

Sector: Infrastructure  
Result Update

	Change
Reco: <b>Buy</b>	↔
CMP: <b>Rs. 97</b>	
Price Target: <b>Rs. 120</b>	↓
↑ Upgrade	↔ No change
↓ Downgrade	

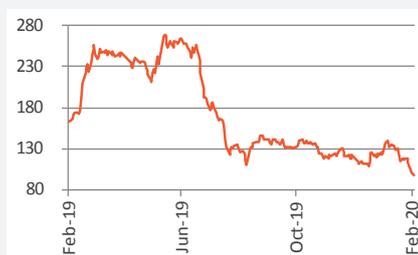
## Company details

Market cap:	Rs. 1,669 cr
52-week high/low:	Rs. 274/95
NSE volume: (No of shares)	1.7 lakh
BSE code:	532710
NSE code:	SADBHAV
Sharekhan code:	SADBHAV
Free float: (No of shares)	15.9 cr

## Shareholding (%)

Promoters	47
FII	12
DII	34
Others	7

## Price chart



## Price performance

(%)	1m	3m	6m	12m
Absolute	-19.1	-18.6	-24.3	-39.8
Relative to Sensex	-17.8	-20.5	-31.6	-48.2

Sharekhan Research, Bloomberg

Sadbhav Engineering Limited (SEL) reported dismal Q3FY2020 performance with standalone revenue declining by 52.5% y-o-y and net earnings down by 79% y-o-y. The weak execution can be attributed to extended monsoon in October, non-receipt of lenders' funds for HAM projects and non-receipt of Right of Way in some HAM projects. Weak execution during Q2 and Q3 led to management trimming down its revenue guidance for FY2020 and FY2021 to ~Rs. 2,400 crore (earlier Rs. 3,200 crore) and Rs. 3,200 crore (earlier Rs. 3,600 crore). The company's order backlog stood at Rs. 8,726 crore (3x its TTM standalone revenue) as it removed three projects totaling Rs. 1,800 crore. On the positive note, it concluded six of the nine operational project sale with IndInfravit trust at Rs. 1,981 crore (Rs. 724 crore worth units of trust plus Rs. 1,167 crore cash). With the transfer of remaining three assets, its net debt (SEL+SIPL) of Rs. 2,372 crore is expected to reduce to Rs. 400 crore. In the meantime, it has bid for five EPC projects worth Rs. 4,523 crore and will be bidding for HAM projects on evaluating them. SEL's weak standalone execution and guidance have led to a steep cut in net earnings for FY2020-FY2021. We have introduced our FY2022E earnings in this note. We have retained our Buy rating on the stock with a revised PT of Rs. 120, factoring cut in standalone estimates and rolling forward our EPC valuation multiple to FY2022E earnings.

## Key positives

- ◆ Transfer of nine assets to IndInfravit to bring down net debt to Rs. 400 crore as against current Rs. 2,372 crore.
- ◆ Received appointed date for Vadodara Kim, Gadag Honnali expected to be February 27, 2020.

## Key negatives

- ◆ Extended monsoons and low funding from lenders' in HAM projects affected execution.
- ◆ Management has trimmed down its revenue guidance for FY2020 and FY2021.

## Our Call

**Valuation – Maintain Buy with a revised PT of Rs. 120:** Weak execution in SEL's standalone business in Q2 and Q3 along with lower guidance from management led to a steep cut in net earnings estimate for FY2020-FY2021. However, with SIPL's nine project sale deal with IndInfravit getting closed and majority of funds to be received by the end of the current month, SEL should be back on the execution of projects from Q1FY2021. The company's strategy of bidding for EPC projects and proper evaluation of HAM projects (learnt from the past experiences) should aid in better order accretion going ahead. We have retained our Buy rating on the stock with a revised PT of Rs. 120, factoring cut in standalone estimates and rolling forward our EPC valuation multiple to FY2022E earnings.

## Key Risks

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

## Valuation (Standalone)

Particulars	Rs cr			
	FY19	FY20E	FY21E	FY22E
Revenue	3,549.2	2,410.2	3,121.8	3,502.7
OPM (%)	12.1	12.4	12.6	12.5
Adjusted PAT	186.1	96.6	147.6	180.0
% YoY growth	(15.7)	(48.1)	52.8	22.0
Adjusted EPS (Rs.)	10.8	5.6	8.6	10.5
P/E (x)	8.9	17.1	11.2	9.1
P/B (x)	0.8	0.8	0.7	0.7
EV/EBITDA (x)	5.8	8.4	6.3	5.7
RoNW (%)	9.5	4.7	6.8	7.7
RoCE (%)	8.8	5.7	7.1	7.7

Source: Company; Sharekhan estimates

**Weak execution affected by multiple factors dents net earnings:** SEL's reported dismal Q3FY2020 results with a 52.5% y-o-y decline in standalone revenue. Factors affecting weak execution during the quarter are 1) extended monsoon in October 2019; 2) SIPL had tied up Rs. 550 crore for equity, but lenders did not disburse any fund for the last 15 months in HAM projects; and 3) Right of Way was not available in some HAM projects due to land-acquisition issues due to which lenders reduced funding frequency. Operating margins remained stable at 12.5% (up 49 BPS y-o-y and 15 BPS q-o-q). Weak execution along with lower other income (down 40% y-o-y) and higher depreciation (up 11% y-o-y) led to standalone net profit declining by 79% y-o-y to Rs. 11.7 crore, which was much lower than our estimate.

**Revenue guidance lowered for FY2020 and FY2021:** Management has lowered its revenue guidance for FY2020 and FY2021 to Rs. 2,400 crore and Rs. 3,200 crore from earlier Rs. 3,200 crore and Rs. 3,600 crore, respectively, on account of weak Q2 and Q3. Management expects execution to normalise from Q1FY2021, as it has received the appointed date for Vadodara Kim projects, appointed date for Gadag Honnali is expected to receive as February 27, 2020, and forest clearance on Mumbai Nagpur project has been received. Further, the company has submitted five bids amounting Rs. 4,523 crore EPC projects as on date. The deal with IndInfraVIT now getting closed with receipt of funds expected by the current month end should aid in improving execution run-rate for the company.

**Asset divestment to IndInfraVIT to aid in de-leveraging:** SEL concluded the sale of six of its nine operational projects with IndInfraVIT trust for total equity value of Rs. 1,891 crore for which it will receive Rs. 724 crore worth units (~10% stake in the trust) and Rs. 1,167 crore in cash (expected by month end). The Mysore Bellary and Aurangabad Jalna projects are expected to close before the end of the month with equity value of Rs. 473.6 crore. The Ahmedabad Ring Road project (equity value of Rs. 267.2 crore) will be closed once it receives the necessary approvals. The company will be utilising Rs. 2,365 crore proceeds from the sale of eight assets to reduce its net debt of Rs. 2,372 crore (SEL and SIPL combine) to Rs. 650 crore. Further, with receipt of net proceeds of Rs. 250 crore for Ahmedabad Ring Road, net debt is expected to further reduce to Rs. 400 crore. The deal will also help in freeing up Rs. 150 crore bank guarantees and Pledging of SIPL is expected to reduce to 28%.

### Key result highlights from earnings call

- ◆ **Lower execution during Q3:** The company's standalone revenue was affected by 1) extended monsoon in October 2019; 2) SIPL had tied up Rs. 550 crore for equity, but lenders did not disburse any fund for the last 15 months in HAM projects; and 3) Right of Way was not available in some HAM projects due to land-acquisition issues because of which lenders reduced funding frequency.
- ◆ **Guidance significantly lowered:** Management has significantly lowered FY2020 and FY2021 revenue guidance to Rs. 2,400 crore and Rs. 3,200 crore from earlier Rs. 3,200 crore and Rs. 3,600 crore, respectively, on account of weak Q3.
- ◆ **IndInfraVIT deal:** IndInfraVIT completed the acquisition of six out of nine operational road projects of SIPL for total equity value of Rs. 1,891 crore for which it will receive Rs. 724 crore worth units (~10% stake in the trust) and Rs. 1,167 crore in cash (expected by month end). The Mysore Bellary and Aurangabad Jalna projects are expected to close before the month end, with equity value of Rs. 473.6 crore. The Ahmedabad Ring Road project (equity value of Rs. 267.2 crore) will be closed once it receives the necessary approvals.
- ◆ **Debt-reduction plan:** The company will be utilising Rs. 2,365 crore proceeds from the sale of eight assets to reduce its net debt of Rs. 2,372 crore (SEL and SIPL combine) to Rs. 650 crore. Further, with receipt of net proceeds of Rs. 250 crore for Ahmedabad Ring Road, net debt is expected to further reduce to Rs. 400 crore. The deal will also help in freeing up Rs. 150 crore bank guarantees and Pledging of SIPL is expected to reduce to 28%.

- ◆ **Equity requirement:** The company's gross equity requirement is Rs. 375 crore and has Rs. 195 crore O&M order book at SIPL level. Hence, net equity requirement stands at Rs. 250 crore for couple of years, which will be financed through dividend received from IndInfravit trust (11-12% yield on Rs. 724 crore investment) and O&M margins from its Rs. 4,000 crore order book (20% margin on Rs. 300 crore revenue).
- ◆ **Order book:** The company's order book stood at Rs. 8,726 crore with cancellation of three orders worth Rs. 1,800 crore and change of scope of work in few projects.
- ◆ **Pending appointed dates for projects:** The company received appointed date for Vadodara Kim project, while Gadag Honnali is expected to receive February 27, 2020, as the appointed date as over 80% land is available. It has also received forest clearance for Mumbai-Nagpur project, which has Rs. 550 crore to be done on 9km stretch.

Results (Standalone)					Rs cr	
Particulars	Q3FY2020	Q3FY2019	y-o-y%	Q2FY2020	q-o-q%	
<b>Net sales</b>	<b>440.0</b>	<b>925.5</b>	<b>-52.5%</b>	<b>565.1</b>	<b>-22.1%</b>	
Total expenses	385.2	814.7	-52.7%	495.5	-22.3%	
<b>Operating profit</b>	<b>54.8</b>	<b>110.8</b>	<b>-50.5%</b>	<b>69.6</b>	<b>-21.2%</b>	
other income	7.6	12.7	-40.1%	6.4	20.2%	
Depreciation	26.8	24.1	10.9%	27.7	-3.4%	
Interest	23.1	29.1	-20.6%	20.7	11.8%	
Exceptional items	0.0	0.0		0.0		
Profit Before Tax	12.6	70.3	-82.1%	27.6	-54.2%	
Taxes	1.0	14.1	-93.1%	1.7	-43.6%	
PAT	11.7	56.3	-79.3%	25.9	-54.9%	
<b>Adjusted PAT</b>	<b>11.7</b>	<b>56.3</b>	<b>-79.3%</b>	<b>25.9</b>	<b>-54.9%</b>	
No of equity shares	17.2	17.2	0.0%	17.2	0.0%	
EPS (Rs.)	0.7	3.3	-79.3%	1.5	-54.9%	
OPM (%)	12.5%	12.0%	49 bps	12.3%	15 bps	
NPM (%)	2.6%	6.1%	-343 bps	4.6%	-193 bps	
Tax rate (%)	7.7%	20.0%	-1237 bps	6.2%	144 bps	

Source: Company; Sharekhan Research

## Outlook

**Expect execution improvement from Q1FY2021:** SEL has trimmed down its revenue guidance for FY2020 and FY2021 on account of weak execution during Q2 and Q3. However, its current order backlog at Rs. 8,726 crore (3x its TTM revenue) and expected improvement in order inflows (five bids submitted totaling Rs. 4,523 crore EPC projects) should aid in putting SEL back on execution from Q1FY2021. Further, closure of the deal with IndInfravit will significantly aid in deleveraging its balance sheet and freeing up bank guarantees to focus on upcoming bids and execution of current projects. Hence, although the company suffered from weak execution during FY2020 as a whole, it should be back on track from Q1FY2021.

## Valuation

**Maintain Buy with a revised PT of Rs. 120:** Weak execution in SEL's standalone business in Q2 and Q3 along with lower guidance from management led to steep cut in net earnings estimate for FY2020-FY2021. However, with SIPL's nine project sale deal with IndInfravit getting closed and majority of funds to be received by the end of the current month, SEL should be back on the execution of projects from Q1FY2021. The company's strategy of bidding for EPC projects and proper evaluation HAM projects (learnt from past experiences) should aid in better order accretion going ahead. We have retained our Buy rating on the stock with a revised PT of Rs. 120, factoring cut in standalone estimates and rolling forward our EPC valuation multiple to FY2022E earnings.

## About company

SEL, incorporated in 1988, is engaged in 1) EPC business for transport, mining and irrigation sectors; and 2) development of roads and highways on a BOT basis through SIPL. SEL has a healthy order book of Rs. 8,726 crore (3.0x its TTM standalone revenue). The company has robust in-house integrated execution capabilities with qualified human resources and owned equipment. The company has been making profits since its inception in its standalone business and has paid regular dividends for the past 16 years.

## Investment theme

We expect SEL to benefit from improved order execution, enhanced order inflows (particularly from the transport segment) and resolution of working capital issues, resulting in a sturdier balance sheet. The company's recent stake sale is likely to significantly deleverage its balance sheet. The reverse merger of SIPL with SEL can lead to an asset-light business model with focus on core EPC and O&M execution. Further, expected improvement in outlook for the Indian roads sector and limited competitive intensity augur well for SEL as it is present in both the asset creation and EPC verticals.

## Key Risks

- ◆ Delay in receipt of appointed dates for HAM projects can lead to lower earnings.
- ◆ Inability to fructify asset sale deal with IndInfravit can limit its ability to bid for future projects.
- ◆ Weak macro-economic environment leading to lower traffic at toll projects affects valuation.

## Additional Data

### Key management personnel

Mr. Vishnubhai M Patel	Chairman Emeritus
Mr. Shashin V. Patel	Chairman and Managing Director
Mr. Nitin R Patel	CFO & Whole time Director
Mr. Tushar D Shah	Company Secretary & Compliance Officer

Source: Company Website

### Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	PATEL SHANTABEN VISHNUBHAI	28.07
2	PATEL SHANTABEN V	28.07
3	SADBHAV FINSTOCK PVT LTD	9.64
4	HDFC Asset Management Co Ltd	9.27
5	ICICI Prudential Life Insurance Co	6.97
6	SBI Funds Management Pvt Ltd	4.13
7	PATEL SHASHIN	3.64
8	Reliance Capital Trustee Co Ltd	3.5
9	Patel Vikramkumar R	2.7
10	Aditya Birla Sun Life Asset Manage	2.67

Source: Bloomberg

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by BNP PARIBAS

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