ANANDRATHI

India I Equities

Infrastructure
Company Update

Change in Estimates ☑ Target ☑ Reco ☑

19 August 2019

Sadbhav Engineering

Rating: **Buy**
Target Price: ₹189
Share Price: ₹125

Asset sale key to de-levering; tempting valuation; raising to a Buy

Protracted delays in receipt of appointed dates for three NHAI hybrid annuity projects mean a large part of Sadbhav Engg's order backlog is not yet contributing. Thus, revenues are subdued. Besides changes in the revenue mix, this means mobilisation advances have not been realised as expected, and de-levering needs to wait. Rather, against the targeted de-levering, debt continues to rise as the BOT holdco continues to seek support. With appointed dates likely to take some time, and with lower targeted inflows, growth is likely to be delayed. Thus, asset monetisation is the key to de-levering in the immediate future. Negatives seem priced in. Hence, we raise our rating to a Buy.

Guidance pruned. With muted awarding till now, and as the group intends to go slow on any fresh opportunities in hybrid annuities, inflow guidance has been reduced to ~₹30bn-40bn (~₹50bn-60bn earlier). The changed inflow outlook and the not-yet-appointed hybrid annuities impelled management to reduce revenue guidance to ~₹36bn (~₹32.5bn from under-execution OB).

Debt up, on support to BOT holdco. Lower revenues should have ideally led to lower debt (on lower working capital required), which rose ~₹0.4bn q/q as Sadbhav again extended support to the BOT holdco (~₹0.95bn in Q1). With cash-flows from operations slightly more than enough, any de-levering appears contingent on asset-sale transactions (likely receipts ~₹8bn).

OB down, on execution and termination. No new inflows, removal of the ~₹4.2bn Vishakaptnam order from the OB (mutually terminated on RoW issue) and work executed during Q1 took the OB down a considerable ~₹12bn to ~₹108bn. *Prima facie*, revenue assurance at ~3x looks good, but adjusted for the not-yet-appointed projects, BtB is just about 2x TTM sales.

Valuation. Delayed appointed dates and the termination compel us to slash FY20e earnings a steep ~24%, and ~29% for FY21. On our revised estimates, the stock quotes at EV/BITDA (excl. the value of BOTs) of 3.8x FY21e. **Risk:** Significant delay in appointed dates for orders.

Key financials (YE Mar)	FY17	FY18	FY19P	FY20e	FY21e
Sales (₹ m)	33,203	35,051	35,492	33,571	36,834
Net profit (₹ m)	1,878	2,207	1,861	1,531	1,586
EPS (₹)	10.9	12.9	10.8	8.9	9.2
Growth (%)	24.0	17.5	-15.7	-17.7	3.5
PE (x)	28.0	23.1	23.0	14.0	13.5
EV / EBITDA (x)	19.7	15.8	13.3	8.6	8.0
PBV (x)	3.2	2.7	2.1	1.0	0.9
RoE (%)	11.9	12.5	9.5	7.3	7.1
RoCE (%)	11.3	12.3	13.0	11.5	11.8
Net debt / equity (x)	1.1	0.8	0.7	0.7	0.7

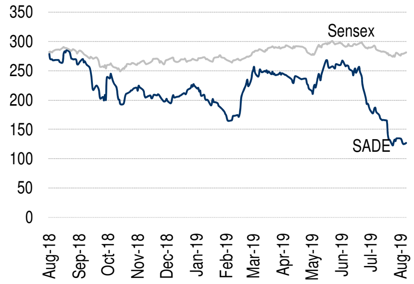
Source: Company, Anand Rathi Research P= provisional

Key data	SADE IN / SADE.BO
52-week high / low	₹308 / 115
Sensex / Nifty	37350 / 11048
3-m average volume	$0.9m
Market cap	₹21bn / $301m
Shares outstanding	172m

Shareholding pattern (%)	Jun' 19	Mar' 19	Dec'18
Promoters	46.6	46.6	46.6
- of which, Pledged	*16.7*	*22.9*	*20.3*
Free float	53.5	53.5	53.5
- Foreign institutions	13.4	14.7	15.6
- Domestic institutions	35.5	34.2	33.2
- Public	4.6	4.6	4.7

Estimates revision (%)	FY20e	FY21e
Sales	-12.7	-15.8
EBITDA	-11.0	-15.2
EPS	-24.3	-29.5

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations (standalone)

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY17	FY18	FY19P	FY20e	FY21e
Order backlog	76,830	1,32,493	1,19,810	1,13,119	1,22,320
Order inflows	35,118	90,644	22,779	30,185	46,002
Net revenues	**33,203**	**35,051**	**35,492**	**33,571**	**36,834**
Growth (%)	*4.2*	*5.6*	*1.3*	*-5.4*	*9.7*
Direct costs	26,552	28,134	28,521	26,878	29,546
SG&A	3,095	2,765	2,692	2,511	2,717
EBITDA	**3,556**	**4,151**	**4,279**	**4,181**	**4,571**
EBITDA margins (%)	*10.7*	*11.8*	*12.1*	*12.5*	*12.4*
Depreciation	1,000	979	958	1,140	1,158
Other income	875	897	1,003	1,000	966
Interest expenses	1,534	1,907	1,749	1,915	2,048
PBT	1,897	2,163	2,575	2,127	2,332
Effective tax rate (%)	*1.0*	*-2.0*	*27.7*	*28.0*	*32.0*
+ Associates / (Minorities)	-	-	-	-	-
Net income	1,878	2,207	1,869	1,531	1,586
Adjusted income	1,878	2,207	1,861	1,531	1,586
WANS	172	172	172	172	172
FDEPS (₹ / sh)	10.9	12.9	10.8	8.9	9.2

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY17	FY18	FY19P	FY20e	FY21e
Share capital	172	172	172	172	172
Net worth	16,609	18,668	20,337	21,661	23,040
Debt	17,771	14,847	14,900	15,489	16,021
Minority interest	-	-	-	-	-
DTL / (Assets)	-477	-994	-994	-994	-994
Capital employed	**33,904**	**32,520**	**34,243**	**36,157**	**38,067**
Net tangible assets	5,222	4,963	4,929	4,768	4,981
Net intangible assets	7	65	43	23	13
Goodwill	-	-	-	-	-
CWIP (tang. & intang.)	-	-	-	-	-
Investments (strategic)	5,694	5,775	6,094	6,094	6,094
Investments (financial)	-	-	-	-	-
Current assets (ex cash)	28,574	31,783	33,314	33,412	35,203
Cash	230	127	604	915	1,024
Current liabilities	5,823	10,192	10,741	9,055	9,247
Working capital	22,751	21,591	22,574	24,357	25,956
Capital deployed	**33,904**	**32,520**	**34,243**	**36,157**	**38,067**
Contingent liabilities	12,881	13,209	-	-	-

Fig 3 – Cash-flow statement (₹ m)

Year-end: Mar	FY17	FY18	FY19P	FY20e	FY21e
PBT+ Net interest expense	2,556	3,172	3,321	3,041	3,414
+ Non-cash items	1,000	979	958	1,140	1,158
Oper. prof. before WC	3,556	4,151	4,279	4,181	4,571
- Incr. / (decr.) in WC	7,467	-1,160	982	1,783	1,599
Others incl. taxes	18	-44	714	595	746
Operating cash-flow	-3,929	5,355	2,582	1,803	2,226
- Capex (tang. + intang.)	299	778	902	960	1,360
Free cash-flow	-4,228	4,577	1,681	843	866
Acquisitions	-	-	-	-	-
- Div.(incl. buyback & taxes)	145	155	206	206	206
+ Equity raised	0	-	-	-	-
+ Debt raised	5,177	-3,442	54	589	531
- Fin investments	65	80	319	-	-
'- Net int. expense + Misc.	676	1,002	732	915	1,082
Net cash-flow	64	-103	477	311	109

Source: Company, Anand Rathi Research P= provisional

Fig 4 – Ratio analysis

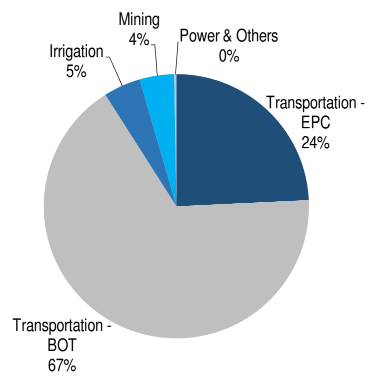
Year-end: Mar	FY17	FY18	FY19P	FY20e	FY21e
P/E (x)	28.0	23.1	23.0	14.0	13.5
EV / EBITDA (x)	19.7	15.8	13.3	8.6	8.0
EV / Sales (x)	2.1	1.9	1.6	1.1	1.0
P/B (x)	3.2	2.7	2.1	1.0	0.9
RoE (%)	11.9	12.5	9.5	7.3	7.1
RoCE (%)	11.3	12.3	13.0	11.5	11.8
Sales / FA (x)	4.9	4.8	4.3	3.7	3.6
DPS (₹ / sh)	0.7	0.8	1.0	1.0	1.0
Dividend yield (%)	0.6	0.6	0.8	0.8	0.8
Dividend payout (%) - incl. DDT	7.7	7.0	11.1	13.5	13.0
Net debt / equity (x)	1.1	0.8	0.7	0.7	0.7
Receivables (days)	187	170	169	169	164
Inventory (days)	14	17	18	22	23
Payables (days)	45	62	45	45	45
CFO : PAT %	-209.2	242.7	138.8	117.7	140.4

Source: Company, Anand Rathi Research P= provisional

Fig 5 – Price movement

Source: Bloomberg

Fig 6 – Revenue break-up (FY19)



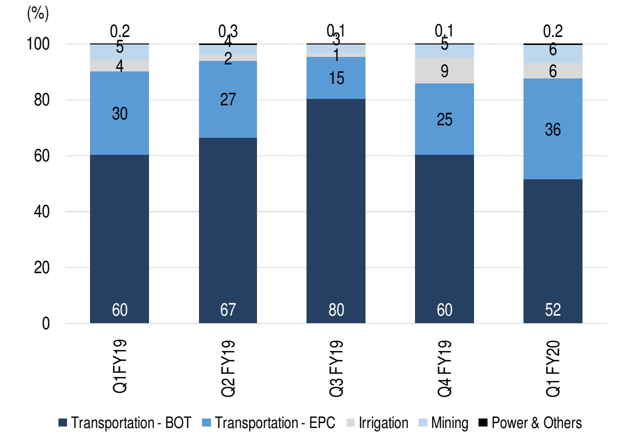
Source: Company

Result / Concall Highlights

- **Restrained revenues on lower effectively-executable OB.** Revenue from operations was down ~8% y/y, to ~₹8.4bn, constrained by the lower effectively-under-execution order backlog as orders of ~₹34bn have yet-to-be-appointed and turn contributing. Besides, experience seems to have led to management treading rather cautiously on mining orders.

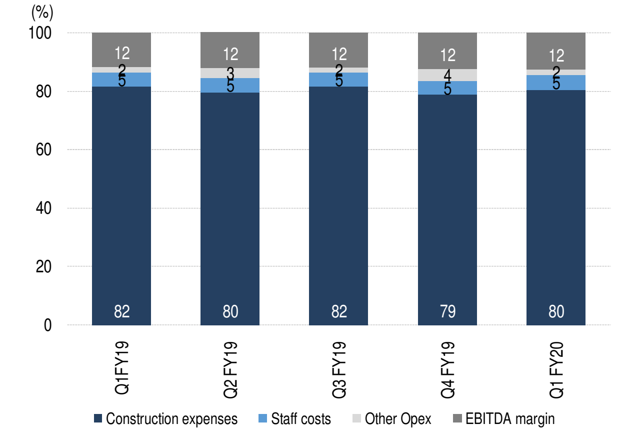
- **EBITDA margin healthy.** With a significant portion of Q1 revenue emanating from higher-margin hybrid annuity projects, the EBITDA margin was a healthy ~12.5%. It seems to have benefitted from the recent adoption of IndAS-116 (pertaining to assets taken on lease).

Fig 7 – Revenue break-up – hybrid annuities key contributor



Source: Company

Fig 8 – Margins healthy on lion's share from hybrid annuities



Source: Company

Fig 9 – Financial highlights

(₹ m)	Q1 FY19	Q2 FY19	Q3 FY19	Q4 FY19	Q1 FY20	% Y/Y	% Q/Q
Sales	9,114	6,906	9,255	10,217	8,376	*-8.1*	*-18.0*
EBITDA	1,070	833	1,108	1,268	1,046	*-2.3*	*-17.5*
EBITDA margins (%)	*11.7*	*12.1*	*12.0*	*12.4*	*12.5*	*74bps*	*8bps*
Interest	257	273	291	282	273	*6.2*	*-3.2*
Depreciation	241	244	241	231	280	*16.3*	*21.1*
Other income	108	66	127	55	41	*-61.8*	*-24.2*
Exceptional item	-	-	-	8	-	-	-
PBT	681	383	703	816	534	*-21.5*	*-34.6*
Tax	46	0	141	527	139	*200.3*	*-73.6*
PAT	634	383	563	289	395	*-37.8*	*36.6*
Adj. PAT	634	383	563	281	395	*-37.8*	*40.3*

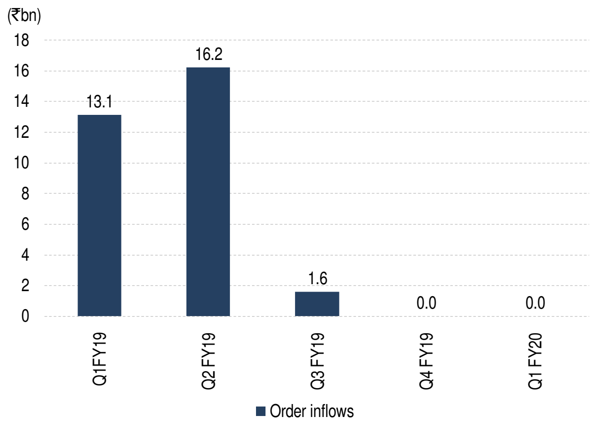
Source: Company

- **Elevated tax charge takes earnings down.** Fading 80-IA benefits meant the tax rate was higher, and weighed on earnings. Besides, the higher tax charge, depreciation and finance costs contributed to the ~38% earnings decline.
  - A part of the higher depreciation was due to the recent adoption of IndAS-116. Assets taken on lease were amortised over the lease tenure, against the earlier practice of recording rent as operating expense.
  - Finance cost was up, largely led by higher debt (on support extended to the BOT holdco) and adoption of IndAS-116.

Order book

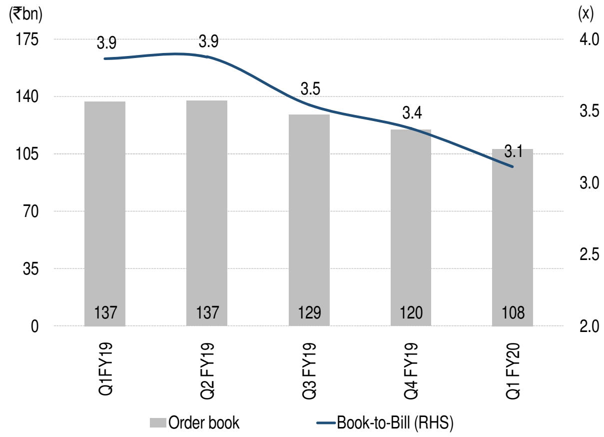
- With slow ordering throughout this year, the company had no new inflows. Adjusted for the orders executed during the quarter and for the removal of an order from the backlog, the OB was down ~₹12bn q/q to ~₹108bn.
  - The removal pertains to the mutually-agreed termination of the Vishakapattnam Port road hybrid annuity project. Significant delay by the NHAI on making RoW available for execution led to the project (EPC scope of~₹4.2bn) being terminated.
  - The order backlog, though, entails book-to-bill of ~3.1x (on TTM revenues); for this to fructify would need management securing appointed dates for orders of ~₹34bn (not moving for want of appointed dates).
  - Excl. the not-yet-appointed projects, the backlog is ~₹75bn, providing assurance of ~2.1x TTM revenues.
  - Of the pending appointed dates (four hybrid-annuity projects), management expects Kim-Ankleshwar to be appointed by end-Q2 FY20 (revised from Q1 FY20). Management expects construction at Gadag-Honnali to start by Oct'19. The two projects, Bhimasur-Bhuj and Tumkur-Shivamogga are expected to be appointed by Q4 FY20.
  - Of the appointed projects, we expect FY20 revenues to be largely driven by stabilising work at the Nagpur-Mumbai Expressway, Ahmedabad-Rajkot and the Lucknow Ring Road projects.

Fig 10 – FY20 road inflow target of ~₹30bn-40bn



Source: Company

Fig 11 – ~31% of OB await appointed dates



Source: Company

Guidance

- With a significant portion of OB not-yet-appointed, and as there is still some time before these get going, management guided-to ~₹36bn revenue. Of the total, it expects ~₹32.5bn from the already under-execution OB; the balance ~₹3.5bn is expected from orders waiting to be appointed. Management hopes to offer more clarity at end-Q2 FY20 as, by then, much more would emerge regarding the state of the orders in question (with respect to RoW and otherwise).
  - To attain the guided-to revenues, ~5% y/y growth is required during the rest of the year.
  - To deliver ~₹32.5bn from the appointed OB, almost a third of the under-execution OB would have to be executed in the rest of the

year.

- The Q1 EBITDA margin is largely in line with the earlier guided-to range of ~12-12.3% for FY20.
- Keeping in mind, the muted road awarding until now, and as management intends to tread cautiously on hybrid annuity opportunities, its inflow guidance has been lowered to ~₹30bn-40bn.
  - The guided-to-figure comprises only the road EPC orders the management is targeting.
  - Its appetite for hybrid annuity opportunities would be decided over the course of the year based on progress on projects not-yet-appointed.
  - Management hopes to provide a clearer picture on inflow guidance at end-Q2 as targeted inflows would take into account order formats (EPC or hybrid annuity), sizes and number of projects, among others.
  - It also intends to look at Jal Shakti opportunities. Any accretion here would add to the guided-to ~₹30bn-40bn; however, management refrained from giving any firm figures as it awaits the authority to float tenders, mostly expected in Q4.
- In conformity with its intent to keep business as asset-light as possible, management intends to incur capex only for critical equipment, and lease non-critical equipment. Consequently, for FY20, it sees capex of ~₹0.8bn to suffice (~₹0.1bn incurred in Q1).
- The shrinking number of 80-IA tax-benefit projects have led to a rise in the overall tax rate. Management expects ~25-26% for FY20 and the full tax rate in FY21.

Inflows outlook

- Management said that, in the past few months, courtesy the general elections, no bids were floated or were pending to be opened. With the new government elected, it expects opportunities in road infrastructure development to be come up starting Q3.
  - 43 NHAI road EPC projects of ~₹291bn; tenders to be floated by 30th Sep'18.
  - In hybrid annuities, a pipeline of 28 projects of ~₹315bn; tenders expected to be floated by 30th Sep'18.
  - Though the hybrid annuity opportunity size is slightly large, the immediate focus, keeping in mind the cash-flow situation and the pending appointed dates for hybrid annuities, the EPC opportunity is its preferred option.
- In mining, it endeavours to first complete the present obligations.
- In irrigation, the river interlinking opportunity is on its radar, but the final decision would be taken once tenders have been floated. There is a great probability that the existing irrigation OB would be done with by the year-end.

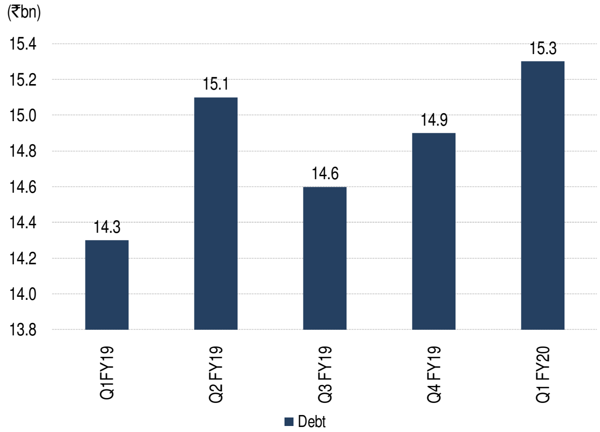
Balance sheet

- At ~₹15.3bn, debt was up a slight ~₹0.4bn q/q, seeming largely due to the need to support the BOT holdco arm.
  - Besides receivables in the normal course of business, during the quarter the company extended ~₹0.95bn to its BOT-holdco arm,

Sadbhav Infrastructure. Exposure, consequently, was up from ~₹5.35bn a quarter back to ~₹6.3bn now.

- The need to extend support was largely due to ~₹1.2bn equity infused in the project SPVs, whereas Sadhav Infrastructure's own cash-flows could suffice to meet repayment obligations on its own.
- Management expects the entire exposure to be cleared once asset monetisation proceeds are in.

Fig 12 – Debt up ~₹0.4bn q/q, meaningful de-levering hinges on asset sale



Source: Company

Others

- **FY20 revenue composition.** Management expects the mining segment to contribute ~₹2.5bn, and hopes to completely exhaust the irrigation OB (~₹4.4bn) by this year-end. This leaves roads with ~₹29bn contribution, of which ~₹3.5bn is expected to come from the not-yet-appointed projects.
- **KSHIP hybrid annuity project.** Financial closure for this ~₹10bn two-laning project (EPC value: ~₹8.9bn) is expected in Q2, and construction to subsequently commence by Oct'19. Management estimates ~₹0.8bn equity required for this project.
- **Update on key road EPC projects.** Mumbai-Nagpur, the largest of the EPC orders, is ~14% executed, ~34% progress has already been made on the Ahmedabad Rajkot project and progress on the Lucknow Ring Road is ~27%.
- **Asset monetisation, hopeful of closure by Q3.** For the six NHAI projects, approvals are in place from the regional offices, project directors, and the technical division; the go-ahead from the finance division is awaited. Regarding the three state projects, Aurangabad-Jalna has been recommended to the Maharashtra government, the authority concerned for the Ahmedabad Ring Road (Gujarat) has sought a legal opinion, and Mysore-Bellary (Karnataka) is pending with the recent state government. Consortium lenders for all the nine assets have already had their first meeting.
- **Amalgamation, a right step.** With a definite agreement in place for the nine assets, Right of First Offer for the balance, and the focus now on asset-light opportunities, the proposed amalgamation is promising. We believe it would simplify the two-tiered structure (address the Holdco discount), improve cash-flow fungibility, and capture the O&M scope in the EPC valuation.

Valuation

To factor in the delayed appointed dates for the NHAI hybrid annuity projects, removal of EPC potential for the Vishakapattnam port road hybrid annuity (on the mutually agreed termination) and on the toned-down inflow guidance, we lower our FY20e earnings ~24% (and ~29% for FY21).

We value the construction business at an EV/EBITDA multiple of 5x FY21e, the company's ~68% stake in the BOT holdco arm on a sum-of-parts basis (and assign a 20% holdco discount), and recoverable exposure to Sadbhav Infrastructure at 1x book value. Consequently, we arrive at a target price of ₹189.

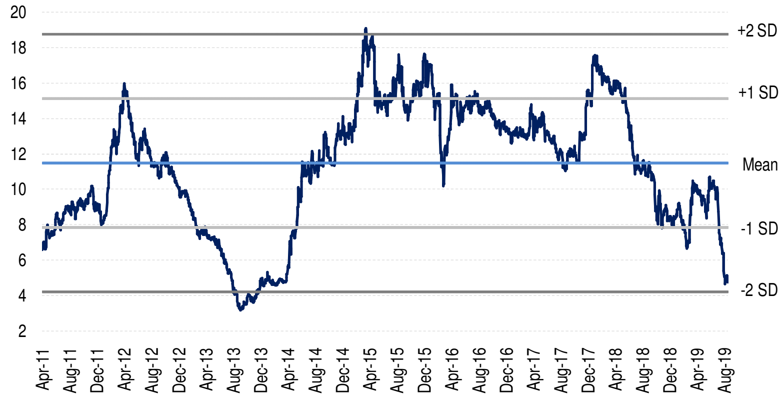
Fig 13 – Change in estimates

(₹ m)	Original		Revised		% change	
	FY20e	FY21e	FY20e	FY21e	FY20e	FY21e
Revenue	38,474	43,757	33,571	36,834	-12.7	-15.8
EBITDA	4,699	5,390	4,181	4,571	-11.0	-15.2
EPS (₹)	11.8	13.1	8.9	9.2	-24.3	-29.5

Source: Anand Rathi Research

At the CMP, the stock trades at EV/EBITDA (excl. the value for the BOTs) of 4x FY20e and 3.8x FY21e.

Fig 14 – EV / EBITDA band



Source: Bloomberg, Anand Rathi Research

Risks

- Any significant delay in orders being awarded.
- Any slower-than-anticipated pace of execution.

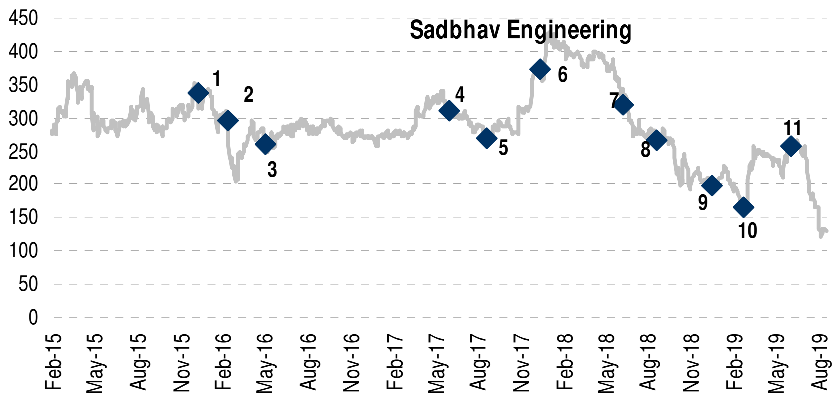
Appendix

Analyst Certification

The views expressed in this Research Report accurately reflect the personal views of the analyst(s) about the subject securities or issuers and no part of the compensation of the research analyst(s) was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this report. The research analysts are bound by stringent internal regulations and also legal and statutory requirements of the Securities and Exchange Board of India (hereinafter "SEBI") and the analysts' compensation are completely delinked from all the other companies and/or entities of Anand Rathi, and have no bearing whatsoever on any recommendation that they have given in the Research Report.

Important Disclosures on subject companies

Rating and Target Price History (as of 19 August 2019)



	Date	Rating	TP (₹)	Share Price (₹)
1	07-Dec-15	Hold	403	355
2	09-Feb-16	Hold	340	299
3	30-Apr-16	Hold	308	264
4	31-May-17	Hold	317	314
5	17-Aug-17	Buy	318	267
6	11-Dec-17	Hold	399	370
7	05-Jun-18	Hold	415	344
8	18-Aug-18	Buy	366	268
9	15-Dec-18	Buy	272	199
10	18-Feb-19	Buy	257	164
11	03-Jun-19	Hold	272	253

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Analysts' ratings and the corresponding expected returns take into account our definitions of Large Caps (>US$1bn) and Mid/Small Caps (<US$1bn) as described in the Ratings Table below:

Ratings Guide (12 months)

	Buy	Hold	Sell
Large Caps (>US$1bn)	>15%	5-15%	<5%
Mid/Small Caps (<US$1bn)	>25%	5-25%	<5%

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