near to medium term. While positive triggers like replacement of SBI-McQ by another investor and execution of its HAM projects exist, we see business risks increasing significantly with its foray into unrelated businesses.

While we hope and wish that these investments turn out to be profitable for the company, we would not recommend investors taking additional business risks at current valuations. We downgrade the stock to NEUTRAL as we maintain our estimates and target of Rs 205. We have not yet factored the contribution from the MIAL project (awaiting clearances and financial closure).

Downgrade to NEUTRAL

CMP RS 208

TARGET Rs 205 (-1%)

COMPANY DATA

O/S SHARES (MN) :	187
MARKET CAP (RSBN) :	38
MARKET CAP (USDBN) :	0.6
52 - WK HI/LO (RS) :	232 / 111
LIQUIDITY 3M (USDMN) :	2.2
PAR VALUE (RS) :	5

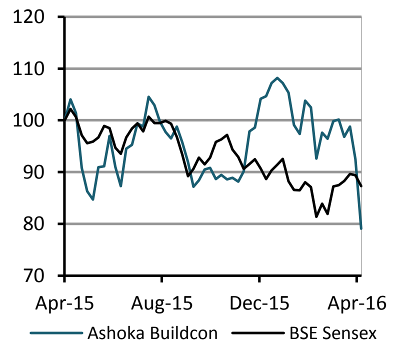
SHARE HOLDING PATTERN, %

	Dec 16	Sep 16	Jun 16
PROMOTERS :	56.7	56.7	56.7
FII / NRI :	8.4	8.4	8.1
FI / MF :	23.3	22.7	22.0
NON PRO :	7.8	5.0	9.5
PUBLIC & OTHERS :	3.8	7.1	3.8

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	12.3	32.5	48.0
REL TO BSE	9.8	21.5	27.7

PRICE VS. SENSEX



Source: Phillip Capital India Research

KEY FINANCIALS

Rs mn	FY17E	FY18E	FY19E
Net Sales	29,380	34,272	39,175
EBIDTA	8,824	10,308	11,051
Net Profit	1,051	1,188	1,448
EPS, Rs	5.6	6.3	7.7
PER, x	36.9	32.6	26.8
EV/EBIDTA, x	9.0	7.7	6.9
PBV, x	2.0	1.9	1.8
ROE, %	5.4	5.7	6.6
Debt/Equity (x)	2.2	2.0	1.8

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MIAL commercial RE project – laden with uncertainties

For the MIAL RE project, the company will be entitled develop 1.17 mn sqft of commercial space for which it would collect rentals for 49 years (including a construction period of three years). It expects a total capex of Rs 9bn, with its equity commitment of Rs 2.5bn (rest through debt). As per the concession agreement, Ashoka will be required to deposit Rs 3.2bn (refundable) and share annual revenue of Rs 152mn from year one, increasing by 15% in every three years. The management expects monthly lease rentals of Rs 140-150 psf from the property, with a construction cost of Rs 3500-4000psf. It expects to generate healthy +20% IRR from the project.

The project has multiple hurdles, which could significantly impact its return profile:

- Ashoka Buildcon needs to develop a masterplan for the commercial complex, and get it approved by BMC (Bombay Municipal Corporation) – a long and cumbersome process. The refundable deposit and revenue share would begin from the first year, irrespective of the stage of clearances and execution.
- Ashoka's land parcels will compete with another land parcel awarded by MIAL, along with a significant upcoming supply of commercial space on the neighboring Andheri-Kurla road. This could significantly impact its lease rental potential.
- The client, MIAL, 'owns' this land under a concession agreement with AAI, for a period of 30+30 years – of which 11 are already over. While MIAL has a 'right' to extend the project after the first 30 years, we do not know under what terms it would do so. Also, with the last AERA tariff order for Mumbai and Delhi airports not granting any returns on real estate deposits, the return profile of the airport project significantly reduces for MIAL – in which case, MIAL itself might not want to extend the project.

Notwithstanding the uncertainties, the project could generate 20% IRR for the company (17% in 19 years), assuming everything goes as per plan and schedule. We derive a valuation of Rs 4.6bn for the project (Rs 25/share) using the management's assumptions.

Assumptions and valuation for the MIAL project

Total area (mn sqft)	1.17	Rentals (FY 2021, Rs psf)	150.0	IRR (19 yrs)	17.3%
FSI	1.30	Triennial escalation	10%	IRR (49 yrs)	20.2%
Leasable area (mn sqft)	1.52	Revenue share (Rs mn)	152.4		
Execution start year	FY18	Triennial escalation	15%	NPV (Rs mn)	4,639
Leasing start year	FY21	Construction cost (Rs psf)	4,000	NPV (per share)	25
Debt repayment start	FY23				
Debt repayment ends	FY35				
Particulars	**Rs mn**	Peak Occupancy year	FY25		
Project Cost	9,000	Peak Occupancy	90%		
Equity	2,500	NOI Margins	90%		
Debt	6,500	Interest rate on debt	10%		
Upfront Deposit	3,240	Tax rate	30%		

Source: Company, PhillipCapital India Research

While this might appear to be an attractive investment, Ashoka would end up locking in significant capital (Rs 2.5-3.0bn) for a period of 49 years – along with increasing leverage at the consolidated level. All this, while taking on the risks of an unrelated sector – real estate – in its balance sheet.

Indiscriminate investments by various firms in the last cycle led to their downfall

The primary reason we do not like the MIAL RE project won by Ashoka Builcon, is because we have seen how indiscriminate investments, especially in real estate sector, led to the downfall of leading construction companies in the last cycle. Companies like IVRCL, Gammon, HCC, NCC, and JP Associates were the leading players of the last cycle. Now NCC is the lone survivor from the pack. JP Associates, Gammon and IVRCL are under CDR, and HCC is running on borrowed oxygen.

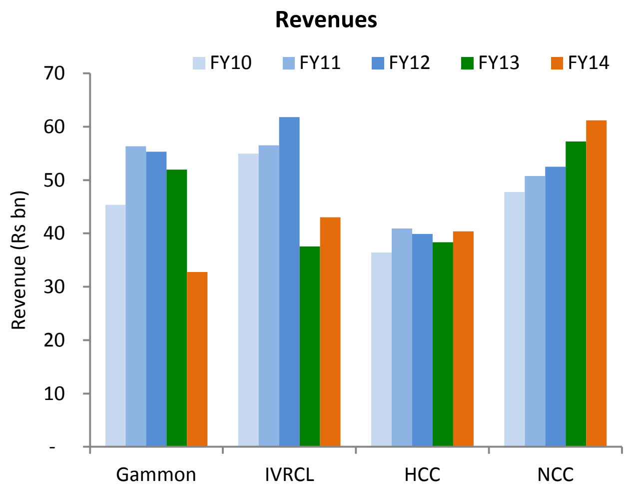
Most EPC companies have had to enter CDR due to their unrelated investments

	CDR entry date	Gross Debt (FY16, Rs bn)	Market Cap (Current, Rs bn)	Indiscriminate Investments in sectors
HCC	Q1FY13	110.2	41.12	Real estate (Lavasa), BOT
Gammon India	Q4FY13	94.7	4.24	BOT, Power (Ansaldo, Italian subs)
IVRCL	Q4FY14	80.6	3.96	Real estate, BOT
GMR Infra	NA	388.5	95.68	Airport, Real estate
GVK Power	NA	247.8	9.71	Airport, Real estate
JP Associates	-	612.6	31.4	Real estate, BOT, Power

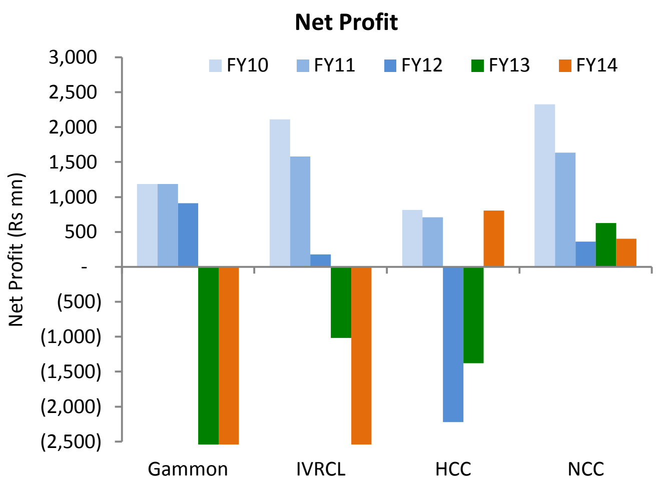
Source: Companies, PhillipCapital India Research

Quick snapshot of how these companies messed up …

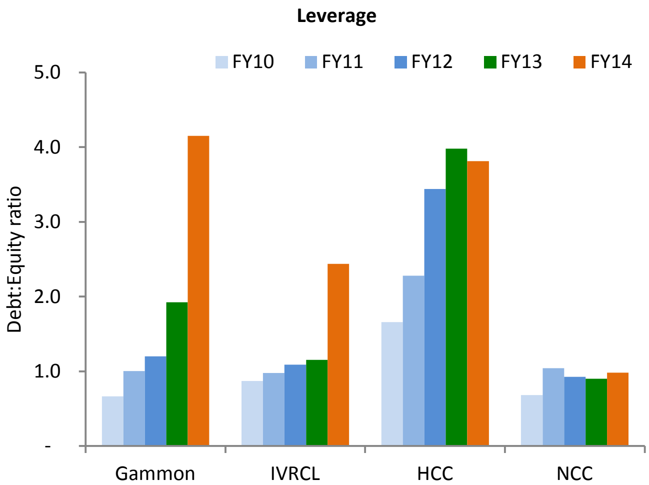
Most companies failed to grow at the topline level …



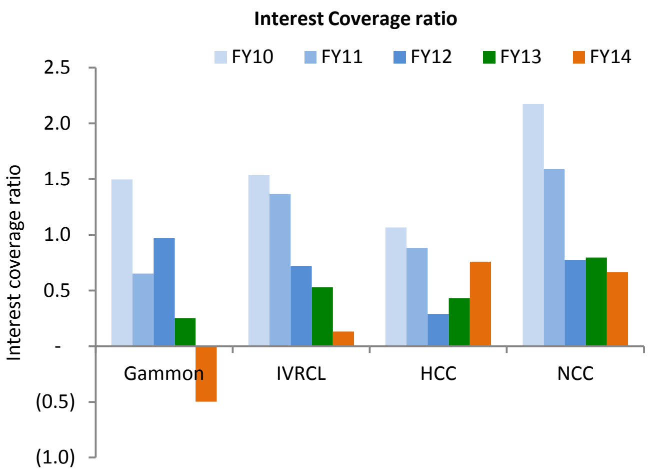
… while reporting highly volatile earnings (except NCC)



The leverage continuously kept on increasing …



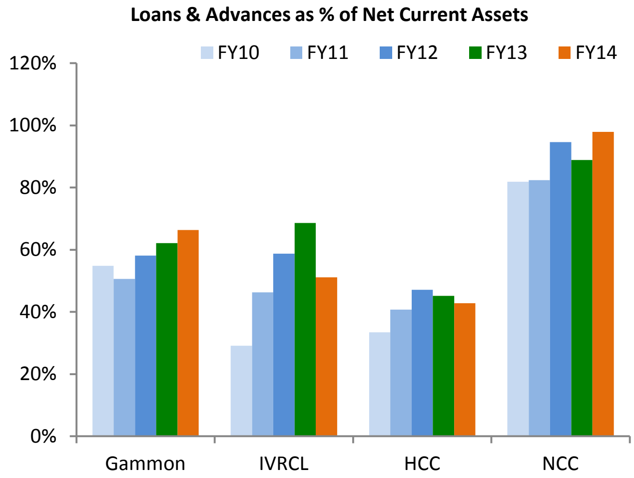
… EBITDA remained insufficient to meet interest obligations



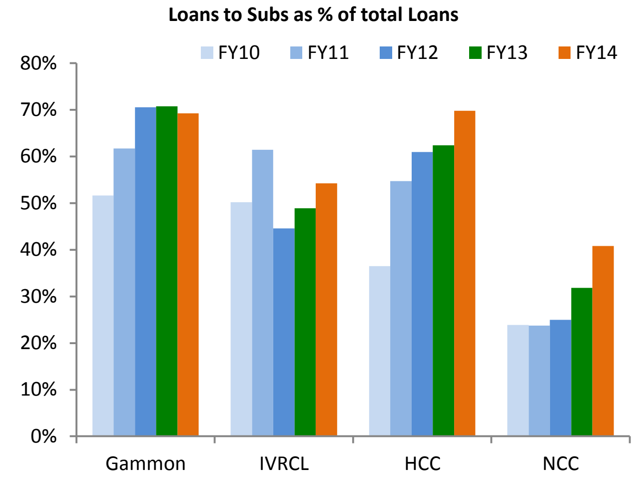
Source: Companies, PhillipCapital India Research

All along, loans and advances to subsidiary companies, primarily real estate and BOT projects, were responsible for higher leverage

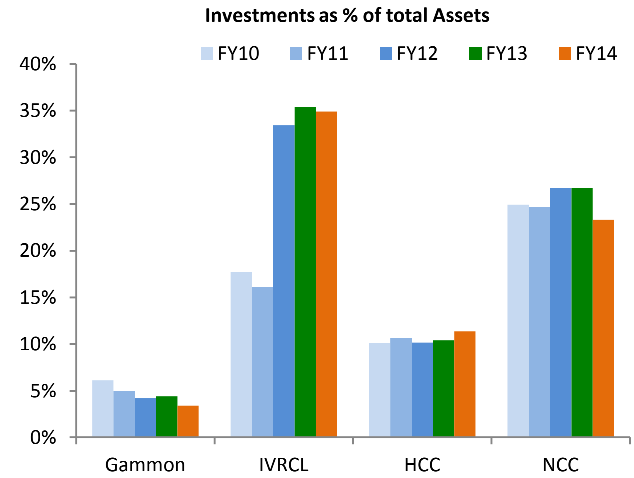
Loans and advances as a % of NWC



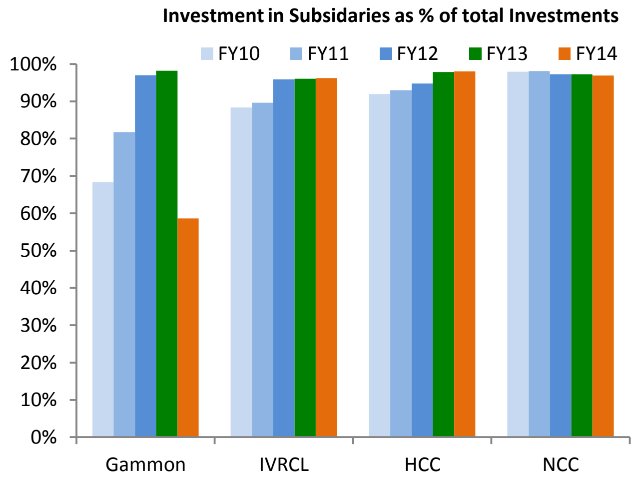
Loans to subsidiaries as % of loans & advances



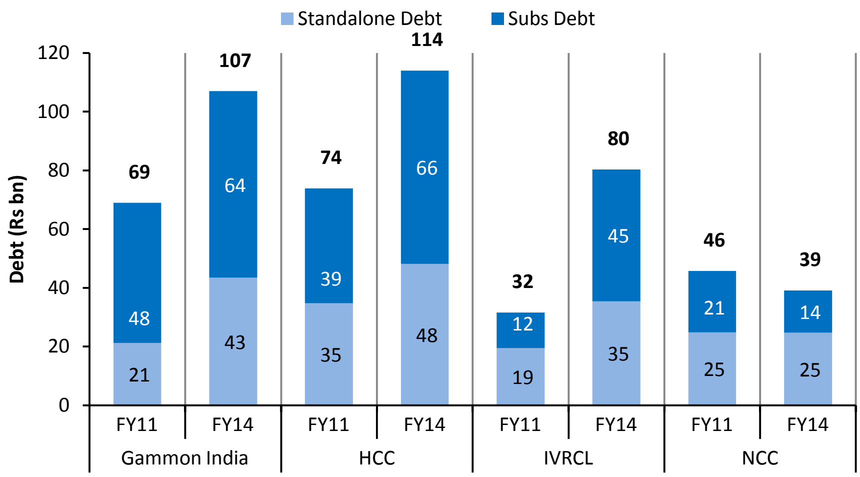
Investments as % of total assets



Investments in subs as % of total investments



Consolidated debt position worsened even more than standalone



Source: Companies, PhillipCapital India Research

Core business stabilising – fuelling management aspirations

We believe Ashoka's management has ventured into these unrelated businesses, as its core EPC/BOT business has significantly stabilised over the last one year:

- In its ACL portfolio, all BOT projects (excl Sambalpur) are now self sufficient, and the company requires minimal equity (Rs 1.7bn) for projects under construction.
- It accrued EPC orders of Rs 41.7bn in FY17 – its highest ever – taking its orderbook to Rs 74bn (3.7x book-to-sales) – providing high revenue visibility.
- It is in the late stages of replacing SBI-Macquarie by another PE investor in its BOT portfolio – ensuring that it will not have to buy the former's stake.
- Rs 5bn raised from its 2015 QIP and release of WC from power T&D projects have released decent cash for the parent company.

Valuations complete, downgrade to NEUTRAL

Ashoka's stock has run-up significantly over the last three months (35%), outperforming its peers. Its valuations, currently at 1.6x P/BV, are in line with our SOTP valuation. We see limited upside from current levels in near to medium term.

SoTP valuation

	Project Equity Value (Rs mn)	Stake (%)	Ashoka Equity Value (Rs mn)	Per Share (Rs)
ABL BOT Projects				***2x FCFE of 18 BOT Projects***
14 Small BOT Projects	3,544	100	3,544	18.9
Jarora Nayagaon *(DCF)*	7,921	38	2,986	16.0
KSHIP *(DCF)*	668	100	668	3.6
Two Annuity Projects *(1x BV)*	823	100	823	4.4
Value to Ashoka Buildcon	**12,956**		**8,021**	**42.9**
EPC Division				***7x FY19 EV/EBITDA***
EPC division	3,822	7.0	26,751	142.9
Net cash at parent level	(1,644)		(1,644)	(8.8)
Value to Ashoka Buildcon	**25,108**		**25,108**	**134.2**
ACL BOT Projects				***NPV @ 13% CoE***
Bhandara	708	51	361	1.9
Jarora Nayagaon	7,921	62	4,935	26.4
Belgaum Dharwad	1,565	100	1,565	8.4
Durg bypass	1,632	51	833	4.4
Sambalpur Baragarh	753	100	753	4.0
Dhankuni Kharagpur	1,660	100	1,660	8.9
Chennai ORR	3,061	50	1,530	8.2
Total	**17,300**		**11,636**	**62.2**
Holding company discount		**20%**	**9,309**	**49.7**
Value to Ashoka Buildcon		**61.0%**	**5,679**	**30.3**
Total value of Ashoka Buildcon			**38,807**	**205.0**

Source: Company, PhillipCapital India Research

We value ABL's BOT portfolio at 2x FY16 FCFE, with only two years of average useful life remaining for the projects, and expected increase in FCFE assumed to be equivalent to the discount rate

We value the EPC division at 7x our FY19 EV/EBITDA – a premium to our valuation for IRB (5x)

We provide a 20% holding company discount to ACL's valuation

BOT sector – Valuation table

Company	Mkt Cap	CMP	P/E		EV/EBITDA		ROE		D/E		P/BV	
	Rs bn	Rs	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
IRB Infra	83.6	238	12.9	12.6	6.7	5.8	9.9	9.3	2.6	2.4	1.3	1.2
Ashoka Buildcon	38.4	205	32.3	26.5	7.6	6.9	5.7	6.6	2.0	1.8	1.9	1.7
Sadbhav Engg*	54.2	316	NA	NA	5.8	5.2	NA	NA	4.4	4.0	2.7	2.4

EPC sector – Valuation table

Company	Mkt Cap	CMP	P/E		EV/EBITDA		ROE		D/E		P/BV	
	Rs bn	Rs	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E	FY18E	FY19E
NCC	47.3	85	13.6	11.1	7.5	6.6	8.9	9.9	0.5	0.5	1.2	1.1
J Kumar	18.5	245	14.1	10.4	6.9	5.7	8.8	10.8	0.4	0.4	1.2	1.1
KNR	27.6	196	21.3	17.4	12.1	10.0	12.6	13.4	0.2	0.1	2.7	2.3
ITD Cementation*	26.1	168	27.5	20.2	11.0	9.3	14.8	16.9	0.7	0.7	4.1	3.4
PNC Infra	32.8	128	14.9	16.0	11.1	9.3	12.5	10.5	0.1	0.1	1.9	1.7
Ahluwalia	22.9	342	18.7	14.8	10.5	8.6	20.2	21.0	0.1	0.0	3.8	3.1
HCC	41.4	41	20.7	13.8	10.7	8.8	6.9	9.4	0.5	0.4	1.4	1.3

Source: Bloomberg, PhillipCapital India Research *(*FY18 equivalent to CY17 for ITDC)*

Financials (Consolidated)

Income Statement

Y/E Mar, Rs mn	FY16	FY17e	FY18e	FY19e
Net sales	**26,145**	**29,380**	**34,272**	**39,175**
Growth, %	13	12	17	14
Total income	26,145	29,380	34,272	39,175
Raw material expenses	0	0	0	0
Employee expenses	-924	-1,039	-1,212	-1,385
Other Operating expenses	-17,499	-19,517	-22,751	-26,738
EBITDA (Core)	**7,722**	**8,824**	**10,308**	**11,051**
Growth, %	51.1	14.3	16.8	7.2
Margin, %	29.5	30.0	30.1	28.2
Depreciation	-2,491	-2,947	-3,964	-4,242
EBIT	**5,230**	**5,876**	**6,344**	**6,809**
Growth, %	45.6	12.4	8.0	7.3
Margin, %	20.0	20.0	18.5	17.4
Interest paid	-4,478	-5,298	-5,965	-6,144
Pre-tax profit	**563**	**1,035**	**892**	**1,248**
Tax provided	-973	-744	-475	-545
Profit after tax	**-410**	**291**	**417**	**702**
Others (Minorities, Associates)	995	760	771	746
Net Profit	**585**	**1,051**	**1,188**	**1,448**
Growth, %	20.7	6.8	13.0	21.9
Unadj. shares (m)	187	187	187	187
Wtd avg shares (m)	187	187	187	187

Balance Sheet

Y/E Mar, Rs mn	FY16	FY17e	FY18e	FY19e
Cash & bank	1,679	1,438	1,230	1,323
Debtors	3,660	3,622	4,225	4,830
Inventory	10,890	11,269	13,145	13,953
Loans & advances	2,575	5,232	6,103	6,976
Other current assets	2,216	2,216	2,216	2,216
Total current assets	21,020	23,777	26,920	29,298
Investments	3,377	3,377	3,377	3,377
Gross fixed assets	134,483	134,783	135,083	135,383
Less: Depreciation	-8,652	-10,883	-13,569	-16,532
Add: Capital WIP	3,455	6,530	6,530	6,530
Net fixed assets	129,286	130,430	128,044	125,381
Total assets	**153,906**	**157,806**	**158,563**	**158,278**
Current liabilities	88,849	90,992	91,508	92,468
Total current liabilities	88,849	90,992	91,508	92,468
Non-current liabilities	41,374	42,211	41,396	38,833
Total liabilities	130,223	133,203	132,904	131,302
Paid-up capital	935	935	935	935
Reserves & surplus	17,752	18,672	19,729	21,046
Shareholders' equity	23,683	24,603	25,659	26,976
Total equity & liabilities	**153,905**	**157,806**	**158,563**	**158,278**

Cash Flow

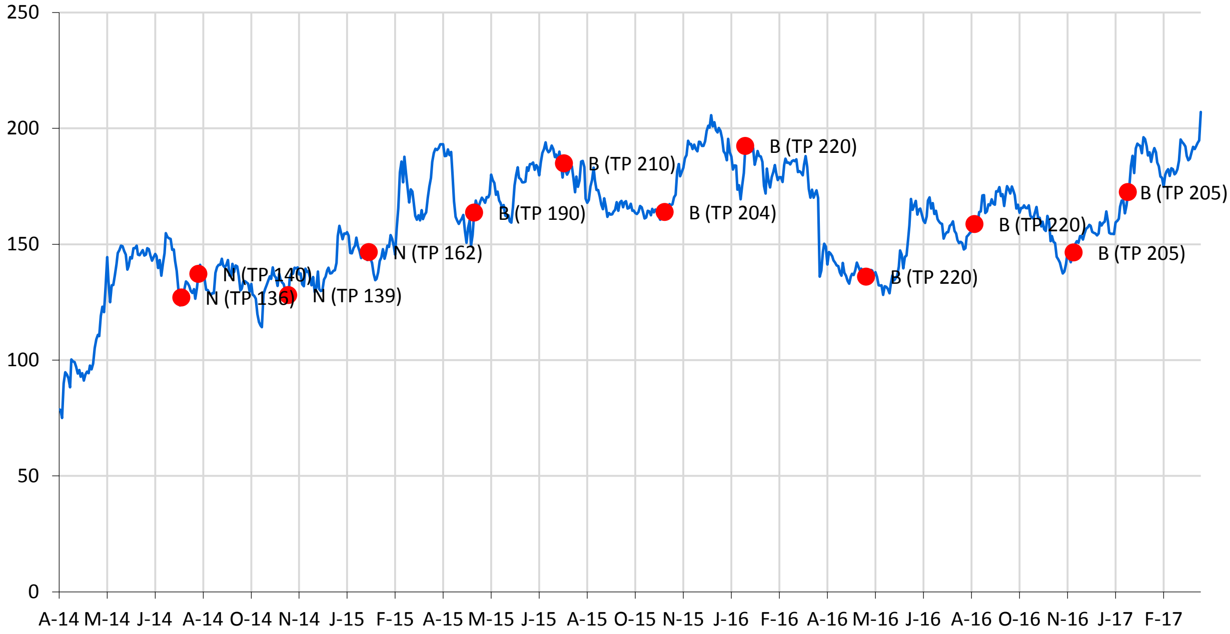
Y/E Mar, Rs mn	FY16	FY17e	FY18e	FY19e
Pre-tax profit	563	1,035	892	1,248
Depreciation	2,491	2,947	3,964	4,242
Chg in working capital	-3,211	-854	-2,835	-1,324
Total tax paid	-1,096	-744	-475	-545
Cash flow from operating activities	**-1,252**	**2,384**	**1,546**	**3,620**
Capital expenditure	-4,752	-4,091	-1,579	-1,579
Chg in investments	-1,032	0	0	0
Cash flow from investing activities	**-5,784**	**-4,091**	**-1,579**	**-1,579**
Free cash flow	-7,036	-1,707	-33	2,041
Equity raised/(repaid)	5,262	0	0	0
Debt raised/(repaid)	2,637	837	-815	-2,563
Other financing activities	-405	0	0	0
Cash flow from financing activities	**8,305**	**1,466**	**-175**	**-1,948**
Net chg in cash	1,269	-241	-208	93

Valuation Ratios

	FY16	FY17e	FY18e	FY19e
Per Share data				
EPS (INR)	5.3	5.6	6.3	7.7
Growth, %	2.4	6.8	13.0	21.9
Book NAV/share (INR)	99.9	104.8	110.4	117.4
FDEPS (INR)	5.3	5.6	6.3	7.7
CEPS (INR)	21.6	21.4	27.5	30.4
CFPS (INR)	(8.7)	10.3	5.5	16.2
Return ratios				
Return on assets (%)	1.6	2.3	2.6	2.8
Return on equity (%)	5.3	5.4	5.7	6.6
Return on capital employed (%)	4.0	5.5	6.1	6.7
Turnover ratios				
Asset turnover (x)	0.5	0.5	0.6	0.6
Sales/Total assets (x)	0.2	0.2	0.2	0.2
Sales/Net FA (x)	0.2	0.2	0.3	0.3
Working capital days	(970.4)	(852.9)	(701.0)	(600.9)
Liquidity ratios				
Current ratio (x)	0.2	0.3	0.3	0.3
Quick ratio (x)	0.1	0.1	0.2	0.2
Interest cover (x)	1.2	1.1	1.1	1.1
Total debt/Equity (x)	2.2	2.2	2.0	1.8
Net debt/Equity (x)	2.1	2.1	1.9	1.7
Valuation				
PER (x)	39.4	36.9	32.6	26.8
Price/Book (x)	2.1	2.0	1.9	1.8
EV/Net sales (x)	3.0	2.7	2.3	1.9
EV/EBITDA (x)	10.2	9.0	7.7	6.9
EV/EBIT (x)	15.0	13.5	12.4	11.2

Source: Company, PhillipCapital India Research Estimates

Stock Price, Price Target and Rating History



Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year.

Rating	Criteria	Definition
BUY	>= +15%	Target price is equal to or more than 15% of current market price
NEUTRAL	-15% > to < +15%	Target price is less than +15% but more than -15%
SELL	<= -15%	Target price is less than or equal to -15%.

Management

Vineet Bhatnagar (Managing Director)	(91 22) 2483 1919
Kinshuk Bharti Tiwari (Head – Institutional Equity)	(91 22) 6246 4101
Jignesh Shah (Head – Equity Derivatives)	(91 22) 6667 9735

Research

Automobiles	
Dhawal Doshi	(9122) 6246 4128
Nitesh Sharma, CFA	(9122) 6246 4126
Banking, NBFCs	
Manish Agarwalla	(9122) 6246 4125
Pradeep Agrawal	(9122) 6246 4113
Paresh Jain	(9122) 6246 4114
Consumer & Retail	
Naveen Kulkarni, CFA, FRM	(9122) 6246 4122
Jubil Jain	(9122) 6246 4117
Preeyam Tolia	(9122) 6246 4129
Cement	
Vaibhav Agarwal	(9122) 6246 4124
Economics	
Anjali Verma	(9122) 6246 4115
Shruti Bajpai	(9122) 6246 4135
Engineering, Capital Goods	
Jonas Bhutta	(9122) 6246 4119
Vikram Rawat	(9122) 6246 4120
IT Services	
Vibhor Singhal	(9122) 6246 4109
Shyamal Dhruve	(9122) 6246 4110
Infrastructure	
Vibhor Singhal	(9122) 6246 4109
Logistics, Transportation & Midcap	
Vikram Suryavanshi	(9122) 6246 4111
Media	
Manoj Behera	(9122) 6246 4118
Metals	
Dhawal Doshi	(9122) 6246 4128
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