INSTITUTIONAL EQUITY RESEARCH

Infrastructure

EPC Sector – Trinity at Work

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Over the last four years, all that could go wrong for the EPC sector – did! The economy went through a downturn, leading to a complete slowdown in order award activity – leading to muted growth in topline. High competitive intensity ensured margins remained under pressure. The high interest rate regime coupled with elongated WC cycle led to lower cash flows, higher debt and even higher interest expense – forcing the companies into a vicious loop.

We expect this vicious vortex to break over the next three years as EPC companies will benefit from a 'trinity' of forces — order awards, reduced competition, lower interest rates. Each of these forces will influence a different line item in the companies' P&Ls in a significantly positive manner, leading to manifold growth in earnings, and the beginning of a new virtuous cycle.

Order awards to pick up: We see a huge investment opportunity in the EPC space, primarily driven by three segments – roads, railways, and MRTS. Our bottom-up analysis indicates that over the next three years Rs-8.5tn worth of projects may be awarded in these segments, which will translate into an EPC opportunity of roughly Rs 6tn. This will lead to robust topline growth, for the companies.

Reduced competition: Most EPC companies suffered heavily due to the lack of order awards and high interest rates in the last four years. While many are currently under the CDR (Corporate Debt Restructuring) program, others have highly stretched balance sheets. These companies will be incapable of bidding and grabbing significant orders, implying lower competition and superior margins for the solvent and capable companies.

Interest rates to fall: RBI is likely to lower the interest rates in the near to medium term → this will lower the interest expenses and result in superior earnings growth for the highly leveraged sector. Lower interest expense will also improve cash flows → leading to lower debt levels further reducing the interest expense → a shift to a virtuous loop from the vicious loop that companies found themselves over the last four years.

However, the beneficiaries, of this trinity of forces, will not be the same as in the last cycle (2007-10). The prominent players of the last cycle – likes of IVRCL, Gammon and HCC – have highly stretched balance sheets and will not be able to capitalise on the opportunity. Instead, a completely new crop of smaller companies like J Kumar (JKIL) and KNR is likely to fill the vacuum created by the fall of the stalwarts. The only survivor from the last cycle is NCC — in fact, it not only survived the downturn with its high degree of financial discipline and operational prudence, but it has also emerged stronger than before.

Overall, we expect the EPC sector to be one of the most exciting turnaround stories of the economic revival of the next three years. In this report, we analyse the EPC opportunity on the anvil and how the trinity of forces will lead to manifold earnings growth for the sector. We also study what went wrong with the old stalwarts' operations and how the new crop is in a better position to capitalise the opportunity.

We maintain **BUY rating on NCC** and initiate coverage on **JKIL and KNR with BUY** rating. We remain negative on HCC, Gammon India, and IVRCL *(not rated)*.

Companies

Nagarjuna Construction	
CMP, Rs	64
Reco	BUY
Target Price, Rs	92
Upside	44%

KNR Construction	
CMP, Rs	300
Reco	BUY
Target Price, Rs	363
Upside	21%

J Kumar Infraprojects	
CMP, Rs	440
Reco	BUY
Target Price, Rs	Rs525
Upside	19%

HCC	
CMP, Rs	30
Reco	NOT RATED

IVRCL	
CMP, Rs	17
Reco	NOT RATED

Gammon India	
CMP, Rs	30
Reco	NOT RATED

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Investment Thesis – Trinity at Work

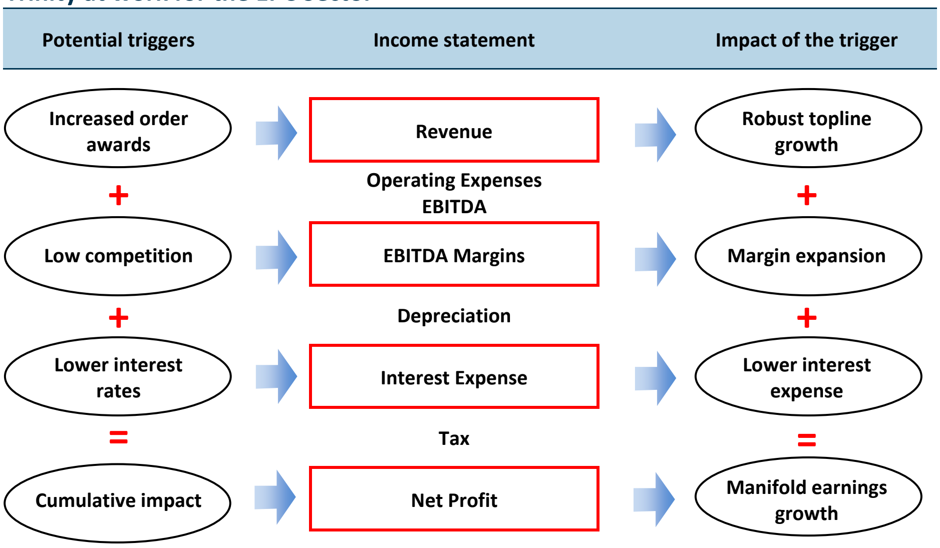
Over the last four years, all that could go wrong for the EPC sector – did! While many of the developments were external and macro-economy related, other were of the companies' own doing.

- The economy went through a downturn leading to a complete slowdown in order award activity → this in turn led to muted topline growth.
- Almost everybody bid for the few orders that surfaced → this increased competition and reduced margins.
- Interest rates remained high putting further pressure on earnings.
- Government bodies delayed payments → due to this, working capital ballooned for most companies → this forced them to take on more debt → which suppressed earnings further.
- Companies invested indiscriminately into subsidiaries (real-estate/BOT) → this put incremental pressure on their cash flows.

Over the next three years, we expect most of these factors to reverse. Cumulatively, three forces will have a manifold impact on earnings. The 'trinity' of forces are:

1) **Increased order awards:** With a huge opportunity in the infrastructure sector set to be awarded over the next three years, most of the companies are expected to report robust topline growth.
2) **Reduced competition:** Over the last few years, many EPC companies were not able to bear the burden of high debt and interest rates and went under the CDR programme (reducing their ability to bid for new projects). This will significantly reduce the competition for the 'survivors' and aid margin expansion.
3) **Lower Interest rates:** With the economy turning around, we expect the RBI to lower interest rates in the near future – this will boost companies' earnings.

Trinity at work for the EPC Sector



Source: PhillipCapital India Research

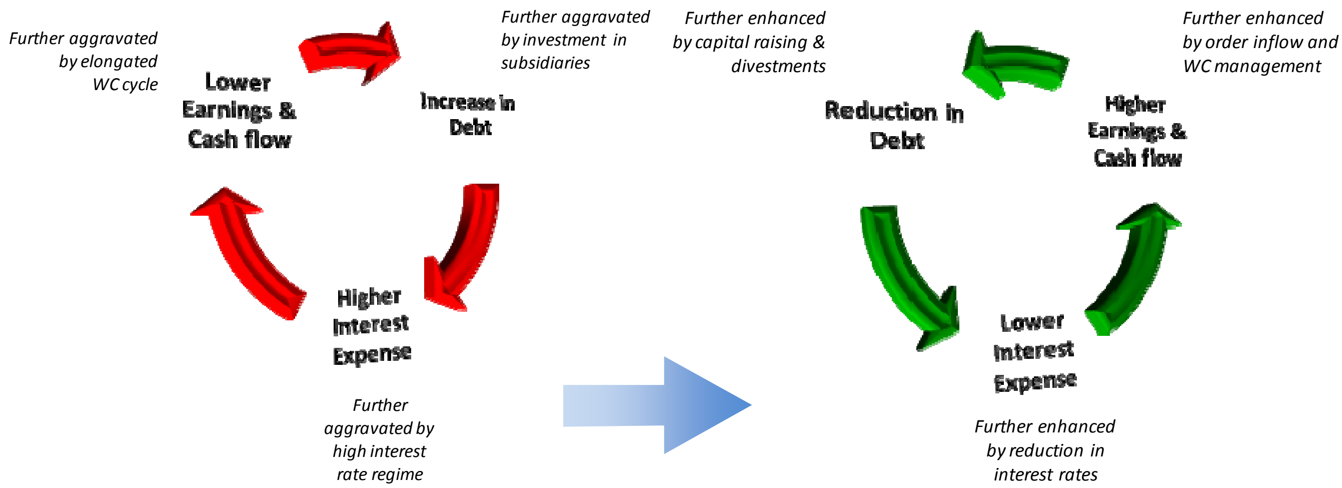
Reversal of the vicious cycle

Over the last four years, the entire infrastructure sector went into a vicious loop.

- Lack of new orders and delay in payments from government bodies led to ballooning working capital, raising debtors days to as high as 150-180 for many companies.
- To ensure that their operations continued even at those debtor day levels, companies borrowed more, which led to corporate debt rising exponentially.
- The high interest-rate regime had already pushed up interest payment and as companies piled on more debt, their interest outgo increased.
- This in turn put more pressure on cash flows, which led to even higher debt levels.
- This led to more interest expenses — the vicious loop.

The WC cycle also elongated because companies invested indiscriminately in their various real estate and BOT subsidiaries. Most of these investments were in the form of loans and advances. Our analysis on page 18 shows that: 1), loans and advances as a percentage of NWC and 2), loans to subsidiaries as a percentage of total loans and advances increased significantly over the last four years for almost all companies.

Reversal of the vicious loop



Source: PhillipCapital India Research

We expect this vicious vortex to break over the next three years. Three triggers will reverse this cycle:

1) Robust order award activity – leading to better WC management
2) Lower interest rate regime – leading to lower interest expense
3) Asset divestment by companies – leading to incremental cash flow

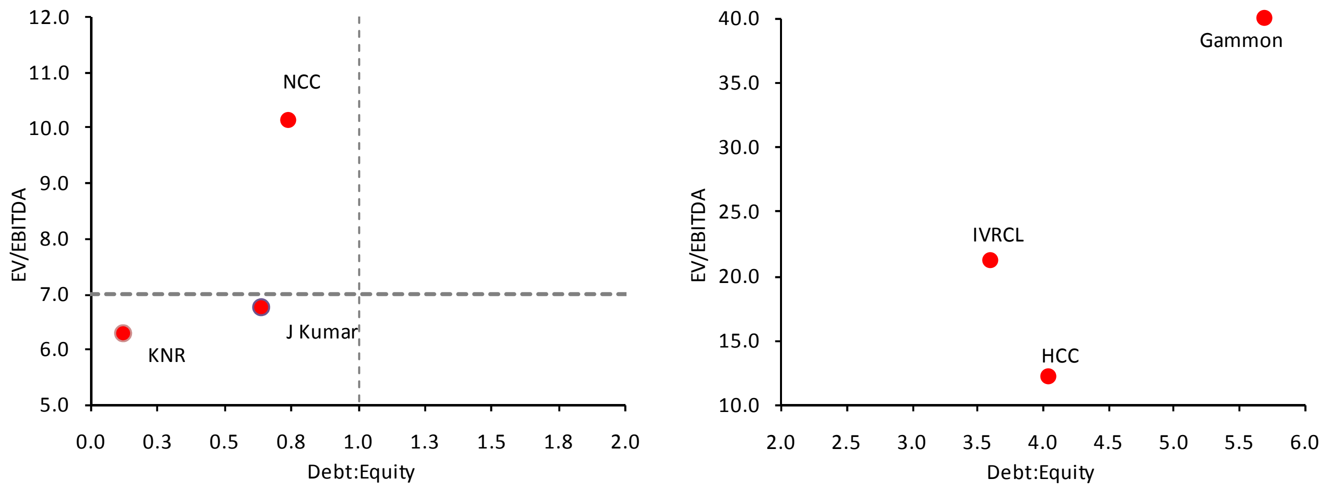
The three factors, which will play out over the next three years, will all contribute to reducing the debt levels, thereby reducing interest expenses, which in turn will enhance cash flows, and eventually help reduce debt levels – the virtuous loop.

Beneficiaries might not be the same this time

Even with the trinity at work, we do not expect all EPC companies to benefit. Only companies with a strong balance sheet and superior execution track record will be able to grab most of the orders that will be awarded over the next three years. We expect the beneficiaries in this round of orders to be completely different from the ones in the last 2007-10 cycle.

The EPC space has seen a lot of reshuffling since FY10. Many big players, the stars of the last cycle, have not been able to sustain themselves when faced with the lack of orders and high interest rates. Their balance sheets are highly stretched (many of them are formally under the CDR), their working capital has ballooned, and the visibility on their revenue and earnings remains extremely poor.

EPC Sector – Relative positioning



Source: PhillipCapital India Research

While the fall of these stalwarts is bad news for the industry, it will benefit many players that are ready to fill the vacuum. These companies will be the biggest beneficiaries of resurgence in order awards and provide the maximum delta for investors. We specifically like J Kumar Infraprojects (JKIL) and KNR Construction (KNR) from this set.

Infrastructure – the likely winners and losers

EPC Space		BOT Space	
Likely Winners	Likely Losers	Likely Winners	Likely Losers
L&T	Gammon India	IRB Infra	Isolux-Soma
NCC	IVRCL	Ashoka Buildcon	Transstroy
J Kumar	Patel Engg	Sadbhav Engg	GVK Power
KNR Construction	HCC	Adani Ports	Lanco Infra
VA Tech Wabag	CCCL	GMR Infra	Gammon Infra

Source: PhillipCapital India Research

Having said that, few companies did manage to stay afloat in the FY10-14 downturn. Through financial discipline and prudent management they have actually emerged stronger. NCC is one such survivor and will be THE biggest beneficiary of the next up-cycle, in our opinion.

Force # 1 – A mammoth opportunity beckons

Over the last four years, the entire infrastructure space was bogged down due to lack of new orders and regulatory issues (land acquisition, environmental clearance), which led to a state of near-complete paralysis for most companies. While the gap between existing and required infrastructure remained huge, there was no clarity on when this would translate into awards and investment.

With the new government at the helm, we expect the scenario to undergo a radical transformation over the next twelve months. In any case, the award pipeline in some sectors (especially roads and railways) has swollen to such an extent that the governing body has no option but to expedite the award process.

We see the potent combination of a strong government and a bursting-at-the-seams award pipeline translating into an opportunity of unprecedented magnitude for infrastructure companies. Our bottom-up analysis of the award pipeline for three sectors (roads, railways, and MRTS) suggests that Rs 8.5tn of the opportunity is already on the anvil and is all set to be awarded over the next three years.

The EPC sector will be the biggest beneficiary of this huge opportunity. Whether it is in roads, railways, or metros, a large part of the capex for the infrastructure projects involves civil work, which will be executed by the local EPC players – irrespective of whether the project is awarded on EPC/BOT basis or to a domestic/foreign player. We estimate that the Rs 8.5tn infrastructure opportunity will translate into Rs 6tn of EPC opportunity over the next three years.

Bottom-up analysis of the opportunity on the anvil

Roads	Length (km)	Total Opportunity (Rs bn)	EPC Opportunity (Rs bn)
Pipeline (excl Phase IV)	6,158	616	616
Phase IV pipeline	9,842	246	246
Backlog of FY12-14 awards	10,000	1,000	1,000
Border & Coastal Roads	22,500	1,125	1,125
Total	**48,500**	**2,987**	**2,987**
Railways			
Railways PPP	NA	1,069	534
High Speed Rail	4,215	674	337
DFCC	3,338	750	375
Total	**7,553**	**2,493**	**1,247**
MRTS			
Under construction Metros	489.9	1,362.4	681.2
Planned Metros	421.6	1,569.1	760.1
Planned Monorails	131.7	193.7	96.8
Total	**1,043**	**3,125**	**1,538**
Grand Total	**57,096**	**8,605**	**5,772**

Source: PhillipCapital India Research

Sectoral analysis of the opportunity and competition

Sector	Major Opportunities	EPC Opp Size (Rs bn)*	Concerns	Competitive intensity	Domestic players	Foreign players
Roads	13,000km of pending awards; Border & coastal roads; backlog of FY12-14 awards	2,987	Backlog of stuck projects, clearances, declining traffic, high interest rates	**High**. Plethora of domestic players; foreign players too waiting in the wings	IRB Infra, L&T, Ashoka Buildcon, All EPC players	Vinci, Leighton Holdings, Balfour Beatty
Railways	High speed rail network; Dedicated Freight Corridor	1,247	Low private investment, new to PPP model, regulatory uncertainty	**Medium**. Few large players have the technical capability	All EPC Players	China Railway & Engg Group,
MRTS	Ten MRTS projects on the anvil. Mega plans in Mumbai	1,538	Inexperienced players and authorities, politicization of projects	**Low**. Most domestic companies inexperienced, in JVs with foreign players	Reliance Infra, L&T, Gammon, J Kumar	Valio, Mitsubishi, Kyivmetrobud, Scomi

Source: PhillipCapital India Research *(*PC estimates)*

An interesting part of this opportunity is the presence of a few key large projects that should transform the infrastructure landscape of the country. These projects are designed to fulfil long-standing demands of their respective sectors and can provide a big boost to the topline of the companies that execute them. We expect ALL these projects to be awarded over the next two years and a large part to be executed in the 12th plan period (2012–17).

Key large projects on the anvil

	Project	Specifics	Sector	Opportunity size (Rs bn)	Status
1	Elevated Rail Corridor	Virar – Churchgate (Mumbai)	Railways	250	All clearances received
2	Mumbai Metro Phase III	Colaba-Bandra-SEEPZ	MRTS	240	Bidding in progress
3	Other MRTS projects	Jaipur, Lucknow, Kochi	MRTS	553km	In various stages of development
4	High Speed Rail Network	Delhi-Mumbai-Chennai-Kolkata	Railways	674	Mumbai-Ahmedabad in FY15
5	Border & Coastal Roads	Mentioned in the NDA manifesto	Roads	22,500km	Projects in NE states already awarded
6	National Waterway Grid	Rs42bn for NW-1 (Allahabad-Haldia)	Ports	250	Conceptual stage

Source: PhillipCapital India Research

This constitutes the first leg of our trinity hypothesis – the huge opportunity in the EPC space will lead to robust topline growth for the companies, which will trickle down the P&L, translating into strong earnings growth.

Roads – The low hanging fruit!

Over the next three years, we see road sector as the low-hanging fruit among infrastructure segments — the new government will try to capitalize on it to break the deadlock and revive the development process. Today the road sector is in a much more mature stage than any other sector in the infrastructure space in terms of attracting private investment. Based on the recommendations of the B. K. Chaturvedi report in 2009, the NHAI made multiple changes to the Model Concession Agreement (MCA), effectively removing most of the lacunae in the award-development process. Along with this, a series of reforms by the RBI and the government of India have smoothened the entire process for the sector.

NHDP current status — Oct 2014 *(length in km)*

Phase	Description	Total length	Already 4-laned	Under Implementation	To be awarded
Phase I	Golden Quadrilateral	5,846	5,846	-	-
Phase II	NS - EW	7,142	6,325	400	417
Phase III	4-laning of intercity connections	12,109	6,300	4,464	1,345
Phase IV	2-laning of arterial road	14,799	776	5,509	8,514
Phase V	6-laning of various highways	6,500	1,919	2,162	2,419
Phase VI	Expressways	1,000	-	-	1,000
Phase VII	Ringroads, flyovers etc	700	22	19	659
Total		**48,096**	**21,188**	**12,554**	**14,354**
Others	Port Connectivity	380	379	1	-
Others	Others	2,142	1,503	362	277
NHAI		**50,618**	**23,070**	**12,917**	**14,631**

Source: NHAI

The pipeline for the sector also appears HUGE with a plethora of old and new projects on the anvil:

- 15,000 km of new road projects are to be awarded from the current NHDP.
- Close to 10,000 km of projects (awarded in FY11-14), but which never saw the light of day) will also be up for re-bidding.
- The NDA manifesto speaks of border and coastal road network. India has 15,000 kms of international border and 7,500 km of coastline. That can translate into a potential opportunity of 22,500 km.
- Lastly, there is a huge network of state roads and highways, which offers an even bigger opportunity.
- Over and above that, the roads that have been four-laned under the current NHDP will need to be six-laned as traffic increases. So we can expect ~20,000 km of six-laning projects to come up in the next NHDP (not until 2017).

According to the Planning Commission's estimates, the sector will need Rs 5tn of investments over the 12th five-year plan period. Our bottom-up analysis indicates that Rs 3tn of this opportunity could be awarded over the next three years.

For FY15, NHAI has set a target of awarding 8,500 km, which are to comprise of 5,000 km of EPC orders. The target is much higher than what NHAI achieved in FY13 and FY14 – so it remains to be seen if they are able to achieve the same. Notwithstanding the awards in FY15, we expect the activity to pick up significantly from FY16.

On the anvil – BOT and EPC projects to be awarded

	BOT	(kms)	Cost (Rs mn)		EPC	(kms)	Cost (Rs mn)
1	Barwa Adda-Panagarh *(awarded to ITNL)*	122.9	16,650	1	Ambedkarnagar-Raebareilly (2 lane)	155.9	4,960
2	Jabalpur-Lakhanadone	80.8	7,770	2	Raebareilly-Banda (2 lane)	133.3	3,510
3	Bhavnagar-Verawal (4 lane)	260.0	32,400	3	Ladnu Nimbi Jodhan-Degna-Merta City (2 lane)	139.0	3,680
4	Yadgiri-Warangal (4 lane)	99.0	9,570	4	Bhilwara-Ladpura (2 lane)	67.8	2,370
5	Hospet-Hubli (4 lane)	143.3	12,930	5	Padhi-Dahod (2 lane)	85.6	2,790
6	Numaligarh-Jorhat (4 lane)	51.2	5,850	6	Unaira-Gulabpura (2 lane)	214.0	5,710
7	Ghoshpukur-Salsabari (4 lane)	154.9	22,120	7	Sitarganj-Tanakpur (2 lane)	52.2	2,200
8	Karaikudi-Ramanathapuram (2 lane)	80.0	3,360	8	Karauli-Dholpur (2 lane)	100.9	2,890
9	Demoh-Dibrugarh (4 lane)	46.0	4,730	9	Biharsharif-Barbigha-Mokama (2 lane)	56.3	1,940
10	Jorhat-Demoh (4 lane)	81.8	8,750	10	Chhapra-Rewaghat-Muzzaffarpur (2 lane)	75.0	3,050
11	Chas-Ramgarh (2/4 lane)	78.3	2,980	11	Patna-Gaya-Dhobi (4 lane)	127.2	10,270
12	Aurangabad-Vedishi (4 lane)	189.1	18,710	12	Jalandhar-Amritsar (6 lane)	20.0	4,930
13	Chandikhole-Dubari-Bhuban (4 lane)	62.2	6,520	13	Thanjavur-Pudukkotai (2 lane)	55.2	1,700
14	Parwanoo-Shimla (4 lane)	89.6	22,930	14	Tirumayam-Mannamadurai (2 lane)	77.7	2,520
15	Chhutmalpur--Haryana/UP border	104.8	10,240	15	Bareilly-Sitarganj (2 lane)	74.5	2,970
16	Eastern Perpheral Expressway (6 lane)	135.0	26.990	16	Uncha Nagar-Khanuawa-Dholpur (4 lane)	75.0	-
17	Solapur-Vedishi (4 lane)	98.7	9,700	17	Bar-Bilara-Jodhupur (2 lane)	125.0	-
18	Hissar-Dabwali (4 lane)	145.8	13,320	18	Barmer-Sanchor-Gujarat Border (2 lane)	154.0	-
	Total	**2023.4**	**232,520**		**Total**	**1788.6**	**55,490**

Source: NHAI, PhillipCapital India Research

Washing old sins…

Over the last few years, the orderbook of most EPC players (like IVRCL, Gammon, HCC) saw little growth due to:

1) Irrigation orders from AP and other parts of the country dried up,
2) Real estate slowdown leading to fewer incremental orders from the sector,
3) Other government departments were also reporting dismal order award activity.

As a result, roads remained the only sector through which EPC players could grow their orderbooks. However, in roads, NHAI awarded over 90% of orders on a BOT basis in FY11-13. Most EPC players (whose core competency is EPC and not traffic estimation and forecasting) were forced to bid for BOT projects to increase their orderbook sizes.

This increased competition leading to highly aggressive bidding (especially in FY12), which in turn led to concerns of low IRR for these projects. High interest rates and declining traffic growth due to the overall weak macro-economic state further aggravated the situation. Because of all this, banks became highly selective and were reluctant to finance BOT projects. Eventually, only 8 out of the 48 projects awarded on BOT basis in FY12 could actually start construction.

NHAI is now trying to make the following amends:

1) The order award pipeline will now comprise of significant share of EPC orders, which will lead to both EPC and BOT players sticking to their core competencies and reducing competition in both segments.
2) NHAI is now trying all measures (e.g delinking of environmental and forest clearance), to revive as many orders, stuck due to clearances.
3) NHAI has extended premium rescheduling offer to many projects, to compensate the developers for the unanticipated traffic decline across various stretches.
4) NHAI is also trying to modify the exit policy for the BOT projects. Modifications proposed to allow the concessionaries complete exit post commissioning of projects, should help developers rotate their capital across multiple projects, while reviving investors' interest in these projects, at the same time.
5) NHAI has also proposed making the MCA more flexible and more powers be vested with NHAI, to modify the same as per the specific requirements of various projects.

Railways – Changing tracks

IN March 2014, a high-level National Transport Development Policy Committee (NTDPC) chaired by Dr. Rakesh Mohan submitted its report to the PMO. As per the report, the Indian Railways needs to increase its annual investment from Rs 300bn in FY12 to Rs 900bn in the 12th plan and further to Rs 4.6tn in the 15th plan period. This would translate into the share of investment in Railways as % of GDP increasing from the current 0.4% to 0.8% in 12th plan and eventually to 1.2% in the following three plan periods. Altogether, it recommends a total investment of Rs 35tn (over FY15-FY32) — majorly in capacity augmentation, rolling stock, and technology upgradation.

That translates into an investment opportunity of Rs 4.5tn over the 12th five-year plan period. The planning commission also pegs the investment needed by the sector over the 12th plan at Rs 5.34tn.

A large part of the investment envisaged by the Planning Commission will be in maintenance and upgradation of necessary infrastructure such as railway lines, bridges, stations, and warehouses:

1) **Railways lines**: Of the total length of 35,187 kms, only 31% is electrified. Large part of the planned investment over the 12th plan period will be spent on electrification of existing routes.
2) **Bridges**: Indian Railways operates through 136,286 bridges. Over the last five years, it has built 5,510 new bridges, upgraded 6,011, and has 1,665 under repair and construction. It also plans to build 4 mega bridges, entailing an investment of Rs 90bn.
3) **Stations**: Indian Railways has 8,500 stations, of which around 407 are major ones (annual earnings of over Rs 60mn each). Over the last five years, IR has upgraded 784 of these stations and another 268 are in progress. It also plans to develop 50 world-class stations across the country.
4) **Warehouses**: The Indian Railways owns 18 warehouses across the country, with a total capacity of 313,500 tonnes. It is planning to build 5 new warehouse complexes in Maharashtra, WB, Gujarat, Assam, and Kerala.

Our bottom-up analysis reveals that a large number of 'new' projects planned by Indian Railways are already on the anvil and can be awarded over the next two years. While Dedicated Freight Corridor (DFCC) would form a bulk of the investment need (Rs 750bn), high-speed rails (Rs 500bn) and capacity augmentation would also require huge investments.

Key PPP railway projects in the pipeline

Project	Investment (Rs bn)	Current Status
Elevated rail corridor in Mumbai (Churchgate - Virar)	225	Bidding
Electric locomotive factory at Madhepura	13	Bidding
Diesel locomotive factory at Marhowra	21	Bidding
Rail Coach Factory at Palakkad	6	Bidding
Rail electronic signal components factory at Cooch Behar	1	Bidding
Redevelopment of station at 5 locations - Anand Vihar, Bijwasan, Chandigarh, Habibganj and Shivajinagar	-	Master plans and feasibility reports under examination
Sonnagar - Dankuni section of the DFC	170	Land acquisition under way
Multimodal logistics parks	-	37 private freight terminals approved by zonal railways
Six packaged drinking water bottling plants	1	Developers/operators appointed for 2 plants, tenders floated for another 2
Mumbai-Ahmedabad Bullet Train	630	Pre-feasibility report accepted by the ministry; joint feasibility study undertaken
25MW wind energy plant in Rajasthan	3	Bids to be invited
Total	**1,069**	

Source: Ministry of Railways, PhillipCapital India Research

High-Speed Rail Corridors on the anvil

Corridor	Length (Km)	Consultant for pre-feasibility study	Current status
Delhi-Agra-Lucknow-Varanasi-Patna	991	UK-based Mott MacDonald	Pre-feasibility study completed
Chennai-Bangalore-Coimbatore-Ernakulam-Thiruvananthapuram	850	Consortium of Japan based Oriental Consultants Co Ltd and Japan Railway Technical Service	Pre-feasibility study in progress
Hyderabad-Dornakal-Vijayawada-Chennai	664	Japan External Trade Organisation, Japan based Oriental Consultants Co Ltd and US based Parsons Brinckerhoff	Pre-feasibility study in progress
Mumbai-Ahmedabad	534	Consortium of France-based Systra, Italy based Italffer and India based rites	Pre-feasibility study completed, final report accepted by MoR
Delhi-Jaipur-Ajmer-Jodhpur	591	Yet to be appointed	Tender to be finalized
Delhi-Chandigarh-Amritsar	450	Yet to be appointed	Financial bids to be finalized
Howrah-Haldia	135	Spain based Ingenieria y Economia del Transporte S.A, Spain based Prointec and Ayesha	Pre-feasibility study completed
Total	**4,215**	**Rs 674bn** *(@ Rs 160mn per km)*	

Source: Ministry of Railways, PhillipCapital India Research

Dedicated Freight Corridor

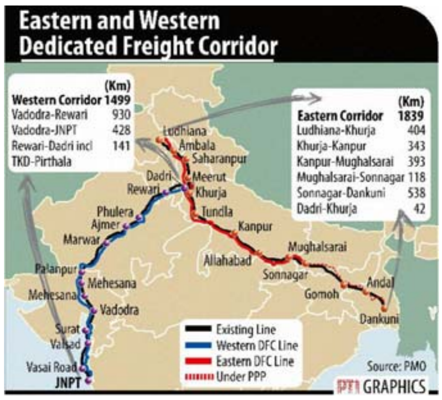
Dedicated Freight Corridor is probably the most talked about infrastructure project these days, given the magnitude of investment required, the benefit that can accrue to the companies, and the potential to change the landscape of freight movement in the country. The project is envisaged to help the Indian Railways reclaim lost market share and ease freight movement across the country.

Ever since the previous government made it a key PMO project in 2011, it has made rapid progress. Loan agreements for a major part of the western corridor have already been signed with JICA, and construction contracts for the Rewari-Vadodara leg have been awarded to the L&T consortium. On the eastern corridor, EPC contracts for 736km of track have been awarded.

Dedicated Freight Corridor – Action plan and status

Section	Phase	Length (Km)	Funding Source	Funding Status	Completion Date	EPC Wnner
Eastern Corridor						
Ludhiana-Dadri-Khurja	III	447	World Bank (APL-3)	Loan awaiting approval	5.5 yrs	
Khurja-Bhaupur	I	343	World Bank (APL-1)	Loan agreement signed on May 31, 2011; EPC Awarded	Mar-17	Tata-Aldesa (Rs32.67bn)
Bhaupur-Mughalsarai	II	393	World Bank (APL-2)	Loan awaiting approval; EPC Bidders shortlisted	Mar-18	GMR-SEW* (Rs50.8bn)
Mughalsarai-Sonnagar	IA	118	MoR	To be funded through budgetary support	Dec-16	
Sonnagar-Dankuni	IV	538	PPP	To be funded via PPP	-NA-	
Total		**1,839**	**Rs 370bn**			
Western Corridor						
Dadri-Rewari	III	141	JICA		Mar-18	
Rewari-Vadodara	I	930	JICA	Civil works have commenced on May-14	Dec-17	M/S Soitz-L&T (Rs98bn)
Vadodara-JNPT	II	428	JICA	Loan agreement signed on Mar 31, 2013	Mar-18	
Total		**1,499**	**Rs 380bn**			

Source: DFCCIL, PhillipCapital India Research *(*declared L1)*



MRTS – Set to grow rapidly

The Indian demographic has seen rapid urbanization over the last decade and its pace is expected to increase over the next few decades. Currently 377mn Indian (31% of the population) resides in urban centers (Census 2011) as compared to 45% in China, 54% in Indonesia and 87% in Brazil. The Planning Commission estimates, that this number will swell upto 600mn by 2031 – an increase of over 200mn in just 20 years.

Most Indian cities remain ill equipped to handle such a large population migration. With such migrations, not only do basic necessities such as water, power, and sanitation need to be provided, but also infrastructure facilities such as public transport and roads need to be upgraded. Since most cities in India are not planned, there is limited scope for intra-city road expansions, and this creates a pressing need for other forms of transport.

Currently, only 5 cities in India (with a population of over one million) have a metro network – Kolkata, Delhi, Bengaluru, Gurgaon and Mumbai. Three other cities – Hyderabad, Chennai, and Kochi will soon be joining the bandwagon. However, the metro network in all these cities (except Delhi) remains too small to be able to decongest the roads or provide a plausible alternative means of transport.

Currently operational / under-construction metros

Operational Metro projects	Length (Km)	Operational Length (Km)	Operational stations (No)	Project Cost (Rs bn)	Implementing Agency	Current Status	Commencement of service (expected)
Delhi Metro	329.7	189.9	143	748	DMRC	Phases I (65.1km - 2006); Phase II (124.8km - 2011)	Phase III by 2016
Bengaluru Metro	114.4	6.7	6	380	BMRCL	Reach 1 & Reach 3 operational	Phase I by 2014, Phase II by 2017
Kolkata Metro	124.8	25.1	23	183	IR & KMRCL	North-South Corridor operational	East-West Corridor -2016
Gurgaon Metro	7.0	5.1	6	12	HUDA, IL&FS	Phase I operational	Phase II by 2016
Mumbai Metro	11.4	11.4	12	24	Reliance Infra	Phase I operational in June-2014	Multiple phases planned
Hyderabad Metro	72.0	-	65*	170	L&T	Phase wise COD to start from Aug-15	
Chennai Metro	45.1	-	34*	180	CMRL	Line II to be operational by Oct-14	Line I by July-15
Kochi Metro	25.6	-	22*	52	KMRL	Expected CoD by June-16	
Total	**730.0**	**238.2**		**1,748**			

Source: PhillipCapital India Research

The opportunity – big, and getting bigger!

Planning Commission estimates that the country would need investment of Rs 1.2tn, over the 12th plan period on the MRTS network across the country. Our bottom-up analysis indicates that currently Metro projects in 9 cities are at various stages of planning and development, while the existing network in other cities is being expanded. Overall, 415 kms of metro network, entailing an investment of Rs 1.5tn, is on the anvil. Simultaneously, monorail networks spanning a length of 131kms and with an investment of Rs 192bn are also under consideration. Overall, projects entailing an investment of Rs 1.7tn could be awarded over the next three-five years in this segment.

Planned Metro Projects

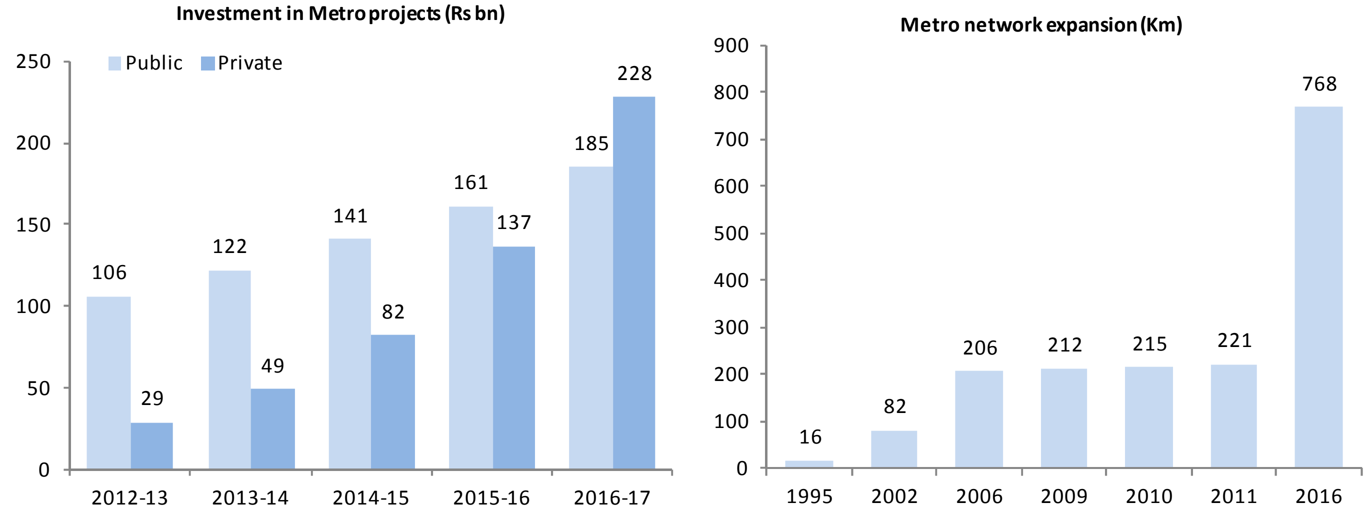
Planned Metro projects	Phase	Length (km)	Cost (Rs bn)
Chennai Metro	Phase II	63.0	360.0
Bengaluru Metro	Phase II	72.1	264.0
Gurgaon Metro	Phase II	7.0	21.4
Jaipur Metro	Phase II	23.1	65.8
Mumbai Metro	Phase III	33.5	244.0
Pune Metro	Phase I	31.5	101.8
Kochi Metro	Phase II	-	15.0
Ludhiana Metro	-	28.8	103.0
Chandigarh Metro	-	37.6	109.0
Lucknow Metro	-	22.9	70.0
Nagpur Metro	-	42.0	80.0
Bhopal Metro	-	28.0	60.0
Indore Metro	-	32.2	75.0
Total		**414.6**	**1,547.6**

Planned Monorail Projects

Planned Monorail projects	Phase	Length (km)	Cost (Rs bn)
Mumbai	Line 2	11.2	15.1
Kozhikode	Phase I	14.2	19.2
Thiruvananthapuram	Phase I	22.5	27.0
Delhi	-	10.8	22.4
Bengaluru	Phase I	16.0	25.0
Chennai	-	57.0	85.0
Total		**131.7**	**193.7**

Source: PhillipCapital India Research

Expected investment and expansion of the Metro network in the country *(Planning Commission estimates)*



Source: Planning Commission

The Mumbai Metro Master-plan

The Mumbai Metropolitan Region Development Authority (MMRDA) has laid out an extensive plan to develop the metro network in the city. It consists of 9 phases, spanning a length of 184km and entailing investment of Rs962bn.

- Phase-I (Versova-Andheri-Ghatkopar) was commissioned recently (June-2014),
- Phase-II (Charkop-Bandra-Mankhurd) was awarded to Reliance Infrastructure, but the contract was later terminated, following disagreement between the parties. The new state government is planning to revive the project, extending it to Dahisar, and has approved Rs265bn for the project.
- Phase-III is in advanced stages, with clearances and land acquisition in place. 9 bidders have been shortlisted for total of 7 packages to be awarded. The bids are expected to be opened in Jan-2015, and execution to start on various packages by April-2015.
- Work on Phase-IV (Navi-Mumbai Metro) is already in progress – being financed by CIDCO.
- Funding of Rs191bn for Phase-V (Wadala-Ghatkopar-Thane-Kasarvadavali) has also been approved, by the state government.
- Other phases are in conceptualization stage.

Proposed metro networks for Mumbai

	Name of Corridor	Length (km)	Estimated Cost (Rs bn)
1	Versova-Andheri-Ghatkopar *(commissioned in Aug-14)*	11.4	24
2	Dahisar-Charkop-Bandra-Mankhurd *(funding approved)*	40.0	265
3	Colaba-Bandra-SEEPZ *(RFPs invited)*	33.5	244
4	Navi Mumbai Metro *(under construction)*	23.4	41
5	Wadala-Ghatkopar-Thane-Kasarvadavali *(funding approved)*	30.7	191
6	Wadala-Carnac Bunder *(deferred due to less ridership)*	13.5	26
7	SEEPZ-Kanjurmarg	10.5	42
8	Andheri (E) – Dahisar (E)	18.0	108
9	Sewri-Prabhadevi	3.5	21
	Total	**184.5**	**962**

Source: MMRDA, PhillipCapital India Research

Force # 2 – Reduced competitive intensity to aid margin expansion

The economic downturn of the last four years has permanently scarred many EPC companies. Their debt and working capital has ballooned to such high levels that it will take them at least 2-3 years of excessive financial and operational discipline to bounce back. Many of them are formally under the CDR programme and will take anywhere between 5-8 years to come out of it.

Most EPC companies had to enter CDR over the last two years

	Date of entry into CDR	Consolidated debt (Rs mn)	Current market cap (Rs mn)
HCC	Q1FY13	78,220	19,600
Gammon India	Q4FY13	110,000	4,200
IVRCL	Q4FY14	55,000	5,090
C&C Construction	Q2FY13	19,730	887
ARSS Infra	Q3FY12	15,950	596
Era Construction	Q3FY14	NA	1,100
Isolux-Soma	Q1FY15	20,700	NA

Source: Company, PhillipCapital India Research

Due to this, the competitive intensity in the bidding process in the EPC sector has reduced significantly. The number of players bidding for projects in ALL sectors (except MRTS, which is a relatively new one) has come down from FY10 levels. Only companies with strong balance sheets and superior fundamentals are able to bid for the new projects and we expect them to grab a much bigger share of the huge impending opportunity.

Competitive intensity – then and now

Sector	FY10 No of bidders	Prominent bidders	FY15No of bidders	Prominent bidders
Buildings	7-10	L&T, NCC, Ahluwalia, CCCL	4-5	L&T, NCC, Ahluwalia, Shapoorji Pallonji
Roads	15-20	L&T, NCC, IVRCL, Gammon, HCC, Patel Engg	7-8	L&T, NCC, KNR, J Kumar, Ashoka, HCC, ITD Cementation
Irrigation	8-10	L&T, NCC, IVRCL, Gammon, Pratiba	5-6	L&T, NCC, IVRCL, ITD Cementation
Water	7-8	L&T, NCC, IVRCL, Patel Engg	4-5	L&T, NCC, IVRCL, VA Tech
Hydro	4-5	L&T, HCC	2-3	L&T, HCC, ITD Cementation
Power	6-7	L&T, NCC, IVRCL, Gammon	2-3	L&T, NCC
MRTS	2-3	L&T, Gammon	5-6	L&T, J Kumar, KNR, Gammon, HCC, ITD Cementation

Source: Company, PhillipCapital India Research

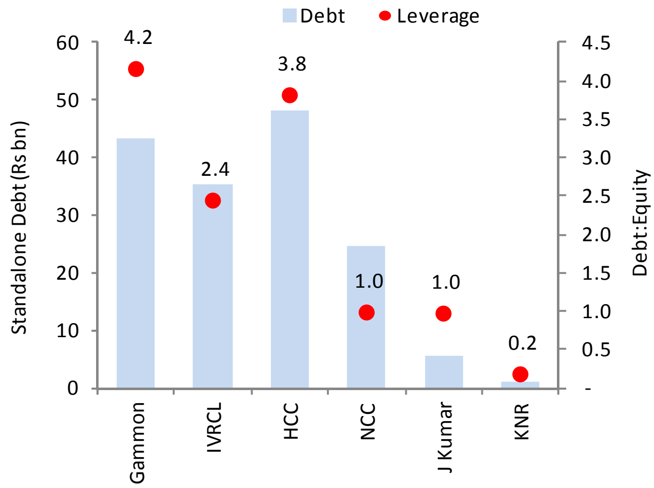
This forms the second leg of our trinity hypothesis – reduced competitive intensity will enable the companies to make better returns on projects, leading to margin expansion over the next three years. Companies like NCC and J Kumar have repeatedly mentioned this over the last two quarters.

In fact, we already have evidence of this hypothesis playing out. NCC's margins have expanded from 5.5% in 4QFY14 to 8.1% in 2QFY15. On similar lines, margins have expanded for J Kumar, KNR as well as HCC, over the last three quarters. NCC has also guided that its margin will expand from 6.6% in FY14 to 8% in FY15 and will be >9% in FY16 because of the higher share of new orders (won at higher margins) being executed over the next two years.

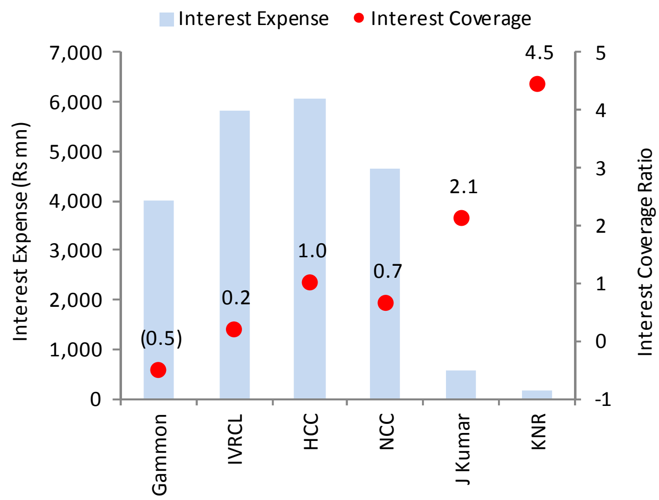
Force # 3 – Lower interest rates to provide additional fillip to the earnings

One of the primary reasons that EPC companies fared so poorly over the last four years was the high interest-rate regime. Fundamentally, most EPC companies do not generate positive OCF because of their high working-capital requirements, implying that most of them are heavily leveraged. Lack of new orders and delay in payments from government bodies over the last four years caused their working capital to balloon, leading to even higher debt levels.

Most companies currently have highly leveraged balance sheets…



Operating profit barely matches interest expenses



Source: Company, PhillipCapital India Research

However, with an uptick in the economic cycle, we expect interest rates to be revised downwards in the near-to medium future. While it may take a few months for this to materialise, the event is surely closer to realisation than four quarters ago. This reduction in interest rates forms the third leg of our trinity hypothesis — it will enhance earnings and cash flows leading to a further reduction in debt — this in turn will lead to a manifold jump in earnings.

EPC companies' earnings are highly sensitive to interest rates — a 100bps fall in interest rates will lead to 22% earnings growth for a relatively low leveraged company such as NCC and 92% earnings growth for the most leveraged company such as HCC.

Earnings sensitivity to fall in interest rates

	KNR	J Kumar	NCC	IVRCL	Gammon	HCC
-200bps	2%	6%	43%	23%	45%	183%
-100bps	1%	3%	22%	12%	23%	92%
0bps	0%	0%	0%	0%	0%	0%
+100bps	-1%	-3%	-22%	-12%	-23%	-92%

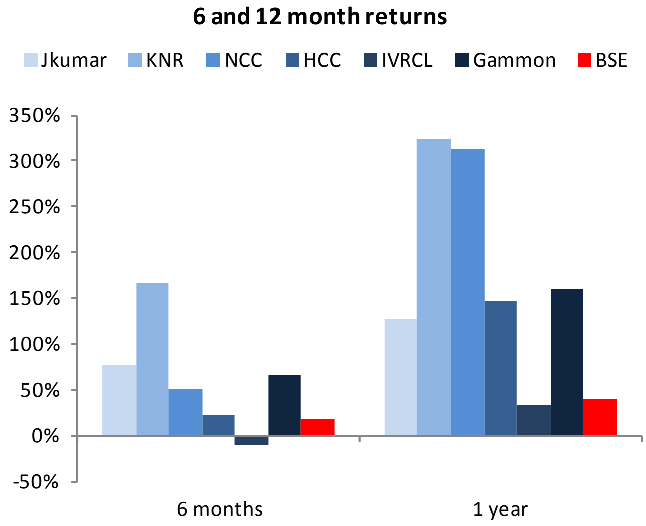
Source: Company, PhillipCapital India Research

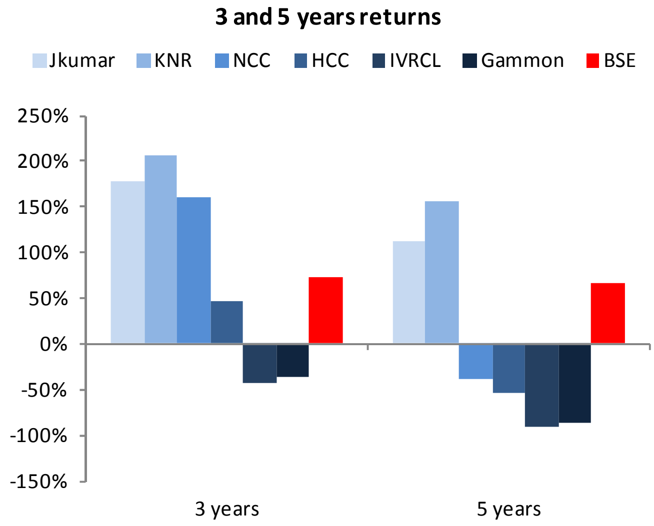
Reduced interest rates will help companies deleverage their balance sheets — this will help them improve their credit ratings, which will lead to an incremental fall in borrowing costs and hence interest expense. NCC, which has managed to bring its leverage down to 0.6x (from 1.0x in FY14) on the back of the recent rights issue, is already talking to its bankers about improvement in its rating.

EPC 'veterans' – How did they mess-up so badly

The EPC sector massively underperformed the broader index, over the last four years. Most stocks are currently trading at a fraction of what they once traded at, at the peak of the economic cycle in 2010. Muted topline growth, losses at the PAT level, and continued deterioration of balance sheets led to a complete lack of investor confidence in the entire infrastructure sector, with EPC companies bearing the brunt.

The stalwarts have significantly underperformed the broader index over the last five years

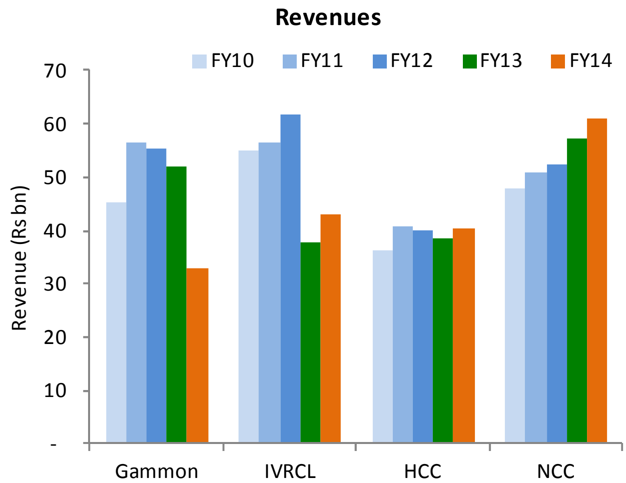


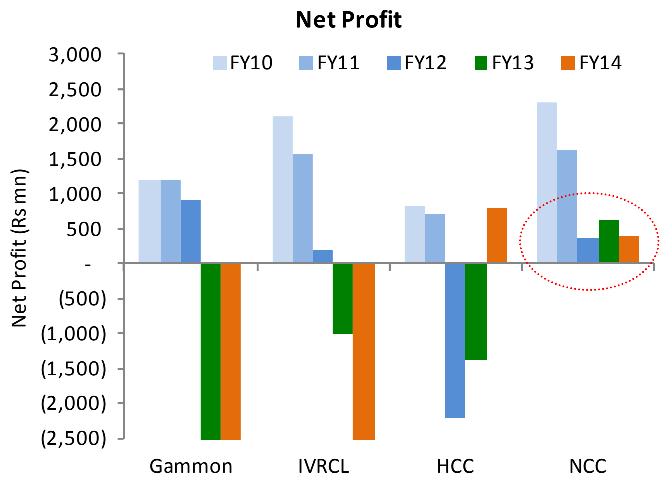


Source: Bloomberg, PhillipCapital India Research

However, the lacklustre performance of EPC stocks had its reasons. On the operational front, lack of new orders and delay in payment by government bodies hit the companies. On the financial front, the high interest-rate regime and ballooning debt levels kept earnings under pressure. Apart from NCC, all large EPC companies (by orderbook size) reported heavy losses over the last four years.

While revenues have shown little growth over the last four years… **… earnings have been highly volatile *(except NCC)***



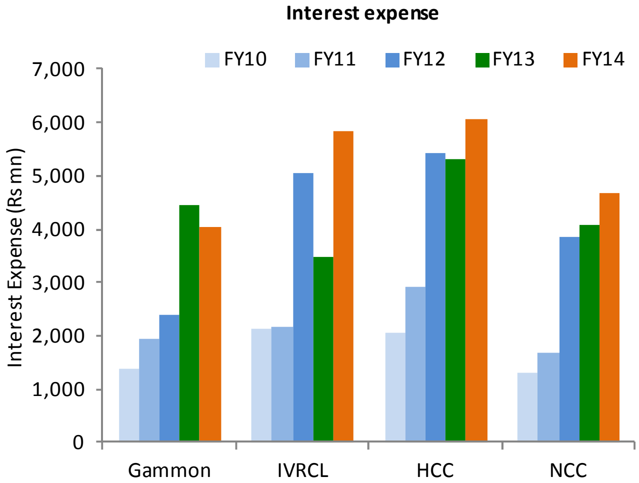


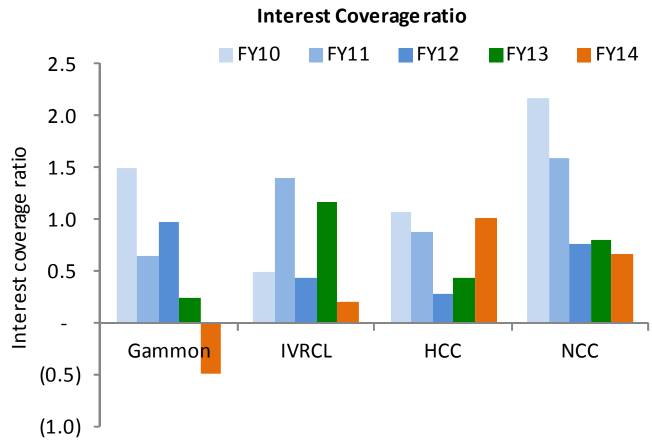
Source: Company, PhillipCapital India Research

The deterioration of the earnings profile was on the back of exponential increase in debt levels, which was caused by elongation of WC cycle. While delayed payments from govt bodies was partly responsible for that, the EPC companies also committed large amount of capital into their real estate / BOT subsidiaries, as loans and advances, further aggravating the situation.

Earnings were depressed for the sector on the back of high interest expense – because of high interest rates and debt levels – which was primarily caused by delays in payment from government bodies

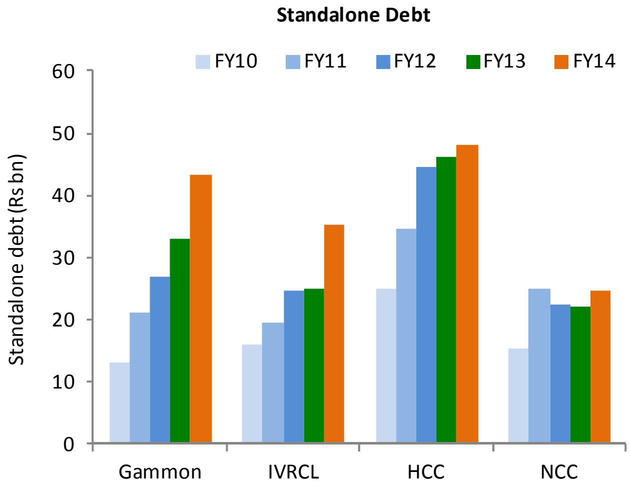
Compounding effect of higher debt and interest rates meant interest expense overshot the operating profits

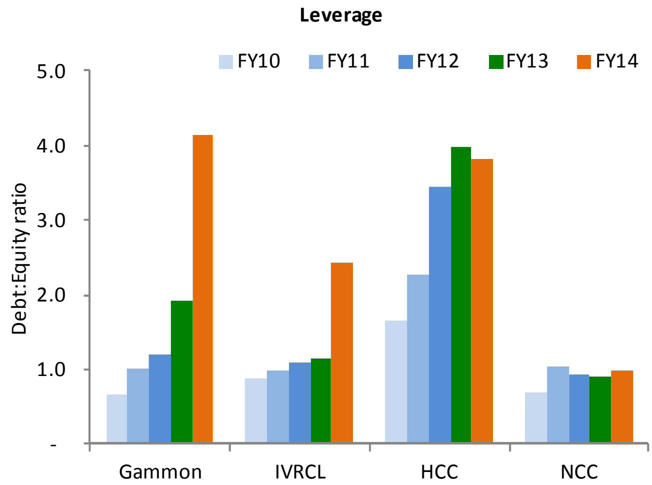




The debt levels ballooned for most companies …

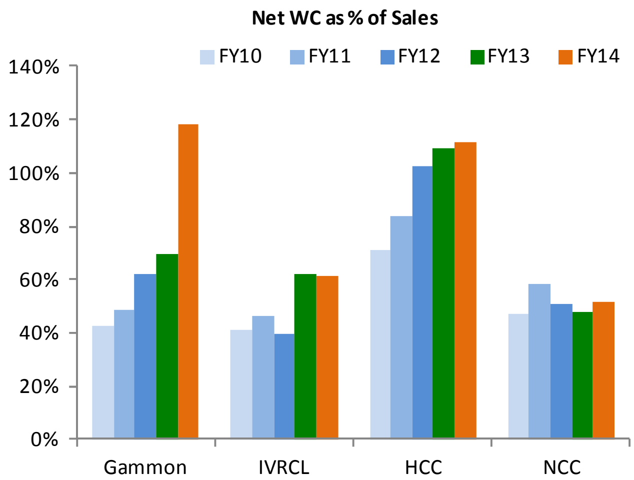
….. leverage crossing 1x for most of them

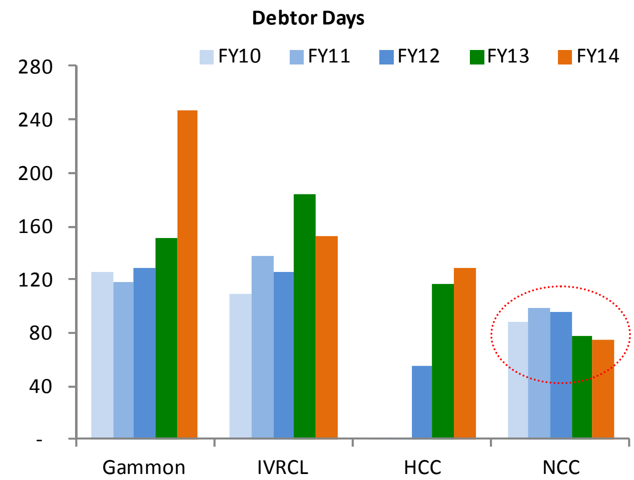




Higher leverage was due to elongated working capital cycle …

… which was mainly due to increase in debtor days



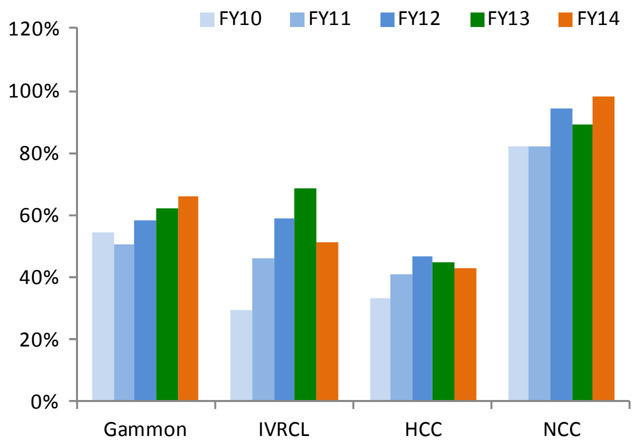


Source: Company, PhillipCapital India Research

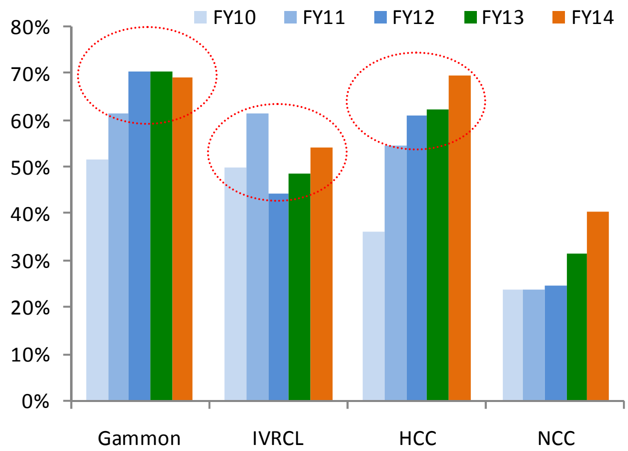
Loans & Advances to subsidiary companies, primarily real estate and BOT projects, were also responsible for higher working capital

Loans & Advances as a % of Net Working Capital increased significantly, with share of subsidiaries remaining high

Loans & Advances as % of Net Current Assets

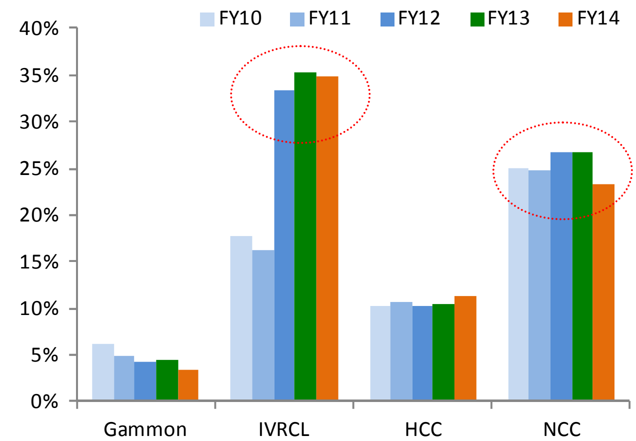


Loans to Subs as % of total Loans

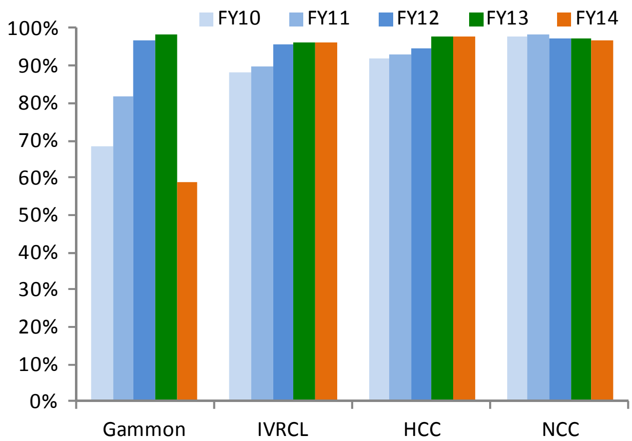


Investments as % of total assets as well as investments in subs as % of total Investments, remained high for all companies

Investments as % of total Assets



Investment in Subsidaries as % of total Investments



Source: Company, PhillipCapital India Research

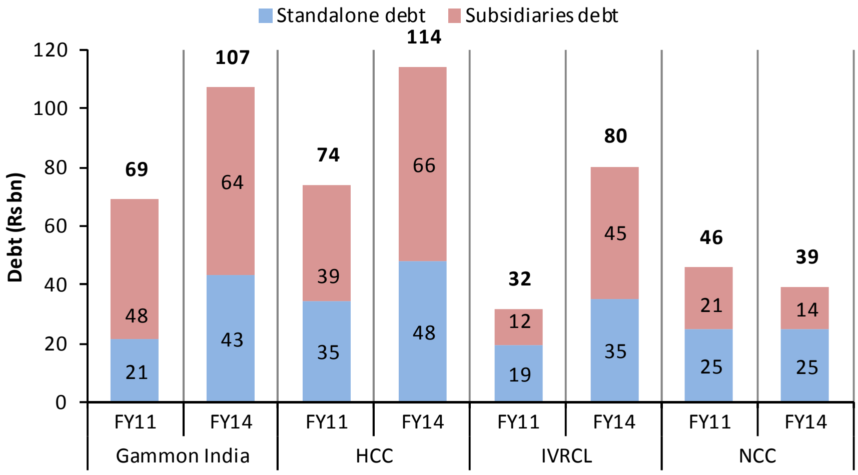
Infrastructure / real-estate portfolios

Rs mn	Gammon	HCC	IVRCL	NCC
BOT Portfolio				
Project capex	94,783	55,380	88,056	128,273
Total equity committed	12,865	10,485	21,300	18,440
Comment	Portfolio of 510km of road, 96MW of power and 23mtpa of port projects	Six road projects under various stages of development	521km of road projects; Other projects include Truck terminal, Desalination plant	Portfolio of 250km of road and 1680MW of power projects
Real estate Portfolio				
Landbank (acres)	180	11,000	3,394	342
Book value	1,050	10,138	8,500	4,936
Comment	Landbank acquired via stake in Metropolitan Infra Ltd - in initial stages of development	Lavasa comprises majority of it; remaining investment in 24x7 parks in Vikhroli	Majority of landbank in Chennai, Hyderabad and Bangalore	Majority of landbank in Hyderabad, Bangalore and Ranchi

Source: Company, PhillipCapital India Research

The consolidated debt profile of EPC companies looks even worse than their standalone ones, with huge debt on the books of real estate and BOT subsidiaries. Most companies are now trying to divest a large part of these assets, but since most such projects are on the block, very few deals are being closed.

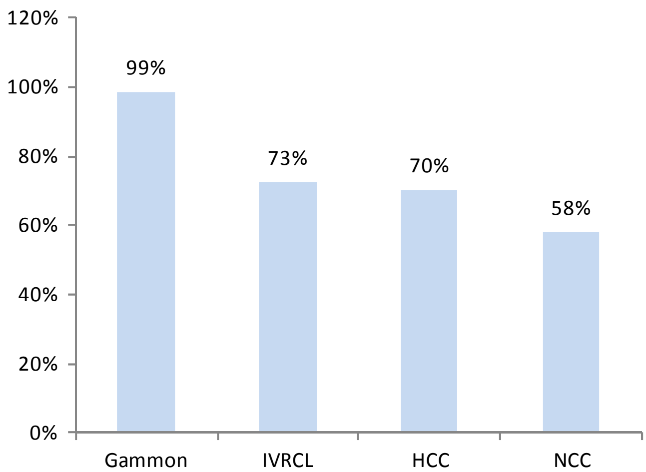
Consolidated debt position looks even worse



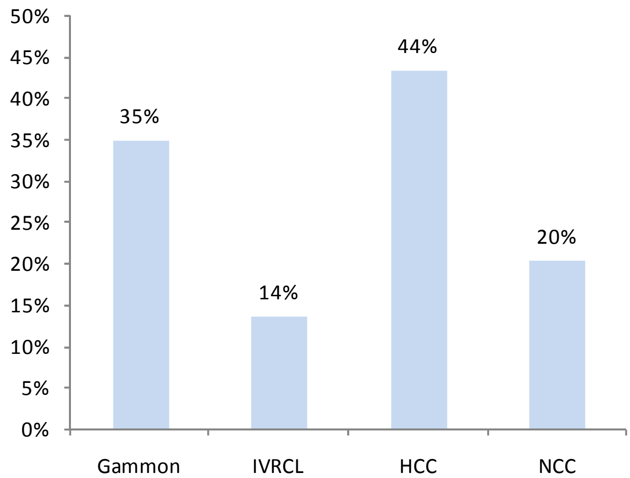
Source: Company, PhillipCapital India Research

The balance sheet deterioration of the EPC companies was not limited to the exponential growth in debt levels, but also dilution of the equity profile. If we dig deeper into balance sheets of these EPC companies, we find that over 50% of their net worth comprises of share premium – money raised from the markets. Continuous losses over the last four years and repetitive capital raising to finance the working capital in prior years have led to this skewed equity profile. The same has also reduced promoter holding in these companies to extremely low levels.

High share of net worth is contributed by share premium



Promoter holding has been reduced to extremely low levels

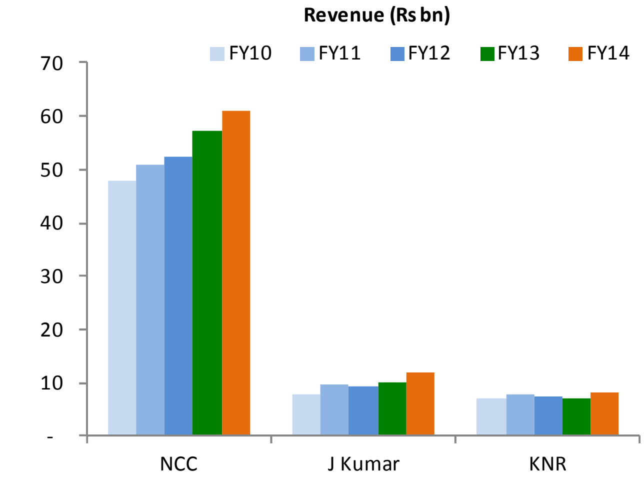


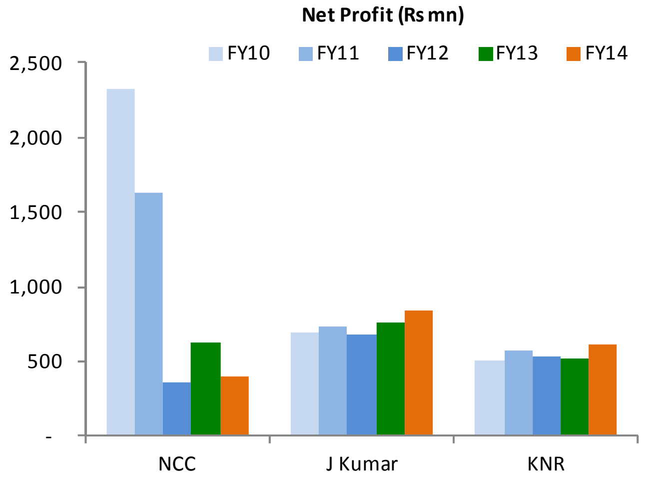
Source: Company, PhillipCapital India Research

The new crop – are they any better?

The new companies (likes of J Kumar and KNR), who we believe will benefit at the expense of the older ones, have a much leaner balance sheet and superior execution track record. These companies have withstood the downturn of the last four years and have emerged stronger. Even in the downturn, they have demonstrated a high level of financial discipline and operational prudence, which has placed them at an advantage versus their senior competitors.

The 'new' companies have managed to maintain consistent revenue profile and profitability over the last five years

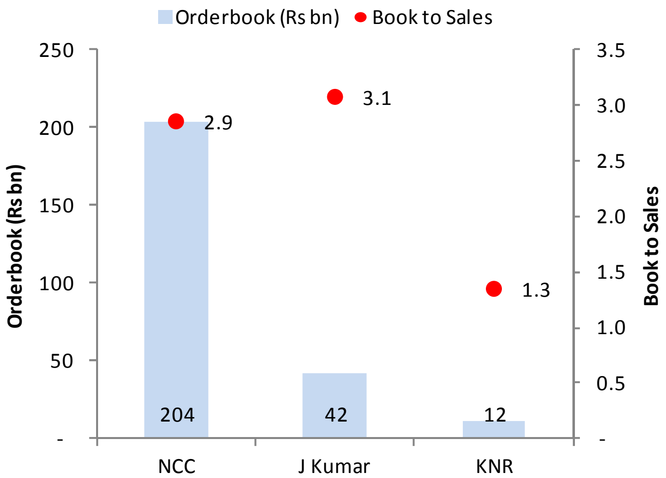


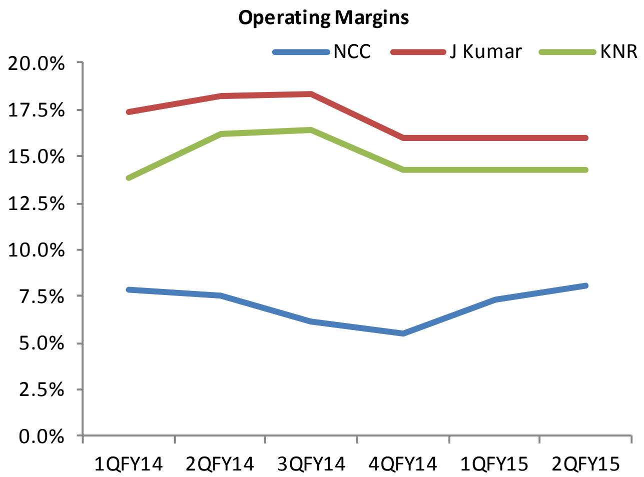


Source: Company, PhillipCapital India Research

The orderbook for all these companies stands at over 3x sales (except KNR), imparting high revenue visibility. With margins moving up over the last few quarters due to lower competitive intensity, we find these companies well prepared to capitalise on the huge investment opportunity in the EPC space.

And are well prepared for the future with robust orderbooks and stable margins

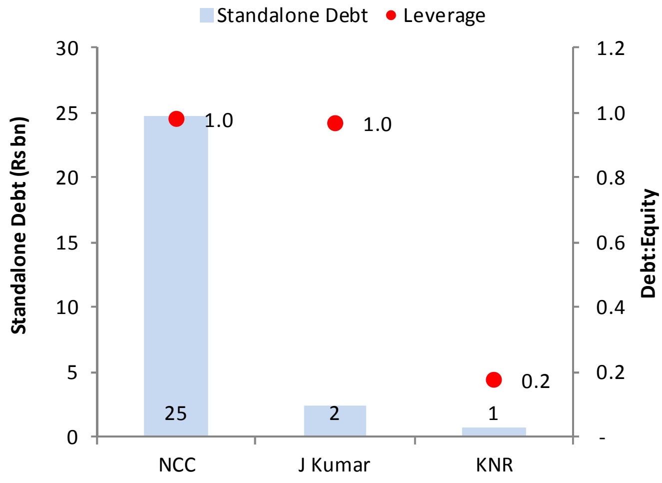


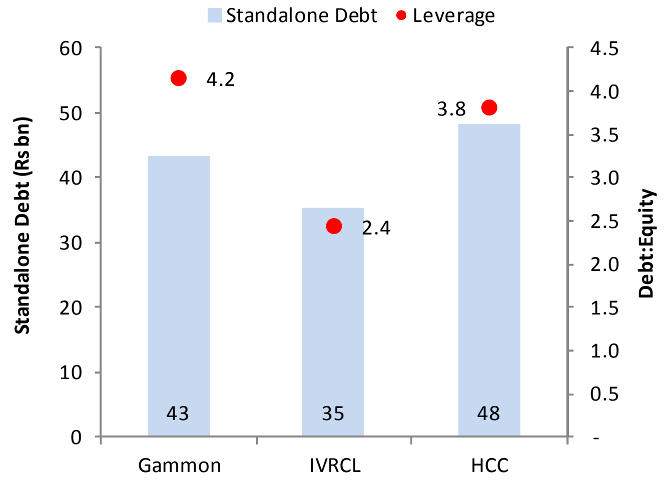


Source: Company, PhillipCapital India Research

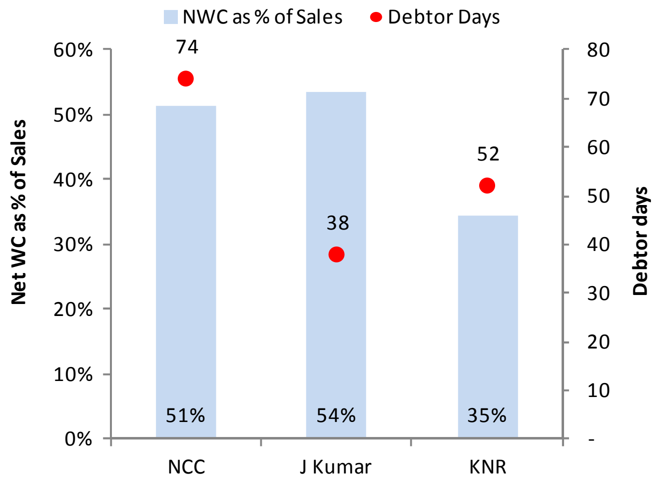
Balance sheets of these new companies are much leaner vs. peers

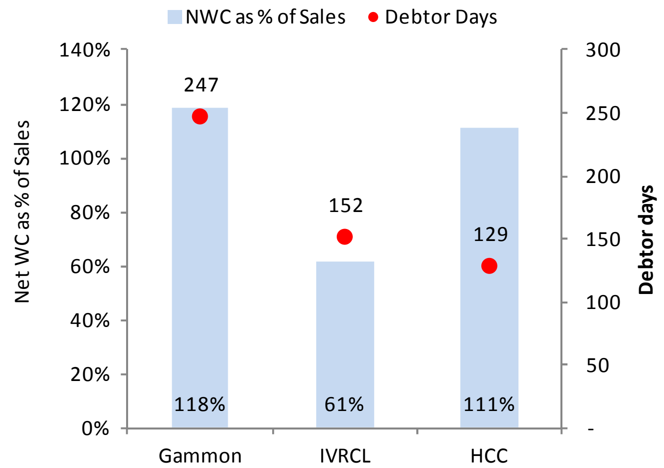
Gross debt and leverage is much lower for the new companies vs. the old ones



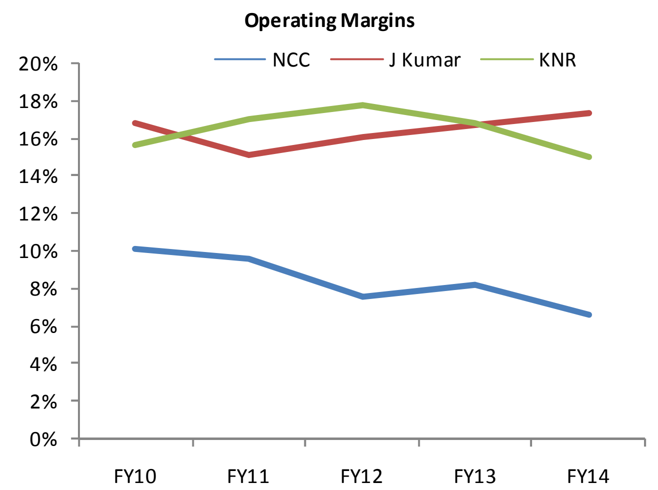


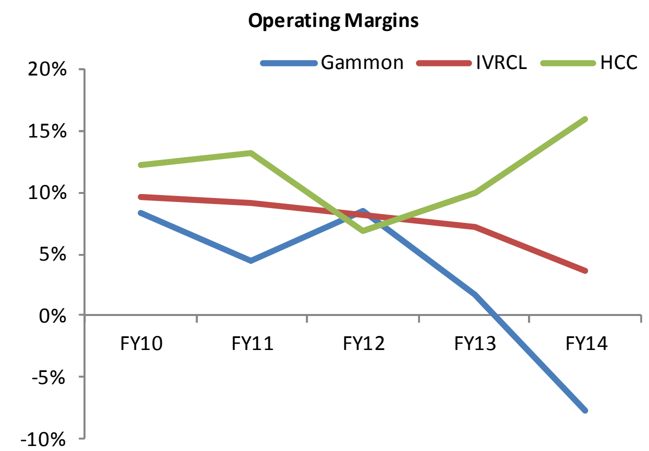
Working capital situation too appears more comfortable for the new companies





Operationally, the new companies have reported significantly lower volatility in margins





Source: Company, PhillipCapital India Research

Valuation – inexpensive vis-à-vis potential

Almost all infrastructure companies (especially EPC) are currently trading at relatively low valuations, especially on a P/E and EV/EBITDA basis, despite the recent surge in stock prices of few companies (such as NCC, J Kumar, and HCC). Notwithstanding the recent surge in prices, we find most of the new companies quite inexpensive, particularly vis-à-vis their manifold earnings growth potential in mind.

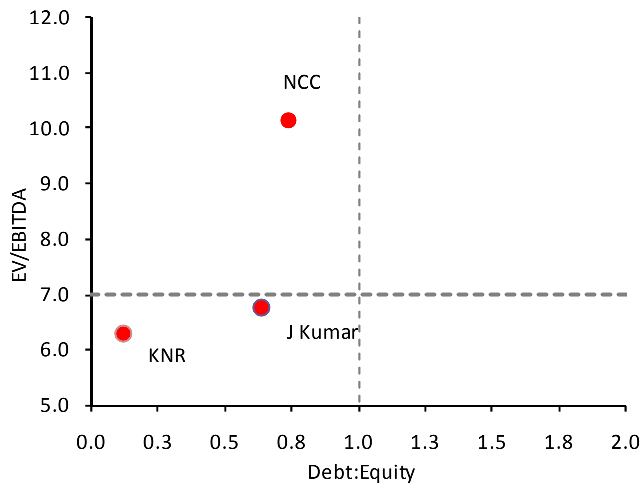
Infrastructure Sector – Valuation Table

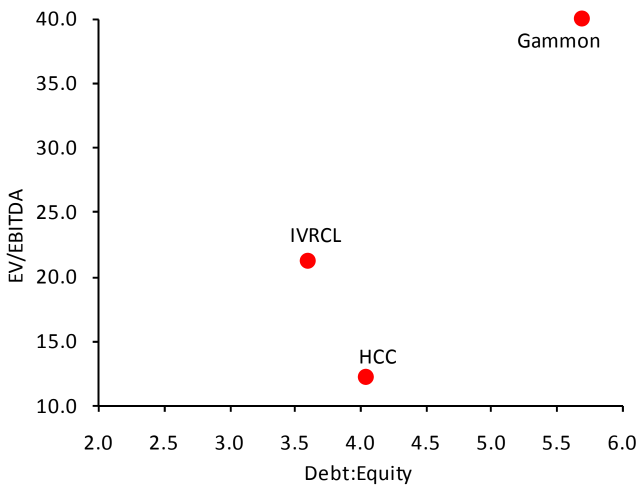
Company	Mkt Cap	CMP	P/E		EV/EBITDA		ROE		D/E		P/BV	
	Rs bn	Rs	FY15E	FY16E	FY15E	FY16E	FY15E	FY16E	FY15E	FY16E	FY15E	FY16E
Asset Owners												
GMR Infra	74.0	19	(8.5)	(13.4)	12.2	13.4	(9.2)	(6.3)	4.7	4.7	0.8	0.8
GVK Power	17.4	11	(1.9)	(2.7)	19.3	9.9	(44.5)	(39.5)	12.0	13.9	0.8	1.1
IRB Infra	89.3	269	14.9	17.1	9.0	7.7	14.3	10.4	2.9	2.7	2.1	1.8
Ashoka Buildcon	21.3	135	20.3	18.8	13.2	9.6	7.9	8.0	3.4	3.5	1.6	1.5
Adani Ports	600.3	290	25.6	20.0	20.9	16.7	20.9	21.6	0.8	0.6	5.3	4.3
EPC												
NCC	35.6	64	48.5	12.2	10.2	7.6	2.3	8.4	0.7	0.6	1.1	1.0
J Kumar	14.2	440	13.8	10.1	6.8	5.4	12.8	15.3	0.6	0.6	1.8	1.5
KNR	8.4	300	13.2	10.2	6.3	5.1	11.1	12.6	0.1	0.1	1.5	1.3
HCC	19.4	30	(40.3)	-	12.3	-	(4.0)	-	4.0	-	1.6	-
IVRCL	4.9	16	(1.4)	-	21.2	-	(30.6)	-	3.6	-	0.4	-
Gammon India	4.1	30	(1.7)	-	39.9	-	(29.8)	-	5.7	-	0.5	-

Source: Bloomberg, PhillipCapital India Research

Based on relative positioning, we find that NCC, KNR, and J Kumar are much better placed than the old stalwarts HCC, Gammon, and IVRCL. We expect their leaner balance sheets and huge opportunity to translate into robust earnings growth and hence superior returns for investors. We have a BUY rating on NCC, KNR, and J Kumar.

EPC Sector – Relative positioning





Source: PhillipCapital India Research

Companies Section

PhillipCapital

Nagarjuna Construction (NJCC IN)

Only getting better…

INDIA | INFRASTRUCTURE | Company Update

2 December 2014

NCC recently raised Rs 6bn in a rights issue, which it will use to reduce its standalone debt — this will lower its interest expense and have a positive impact on PAT to the tune of Rs 377mn in FY15 and Rs 754mn in FY16. The D/E ratio should come down to 0.6x in FY15 from 1.0x in FY14.

We note that any debt reduction has a compounding effect on its earnings, as its average cost of debt *(including bank charges and commission)* is around 18%. We expect a similar impact for the cash proceeds from its stake sale in Nelcast Power (which we currently value at 1x book value).

Best placed to capitalise on the opportunity: Over the last four years, while many EPC companies filed for CDR, NCC has improved its working capital situation (debtor days have come down from 105 in FY11 to 80 in FY14) while maintaining steady debt levels.

Over the same period, it has been able to maintain EBITDA margins in the 7-8% range, while most of its peers have reported highly volatile margins because of reduced operating leverage and write offs. With reduced competition, we expect NCC's margins to expand significantly *(by 240bps over FY14-17)*.

Multiple triggers awaiting: NCC has multiple triggers that can lead to significant cash accrual, over the next twelve months. The Nelcast power project deal with Sembelcorp would lead to a potential cash accrual of Rs 5bn. That, along with potential divestment of its BOT road projects (equity invested Rs3.7bn) and real estate (about 200 acres), could lead to further deleveraging of its balance sheet.

Clear management focus: In an effort to deleverage its balance sheet it has divested multiple land parcels over the last two years leading to cash accrual of Rs 3.5bn (FY15 target is Rs 2bn). It has also put ALL its BOT projects on the block of which it has already sold its stake in two power projects. The management's clarity is evident from the fact that its board has resolved NOT to bid for any BOT projects, focusing on its core competency, EPC.

Robust and diversified orderbook: Its orderbook (Rs 204bn, 3.0x book-to-sales) provides high revenue visibility and is well diversified (building, roads, power, water; 9% outside India). We expect robust growth in the order book over the next two years, esp on the back of EPC road projects to be awarded by NHAI.

Outlook and valuation: We believe that NCC's superior position vs. EPC peers will enable it to capitalise on the HUGE impending investment opportunity in infrastructure. While the stock price has risen sharply over the last few months (3m, +55%), we still see significant upside potential from current levels.

We expect a topline CAGR of 18% over FY14-17 and EBITDA margin expansion of 240bps (from 6.6% in FY14 to 9.0% in FY17) on legacy orders getting completed and low competition resulting in higher margins for new orders. This should result in 120% earning CAGR over the same period.

We roll forward our valuation for the stock to FY17. Our **price target of Rs92** (adjusted for new shares for the rights issue), represents a **44% upside** from current levels. We maintain a **BUY** rating.

BUY (Maintain)

CMP RS 64

TARGET RS 92 (+44%)

COMPANY DATA

O/S SHARES (MN) :	556
MARKET CAP (RSBN) :	36
MARKET CAP (USDBN) :	0.6
52 - WK HI/LO (RS) :	71 / 14
LIQUIDITY 3M (USDMN) :	7
PAR VALUE (RS) :	2

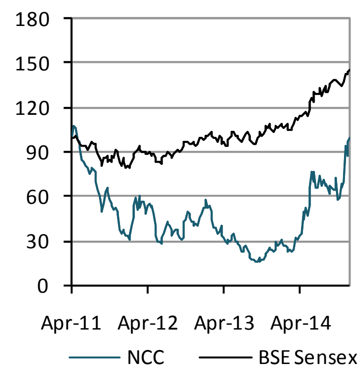
SHARE HOLDING PATTERN, %

PROMOTERS :	20.4
FII / NRI :	29.8
FI / MF :	11.4
NON PROMOTER CORP. HOLDINGS :	11.7
PUBLIC & OTHERS :	26.7

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	7.2	54.9	313.8
REL TO BSE	4.7	48.6	276.4

PRICE VS. SENSEX



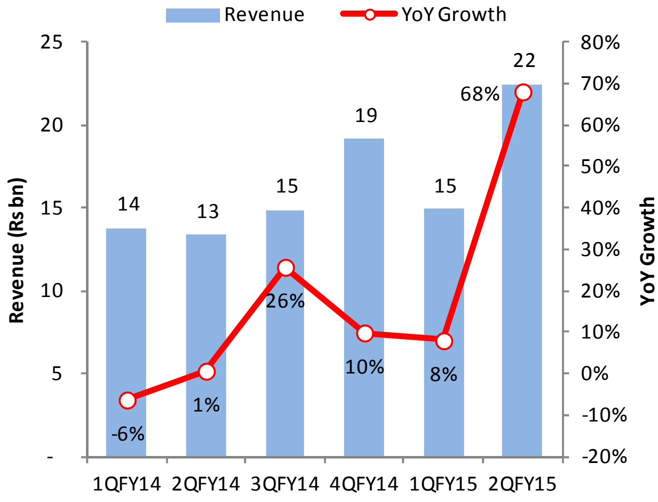
Source: Phillip Capital India Research

KEY FINANCIALS

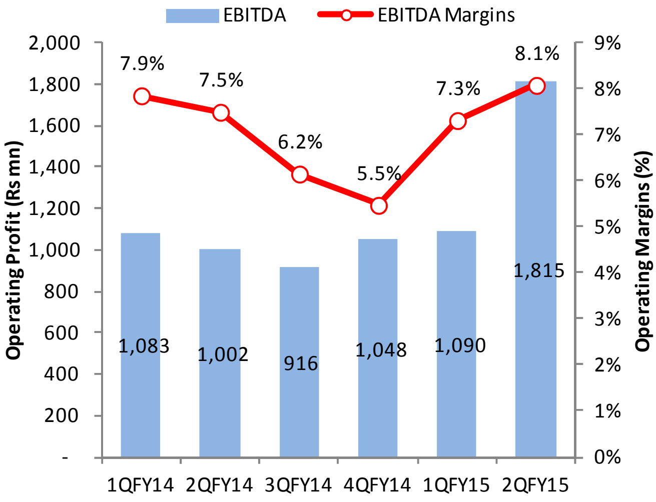
Rs mn	FY15E	FY16E	FY17E
Net Sales	72,178	85,164	100,487
EBIDTA	5,594	7,239	9,044
Net Profit	733	2,917	4,237
EPS, Rs	1.3	5.2	7.6
PER, x	48.5	12.2	8.4
EV/EBIDTA, x	10.2	7.6	6.0
P/BV, x	1.1	1.0	0.9
ROE, %	2.3	8.4	10.8
Debt/Equity (x)	0.7	0.6	0.5

Source: PhillipCapital India Research Est.

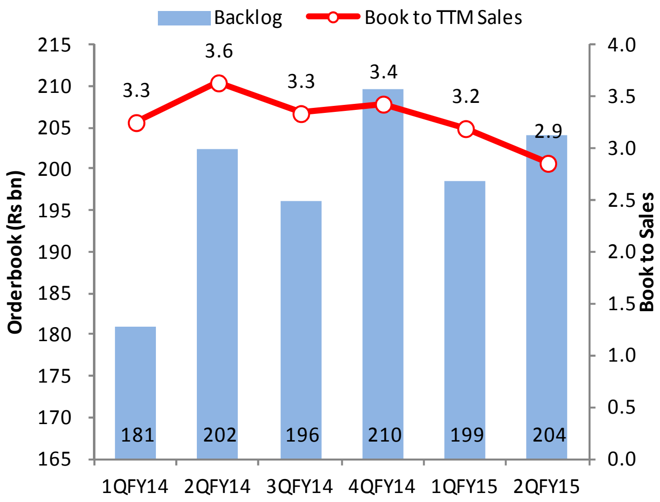
Revenue growth has been robust for NCC....



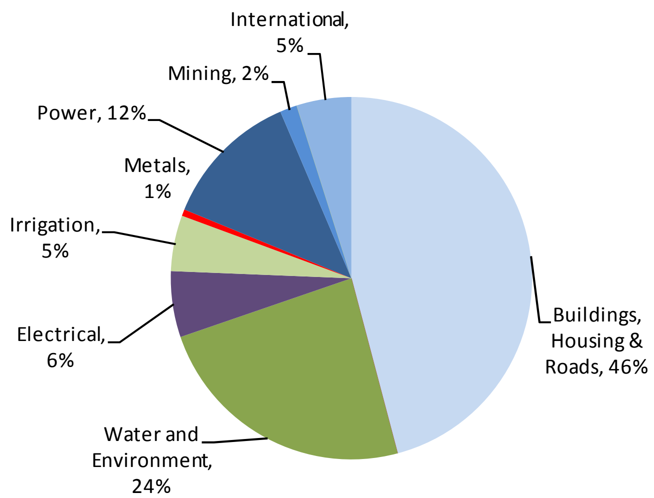
.... with stable and improving margins



Orderbook has been steady....



.... and is well diversified across segments



Nelcast Power project – Sembcorp deal removes a big overhang

Project Details	Rs mn	Sembcorp Deal	
Total project cost	70,470	Stake acquired	45%
Debt	52,850	Consideration (Rs mn)	8,500
Equity required	17,620	Implied P/BV	1.07
NCC Share (55%)	9,690	Stake Left	
Equity already infused	4,548	NCC	30%
Equity required	5,142	Gayathri	25%

SoTP Valuation

Business division	FY17 EPS	Equity Invested	Multiple	Valuation	Per share
	Rs	Rs mn		Rs mn	Rs
EPC	7.6		10.0x	42,371	76.2
BOT Road Projects		3,707	0.7x	2,595	4.7
Power Projects		6,120	1.0x	6,120	11.0
Total Valuation				**51,086**	**92**

Source: Company, PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY14	FY15e	FY16e	FY17e
Net sales	**61,173**	**72,178**	**85,164**	**100,487**
Growth, %	7	18	18	18
Total income	61,173	72,178	85,164	100,487
Employee expenses	-2,404	-2,836	-3,347	-3,949
Other Operating expenses	-28,631	-34,750	-41,002	-48,379
EBITDA (Core)	4,049	5,594	7,239	9,044
Growth, %	(14.0)	38.2	29.4	24.9
Margin, %	6.6	7.7	8.5	9.0
Depreciation	-895	-1,052	-1,158	-1,206
EBIT	**3,153**	**4,541**	**6,081**	**7,838**
Growth, %	(16.8)	44.0	33.9	28.9
Margin, %	5.2	6.3	7.1	7.8
Interest paid	-4,660	-5,184	-3,569	-3,357
Other Non-Operating Income	1,535	1,721	1,843	1,843
Pre-tax profit	**29**	**1,078**	**4,354**	**6,324**
Tax provided	376	-345	-1,437	-2,087
Profit after tax	**405**	**733**	**2,917**	**4,237**
Net Profit	**405**	**733**	**2,917**	**4,237**
Growth, %	(35.3)	80.9	298.0	45.2
Net Profit (adjusted)	**405**	**733**	**2,917**	**4,237**
Unadj. shares (m)	257	556	556	556
Wtd avg shares (m)	257	556	556	556

Balance Sheet

Y/E Mar, Rs mn	FY14	FY15e	FY16e	FY17e
Cash & bank	688	2,201	2,426	2,691
Debtors	13,410	15,820	18,666	22,025
Inventory	15,987	18,786	20,999	23,401
Loans & advances	30,739	34,606	34,999	37,166
Total current assets	72,612	83,200	88,877	97,070
Investments	11,643	11,643	11,643	11,643
Gross fixed assets	11,494	11,994	12,494	12,994
Less: Depreciation	-4,577	-5,630	-6,788	-7,994
Add: Capital WIP	104	104	104	104
Net fixed assets	7,020	6,467	5,809	5,103
Total assets	**91,275**	**101,310**	**106,329**	**113,816**
Current liabilities	41,201	45,830	49,432	53,682
Total current liabilities	41,201	45,830	49,432	53,682
Non-current liabilities	24,871	23,558	22,058	21,058
Total liabilities	66,072	69,388	71,490	74,739
Paid-up capital	513	1,112	1,112	1,112
Reserves & surplus	24,690	30,811	33,728	37,965
Shareholders' equity	25,203	31,923	34,840	39,077
Total equity & liabilities	**91,275**	**101,310**	**106,329**	**113,816**

Source: Company, PhillipCapital India Research Estimates

Cash Flow

	FY14	FY15e	FY16e	FY17e
Pre-tax profit	29	1,078	4,354	6,324
Depreciation	895	1,052	1,158	1,206
Chg in working capital	-4,144	-4,446	-1,851	-3,678
Total tax paid	270	-345	-1,437	-2,087
Cash flow from operating activities	**-2,950**	**-2,661**	**2,225**	**1,765**
Capital expenditure	-668	-500	-500	-500
Chg in investments	893	0	0	0
Cash flow from investing activities	**225**	**-500**	**-500**	**-500**
Free cash flow	-2,725	-3,161	1,725	1,265
Equity raised/(repaid)	327	5,987	0	0
Debt raised/(repaid)	2,496	-1,313	-1,500	-1,000
Dividend (incl tax)	-60	0	0	0
Cash flow from financing activities	**2,763**	**4,673**	**-1,500**	**-1,000**
Net chg in cash	38	1,513	225	265

Valuation Ratios

	FY14	FY15e	FY16e	FY17e
Per Share data				
EPS (INR)	1.6	1.3	5.2	7.6
Growth, %	(35.3)	(16.5)	298.0	45.2
Book NAV/share (INR)	98.2	57.4	62.7	70.3
FDEPS (INR)	1.6	1.3	5.2	7.6
CEPS (INR)	5.1	3.2	7.3	9.8
CFPS (INR)	(17.5)	(7.9)	0.7	(0.1)
Return ratios				
Return on assets (%)	3.9	4.2	5.0	5.8
Return on equity (%)	1.6	2.3	8.4	10.8
Return on capital employed (%)	7.0	7.7	9.3	10.9
Turnover ratios				
Asset turnover (x)	1.7	1.8	2.0	2.3
Sales/Total assets (x)	0.7	0.7	0.8	0.9
Sales/Net FA (x)	8.6	10.7	13.9	18.4
Working capital/Sales (x)	0.5	0.5	0.4	0.4
Receivable days	80.0	80.0	80.0	80.0
Inventory days	95.4	95.0	90.0	85.0
Payable days	261.2	249.5	230.0	213.0
Working capital days	183.3	177.8	158.7	147.8
Liquidity ratios				
Current ratio (x)	1.8	1.8	1.8	1.8
Quick ratio (x)	1.4	1.4	1.4	1.4
Interest cover (x)	0.7	0.9	1.7	2.3
Total debt/Equity (x)	1.0	0.7	0.6	0.5
Net debt/Equity (x)	1.0	0.7	0.6	0.5
Valuation				
PER (x)	40.5	48.5	12.2	8.4
PEG (x) - y-o-y growth	(1.1)	(2.9)	0.0	0.2
Price/Book (x)	0.7	1.1	1.0	0.9
EV/Net sales (x)	0.7	0.8	0.6	0.5
EV/EBITDA (x)	10.0	10.2	7.6	6.0
EV/EBIT (x)	12.8	12.5	9.1	6.9

PhillipCapital

KNR Construction (KNRC IN)

Slow and steady wins the race…

INDIA | INFRASTRUCTURE | Initiating Coverage

2 December 2014

KNR Construction personifies the idiom 'slow and steady wins the race'. It has been on the sidelines for over a decade now, doing subcontracting work for companies like GMR and Sadbhav Engineering and relatively small projects for NHAI and state governments. Over the last five years, it has reported revenue CAGR of only 4% (to Rs 8.3bn in FY14 from Rs7.1bn in FY10).

However, over the same time period, it has reported average EBITDA margins of 16.5% - (lowest being 15.5% in FY14), its debt-to-equity ratio never exceeded 0.5x, and its debtor days were always <80 (average 65). Today, it possesses one of the strongest balance sheets in the infrastructure space and is all set to capitalise on the huge investment opportunity in EPC over the next three years.

Early Completion: KNR has had a superior execution track record because of operational discipline, which has helped it claim early completion bonuses for many of its projects. It expects to complete its on-going BOT project in Kerala (four-laning the Walayar-Vadakkancherry highway) six months ahead of schedule.

Backward integration: KNR's margins are superior to its contemporaries such as NCC, IVRCL, and Gammon, primarily due to backward integration. It owns a host of quarries and RMC plants across the country, giving it the benefit in term of raw material costs. Its own fleet of equipment (excavators, tippers, pavers, and cranes) ensures minimum lease rental. Its in-house team of 700 qualified professionals ensures that most of its projects are completed ahead of schedule – this means zero time-and-cost overruns.

Current orderbook a concern: KNR's orderbook currently stands at Rs 11.8bn, 1.35x book-to-sales, inferior to its peers such as NCC (3x) and J Kumar (3x). 95% of KNR's orderbook is in the roads segment, which has been hit by lack of awards from NHAI and other state governments over the last six months. However, the management remains optimistic about the order award potential in 2HFY15 and expects to close FY15 with total order inflow of Rs 20bn, which should provide decent revenue visibility for the next two years.

Outlook and valuation: We expect the potent combination of operational efficiency and financial discipline to help KNR grow at the cost of its peers in the EPC space. Few companies in this space can match KNR in terms of balance sheet strength and operating margins. We expect it to benefit from a surge of orders in the roads segment (from NHAI and state governments). Its diversification into irrigation and overhead MRTS projects should also help it grow its orderbook beyond roads.

KNR's stock has surged 135% in the last six months and is currently trading at 10.2x FY16 and 8.2x FY17 earnings, already at a significant premium to its historical average (5.7x). However, we believe it is set to enter the 'big league' of EPC players, leading to a significant rerating potential.

We value the company at 9x FY17 earnings, a 10% discount to the larger and more diversified player NCC (10x). We value its investments in BOT projects at 0.7x BV. Our price target of Rs 363 represents 21% upside from current levels. We initiate coverage with a BUY rating.

BUY

CMP RS 300

TARGET RS 363 (+21%)

COMPANY DATA

O/S SHARES (MN) :	28
MARKET CAP (RSBN) :	9
MARKET CAP (USDBN) :	0.1
52 - WK HI/LO (RS) :	334 / 69
LIQUIDITY 3M (USDMN) :	0.4
PAR VALUE (RS) :	10

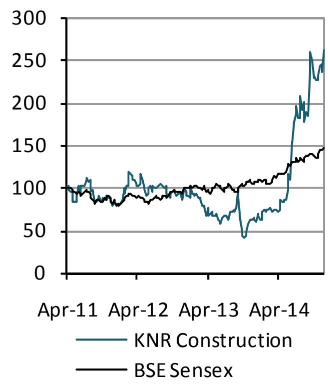
SHARE HOLDING PATTERN, %

PROMOTERS :	67.3
FII / NRI :	1.3
FI / MF :	17.2
NON PROMOTER CORP. HOLDINGS :	3.7
PUBLIC & OTHERS :	10.5

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	2.6	29.8	306.0
REL TO BSE	0.1	23.5	268.6

PRICE VS. SENSEX



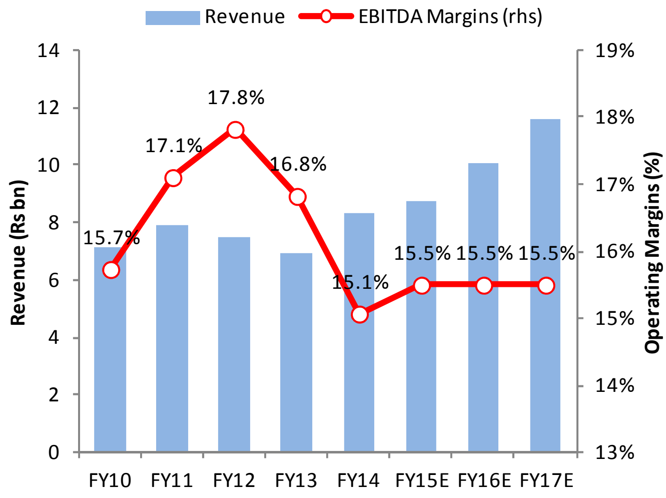
Source: Phillip Capital India Research

KEY FINANCIALS

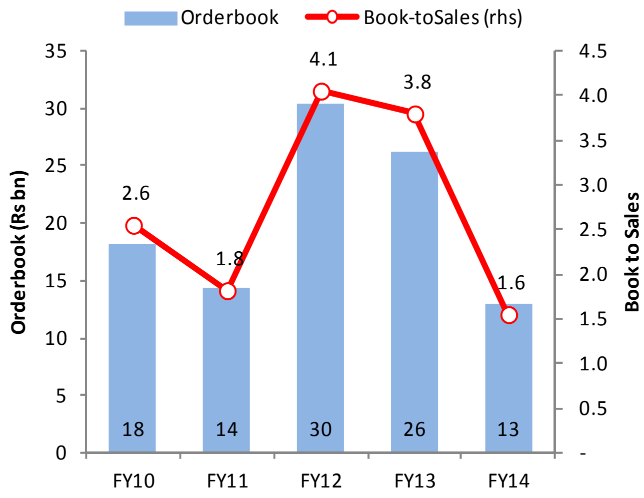
Rs mn	FY15E	FY16E	FY17E
Net Sales	8,765	10,080	11,592
EBIDTA	1,359	1,562	1,797
Net Profit	640	830	1,028
EPS, Rs	22.8	29.5	36.6
PER, x	13.2	10.2	8.2
EV/EBIDTA, x	6.3	5.1	4.1
P/BV, x	1.5	1.3	1.1
ROE, %	11.8	13.5	14.6
Debt/Equity (x)	0.1	0.1	0.0

Source: PhillipCapital India Research Est.

KNR has stable revenue and margin profile ...

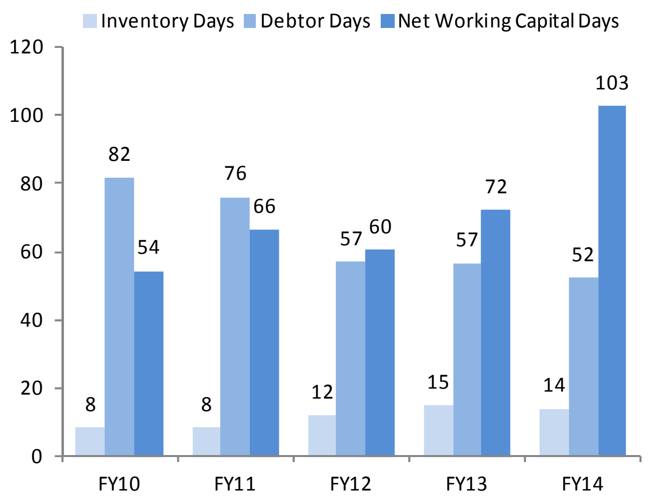


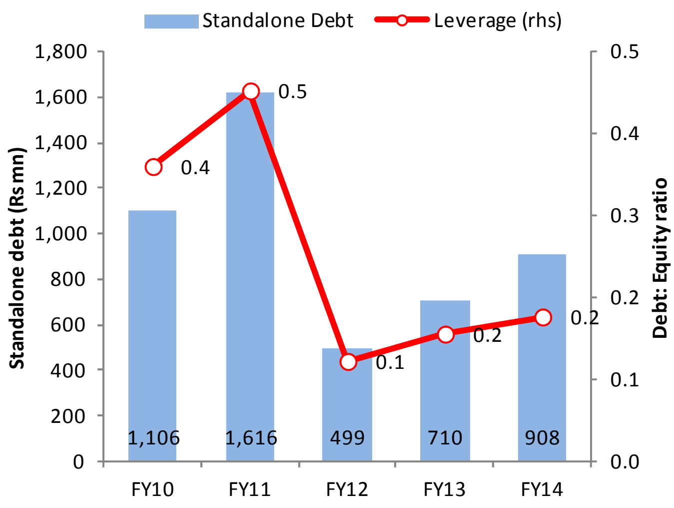
... but the current orderbook appears weak



Source: Company, PhillipCapital India Research

The company has one of the strongest balance sheets in the EPC space





Source: Company, PhillipCapital India Research

A relatively small BOT portfolio

Project	Length km	KNR Stake %	Type	CoD	Period	TPC Rs mn	Equity Rs mn	Grant Rs mn	Debt Rs mn	Current Debt Rs mn	KNR Equity Invested Rs mn	Annuity/ Toll Rs mn
Karnataka	60	40%	Annuity	Dec-09	20	4,429	1,129	-	3,300	3,527	452	329
AP	48	40%	Annuity	Jun-10	20	5,920	1,480	-	4,440	4,954	592	444
Kerala	54	100%	Toll	Nov-15	20	9,005	1,365	2,640	5,000	2,823	NA	378
Total	**162**					**19,354**	**3,974**			**11,303**	**1,044**	**1,151**

Source: Company, PhillipCapital India Research

SoTP Valuation

Business division	FY17 EPS Rs	Book Value Rs mn	Multiple	Valuation Rs mn	Per share Rs
EPC	36.6		9.0x	9,253	329.0
Kerala BOT Project		1,365	0.7x	956	34.0
Total Valuation				**10,208**	**363.0**

Source: PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY14	FY15e	FY16e	FY17e
Net sales	**8,348**	**8,765**	**10,080**	**11,592**
Growth, %	21	5	15	15
Total income	8,348	8,765	10,080	11,592
Employee expenses	-349	-367	-422	-485
Other Operating expenses	-3,834	-3,988	-4,586	-5,274
EBITDA (Core)	**1,258**	**1,359**	**1,562**	**1,797**
Growth, %	8.0	8.0	15.0	15.0
Margin, %	15.1	15.5	15.5	15.5
Depreciation	-572	-598	-632	-665
EBIT	**686**	**760**	**931**	**1,132**
Growth, %	12.8	10.9	22.4	21.6
Margin, %	8.2	8.7	9.2	9.8
Interest paid	-172	-145	-97	-65
Other Non-Operating Income	155	166	178	187
Pre-tax profit	**669**	**781**	**1,012**	**1,254**
Tax provided	-59	-141	-182	-226
Profit after tax	**610**	**640**	**830**	**1,028**
Net Profit	**610**	**640**	**830**	**1,028**
Growth, %	17.0	5.0	29.5	23.9
Net Profit (adjusted)	**610**	**640**	**830**	**1,028**
Unadj. shares (m)	28	28	28	28
Wtd avg shares (m)	28	28	28	28

Balance Sheet

Y/E Mar, Rs mn	FY14	FY15e	FY16e	FY17e
Cash & bank	112	574	978	1,452
Debtors	1,171	1,249	1,381	1,588
Inventory	341	384	414	476
Loans & advances	3,078	3,242	3,728	4,288
Total current assets	6,387	7,135	8,187	9,490
Investments	400	400	400	400
Gross fixed assets	5,252	5,552	5,852	6,152
Less: Depreciation	-2,615	-3,214	-3,845	-4,510
Add: Capital WIP	3	3	3	3
Net fixed assets	2,640	2,342	2,010	1,645
Total assets	**9,546**	**9,995**	**10,716**	**11,654**
Current liabilities	3,505	3,547	3,671	3,814
Total current liabilities	3,505	3,547	3,671	3,814
Non-current liabilities	908	708	508	308
Total liabilities	4,412	4,254	4,178	4,121
Paid-up capital	281	281	281	281
Reserves & surplus	4,852	5,460	6,256	7,252
Shareholders' equity	5,133	5,741	6,538	7,533
Total equity & liabilities	**9,546**	**9,995**	**10,716**	**11,654**

Source: Company, PhillipCapital India Research Estimates

Cash Flow

	FY14	FY15e	FY16e	FY17e
Pre-tax profit	669	781	1,012	1,254
Depreciation	572	598	632	665
Chg in working capital	-1,035	-244	-524	-686
Total tax paid	-141	-141	-182	-226
Cash flow from operating activities	**65**	**995**	**937**	**1,007**
Capital expenditure	-273	-300	-300	-300
Chg in investments	83	0	0	0
Cash flow from investing activities	**-190**	**-300**	**-300**	**-300**
Free cash flow	-124	695	637	707
Equity raised/(repaid)	15	0	0	0
Debt raised/(repaid)	197	-200	-200	-200
Dividend (incl. tax)	-33	-33	-33	-33
Cash flow from financing activities	**164**	**-233**	**-233**	**-233**
Net chg in cash	40	462	404	474

Valuation Ratios

	FY14	FY15e	FY16e	FY17e
Per Share data				
EPS (INR)	21.7	22.8	29.5	36.6
Growth, %	17.0	5.0	29.5	23.9
Book NAV/share (INR)	182.5	204.1	232.5	267.8
FDEPS (INR)	21.7	22.8	29.5	36.6
CEPS (INR)	42.0	44.0	52.0	60.2
CFPS (INR)	(3.2)	29.5	27.0	29.2
Return ratios				
Return on assets (%)	7.5	7.5	8.6	9.6
Return on equity (%)	12.6	11.8	13.5	14.6
Return on capital employed (%)	12.7	11.7	13.2	14.4
Turnover ratios				
Asset turnover (x)	1.7	1.6	1.8	2.0
Sales/Total assets (x)	0.9	0.9	1.0	1.0
Sales/Net FA (x)	3.0	3.5	4.6	6.3
Working capital/Sales (x)	0.3	0.3	0.4	0.4
Receivable days	51.2	52.0	50.0	50.0
Inventory days	14.9	16.0	15.0	15.0
Payable days	158.0	153.3	138.6	125.8
Working capital days	121.1	125.5	128.1	133.0
Liquidity ratios				
Current ratio (x)	1.8	2.0	2.2	2.5
Quick ratio (x)	1.7	1.9	2.1	2.4
Interest cover (x)	4.0	5.2	9.6	17.4
Total debt/Equity (x)	0.2	0.1	0.1	0.0
Net debt/Equity (x)	0.2	0.0	(0.1)	(0.2)
Valuation				
PER (x)	13.8	13.2	10.2	8.2
PEG (x) - y-o-y growth	0.8	2.6	0.3	0.3
Price/Book (x)	1.6	1.5	1.3	1.1
EV/Net sales (x)	1.1	1.0	0.8	0.6
EV/EBITDA (x)	7.3	6.3	5.1	4.1
EV/EBIT (x)	13.5	11.3	8.6	6.4

J Kumar Infraprojects (JKIP IN)

All set for the big leap …

INDIA | INFRASTRUCTURE | Initiating Coverage

2 December 2014

J Kumar Infraprojects Ltd (JKIL) has, for long, been known as a local Mumbai based EPC company, primarily working on urban infrastructure projects such as flyovers, over-bridges, and skywalks. It has worked on some marquee projects such as the Sion-Panvel highway, Andher—Burfiwala flyover, and projects for DMRC, and is known for its superior execution track record.

Strong orderbook: The company is all set to expand its wings now. It possesses a strong orderbook of Rs 41bn (including L1), a handsome 3x book-to-sales, which provides high revenue visibility. We expect it to be one of the biggest beneficiaries of the slew of large projects to be awarded in Mumbai (read detailed report ***here***). Apart from Maharashtra, it has also expanded its geographic presence to Gujarat, Rajasthan, and Delhi.

Entry into MRTS segment: It has also entered into the highly lucrative MRTS segment. It is currently working on Rs 15.8bn orders from DMRC and is one of the nine consortiums shortlisted for the prestigious Rs 230bn Mumbai Metro Phase-3 project. It has recently bought four tunnel-boring machines in anticipation of a surge in orders as more cities are expected to join the MRTS bandwagon. We expect it to benefit from its early entry and preparedness for orders from this relatively new segment.

Backward integration: JKIL's margins are higher (around 17%) to its contemporaries such as NCC, IVRCL and Gammon, primarily due to backward integration. The fact that it owns a host of quarries and RMC plants (15) across the country leads to benefit in term of cost of raw materials. Its own fleet of equipment (excavators, tippers, pavers, and cranes) ensures minimum lease rental costs. Zero subcontracting and strong focus on timely execution ensures minimum time and cost overruns.

Its revenues saw a robust CAGR of 12% over FY10-14, inspite of slowdown in order awards. Its current strong orderbook is expected to translate into even stronger topline growth over FY14-17 (revenue CAGR at 26%). JKIL possesses one of the leanest balance sheets in the infrastructure sector with D/E at 0.5x (after its recent rights issue). Its debtor days, at 38, are also one of the lowest in the industry.

Outlook and valuation: We expect the surge of order awards in urban infrastructure (roads, flyovers, and MRTS) to catapult JKIL into being one of the leading EPC players in the next three years. Its strong balance sheet and superior margin profile should translate into robust earnings growth, and superior returns to its investors.

JKIL's stock has surged 143% in the last twelve months and it currently trades at 10x FY16 and 7.5x FY17 earnings, a significant premium to its historical average (6.1x). However, we see major rerating potential, even from current levels. We value the company at 9x FY17 earnings, a 10% discount to the larger and more-diversified player NCC (10x). Our price target of Rs 525 represents 19% upside from current levels. We initiate with a BUY rating.

BUY

CMP RS 437

TARGET RS 525 (+20%)

COMPANY DATA

O/S SHARES (MN) :	32
MARKET CAP (RSBN) :	14
MARKET CAP (USDBN) :	0.2
52 - WK HI/LO (RS) :	440 / 156
LIQUIDITY 3M (USDMN) :	0.3
PAR VALUE (RS) :	10

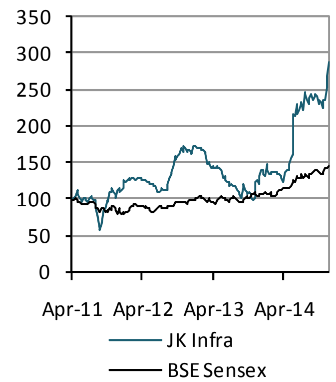
SHARE HOLDING PATTERN, %

PROMOTERS :	51.0
FII / NRI :	18.1
FI / MF :	10.4
NON PROMOTER CORP. HOLDINGS :	13.8
PUBLIC & OTHERS :	6.8

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	36.2	34.7	142.5
REL TO BSE	33.8	28.4	105.2

PRICE VS. SENSEX



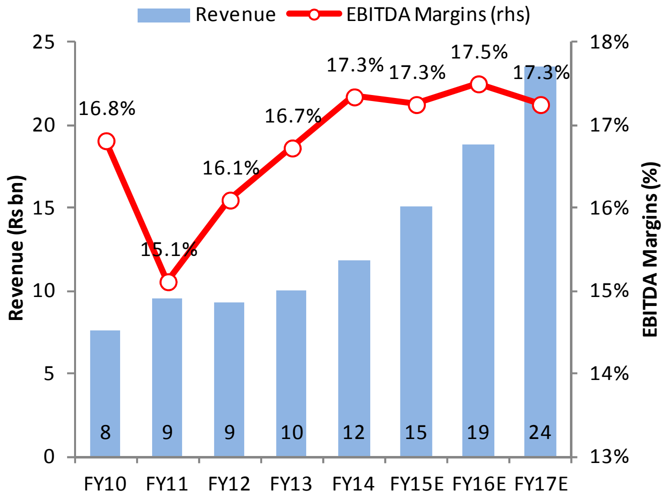
Source: Phillip Capital India Research

KEY FINANCIALS

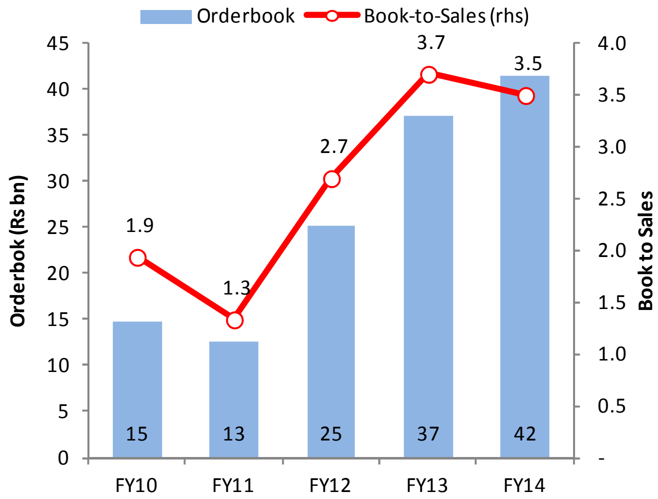
Rs mn	FY15E	FY16E	FY17E
Net Sales	15,072	18,840	23,550
EBIDTA	2,600	3,297	4,062
Net Profit	1,026	1,406	1,881
EPS, Rs	31.8	43.6	58.4
PER, x	13.8	10.1	7.5
EV/EBIDTA, x	6.8	5.4	4.4
P/BV, x	1.8	1.5	1.3
ROE, %	14.9	16.4	18.8
Debt/Equity (x)	0.6	0.6	0.5

Source: PhillipCapital India Research Est.

JKIL has reported a robust revenue growth and margin profile ...



... and has a strong orderbok to take it forward



Source: Company, PhillipCapital India Research

Planned Metro projects – huge opportunity for JKIL

	Phase	Planned length (2014-19) (km)	Cost (Rs bn)
Chennai Metro	Phase II	63.0	360.0
Bengaluru Metro	Phase II	72.1	264.0
Jaipur Metro	Phase II	23.1	65.8
Mumbai Metro	Phase III	33.5	244.0
Pune Metro	Phase I	31.5	101.8
Kochi Metro	Phase II	-	15.0
Ludhiana Metro	-	28.8	103.0
Chandigarh Metro	-	37.6	109.0
Lucknow Metro	-	22.9	70.0
Nagpur Metro	-	42.0	80.0
Bhopal Metro	-	28.0	60.0
Indore Metro	-	32.2	75.0
Total		**414.6**	**1,547.6**

Source: PhillipCapital India Research

Shortlisted bidders for Mumbai Metro phase III

Domestic Company	Foreign Partner
AFCONS Infrastructure Ltd	Kyivmetrobud
ITD Cementation -Tata Projects	Continental Engineering Corporation
SOMA	DOGUS
IL&FS Engineering and Construction	China Railway 25th Bureau Group
J Kumar Infraprojects	China Railway & Engineering Group
Larsen & Toubro	Shanghai Tunnel Engineering
Hindustan Construction Company	OSJC Moscow Metrostroy
Pratibha Industries	Guandong Tuantian Engineering
Unity Infraprojects-IVRCL	China Railway Tunnel Group

Key projects executed by the company

Project	City/State	Sector	Order Size (Rs mn)
Public Water transport platforms for 1) Nariman Point to Bandra 2) Dadar to Nerul	Mumbai	Transport	6,780
Phase II BRTS Corridor	Ahmedabad	Transport	1,160
Design & Construction of Amar Mahal flyover	Mumbai	Transport	729
Design & Construction of viaducts, tunnels and elevated stations for Delhi Metro Rail Corporation	Delhi	Transport	15,862
Widening & Improvement to Sion-Panvel Highway	Mumbai	Transport	6,000
Construction of barrage - Lower Wardha Mail Canal	Maharashtra	Irrigation	926
Building for UP Rajkiya Nirman Nigam Ltd	Rajasthan	Buildings	5,773

Source: Company, PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY14	FY15e	FY16e	FY17e
Net sales	**11,868**	**15,072**	**18,840**	**23,550**
Growth, %	19	27	25	25
Total income	11,868	15,072	18,840	23,550
Employee expenses	-773	-982	-1,227	-1,534
Other Operating expenses	-2,216	-1,319	-1,602	-2,061
EBITDA (Core)	**2,058**	**2,600**	**3,297**	**4,062**
Growth, %	23.0	26.3	26.8	23.2
Margin, %	17.3	17.3	17.5	17.3
Depreciation	-348	-487	-579	-625
EBIT	**1,711**	**2,113**	**2,718**	**3,437**
Growth, %	19.7	23.5	28.6	26.5
Margin, %	14.4	14.0	14.4	14.6
Interest paid	-576	-671	-710	-710
Other Non-Operating Income	108	112	123	123
Pre-tax profit	**1,242**	**1,555**	**2,131**	**2,850**
Tax provided	-402	-529	-725	-969
Profit after tax	**841**	**1,026**	**1,406**	**1,881**
Net Profit	**841**	**1,026**	**1,406**	**1,881**
Growth, %	11.0	22.1	37.1	33.8
Net Profit (adjusted)	**841**	**1,026**	**1,406**	**1,881**
Unadj. shares (m)	28	32	32	32
Wtd avg shares (m)	28	32	32	32

Balance Sheet

Y/E Mar, Rs mn	FY14	FY15e	FY16e	FY17e
Cash & bank	1,212	1,640	1,464	1,182
Debtors	1,320	1,652	2,065	2,581
Inventory	5,658	6,607	7,743	9,356
Loans & advances	1,420	1,858	2,323	2,903
Total current assets	11,500	13,647	15,484	17,912
Investments	23	23	23	23
Gross fixed assets	4,523	6,023	6,523	7,023
Less: Depreciation	-1,268	-1,754	-2,333	-2,959
Add: Capital WIP	1,752	752	752	752
Net fixed assets	5,007	5,021	4,942	4,817
Total assets	**16,531**	**18,690**	**20,448**	**22,751**
Current liabilities	5,136	5,548	6,105	6,802
Total current liabilities	5,136	5,548	6,105	6,802
Non-current liabilities	5,642	5,142	5,142	5,142
Total liabilities	10,778	10,690	11,247	11,944
Paid-up capital	278	322	322	322
Reserves & surplus	5,475	7,678	8,879	10,485
Shareholders' equity	5,753	8,001	9,201	10,807
Total equity & liabilities	**16,531**	**18,690**	**20,448**	**22,751**

Source: Company, PhillipCapital India Research Estimates

Cash Flow

	FY14	FY15e	FY16e	FY17e
Pre-tax profit	1,242	1,555	2,131	2,850
Depreciation	348	487	579	625
Chg in working capital	-1,924	-1,307	-1,456	-2,013
Total tax paid	-383	-529	-725	-969
Cash flow from operating activities	**-717**	**206**	**530**	**493**
Capital expenditure	-2,254	-500	-500	-500
Chg in investments	-22	0	0	0
Cash flow from investing activities	**-2,276**	**-500**	**-500**	**-500**
Free cash flow	-2,992	-294	30	-7
Equity raised/(repaid)	84	1,372	0	0
Debt raised/(repaid)	3,208	-500	0	0
Dividend (incl. tax)	-122	-150	-206	-275
Cash flow from financing activities	**3,086**	**722**	**-206**	**-275**
Net chg in cash	94	428	-176	-282

Valuation Ratios

	FY14	FY15e	FY16e	FY17e
Per Share data				
EPS (INR)	30.2	31.8	43.6	58.4
Growth, %	11.0	5.3	37.1	33.8
Book NAV/share (INR)	206.9	248.3	285.5	335.4
FDEPS (INR)	30.2	31.8	43.6	58.4
CEPS (INR)	42.7	46.9	61.6	77.8
CFPS (INR)	(29.7)	2.9	12.6	11.5
Return ratios				
Return on assets (%)	8.6	8.3	9.5	10.8
Return on equity (%)	15.6	14.9	16.4	18.8
Return on capital employed (%)	12.8	11.9	13.5	15.4
Turnover ratios				
Asset turnover (x)	1.4	1.4	1.5	1.7
Sales/Total assets (x)	0.8	0.9	1.0	1.1
Sales/Net FA (x)	2.9	3.0	3.8	4.8
Working capital/Sales (x)	0.4	0.4	0.4	0.4
Receivable days	40.6	40.0	40.0	40.0
Inventory days	174.0	160.0	150.0	145.0
Payable days	184.7	157.3	139.3	124.2
Working capital days	158.5	156.4	153.3	153.9
Liquidity ratios				
Current ratio (x)	2.2	2.5	2.5	2.6
Quick ratio (x)	1.1	1.3	1.3	1.3
Interest cover (x)	3.0	3.2	3.8	4.8
Total debt/Equity (x)	1.0	0.6	0.6	0.5
Net debt/Equity (x)	0.8	0.4	0.4	0.4
Valuation				
PER (x)	14.6	13.8	10.1	7.5
PEG (x) - y-o-y growth	1.3	2.6	0.3	0.2
Price/Book (x)	2.1	1.8	1.5	1.3
EV/Net sales (x)	1.4	1.2	0.9	0.8
EV/EBITDA (x)	8.1	6.8	5.4	4.4
EV/EBIT (x)	9.7	8.3	6.5	5.3

HCC (HCC IN)

If only it was so easy …

INDIA | INFRASTRUCTURE | Company Update

2 December 2014

HCC now appears a grim shadow of what it once was — a leading EPC company with a high pedigree and great technical capability. Cashless growth and huge investment into subsidiaries (real estate, BOT) led to a ballooning of its working capital and debt profile over FY10-14, resulting into the company entering CDR in June 2013.

HCC has one of the most stretched balance sheets in the construction space (excluding the asset owners). Its standalone debt is Rs 49bn (3.6x D/E) and consolidated is Rs 114bn (15.1x D/E). It has reported losses for the last 13 successive quarters from 2QFY12 (on an adjusted basis) and looks unlikely to break the vicious cycle with interest coverage of less than 1x (adjusted for one-time provisions).

It has a decent sized orderbook (Rs 136bn, 3.4x book-to-sales), which is well diversified across segments and geographies. However, extremely high debtor days (146 days) and a long working-capital cycle (393 days) will restrict its revenue growth potential, in our opinion.

HCC's investments in subsidiaries remain stuck due to various reasons. Lavasa has failed to attract customer and investors interest, even after the MoEF clearance. Its operational BOT road projects are doing well, but its three West-Bengal projects are delayed due to land-acquisition issues. And lastly, while losses in its Swiss subsidiary, Karl Stiener AG, have reduced considerably over the last few quarters, the overall macro-environment and real estate market in Europe remains weak, thus limiting its value potential.

HCC's management has been showcasing a three-pronged strategy, through which it intends to come out of CDR in the next two years (for which it needs to repay Rs 20bn of debt). The management intends to raise 1) Rs7.5bn through QIP, 2) Rs7-10bn from payments stuck with various government bodies, 3) Rs5bn through divestment of various assets, including its BOT road assets. As a long term strategy, the management claims it will recover Rs 17bn of stuck receivables from various government bodies over the next two years.

Outlook: We remain sceptical of its ability to achieve any of its planned strategies. We see limited investor interest for a QIP, especially as the stock has run up 150% in the last one year, without any change in fundamentals. In any case, Lavasa's IPO will be a prerequisite for any successful HCC QIP, for which we see limited investor interest and valuation potential.

More importantly, if it were so easy to get payments cleared from government bodies, the entire EPC sector would not have been in such a mess today. Even if we assume that the new government expedites the payments of dues over the next few quarters (in an attempt to revive the investment cycle), HCC will not be the only beneficiary. Companies such as NCC, which better financials, will benefit more and will be able to convert the proceeds into superior growth vs. HCC, which still has a substantial debt burden to take care of.

Also, large number of BOT projects with various developers, are currently on the block, and very few deals are being closed. Presence of Xander group (14.5% stake), as a private equity investor in HCC's portfolio, also inhibits investors looking to acquire majority stake. The company has seen muted interest in its 24x7 Corporate Park (real estate) and has failed to close two deals in last twelve months. Thus we remain sceptical of any material benefit arising of the company's asset monetization strategy too.

Overall, we remain negative on the company, and expect it to lose out to stronger competitors such as L&T, NCC, J Kumar, and KNR, in capitalising the huge impending opportunity in the EPC space over the next three years.

Not Rated

CMP RS 30

COMPANY DATA

O/S SHARES (MN) :	646
MARKET CAP (RSBN) :	20
MARKET CAP (USDBN) :	0.3
52 - WK HI/LO (RS) :	49 / 11
LIQUIDITY 3M (USDMN) :	1.4
PAR VALUE (RS) :	1

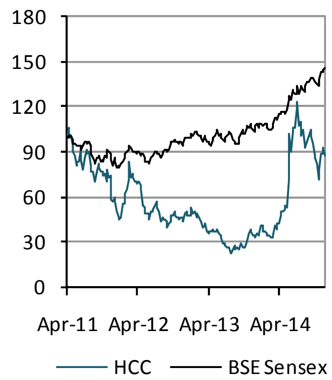
SHARE HOLDING PATTERN, %

PROMOTERS :	43.5
FII / NRI :	12.5
FI / MF :	3.6
NON PROMOTER CORP. HOLDINGS :	11.4
PUBLIC & OTHERS :	29.1

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	-9.2	-22.2	140.2
REL TO BSE	-11.7	-28.4	102.8

PRICE VS. SENSEX



Source: Phillip Capital India Research

KEY FINANCIALS

Rs mn	FY12	FY13	FY14
Net Sales	39,915	38,371	40,395
EBIDTA	2,767	3,834	6,407
Net Profit	-2,223	-1,532	806
EPS, Rs	(3.7)	(2.5)	1.3
PER, x	(8.2)	(11.9)	22.6
EV/EBIDTA, x	22.1	16.6	10.1
P/BV, x	1.4	1.6	1.4
ROE, %	(15.8)	(12.5)	6.6
Debt/Equity (x)	3.4	4.0	3.8

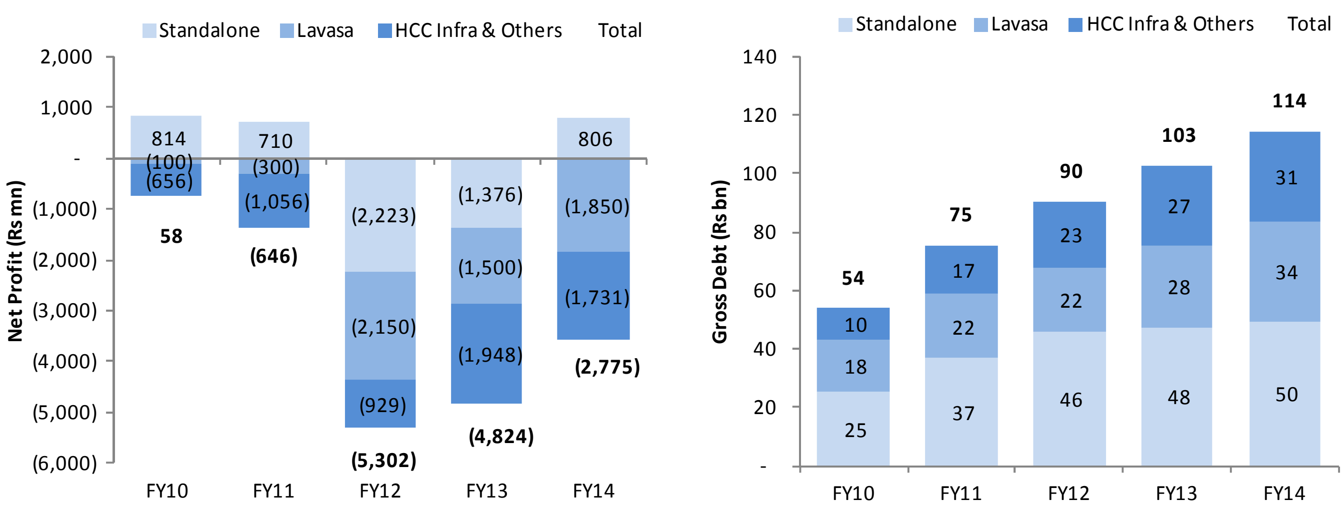
Source: PhillipCapital India Research Est.

HCC's capital raising strategy to come out of the CDR

Event	Funds to be raised (Rs mn)	Timeline	Our comment
Lavasa IPO	7,500	1HCY15	Little Interest in the project; Necessary for a successful HCC QIP; Will only reduce debt at Lavasa level
HCC QIP	7,500	CY15	Without much change in fundamentals or Lavasa IPO, we see limited interest
Stuck payments from govt bodies	17,000	Next two years	Highly unlikely - govt rarely clears payments without arbitration; the claimed amount anyways bloated with interest and other charges; no cash recovery till date; revenues booked only added up in receivables accounts
Asset monetization			
BOT Projects			Competition from large no of projects with other developers on the block; presence of Xander group will be a hindrance
Real Estate	5,000	CY15	Muted interest in 24x7 Park; two deals in late stages have been cancelled over last four quarters

Source: Company, PhillipCapital India Research

The last four years have seen declining group profitability, on the back of deteriorating debt profile



Source: Company, PhillipCapital India Research

HCC's road BOT portfolio

Road Projects	Badarpur elevated	Nirmal	Dhule	Bahrampur - Farraka	Farraka - Raiganj	Raiganj - Dalkhola	Total
Length of Road (km)	4	33	89	103	103	50	**382**
Project cost (Rs mn)	**5,720**	**3,150**	**14,200**	**11,690**	**13,780**	**6,840**	**55,380**
Grant (Rs mn)	-	-	-		10,335		
Project equity (Rs mn)	1,716	630	3,550		6,009		**11,905**
Debt (Rs Mn)	4,004	2,520	10,650		15,961		**33,135**
HCC stake (%)	100	100	60		100		
HCC equity share	1,716	630	2,130		6,009		**10,485**
COD	Jan-11	Jun-09	Oct-11	Jun-14	Q3FY15	Land WIP	
CP (years)	20	20	18	25	30	30	
Concession	Toll	Annuity	Toll	Toll	Toll	Toll	
FY14 Toll/Annuity (Rs mn)	416	518	1,127				

Source: Company, PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY11	FY12	FY13	FY14
Net sales	**40,932**	**39,915**	**38,371**	**40,395**
Growth, %	12	-2	-4	5
Total income	40,932	39,915	38,371	40,395
Employee expenses	-4,676	-4,392	-4,020	-3,885
Other Operating expenses	-35,534	-21,859	-17,610	-19,834
EBITDA (Core)	**5,398**	**2,767**	**3,834**	**6,407**
Growth, %	21.9	(48.7)	38.5	67.1
Margin, %	13.2	6.9	10.0	15.9
Depreciation	-1,527	-1,621	-1,634	-1,446
EBIT	**3,871**	**1,146**	**2,200**	**4,961**
Growth, %	17.7	(70.4)	91.9	125.5
Margin, %	9.5	2.9	5.7	12.3
Interest paid	-2,899	-5,431	-5,297	-6,079
Other Non-Operating Income	145	1,101	1,005	2,028
Pre-tax profit	**1,117**	**-3,185**	**-1,936**	**910**
Tax provided	-407	962	559	-103
Profit after tax	**710**	**-2,223**	**-1,377**	**806**
Net Profit	**710**	**-2,223**	**-1,377**	**806**
Growth, %	(12.8)	(413.0)	(31.1)	(152.6)
Net Profit (adjusted)	**710**	**(2,223)**	**(1,532)**	**806**
Unadj. shares (m)	607	607	607	607
Wtd avg shares (m)	607	607	607	607

Balance Sheet

Y/E Mar, Rs mn	FY11	FY12	FY13	FY14
Cash & bank	1,937	1,600	991	1,470
Debtors	27	12,028	12,358	16,143
Inventory	44,991	37,554	36,722	32,936
Loans & advances	13,948	19,243	18,878	19,243
Total current assets	60,960	70,793	69,052	69,856
Investments	5,313	5,847	6,012	6,900
Gross fixed assets	19,875	20,562	20,629	20,258
Less: Depreciation	-8,032	-9,318	-10,525	-11,104
Add: Capital WIP	257	258	123	50
Net fixed assets	12,100	11,502	10,227	9,204
Total assets	**78,373**	**88,143**	**85,291**	**85,959**
Current liabilities	26,772	29,924	27,240	24,917
Total current liabilities	26,772	29,924	27,240	24,917
Non-current liabilities	36,379	45,271	46,423	48,407
Total liabilities	63,151	75,195	73,663	73,325
Paid-up capital	607	607	607	767
Reserves & surplus	14,615	12,341	11,021	11,867
Shareholders' equity	15,222	12,949	11,628	12,634
Total equity & liabilities	**78,373**	**88,143**	**85,291**	**85,959**

Source: Company, PhillipCapital India Research Estimates

Cash Flow

	FY11	FY12	FY13	FY14
Pre-tax profit	1,117	-3,185	-1,936	910
Depreciation	1,527	1,621	1,634	1,446
Chg in working capital	-8,321	-7,019	-1,550	-2,648
Total tax paid	-168	0	0	-9
Cash flow from operating activities	**-5,846**	**-8,582**	**-1,852**	**-302**
Capital expenditure	-1,781	-1,024	-358	-423
Chg in investments	-1,226	-534	-165	-887
Cash flow from investing activities	**-3,007**	**-1,558**	**-523**	**-1,311**
Free cash flow	-8,854	-10,140	-2,376	-1,612
Equity raised/(repaid)	-232	-55	55	200
Debt raised/(repaid)	9,567	9,855	1,711	1,891
Dividend (incl. tax)	-284	0	0	0
Cash flow from financing activities	**8,907**	**9,804**	**1,766**	**2,090**
Net chg in cash	53	-336	-609	478

Valuation Ratios

	FY11	FY12	FY13	FY14
Per Share data				
EPS (INR)	1.2	(3.7)	(2.5)	1.3
Growth, %	(12.8)	(413.0)	(31.1)	(152.6)
Book NAV/share (INR)	25.1	21.3	19.2	20.8
FDEPS (INR)	1.2	(3.7)	(2.5)	1.3
CEPS (INR)	3.7	(1.0)	(0.1)	3.7
CFPS (INR)	(9.9)	(16.0)	(4.7)	(3.8)
Return ratios				
Return on assets (%)	3.6	1.5	2.3	5.5
Return on equity (%)	4.7	(15.8)	(12.5)	6.6
Return on capital employed (%)	5.5	2.3	3.5	7.9
Turnover ratios				
Asset turnover (x)	1.0	0.8	0.8	0.8
Sales/Total assets (x)	0.6	0.5	0.4	0.5
Sales/Net FA (x)	3.4	3.4	3.5	4.2
Working capital/Sales (x)	0.8	1.0	1.1	1.1
Receivable days	0.2	110.0	117.5	145.9
Inventory days	401.2	343.4	349.3	297.6
Payable days	267.8	287.8	283.1	263.0
Working capital days	287.6	359.1	388.3	392.8
Liquidity ratios				
Current ratio (x)	2.3	2.4	2.5	2.8
Quick ratio (x)	0.6	1.1	1.2	1.5
Interest cover (x)	1.3	0.2	0.4	0.8
Total debt/Equity (x)	2.3	3.4	4.0	3.8
Net debt/Equity (x)	2.2	3.3	3.9	3.7
Valuation				
PER (x)	25.6	(8.2)	(11.9)	22.6
PEG (x) - y-o-y growth	(2.0)	0.0	0.4	(0.1)
Price/Book (x)	1.2	1.4	1.6	1.4
EV/Net sales (x)	1.2	1.5	1.7	1.6
EV/EBITDA (x)	9.4	22.1	16.6	10.1
EV/EBIT (x)	13.2	53.4	28.9	13.1

IVRCL Ltd (IVRC IN)

Struggling in the quagmire…

INDIA | INFRASTRUCTURE | Company Update

2 December 2014

It sounds quite difficult to believe. IVRCL, which was not so long ago, one of the most admired and fastest growing company in the EPC space — suffered its tenth successive quarterly loss and is now a part of CDR. Until four years ago, it was riding on the wave of irrigation orders from AP, road orders from NHAI, formidable presence in other verticals, and operations even outside India (Sri Lanka, Dubai, Singapore).

However, much has changed since then. Its slackness in working capital management, reckless investments into real estate and BOT subsidiaries, and high interest rates pushed IVRCL into a vortex of debt-interest-cashflow. At FY14, debt at standalone level stood at Rs35.4bn (consolidated debt of Rs80.4bn). It entered the CDR programme in Jan-2014.

Its topline has shrunk to Rs43bn (in FY14) from Rs55bn (in FY10) due to longer working-capital cycle and inadequate liquidity. Its margins have been highly volatile because of cost-and-time overruns and write-offs. Earnings have literally disappeared. Over the same time, its balance sheet has deteriorated with D/E at 2.4x and a working-capital cycle of 210 days.

IVRCL's fall was more of its own making than due to the deteriorating macro environment. Over FY07-14, it put in Rs24bn as investments and loans into its real estate and BOT subsidiaries. Its lack of clarity was evident when it initially de-merged and subsequently merged these subsidiaries with the parent — all within three years.

In its focus on growing its orderbook, it neglected quality. As late as FY11, a large part of its orderbook comprised of irrigation orders from AP, which were stuck for over twelve months. It acquired real estate and bid aggressively for BOT road projects (even at single-digit IRRs) to ensure its orderbook grew at a healthy rate. As a result, it is today stuck with land parcels and BOT projects, which few investors are willing to buy, even below book value.

IVRCL, in April 2013, had entered into a definitive agreement with Tata Realty and Infrastructure Ltd (TRIL) to sell its stake in 3 contiguous road projects in TamilNadu (Salem-Kumarapalyanm, Kumaraplayam-Chengapalli and Chengapalli-Walayar). The stake sale was expected to fetch the company Rs3-5bn, which could have been utilized to partly deleverage the balance sheet. However, since the last project (Chengapalli–Walayar) was under construction, IVRCL was not allowed to sell its stake, as per the exit policy. Thereafter, failure to complete project (due to fund constraints) and obtain the NOC from the lending consortiums has put the deal on hold.

IVRCL's current situation is worse than HCC and Gammon, who do not have to invest much equity into their subsidiaries (in fact, both are trying to raise cash through asset divestment). Most of HCC and Gammon's projects are already operational, or the entities are separately listed (or planning to, such as Lavasa), implying that the parent company will not be investing any more equity into them. IVRCL still has to invest ~Rs5bn equity into its under-construction BOT projects.

Outlook: We believe IVRCL, which was one of the biggest beneficiaries of the infrastructure boom in 2007-10, will be relegated to an 'also ran' player in this up-cycle. It does not have the financial wherewithal to bid for new projects, nor has it developed enough capabilities to execute projects in relatively new domains like MRTS.

Not Rated

CMP RS 17

COMPANY DATA

O/S SHARES (MN) :	307
MARKET CAP (RSBN) :	5
MARKET CAP (USDBN) :	0.1
52 - WK HI/LO (RS) :	31 / 10
LIQUIDITY 3M (USDMN) :	0.6
PAR VALUE (RS) :	2

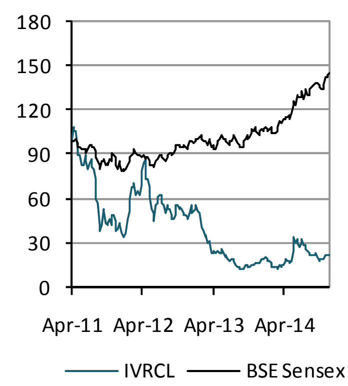
SHARE HOLDING PATTERN, %

PROMOTERS :	13.7
FII / NRI :	12.4
FI / MF :	2.1
NON PROMOTER CORP. HOLDINGS :	24.2
PUBLIC & OTHERS :	47.7

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	-12.5	-11.3	17.9
REL TO BSE	-15.0	-17.6	-19.5

PRICE VS. SENSEX



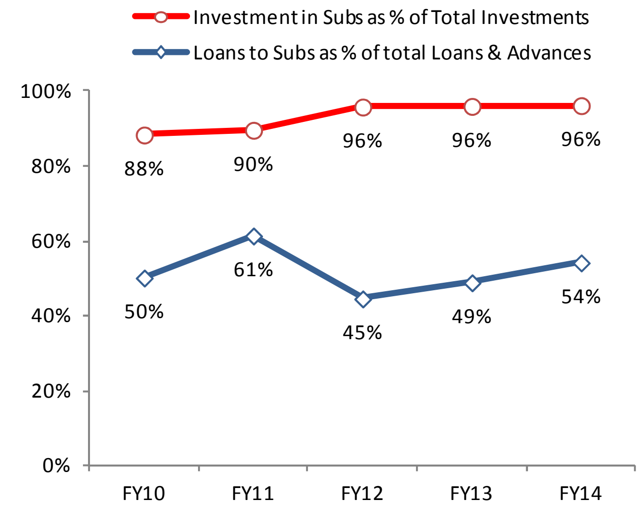
Source: Phillip Capital India Research

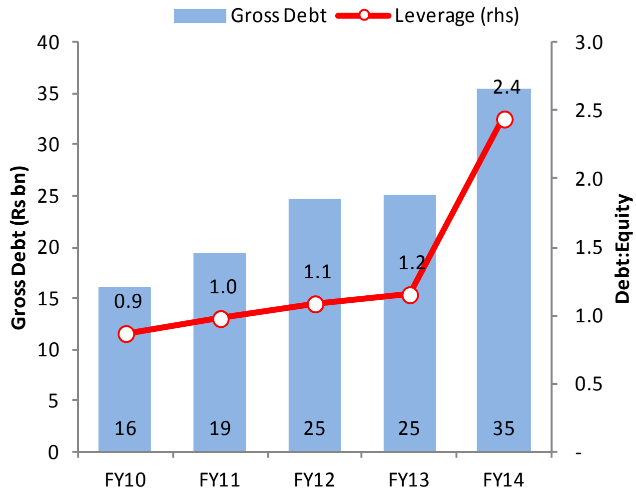
KEY FINANCIALS

Rs mn	FY12	FY13	FY14
Net Sales	61,780	37,591	43,048
EBIDTA	5,012	2,723	1,595
Net Profit	181	-1,017	-7,168
EPS, Rs	0.6	(3.3)	(23.4)
PER, x	28.8	(5.1)	(0.7)
EV/EBIDTA, x	5.8	10.8	24.7
P/BV, x	0.2	0.2	0.4
ROE, %	0.8	(4.6)	(39.6)
Debt/Equity (x)	1.1	1.2	2.4

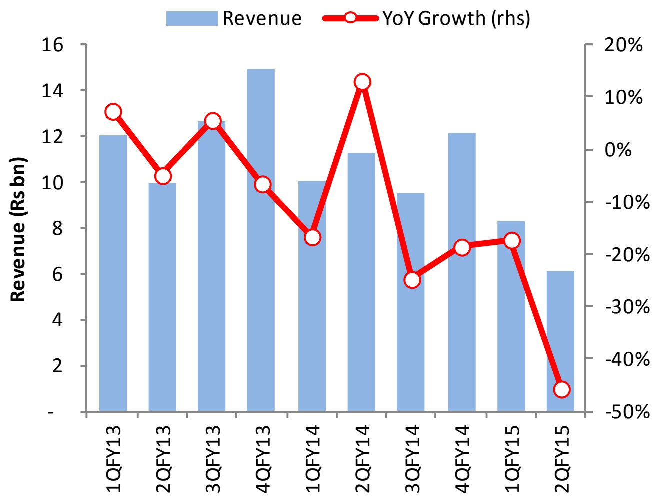
Source: PhillipCapital India Research Est.

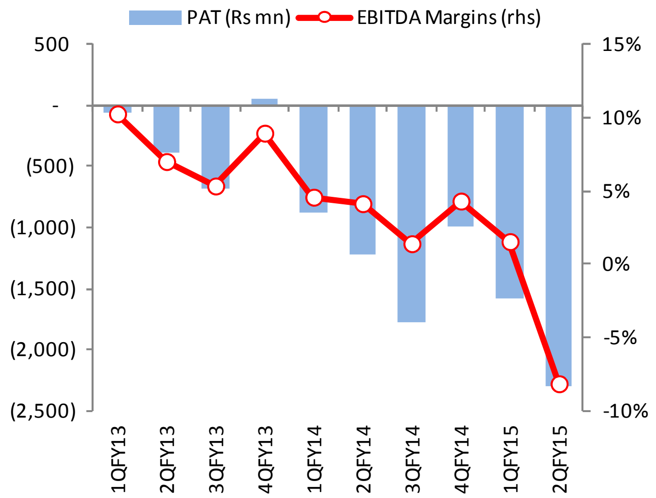
As a result of continuous investments into subsidiaries, IVRCL's debt profile deteriorated over the last five years





Last ten quarters have seen revenue decline on YoY basis, with lower margins and higher losses





A relatively large BOT portfolio, which might be difficult to monetize

	Length (km)	Client	Concession period	Project Cost (Rs mn)	Project Equity (Rs mn)	Debt (Rs mn)	Grant (Rs mn)	Stake (%)	Expected COD
Road projects									
Salem-Kumarapalyanm*	53.0	NHAI	20.0	6,393	1,782	3,321	1,290	100.0	Jun-10
Kumaraplayam-Chengapalli*	47.0	NHAI	20.0	4,432	834	3,423	175	100.0	Aug-09
Chengapalli – Walayar*	54.8	NHAI	27.0	11,230	3,260	7,970	-	100.0	WIP
Jalandhar-Amritsar	48.5	NHAI	20.0	4,102	1,012	2,696	395	100.0	Apr-10
Baramati - Phaltan	77.9	MSRDC	25.0	3,821	690	1,911	1,220	75.0	Sep-12
Indore-Ahemdabad	155.0	NHAI	25.0	15,237	3,809	11,428	-	100.0	WIP
Chandrapur	85.0	MSRDC	30.0	7,500	2,180	3,000	2,320	100.0	WIP
Total Roads				**52,715**	**13,567**	**33,748**	**5,400**		
Other projects									
Chennai Water Desalination	100 MLD	Chennai Metro	25.0	5,575	1,730	3,845		75.0	Jul-10
First STP Sewage treatment	24 MLD	Alandur Municiplty	14.0	56	30	26		95.0	Dec-02
IOTL Oil Tankage	11 tanks	IOCL	15.0	29,410	5,882	23,528		37.5	Nov-13
Patalganda Truck terminal	450 trucks	MIDC	95.0	300	91	209		100.0	NA
Total				**88,056**	**21,300**	**61,356**			

Source: Company, PhillipCapital India Research *(*Agreement signed with TRIL for divestment)*

Financials

Income Statement

Y/E Mar, Rs mn	FY11	FY12*	FY13*	FY14
Net sales	**56,515**	**61,780**	**37,591**	**43,048**
Growth, %	3	9	-39	15
Total income	56,515	61,780	37,591	43,048
Employee expenses	-2,623	-3,233	-1,774	-2,105
Other Operating expenses	-51,369	-32,779	-22,560	-29,141
EBITDA (Core)	**5,146**	**5,012**	**2,723**	**1,595**
Growth, %	(3.1)	(2.6)	(45.7)	(41.4)
Margin, %	9.1	8.1	7.2	3.7
Depreciation	-758	-1,189	-640	-880
EBIT	**4,388**	**3,822**	**2,084**	**716**
Growth, %	(8.0)	(12.9)	(45.5)	(65.7)
Margin, %	7.8	6.2	5.5	1.7
Interest paid	-2,182	-5,055	-3,479	-5,847
Other Non-Operating Income	120	1,696	704	452
Pre-tax profit	**2,326**	**462**	**-691**	**-6,971**
Tax provided	-747	-282	-325	-197
Profit after tax	**1,579**	**181**	**-1,017**	**-7,168**
Net Profit	**1,579**	**181**	**-1,017**	**-7,168**
Growth, %	(25.3)	(88.6)	(662.3)	605.1
Net Profit (adjusted)	**1,579**	**181**	**(1,017)**	**(7,168)**
Unadj. shares (m)	267	307	307	307
Wtd avg shares (m)	267	307	307	307

Balance Sheet

Y/E Mar, Rs mn	FY11	FY12*	FY13*	FY14
Cash & bank	1,349	885	924	1,243
Debtors	23,037	19,259	18,667	17,153
Inventory	2,732	2,723	2,687	2,000
Loans & advances	12,098	14,255	15,998	13,513
Total current assets	54,757	55,687	61,264	60,095
Investments	6,347	15,843	16,535	17,408
Gross fixed assets	9,242	10,114	10,327	10,190
Less: Depreciation	-2,324	-3,215	-3,744	-4,409
Add: Capital WIP	26	15	5	0
Net fixed assets	6,944	6,914	6,588	5,781
Total assets	**68,048**	**78,833**	**84,695**	**83,590**
Current liabilities	28,616	31,429	37,955	33,687
Total current liabilities	28,616	31,429	37,955	33,687
Non-current liabilities	19,559	24,700	25,047	35,400
Total liabilities	48,175	56,128	63,003	69,087
Paid-up capital	534	614	614	614
Reserves & surplus	19,340	22,091	21,078	13,889
Shareholders' equity	19,874	22,705	21,692	14,503
Total equity & liabilities	**68,048**	**78,833**	**84,695**	**83,590**

Source: Company, PhillipCapital India Research Estimates

(The company had changed its financial year in FY12 to end in June-2012 and then again in FY13 to end in March-2013. Hence FY12 had fifteen months of reporting while FY13 had nine).*

Cash Flow

	FY11	FY12*	FY13*	FY14
Pre-tax profit	2,326	462	-691	-6,971
Depreciation	758	1,189	640	880
Chg in working capital	-3,801	1,419	989	-2,779
Total tax paid	-785	-757	-243	-197
Cash flow from operating activities	**-1,502**	**2,314**	**694**	**-9,067**
Capital expenditure	-1,685	-1,159	-314	-72
Chg in investments	-209	-9,496	-693	-872
Cash flow from investing activities	**-1,894**	**-10,655**	**-1,006**	**-944**
Free cash flow	-3,396	-8,341	-312	-10,012
Equity raised/(repaid)	492	2,700	4	-21
Debt raised/(repaid)	3,339	5,227	348	10,352
Dividend (incl. tax)	-183	0	0	0
Cash flow from financing activities	**3,101**	**7,877**	**352**	**10,331**
Net chg in cash	-295	-464	39	319

Valuation Ratios

	FY11	FY12*	FY13*	FY14
Per Share data				
EPS (INR)	5.9	0.6	(3.3)	(23.4)
Growth, %	(25.3)	(90.0)	(662.3)	605.1
Book NAV/share (INR)	74.4	74.0	70.7	47.3
FDEPS (INR)	5.9	0.6	(3.3)	(23.4)
CEPS (INR)	8.8	4.5	(1.2)	(20.5)
CFPS (INR)	(6.1)	2.0	(0.0)	(23.6)
Return ratios				
Return on assets (%)	4.7	4.6	1.5	(4.1)
Return on equity (%)	8.2	0.8	(4.6)	(39.6)
Return on capital employed (%)	8.0	7.9	2.6	(7.1)
Turnover ratios				
Asset turnover (x)	1.9	2.0	1.3	1.4
Sales/Total assets (x)	0.9	0.8	0.5	0.5
Sales/Net FA (x)	8.7	8.9	5.6	7.0
Working capital/Sales (x)	0.4	0.4	0.6	0.6
Receivable days	148.8	113.8	181.3	145.4
Inventory days	17.6	16.1	26.1	17.0
Payable days	200.2	200.3	394.4	294.4
Working capital days	160.1	138.1	217.4	213.4
Liquidity ratios				
Current ratio (x)	1.9	1.8	1.6	1.8
Quick ratio (x)	1.8	1.7	1.5	1.7
Interest cover (x)	2.0	0.8	0.6	0.1
Total debt/Equity (x)	1.0	1.1	1.2	2.4
Net debt/Equity (x)	0.9	1.0	1.1	2.4
Valuation				
PER (x)	2.9	28.8	(5.1)	(0.7)
PEG (x) - y-o-y growth	(0.1)	(0.3)	0.0	(0.0)
Price/Book (x)	0.2	0.2	0.2	0.4
EV/Net sales (x)	0.4	0.5	0.8	0.9
EV/EBITDA (x)	4.4	5.8	10.8	24.7
EV/EBIT (x)	5.2	7.6	14.1	55.0

Gammon India (GMON IN)

Miles to go before …

INDIA | INFRASTRUCTURE | Company Update

2 December 2014

Gammon India (GIL), once a blue-chip company in the EPC domain, has seen a complete reversal of its fortunes – failing to deliver operationally and financially. First DMRC blacklisted it for multiple accidents and then it had to take the CDR package – its market cap is now lower than its 59% subsidiary Gammon Infra's.

GIL is in a precarious situation with no visibility in revenue or earnings and debt beyond manageable levels. Repeated accidents at construction sites (four major in the last five years), mismanagement of working capital, and indiscriminate investment in subsidiaries (domestic and foreign) have led to the ballooning of working capital and debt levels. At the end of FY14, standalone debt was Rs 47bn, (6.5x D/E) and consolidated was Rs 107bn, (20x D/E). It formally took the CDR package in March-2013.

While GIL's orderbook of Rs 140bn is at a robust 3.4x book-to-sales, its ballooning working capital (240 debtor days) means there is little visibility to revenues. With such a stretched balance sheet, margins will be volatile and cost-and-time overruns are almost certain.

GIL's management intends to reduce its balance sheet stress through asset divestment – domestic and foreign. It has initiated the divestment process for its three Italian subsidiaries (Franco Tussi, Sofinter, and SAE) which it had acquired in 2010. It expects the divestment to fetch € 150-160mn, which it intends to use to pay back the acquisition debt. The remaining cash, if any, will be used to reduce debt at the standalone level.

GIL possesses 180 acres of land in Dombivali, bought from Metropolitan Infra Ltd in 2011. It is in the late stages of monetising 65 acres of this land and expects a cashflow of about Rs3bn from it. It intends to develop the remaining land in partnership over the next five years. GIL also has arbitrations worth Rs 35bn with various government bodies, but we see limited scope of any significant cash being relieved from this source.

As per media reports, Gammon India has been looking to divest partial stake in its listed BOT subsidiary, Gammon Infrastructure Projects Ltd (GIPL), which owns 9 BOT road projects (total length: 510km), 96MW of power projects (mainly biogas and hydro) and 2 port projects (total capacity 23mtpa). Many of these projects are currently under construction, and GIPL is scouting for sources to fund their equity requirement. GIPL has a market cap of Rs15bn – thus a 25% stake divestment can lead to potential cash accrual of Rs3.5bn for GIL.

GIL's asset-divestment plan thus, might reduce the consolidated debt from Rs107bn to Rs84bn, but may not lead to significant reduction in standalone debt *(unless divestment in GIPL is successful)*. Hence we do not see it coming out of CDR in the next three years. Being part of the CDR programme will restrict GIL from drawing any more debt. With its working capital cycle at a high of 420 days, we believe it will miss capitalising on the huge investment opportunity in the EPC space.

Outlook: Overall we remain bearish on GIL and its ability to turnaround its operations in the next three years. It does not have large assets that it can monetise to deleverage its balance sheet. At the same time, its high working capital will keep its organic growth under check. While the order award opportunity appears massive, we remain sceptical of GIL's ability to capitalize because of its dire financial state and as competitors (NCC, J Kumar, and KNR) are in a much superior position.

Not Rated

CMP RS 30

COMPANY DATA

O/S SHARES (MN) :	136
MARKET CAP (RSBN) :	4
MARKET CAP (USDBN) :	0.1
52 - WK HI/LO (RS) :	45 / 12
LIQUIDITY 3M (USDMN) :	0.6
PAR VALUE (RS) :	2

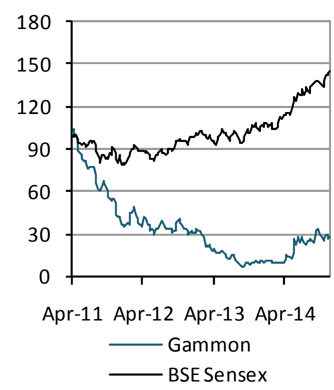
SHARE HOLDING PATTERN, %

PROMOTERS :	35.0
FII / NRI :	11.6
FI / MF :	14.1
NON PROMOTER CORP. HOLDINGS :	16.3
PUBLIC & OTHERS :	23.0

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	-15.3	0.8	114.7
REL TO BSE	-17.7	-5.5	77.4

PRICE VS. SENSEX



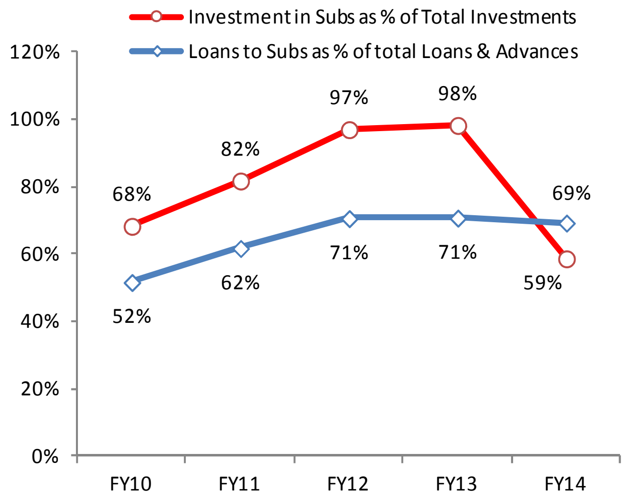
Source: Phillip Capital India Research

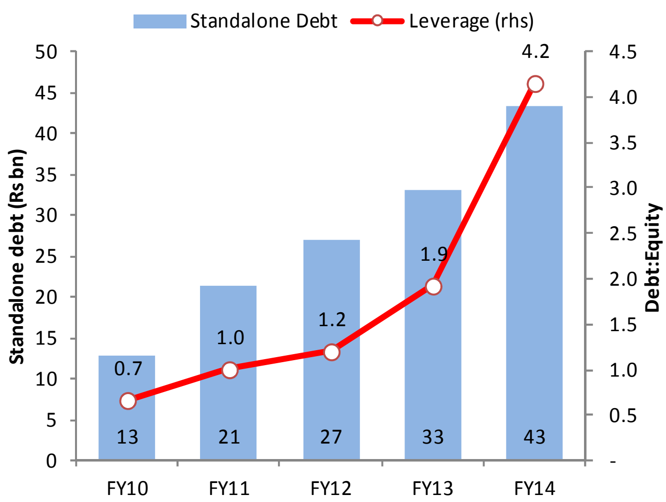
KEY FINANCIALS

Rs mn	FY12	FY13	FY14
Net Sales	55,337	51,974	32,793
EBIDTA	4,716	849	-2,526
Net Profit	959	-3,390	-4,950
EPS, Rs	7.0	(24.8)	(36.3)
PER, x	4.3	(1.2)	(0.8)
EV/EBIDTA, x	6.4	42.8	(18.5)
P/BV, x	0.2	0.2	0.4
ROE, %	4.4	(17.1)	(35.9)
Debt/Equity (x)	1.2	1.9	4.2

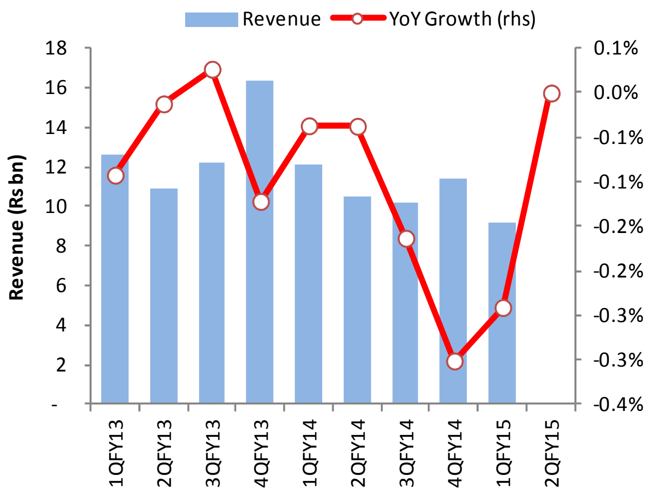
Source: PhillipCapital India Research Est.

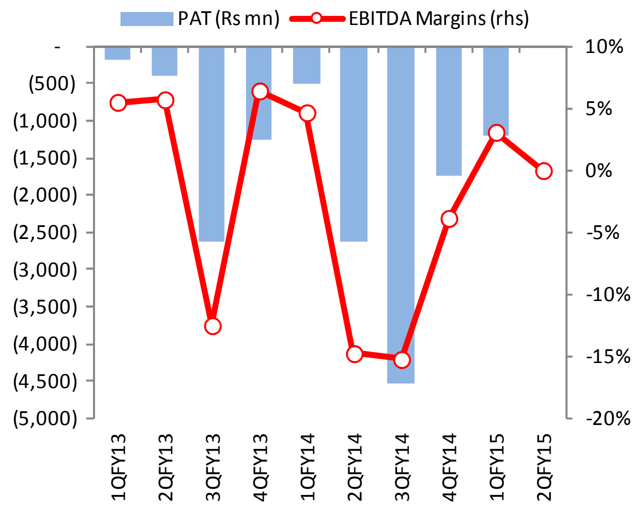
As a result of continuous investments into subsidiaries, Gammon's debt profile deteriorated over the last five years



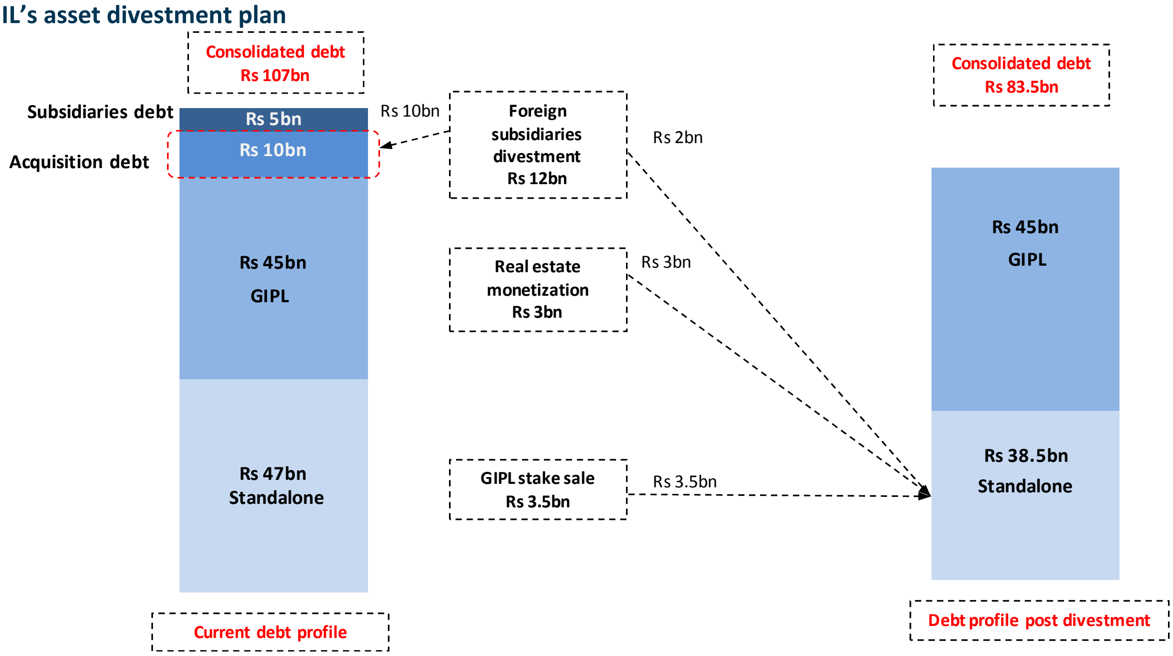


Last 10 quarters have seen muted revenue growth, with highly volatile margins and mounting losses





GIL's asset divestment plan



Source: Company, PhillipCapital India Research

Financials

Income Statement

Y/E Mar, Rs mn	FY11	FY12	FY13	FY14*
Net sales	**55,481**	**55,337**	**51,974**	**32,793**
Growth, %	24	0	-6	-37
Total income	55,481	55,337	51,974	32,793
Employee expenses	-3,331	-4,493	-5,188	-3,282
Other Operating expenses	-52,985	-22,152	-20,124	-14,824
EBITDA (Core)	**2,497**	**4,716**	**849**	**-2,526**
Growth, %	(34.4)	88.9	(82.0)	(397.6)
Margin, %	4.5	8.5	1.6	(7.7)
Depreciation	-917	-1,020	-1,074	-833
EBIT	**1,579**	**3,696**	**-225**	**-3,359**
Growth, %	(49.0)	134.0	(106.1)	1,392.2
Margin, %	2.8	6.7	(0.4)	(10.2)
Interest paid	-1,943	-2,376	-4,434	-4,022
Other Non-Operating Income	311	314	1,326	979
Pre-tax profit	**1,767**	**1,587**	**-4,399**	**-9,110**
Tax provided	-582	-674	-58	1,451
Profit after tax	**1,185**	**912**	**-4,457**	**-7,659**
Net Profit	**1,185**	**912**	**-4,457**	**-7,659**
Growth, %	(153.6)	(251.0)	(453.4)	46.0
Net Profit (adjusted)	**(635)**	**959**	**(3,390)**	**(4,950)**
Unadj. shares (m)	137	137	137	137
Wtd avg shares (m)	137	137	137	137

Balance Sheet

Y/E Mar, Rs mn	FY11	FY12	FY13	FY14*
Cash & bank	577	856	780	905
Debtors	18,663	20,264	22,911	21,525
Inventory	14,881	18,085	20,020	17,520
Loans & advances	13,814	19,979	22,559	25,742
Total current assets	50,328	61,510	69,956	69,225
Investments	2,113	2,087	2,214	1,840
Gross fixed assets	18,026	18,528	17,877	18,641
Less: Depreciation	-4,726	-5,579	-6,595	-7,365
Add: Capital WIP	527	573	339	299
Net fixed assets	13,827	13,523	11,620	11,576
Total assets	**66,267**	**77,414**	**84,513**	**84,306**
Current liabilities	23,023	27,160	33,659	30,413
Total current liabilities	23,023	27,160	33,659	30,413
Non-current liabilities	22,076	27,734	33,708	43,435
Total liabilities	45,099	54,894	67,366	73,848
Paid-up capital	287	275	275	275
Reserves & surplus	20,882	22,245	16,871	10,183
Shareholders' equity	21,168	22,520	17,146	10,458
Total equity & liabilities	**66,267**	**77,414**	**84,513**	**84,306**

Source: Company, PhillipCapital India Research Estimates

*(*The company had changed its financial year in FY14 to end in Dec-2013 – hence FY14 had only nine months of reported operations)*

Cash Flow

	FY11	FY12	FY13	FY14*
Pre-tax profit	1,767	1,587	-4,399	-9,110
Depreciation	917	1,020	1,074	833
Chg in working capital	-8,012	-7,060	-2,452	-2,559
Total tax paid	-485	-817	-26	-26
Cash flow from operating activities	**-5,814**	**-5,270**	**-5,803**	**-10,862**
Capital expenditure	-3,085	-742	-403	-812
Chg in investments	-131	26	-126	373
Cash flow from investing activities	**-3,216**	**-716**	**-529**	**-439**
Free cash flow	-9,030	-5,986	-6,332	-11,301
Equity raised/(repaid)	1,067	1,111	313	994
Debt raised/(repaid)	8,316	5,801	5,942	10,431
Dividend (incl. tax)	-124	-32	0	0
Cash flow from financing activities	**8,882**	**6,266**	**6,256**	**11,425**
Net chg in cash	-148	280	-76	124

Valuation Ratios

	FY11	FY12	FY13	FY14*
Per Share data				
EPS (INR)	(4.7)	7.0	(24.8)	(36.3)
Growth, %	(143.4)	(251.0)	(453.4)	46.0
Book NAV/share (INR)	155.1	165.0	125.6	76.6
FDEPS (INR)	(4.7)	7.0	(24.8)	(36.3)
CEPS (INR)	(11.3)	14.8	(9.2)	(10.3)
CFPS (INR)	(44.9)	(38.8)	(49.1)	(85.5)
Return ratios				
Return on assets (%)	4.0	3.4	(2.0)	(6.0)
Return on equity (%)	(3.1)	4.4	(17.1)	(35.9)
Return on capital employed (%)	6.4	5.2	(3.2)	(9.7)
Turnover ratios				
Asset turnover (x)	1.6	1.3	1.1	0.7
Sales/Total assets (x)	0.9	0.8	0.6	0.4
Sales/Net FA (x)	4.3	4.0	4.1	2.8
Working capital/Sales (x)	0.5	0.6	0.7	1.2
Receivable days	122.8	133.7	160.9	239.6
Inventory days	97.9	119.3	140.6	195.0
Payable days	156.8	193.8	238.8	293.2
Working capital days	175.8	220.9	249.4	421.9
Liquidity ratios				
Current ratio (x)	2.2	2.3	2.1	2.3
Quick ratio (x)	1.5	1.6	1.5	1.7
Interest cover (x)	0.8	1.6	(0.1)	(0.8)
Total debt/Equity (x)	100.4	120.2	192.5	415.3
Net debt/Equity (x)	97.7	116.4	187.9	4.1
Valuation				
PER (x)	(6.4)	4.3	(1.2)	(0.8)
PEG (x) - y-o-y growth	0.0	(0.0)	0.0	(0.0)
Price/Book (x)	0.2	0.2	0.2	0.4
EV/Net sales (x)	0.4	0.5	0.7	1.4
EV/EBITDA (x)	9.9	6.4	42.8	(18.5)
EV/EBIT (x)	15.7	8.2	(161.3)	(13.9)

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