ANANDRATHI

India I Equities

Construction

Initiating Coverage

28 October 2014

Ahluwalia Contracts India

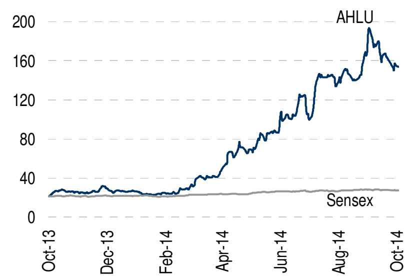
Back on growth trajectory; initiating with a Buy

Rating: **Buy**
Target Price: ₹237
Share Price: ₹147

Key data	AHLU IN / AHLU.BO
52-week high / low	₹198 / ₹21.2
Sensex / Nifty	26753 /7992
3-m average volume	US$0.6m
Market cap	₹10bn / US$179m
Shares outstanding	62.4m

Shareholding pattern (%)	Sep '14	Jun '14	Mar '14
Promoters	72.61	72.61	72.61
- of which, Pledged	*19.55*	*19.55*	*18.76*
Free Float	27.39	27.39	27.39
- Foreign Institutions	12.55	12.70	13.48
- Domestic Institutions	2.35	-	-
- Public	12.49	14.69	13.91

Relative price performance



Source: Bloomberg

Key takeaways

Optimum order-mix assuring. Ahluwalia Contracts India, (AHLU) is sharpening its focus on govt contracts as they are more scalable and highly predictable in terms of execution. Its exposure to the private sector has, thus, reduced from 85% to 48%. This shift in order mix has caused a turnaround in its operations with operating profits rising over last two quarters. Going forward, the company aims to maintain the public-private mix at 60:40.

Strong order inflow continues. A major operator in the building segment, AHLU has a good track record of execution. Its strong order book of ~₹32bn (3.2x TTM revenue) covers 80 projects in more than 15 states. The company could also be a huge beneficiary of new redevelopment orders in the NCR and we expect its orderbook to increase to over ₹60bn in FY17.

Profitability back on track. In the past two quarters, operating margin is up 820bps and a minor profit was reported in FY14. Also, the company is endeavouring to minimise providing bank guarantees to private clients, which has strengthened its balance sheet. Margins could improve from 4.3% in FY14 to 11%+ in FY17, with AHLU done with majority of its loss-making orders and new orders coming at 11%+.

Litigations not an overhang. AHLU has been cleared in the case of Talkatora stadium project and expects to receive outstanding dues of ₹250m in 2-3 months. Further, we believe it has a strong case in most of the other litigations, and do not see any major liability arising out of these actions in future.

Our take. The company is swiftly moving towards a significant turnaround in operations, with margins rising from 4.3% in FY14 to 11% in FY17. Return ratios are expected to increase from lower single digit to higher twenties over the period. We initiate coverage on the stock with a target price of ₹237 based on 14x FY17e PE. **Risks.** Lack of building orders from govt. sector, any major liability arising out of litigations.

Key financials (YE Mar)	FY13	FY14	FY15e	FY16e	FY17e
Sales (₹m)	13,882	9,603	11,948	14,340	17,208
Net profit (₹m)	(820)	76	474	763	1,135
EPS (₹)	(13.1)	1.2	7.1	11.4	16.9
Growth (%)	NA	NA	481.0	61.1	48.8
PE (x)	NA	120.8	20.8	12.9	8.7
EV/EBITDA (x)	NA	26.2	10.8	7.7	5.4
PBV (x)	0.9	0.8	0.6	0.5	0.4
RoE (%)	(33.9)	3.6	17.3	21.1	24.9
RoCE (%)	(14.5)	6.9	19.1	23.5	28.7
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Net gearing (x)	0.72	0.76	0.44	0.26	0.10

Source: Company, Anand Rathi Research

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m)

Year-end: Mar	FY13	FY14	FY15e	FY16e	FY17e
Net revenues	13,882	9,603	11,948	14,340	17,208
Revenue growth (%)	2	(31)	24	20	20
- Oper. expenses	14,170	9,186	10,907	12,919	15,276
EBIDTA	(288)	417	1,041	1,421	1,932
EBITDA margin (%)	(2)	4	9	10	11
- Interest expenses	334	363	380	345	330
- Depreciation	352	122	133	151	165
+ Other income	154	144	130	135	140
- Tax	1	1	184	297	442
Effective tax rate (%)	(0)	0	28	28	28
Reported PAT	(762)	217	474	763	1,135
+/- Extraordinary items	58	141	-	-	-
+/- Minority interest	-	-	-	-	-
Adjusted PAT	(820)	76	474	763	1,135
Adj. FDEPS (₹/sh)	(13)	1	7	11	17
Adj. FDEPS growth (%)	102	(109)	481	61	49

Source: Company, Anand Rathi Research

Fig 2 – Balance sheet (₹ m)

Year-end: Mar	FY13	FY14	FY15e	FY16e	FY17e
Share capital	126	126	134	134	134
Reserves & surplus	1,919	2,136	3,101	3,864	5,000
Net worth	2,044	2,262	3,235	3,998	5,134
Minority interest	-	-	-	-	-
Total debt	2,322	2,265	2,065	1,865	1,665
Def. tax liab. (net)	(162)	(162)	(162)	(162)	(162)
Capital employed	**4,205**	**4,364**	**5,138**	**5,701**	**6,636**
Net fixed assets	1,793	1,984	2,051	2,100	2,135
Investments	15	15	15	15	15
- of which, Liquid	-	-	-	-	-
Net working capital	1,542	1,820	2,437	2,740	3,319
Cash and bank bal.	855	545	634	846	1,167
Capital deployed	**4,205**	**4,364**	**5,138**	**5,701**	**6,636**
Net debt	1,468	1,720	1,430	1,019	498
WC days	49	64	65	66	64
Book value (`/sh)	162	180	241	298	383

Source: Company, Anand Rathi Research

Fig 3 – Cash-flow statement (₹ m)

Year end: Mar	FY13	FY14	FY15e	FY16e	FY17e
PAT	(820)	76	474	763	1,135
+Non-cash items	352	122	133	151	165
Cash profit	(468)	198	607	914	1,300
- Incr./(Decr.) in WC	(666)	277	618	302	579
Operating cash flow	198	(79)	(11)	612	721
-Capex	325	313	200	200	200
Free-cash-flow	(127)	(393)	(211)	412	521
-Dividend	0	0	0	0	0
+ Equity raised	-	(0)	500	-	-
+ Debt raised	306	(58)	(200)	(200)	(200)
-Investments	(120)	(0)	-	-	-
-Misc. items	(58)	(141)	-	-	-
Net cash-flow	356	(309)	89	212	321
+Opening cash	499	855	545	634	846
Closing cash	855	545	634	846	1,167

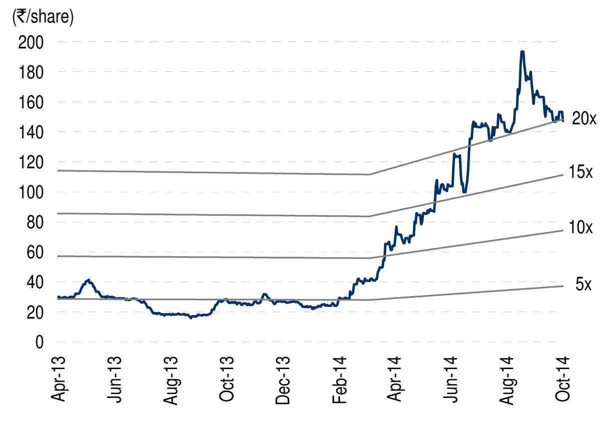
Source: Company, Anand Rathi Research

Fig 4 – Ratio analysis @ ₹147

Year end: Mar	FY13	FY14	FY15e	FY16e	FY17e
P/E (x)	NA	120.8	20.8	12.9	8.7
P/E Core (x)	NA	120.8	20.8	12.9	8.7
P/B (x)	0.9	0.8	0.6	0.5	0.4
EV/EBITDA (x)	NA	26.2	10.8	7.7	5.4
RoE (%)	(33.9)	3.6	17.3	21.1	24.9
RoCE (%)	(14.5)	6.9	19.1	23.5	28.7
Fixed Asset turnover (x)	4.2	2.9	3.3	3.6	4.1
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Dividend payout (%)	(0.0)	0.0	0.0	0.0	0.0
Interest exp./Sales	2.4	3.8	3.2	2.4	1.9
Debtors (days)	122	179	179	175	175
Revenue growth (%)	1.8	(30.8)	24.4	20.0	20.0
PAT growth (%)	NA	NA	520.2	61.1	48.8
EBITDA growth (%)	(260.9)	(245.0)	149.5	36.5	36.0
EPS growth (%)	101.9	(109.3)	481.0	61.1	48.8

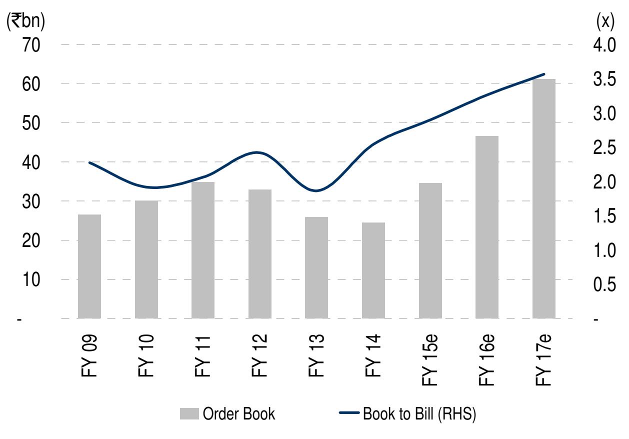
Source: Company, Anand Rathi Research

Fig 5 – PE band



Source: Bloomberg, Anand Rathi Research

Fig 6 – Order-book vs Book-to-bill

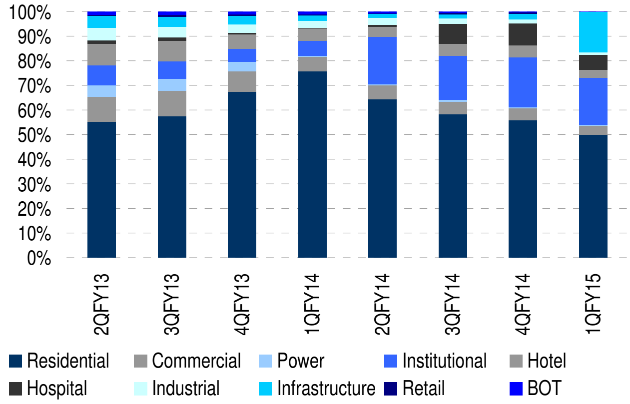


Source: Company, Anand Rathi Research

Strong order book

AHLU is a major operator in the buildings segment, with a healthy order book of ~₹32bn, 3.2x TTM revenue and good execution record. Its orderbook is diversified geographically as well as segment-wise. Within buildings, it is present across industrial, commercial, institutional, residential, hotel, hospital, etc. Although residential segment holds the lion's share in its orderbook, proportion of infra has picked up with higher share of the govt orders.

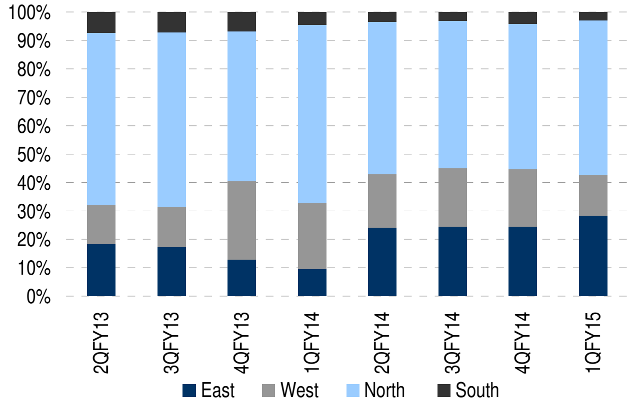
Fig 7 – Order-book breakup (segment-wise)



Source: Company, Anand Rathi Research

AHLU is a pan-India player and dominant in the National Capital Region (NCR). Besides, its exposure to the eastern region is increasing. It recently bagged significant orders of ₹6.15bn to construct institutional/commercial buildings. Of these, one is headquarters for the Punjab National Bank in Dwarka, Delhi, of ₹2.02bn; another is headquarters of the Police Bhawan in Patna, of about ₹3.3bn. These are to be executed in the next 2.5 years.

Fig 8 – Orderbook break-up (geographically)

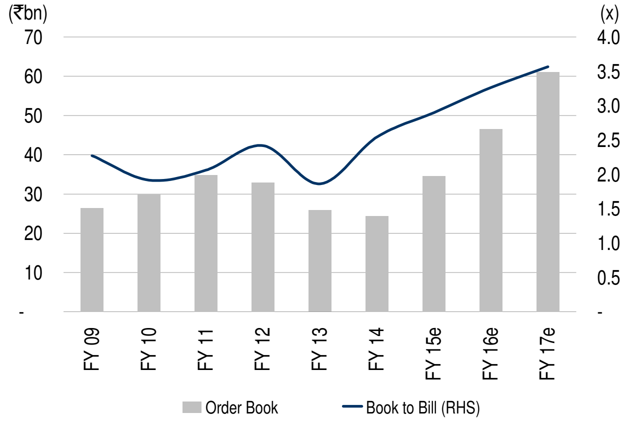


Source: Company, Anand Rathi Research

Management is confident of stable order inflows from various govt agencies in the next 2-3 years. It is likely to be a huge beneficiary of the redevelopment orders coming up in Delhi. Govt. companies like NBCC can provide a huge fillip to the company's orderbook given the expected increase in their orderbook. Management believes that competitive intensity in turnkey building orders is comparatively low as there are very few operators for high-ticket-size orders.

The company has a good set of clients, including the Central Public Works Department (CPWD), NBCC, the Ministry of Health and Family Welfare (AIIMS), the Airport Authority of India, the Delhi Metro Rail Corp. and private operators such as Reliance Infrastructure, Tata Housing Development, EMAAR-MGF Land, Interglobe Hotels (Accor group), amongst others. Its relationship with private parties secures it many repeat orders.

Fig 9 – Orderbook v/s book-to-bill



Source: Company, Anand Rathi Research

Major ongoing projects as on July'14

AHLU has 80 ongoing projects across high-rise residential, commercial complexes, luxury hotels, institutional buildings, hospitals & medical colleges, corporate office complexes, IT parks & industrial complexes, metro rail stations & depots, power plants, motorised car parking and many others. Few other major projects are as follows.

Fig 10 – Major ongoing projects

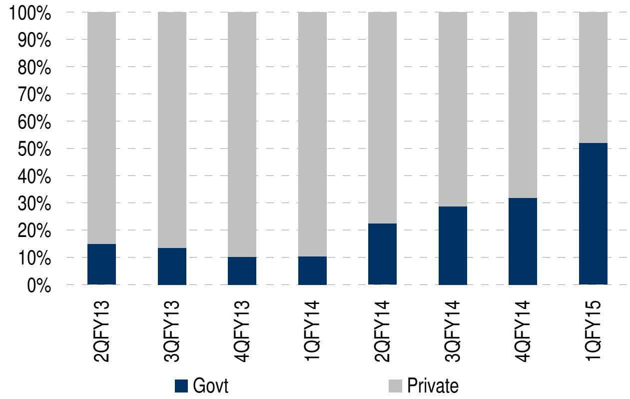
On-going projects	Value (₹m)
Housing Development and Infrastructure, Mulund, Mumbai	4,237
Construction of an international convention centre, Patna	4,177
DDA: Narela, Delhi	3,389
Police headquarters, Patna	3,350
PNB head-office building at Dwarka, Delhi	2,029
Commercial complex "GYS Vision" at Sector-62, Gurgaon	2,100
Emaar MGF: "Palm Drive" at Sector-66, Gurgaon	1,974
Construction of an emergency block of Safdarjung Hospital	1,967
Residential building project "Jaypee Kensington", Noida	1,773
Group housing project "Winter Hills", Gurgaon	1,695
Residential building project "Logix Bloosoom", Noida	1,670
Infrastructure building for the National Intelligence Grid	1,542
Construction of three elevated metro stations, Bangalore	1,444
Construction of a multi-storey complex (Jewel of Noida), Noida	1,300

Source : Company

Diversified revenue profile

AHLU has consciously reduced its exposure to private-sector contracts to 48% in 1QFY15 from 85% in 2QFY13. Proportion of govt contracts, on the other hand, has increased to 52% in 1QFY15 from 15% in 2QFY13. Govt contracts are more scalable and highly predictable in terms of execution, offering the company surety of revenue and consistent payment against their bills. Of late, the company has bagged contracts worth ₹10bn mainly from the govt and expects to maintain its public-private mix at 60:40 in future.

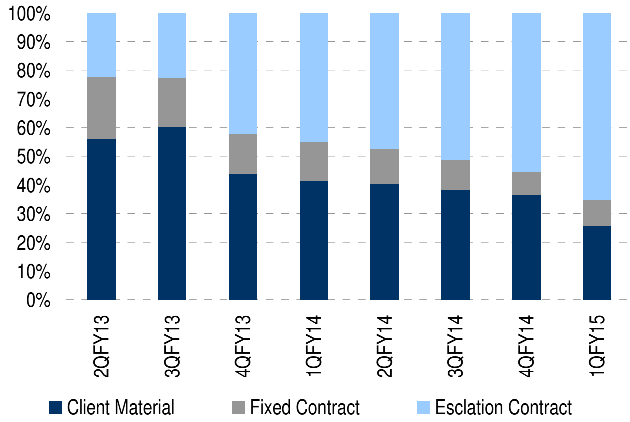
Fig 11 – Order-book mix: Government vs. private



Source: Company

As a part of its macro strategy, AHLU has been reducing exposure to the fixed price contracts and moving towards the escalation contracts. Its fixed price contracts have reduced from 22% in 2QFY13 to 9% in 1QFY15, leading to more predictable profitability.

Fig 12 – Order-book mix: Fixed price vs. escalation contracts

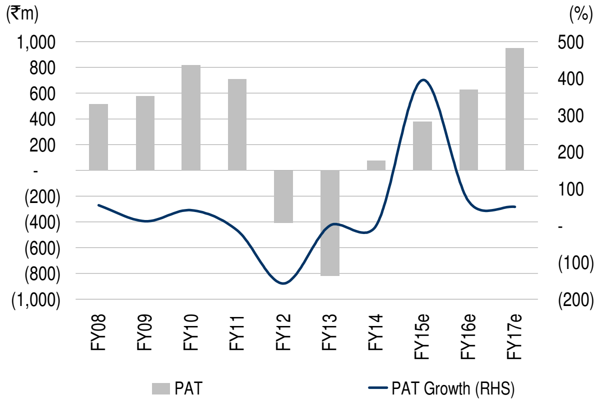


Source: Company

Back to profitability

Until FY11, AHLU had a strong history of consistent performance. FY12 and FY13, however, saw a significant slowdown in orders and execution because of global concerns, sluggish progress in domestic reforms, regulatory decisions and poor sentiment, in general. AHLU was particularly hit owing to: (1) Reduction in fund- and non-fund-based limits by banks; (2) more debtors days due to litigation in certain cases; and (3) higher exposure to private-sector contracts. Hence, the company suffered losses of ₹406m and ₹762m in FY12 and FY13, as did many other major construction companies.

Fig 13 – PAT dipped in FY12 and FY13



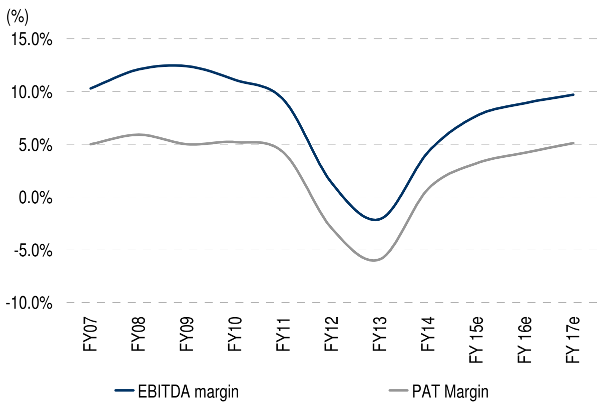
Source: Company, Anand Rathi Research

In the past two quarters, however, EBITDA margin has turned around, rising 820bps, due to corrective measures taken by the management such as:

- Negotiation with clients to revise order value, to include escalation and also to revise scope of work. and completion of most of loss-suffering contracts
- Proposed equity infusion of ₹500m by promoters
- Unsecured loan of ₹238m infused by promoters (till June'14)
- Promoters' pledge of personal assets of above ₹1bn, which could enhance the company's borrowing limits
- Sale of non-core assets to increase cash flow.

In FY14, AHLU clocked 4.3% EBITDA margin and ~0.8% PAT margin. Net profit was at ₹217m vs. ₹406m and ₹762m losses in FY12 and FY13, respectively.

Fig 14 – Margins getting back on track



Source: Company, Anand Rathi Research

Litigations not an overhang

AHLU has been cleared in the case of the Talkatora stadium project by the CBI on the common wealth program. It expects to receive outstanding dues of ₹250m in the next 2-3 months.

A major case involving payment to be received from Emmar MGF, where claims of ₹4.2bn were made (actual debtors associated is ₹450m) remains under litigation. Management is very confident of receiving these dues and, hence, has not written off the debtors as bad.

The issue relating to service tax on the wrongful availing of abatement because of the free supply of material by the client is likely to be cleared by the bench as a similar case has already been decided in favour of the company and also, many other contractors involved in a similar case, hence we believe a solution should come soon as and when other matters on similar issues will be tabled before the court for hearing.

In the case relating the Employees Provident Fund, the management believes that the demand is arbitrary and there are errors in calculation of PF demand and, hence, the case is likely to be in the company's favour.

We believe the company has a strong case in most of the litigations, and do not see any major liability arising out of these actions.

Fig 15 – Contingent liability breakup

Particulars (₹m)	FY14	FY13	Comment
Counter-guarantees given to bankers against bank guarantees	3,846	4,397	Normal course of business
Indemnity bonds / performance bonds/sureties Bonds / corporate guarantees given to clients	1,539	1,219	Normal course of business
Value-added-tax liability	20	354	Normal course of business
Demand for stamp duty on real-estate project	6	6	Normal course of business
Claims against the company not acknowledged as debt	505	500	Smaller multiple claims, which management believes will come in their favour and are baseless
Excise duty demand for FYs1998-99 and 2000-2001	1	4	Normal Course of business
Service tax demand on alleged			
- wrong availment of abatement on account of free supply of material by client*	2,092	2,031	No liability likely, based on similar case outcomes which has been in favour of the company
- composition scheme	1,194	874	Due to ambiguity in law; also obtained favourable opinions from learned councils. Hence, demand is not likely to materialise.
- exempted projects	478	467	Due to ambiguity in law; also obtained favourable opinions from learned councils. Hence, demand is not likely to materialise.
- Others	471	466	Due to ambiguity in law; also obtained favourable opinions from learned councils. Hence, demand is not likely to materialise.
Provident-fund demand	546	546	Outcome likely in two years

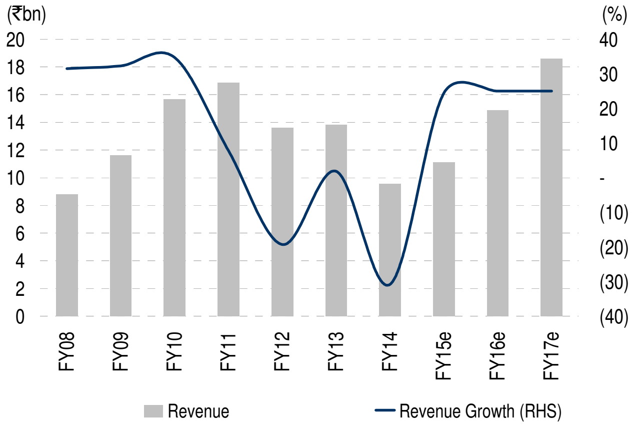
Source: Company, Anand Rathi Research

Financials

Revenues strong

On the back of its proven execution capabilities, healthy order backlog and altered strategy to shift to government contracts, AHLU is likely to report strong revenue growth in the next two years. We estimate 22% CAGR in revenue over FY14-17. In 1QFY15, it bagged orders of ₹10bn, expected to be reflected in strong growth over FY15/17.

Fig 16 – Strong revenue growth likely

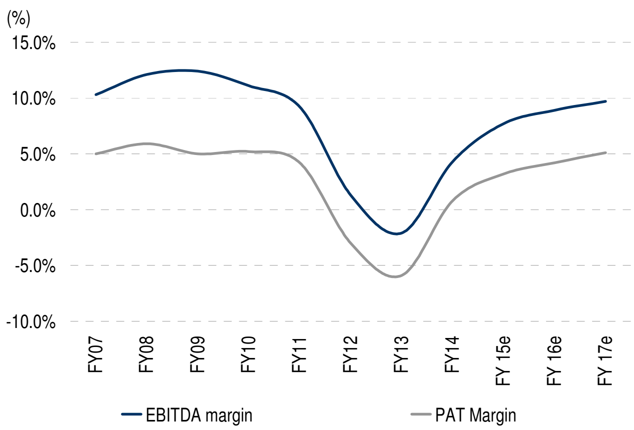


Source: Company, Anand Rathi Research

Stable margins

We expect EBITDA margin to improve significantly as the company has finished with most of the old loss-suffering fixed-price contracts. Currently, loss-making-orders comprise less than 1% of the orderbook, for which the company has already accounted for the necessary write offs. We estimate 145% CAGR in net profit over FY14-17, higher than the industry growth rate, because of the turnaround in operations.

Fig 17 – EBITDA and PAT margin

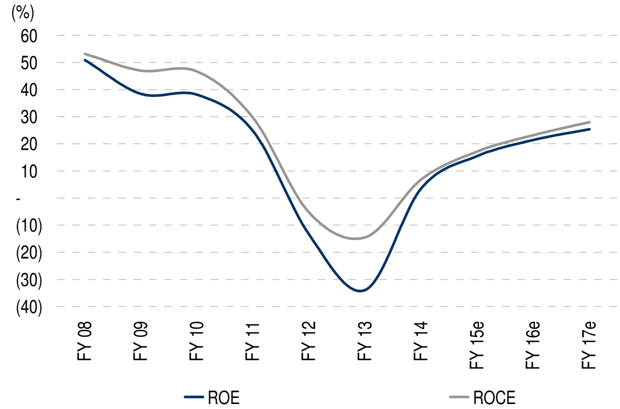


Source: Company, Anand Rathi Research

Return ratios to improve

Better operating performance and low gearing will help the company improve its return ratios. We expect the RoE and RoCE to rise from 3.6% and 6.9% in FY14 to 24.9% and 28.7% in FY17, respectively.

Fig 18 – Return ratios to look up

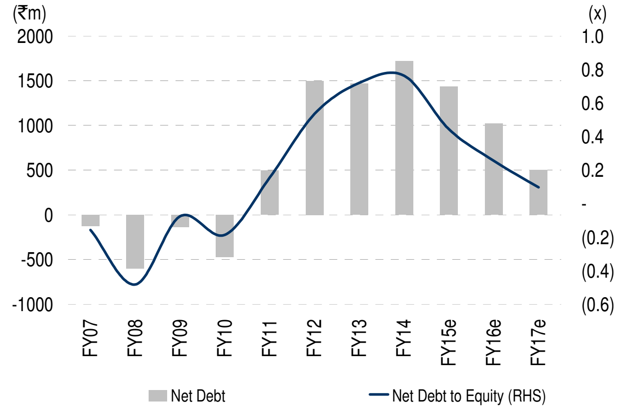


Source: Company, Anand Rathi Research

Debt in check

AHLU held its gearing in control, even through all the tough times. Despite its debtor days increasing, it kept overall working capital lower than most of its peers. Also, its debt-to-equity ratio is one of the lowest in the industry.

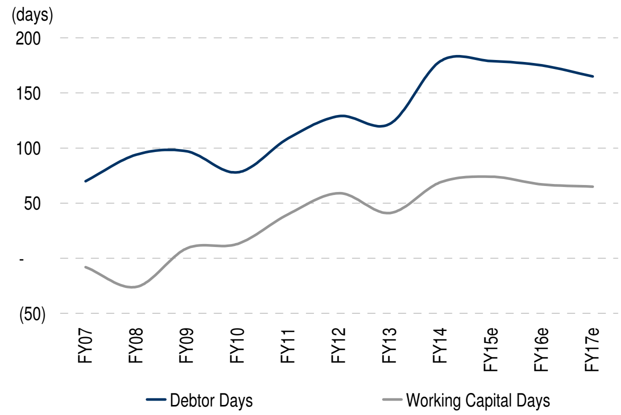
Fig 19 – Net debt and net-debt-to-equity



Source: Company, Anand Rathi Research

Increase in debtor days to 180 has raised working capital cycle to 64 days in FY14. Reduced exposure to private contracts would help reduce debtor days and improve the quality of debtors over time.

Fig 20 – Increase in debtor days has raised working capital

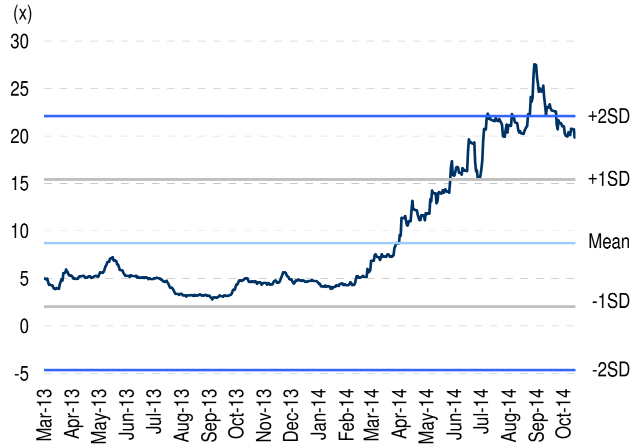


Source: Company, Anand Rathi Research

Valuations

The company is on the path of a significant turnaround in operations, which can lead to revival in margins and hence return ratios over the next three years. We initiate coverage on the stock with a target price of `237 based on 14x FY17e PE.

Fig 21 – 12-month forward PE: Mean & std. deviation



Source: Bloomberg, Anand Rathi Research

Risks

- Lack of building orders from Government & Private sector
- Any major liability arising out of litigations.

Company Background & Management

Company overview

With a rich history of over five decades in construction in India and abroad in diverse areas of infrastructure development, Ahluwalia Contracts (India) is today one of the leading and largest civil contractors in India, having carved a niche for itself with its specialised experience in construction.

Business overview

- AHLU is primarily into construction of buildings. It focuses on residential, commercial, power, hotel, hospital and institutional and industrial projects.
- It is among a select group of 3–4 contractors, along with L&T and Shapoorji Pallonji, who are pre–qualified to bid for most of the mega building projects in India.
- Its backward integration comprises design, civil construction, ready-mix concrete, electro-mechanical, plumbing and fire-fighting, heating ventilating and air-conditioning, aluminium facades and building glasses.

Fig 22 – Management and Board of Directors

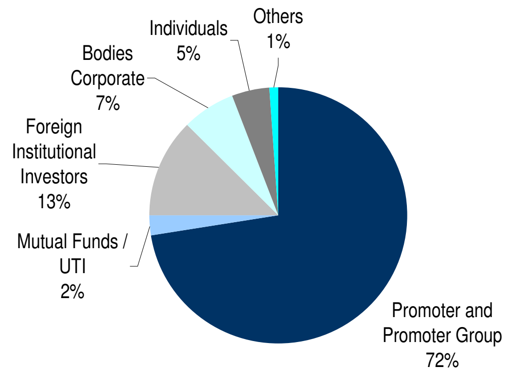
Name	Designation	
Bikramjit Ahluwalia	Chairman & Managing Director	Promoter, founder and chairman. The guiding figure directing, managing and overseeing all activities, has been involved in construction for the last 41 years
Vinay Pal	Whole-time Director	Experience of nearly 29 years in construction; has executed prestigious projects
S K Chawla	Independent Director	About 33 years' experience in handling construction projects and engineering activities. An engineer, been associated with various government departments. Retired as director, CPWD
Shobhit Uppal	Deputy Managing Director	Graduate in electrical engineering and has to his credit more than 17 years experience in multifarious activities relating to infrastructure
Arun K Gupta	Independent Director	CA, with ~30 years experience in subjects relating to tax planning, corporate re-structuring, management-information systems and company law
Sushil Chandra	Independent Director	M.A., Ph.D. At present, director Andhra Cements, Radials International, Tip-Top General Agencies (Germany), Oswal Electricals and Group Industries, Faridabad

Source: Company

Auditors

M/s Arun K. Gupta & Associates

Fig 23 – Shareholding pattern



Source: BSE

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.

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Anand Rathi Ratings Definitions

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

Anand Rathi Research Ratings Distribution (as of 3 September 2014)			
	Buy	**Hold**	**Sell**
Anand Rathi Research stock coverage (196)	60%	27%	13%
% who are investment banking clients	4%	0%	0%

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