

Ahluwalia Contracts India Ltd

21 September, 2015

Poised for growth

Ahluwalia Contracts India Ltd (ACIL), a preferred EPC contractor will benefit immensely from robust rollout of composite package contracts for building and institutions from NBCC, DDA and other government agencies. Current order book of Rs41.0bn comprises 65% government orders won amidst limited competition for composite contracts, are with price escalation clause vs fixed price earlier which will support margin expansion to 11.9%/13% for FY16/FY17 compared to 10.8% in FY15. Private sector orders which face severe payment challenges are reduced to 35% of the orderbook vs 68% in FY14. Improved quality of orderbook provides visibility for 22% revenue CAGR over FY15-FY18. Lower working capital in government orders, minimal capex requirement and deleveraged balance sheet and improve ROE/ROCE to 24%/31% for FY17.

At CMP, the stock trades at 20.3x/14.6x FY16/FY17 earnings respectively. We initiate coverage on Ahluwalia Contracts with a XXX rating and target price of XXX.

Key beneficiary of government's robust pipeline – order inflows to swell

Strong thrust of government on providing social infrastructure, has created robust order pipeline that includes 1) NBCC tenders aggregating to ~Rs400bn over 3-5 years comprising of government building orders and redevelopment orders from DDA 2) ~16% rise in budgeted capital outlay for Urban Development 3) Housing for All by 2022, 20mn houses in urban areas 4) setting up multiple new IIT/IIMs, medical colleges and private institutes like Amity, Kolkata and 4) orders for hospitals (new AIIMS). As a result, ACIL's order accretion YTD FY16 from government orders is at Rs6.7bn (Rs16bn FY16 guidance) and is favorably placed (L1) in orders worth Rs4.5bn. Given that government's new construction orders are given for composite packages vs separate packages earlier, only 3-5 players are pre-qualified and bid for these packages compared to 12-15 players in pre-2009 cycle. We feel L&T and Shapoorji Palonji given their scale will bid for higher ticket size orders compared to average ticket size of Rs1.5-2.0bn where ACIL normally bids. With limited competition and near term bid pipeline of Rs20bn mainly from above orders, we expect XXX CAGR in order accretion over FY16e-FY18e.

Optimum order book mix, strong execution to perk up revenues

ACIL's order book at the end of 1QFY16 was at Rs37bn, well diversified among segments such as residential (44%), institutional (22%), hospitals (16%), infrastructure (13%) and others (5%). By Aug'15 the order book has moved to Rs41bn and sharpening focus on government orders has led to optimum mix of 65:35 for government: private. In spite of NCR being its base and key focus area, the order book is well spread across 16+ states and 50+ cities. Few private sector orders are slow moving given the sluggish balance sheet of developers. Given the large share of government orders where payments are regular and sufficient in house asset base with no immediate capex requirement, ACIL can easily boost execution of current and prospective government orders and perk up revenues. We expect XXX CAGR in revenues over FY15-FY18.

OPM expansion, generation of FCF to boost return ratios to pre-FY11 levels

A ACIL's operating margins have recovered to 10.8%/12.4% in FY15/1QFY16 vs 4.3% in FY14 due to 1) completion of fixed priced legacy orders and 2) renegotiation of current contracts to include input cost escalation (RM+labour). Better bid margins in new compo composite packages, inclusion of price variation clause and limited competition will support OPM expansion to 11.9%/13.0% for FY16/FY17, a level last seen before FY11. This coupled with lower working capital requirement for government contracts at 45-50 days vs 90 days for private contracts, minimal capex requirement will lead to generation of FCF of Rs1.0bn over next 2 years. We expect net gearing to improve to 0.1x and ROE/ ROCE to increase to XXX/XXX respectively in FY17, one of the best in the industry compared to 7-17% for peer construction EPC players.

INITIATING COVERAGE

Sector: Construction **Rating: Not Rated**
CMP: Rs244 **Target Price: XXXX**

Stock Info

Sensex/Nifty	26,219/7,982
Bloomberg	AHLU IN
Equity shares (mn)	67
52-wk High/Low	Rs300/142
Face value	Rs2
M-Cap (Rs bn)/(\$ bn)	Rs16bn/\$0.3bn
3-m Avg volume	\$0.9mn

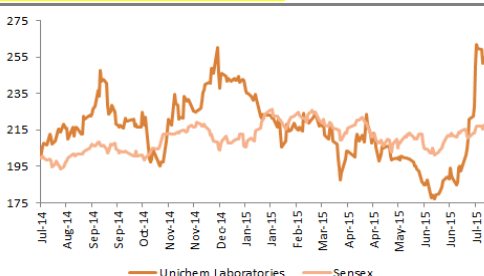
Financial Snapshot (Rs mn)

Y/E Mar	FY16e	FY17e	FY18e
Sales			
EBITDA			
PAT			
EPS (Rs)			
PE (x)			
EV/EBITDA (x)			
P/BV (x)			
RoE (%)			
RoCE (%)			
Dividend yield (%)			
Net gearing (x)			

Shareholding pattern (%)

	Jun '15	Mar '15	Dec '14
Promoter	66.9	66.9	68.9
—Pledged	-	-	-
FII	15.1	15.0	13.6
DII	5.9	5.1	3.3
Others	12.1	13.0	14.2

Stock Performance (1-year)



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FINANCIALS (STANDALONE)

Profit & Loss Statement

YE: Mar (Rs mn)	FY14	FY15	FY16e	FY17e	FY18e
Net revenues	9,603	10,599			
Revenue growth (%)	(30.8)	10.4			
- Op. expenses	9,186	9,451			
EBIDTA	417	1,149			
EBITDA margins (%)	4.3	10.8			
- Interest expenses	363	386			
- Depreciation	122	212			
+ Other income	144	117			
- Tax	1	26			
Effective tax rate (%)	0.2	4.0			
Reported PAT	217	641			
+/- Extraordinary items	141	-	-	-	-
+/- Minority interest	-	-	-	-	-
Adjusted PAT	76	641			
Adj. FDEPS (₹/share)	1.2	9.6			
Adj. FDEPS growth (%)	NA	686.7			

Source: Company, Systematix Institutional Research

Balance Sheet

YE: Mar (Rs mn)	FY14	FY15	FY16e	FY17e	FY18e
Share capital	126	134	134	134	134
Reserves & Surplus	2,136	3,243	4,015	5,051	6,308
Networth	2,262	3,377	4,149	5,185	6,442
Minority interest	-	-	-	-	-
Total Debt	2,386	1,731			
Def. tax liab. (net)	(162)	(154)	(154)	(154)	(154)
Capital employed	4,485	4,955	5,396	6,412	7,519
Net Fixed assets	1,984	1,948	1,916	1,961	2,161
Investments	15	63	112	112	112
- of which liquid	-	-	-	-	-
Net Working capital	1,941	2,179	2,828	3,631	4,293
Cash and bank balance	545	765	540	709	953
Capital deployed	4,485	4,955	5,396	6,412	7,519
Net debt	1,841	967	861	672	278
WC (days)	74	75	81	83	82
Book value (Rs/sh)	36	50	62	77	96

Source: Company, Systematix Institutional Research

Cash Flow

YE: Mar (Rs mn)	FY14	FY15	FY16e	FY17e	FY18e
PAT	76	641	807	1,123	1,408
+ Non cash items	122	220	232	255	300
Cash profit	198	861	1,039	1,378	1,708
- Incr/(Decr) in WC	194	238	650	802	663
Operating cash flow	4	624	389	576	1,046
- Capex	313	175	200	300	500
Free cash flow	(309)	448	189	276	546
- Dividend	0	0	35	87	151
+ Equity raised	(0)	474	-	-	-
+ Debt raised	(142)	(655)	(331)	(20)	(150)
- Investments	(0)	49	49	-	-
- Misc. items	(141)	-	-	-	-
Net cash flow	(309)	220	(225)	169	244
+ Opening cash	855	545	765	540	709
Closing cash	545	765	540	709	953

Source: Company, Systematix Institutional Research

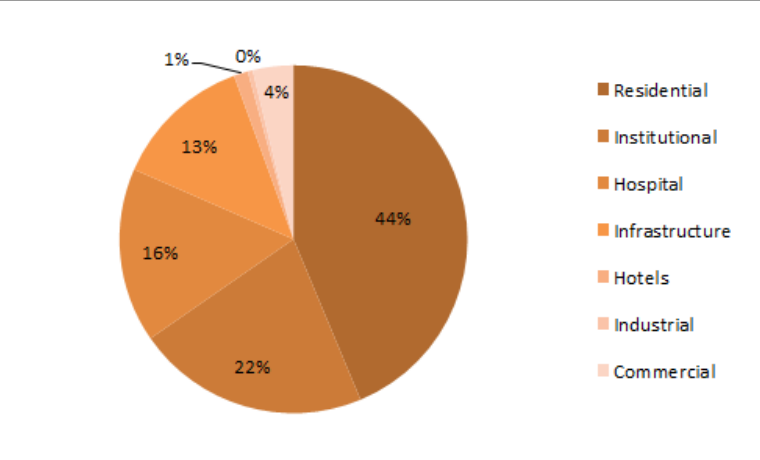
Ratios

YE: Mar	FY14	FY15	FY16e	FY17e	FY18e
P/E (x)	200.5	25.5	20.3	14.6	11.6
P/E Core (x)	200.5	25.5	20.3	14.6	11.6
P/B (x)	6.8	4.9	3.9	3.2	2.5
EV/EBITDA (x)	41.1	15.1	11.4	8.2	6.6
RoE (%)	3.6	22.8	21.5	24.1	24.2
RoCE (%)	6.7	19.9	24.7	30.6	31.6
Fixed Asset turnover (x)	2.9	3.2	3.3	3.6	3.9
Dividend yield (%)	0.0	0.0	0.2	0.5	0.8
Dividend payout (%)	0.0	0.0	3.7	6.7	9.2
Interest exp./Sales	3.8	3.6	2.9	2.1	1.6
Debtors (days)	179	166	160	145	135
Revenue growth (%)	(30.8)	10.4	20.2	25.0	20.0
PAT growth (%)	NA	739.7	25.9	39.2	25.4
EBITDA growth (%)	(245.0)	175.4	31.5	36.5	21.2
EPS growth (%)	NA	686.7	25.9	39.2	25.4

Source: Company, Systematix Institutional Research

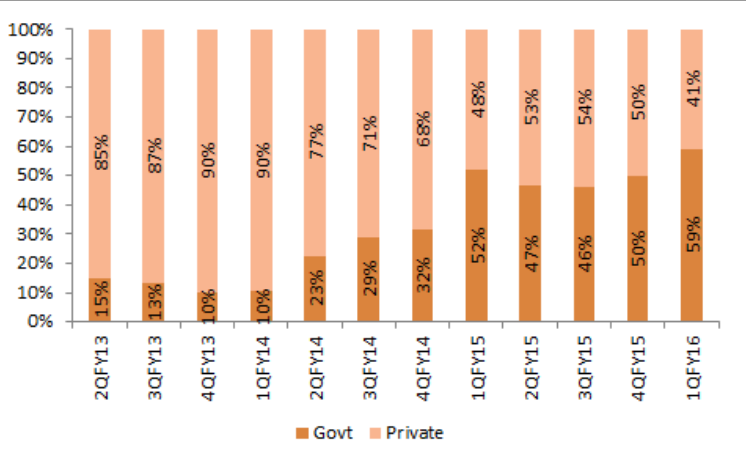
Charting the story

Chart 1: Strong and diversified orderbook: Rs37bn



Source: Company, Systematix Institutional Research

Chart 2: Orderbook mix moving in favour of government



Source: Company, Systematix Institutional Research

Chart 3: Revenue growth to accelerate



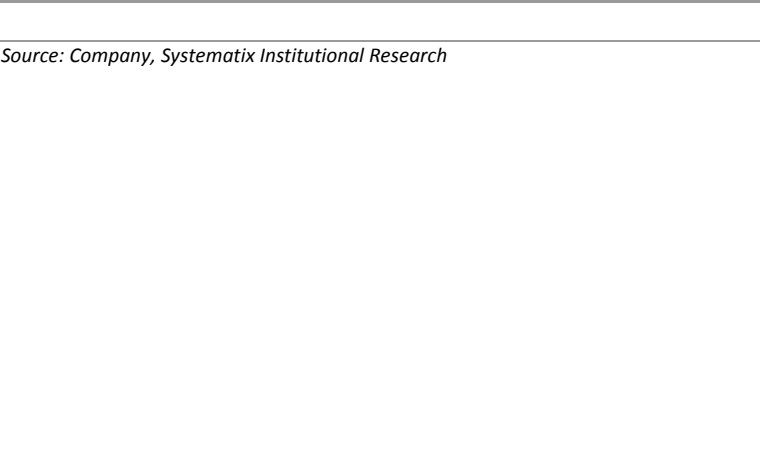
Source: Company, Systematix Institutional Research

Chart 4: OPM & PAT margins springs back to pre-FY11 levels



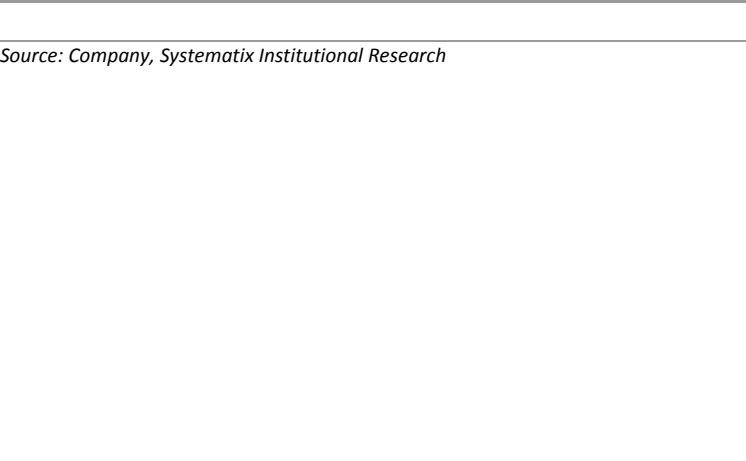
Source: Company, Systematix Institutional Research

Chart 5: Free cash flow generation to retire debt



Source: Company, Systematix Institutional Research

Chart 6:leading to attractive ROE/ROCE



Source: Company, Systematix Institutional Research

Frame by Frame

Chart 7: Institutional

Institutional:

- Indian Institute of Technology (IIT), Mandi
- Ahlcon International School, New Delhi
- Hospital Campus & Medical College for Government of Haryana.
- National Institute of Fashion Technology, Delhi

Institutional Campus Rohtak



Indian Institute of Corporate Affairs, Haryana



Source: Company, Systematix Institutional Research

Chart 8: Residential

Residential:

- Brigade Metropolis & Gateway Towers at Bangalore
- Richmond Park at Gurgaon
- Mass Housing Complex for DDA at Delhi
- Bengal Silver Spring Project – Kolkata

Rosedale, Kolkatta



GYS Residential, Noida



Source: Company, Systematix Institutional Research

Chart 9: Hospitals

Hospitals:

- AIIMS Trauma Center at New Delhi
- Apollo Gleneagles Hospital at Kolkata
- Fortis Hospital at Noida
- Tata Medical Center at Kolkata
- B.L. Kapoor Memorial Hospital at New Delhi

Tata medical centre, kolkatta



Fortis, New Delhi



Source: Company, Systematix Institutional Research

Chart 10: Infrastructure

Infrastructure:

- Integrated Passenger Terminal building at Ranchi Airport
- Pitampura Metro station, DMRC
- Dr. SPM Swimming Pool Stadium
- Complex at New Delhi
- Dwarka Depot for DAMEPL at New Delhi

Metro depot cum workshop, Bangalore**Mumbai Metro Depot**

Source: Company, Systematix Institutional Research

Chart 11: Hotels & Commercials

Hotels:

- ITC Grand Central Seven Star Hotel at Mumbai
- Raddison Hotels at Bhubaneswar
- Four Season Hotel at Mumbai
- IBIS Hotel at New Delhi, Bangalore & Nasik

Commercial:

- First Financial Center for TCG at Mumbai
- Corporate office for HCL Perot Systems at Noida

Commercials**Grand villas for Caparo at greater Noida**

Source: Company, Systematix Institutional Research

Chart 12: Industrial

Industrial:

- Moser Baer plant at Greater Noida
- Cielo Car Plant for Daewoo Motors
- Hyundai Car Plant at Chennai and R&D Centre at Hyderabad
- Electrical works for Michelin Tyre Factory in Chennai

District Court complex, Delhi**Maruti Corporate office, Gurgaon**

Source: Company, Systematix Institutional Research

Key beneficiary of government's robust pipeline – order inflows to swell

Ahuwalia Contracts India Ltd (ACIL) with over five decades of experience has executed marquee contracts and delivered projects across 14+ sectors for various government agencies -- CPWD, NBCC, DDA, AIIMS, DMRC, educational institutes (IIT, IIMs) and private players like Emmar MGF, Tata Housing, Reliance Infra among others.

With strong thrust of government on providing social infrastructure, the order pipeline remains robust led by 1) Tenders from NBCC aggregating to ~Rs400bn to come up for ordering over 3-5 years comprising of government building orders and redevelopment orders from DDA 2) ~16% rise in capital outlay on Urban Development in Feb'15 budget 3) Housing for All by 2022, capital outlay of Rs142bn for 20mn houses in Urban areas and 40mn houses in Rural areas 4) setting up of educational institutes -multiple new IIT/IIMs, medical colleges and private institutes like Amity, Kolkata 4) orders for hospitals (new AIIMS) and institutional buildings by the Central government in various states.

ACIL places bids for contracts with average ticket size of Rs1.5-2.0bn and emphasizes its near term bid pipeline at Rs20bn. It will continue to bid for orders in geographies where it has proven execution track record (namely cites like Delhi, Mumbai, Patna and Kolkata).

Table 1: Few projects in Bid pipeline – Rs20bn, average ticket size Rs1.5-2bn

	Projects	Client
1	IIT Campus, Roorkee	NBCC
2	Bank of India, Mumbai	
3	District Court Complex, Dehradun	NBCC
4	IIM, Raipur	
5	Chitranjan National Cancer Institute, Kolkata	NBCC
6	Indian Culinary Institute, Noida	
7	Brookfield, Gurgaon	
8	Library for Indiabulls, Mumbai	

Source: Company, Systematix Institutional Research

New orders from government are for composite packages vs separate packages for civil works, electrical works, fire-fighting works where 4-5 construction companies are pre-qualified namely L&T, Shapoorji Palonji, Ahluwalia Contracts, Simplex Infra and JMC projects. Traditional competitors like BL Kashyap, CCCL, Era Infra, Unity infra etc are no longer meeting qualification criteria as they lack ability to execute composite contracts and few are going through CDR.

We believe L&T and Shapoorji Palonji may bid for higher ticket size orders given their scale thus reducing the competition to 3-4 players. We expect robust bid pipeline and limited competition can augment ACIL's success rate to win orders from the above bid pipeline and exceed its FY16 order accretion guidance of Rs16bn.

Order accretion for ACIL in FY15 was at Rs13.8bn, up 6.2% yoy. YTD FY16 ACIL has won contracts worth Rs6.7bn which include - AIIMS, Delhi: Rs4.9bn; IT Dept, Mumbai: Rs1.6 bn and a private commercial building order where JMC and L&T were other bidders.

In addition, ACIL is L1 in two orders worth ~Rs4.5bn -- 1) Hospital building (HSCC), Kolkata: Rs0.8bn and 2) Hospital building (HSCC), Jhajjar: Rs3.3bn likely to be converted with 45 days. We expect XXX CAGR in order accretion over FY15-FY18.

Optimum order book mix, strong execution to perk up revenues

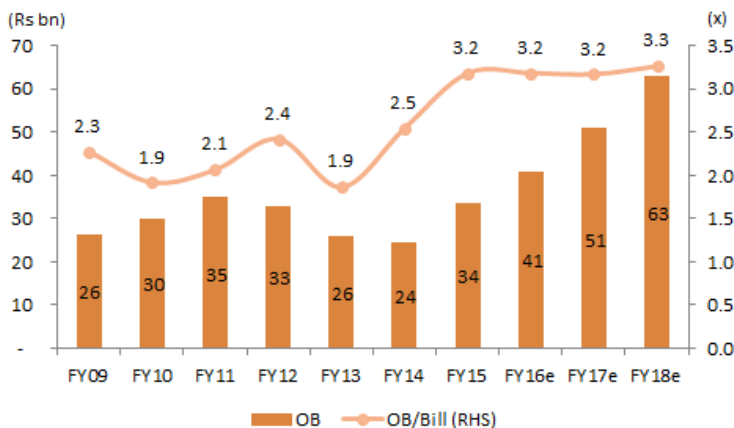
ACIL, a dominant player in the execution of high value building construction contracts, has well diversified portfolio with contracts spread across residential (44%), institutional (22%), hospitals (16%), infrastructure including metros (13%), commercial (3%) and remaining 2% hotels and industrials segment. Inspite of NCR being its base and key focus area, the current construction order book at Rs41.0bn (3.9x FY15 revenue), is well spread across 16+ states and 50+ cities and is to be executed over 2.5-3 years. ACIL's in-house asset base of 175+ batching plants, +99 cranes, +45 transit mixtures etc enables it to offer turnkey solutions in design, civil, RMC, electro-mechanical, plumbing, fire fighting, HVAC among others and will require capex of 10% of incremental revenues above Rs17bn.

In the previous boom, majority of ordering were fixed price contracts from private sector. For ACIL, this number was as high as 90%/68% of the orderbook during FY13/14. However the situation worsened in private construction contracts over the last three years and contractors faced severe execution challenges, deteriorating payment cycle and loss on fixed price contracts led by volatile input prices. Owing to these challenges, ACIL incurred losses/muted operating margins during FY12-FY14. ACIL consciously shifted its focus towards government orders and will continue to bid for contracts only with price escalation clause. Government contracts formed 59% of orderbook in 1QFY16 and have inched up to 65% (Rs26.7bn) in Aug'15. These contracts are high ticket size orders with required clearances in place, enabling faster execution.

Share of private sector orders is reduced to 35% (Rs14.4bn) of orderbook of which ~ 50% of orders are slow moving owing to financial crunch with developers. The management has indicated that they will push deliveries in these orders with caution.

We believe good quality orderbook and robust order accretion can result in XXX CAGR in revenues over FY15-FY18e.

Chart 13: Orderbook –to-Bill provides revenue visibility



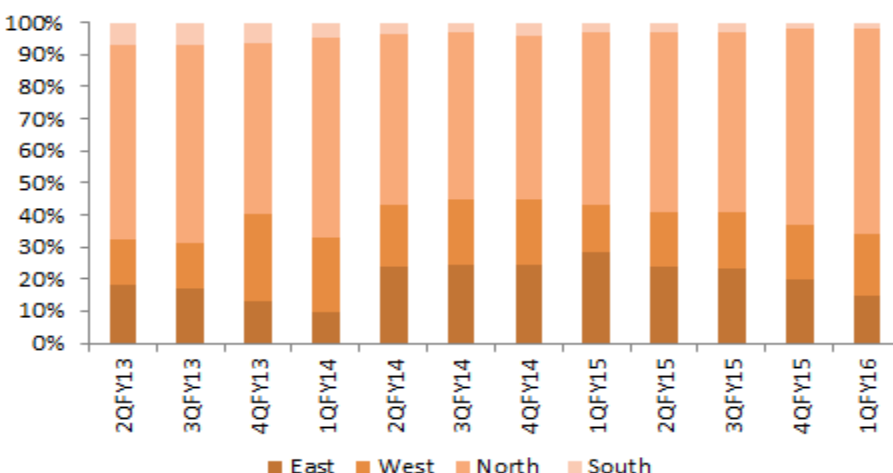
Source: Company, Systematix Institutional Research

Chart 14: Revenue growth to accelerate



Source: Company, Systematix Institutional Research

Chart 15: Geographically well spread orderbook



Source: Company, Systematix Institutional Research

Table 2: Ongoing projects

Projects	Client	Segment	Value (Rs mn)
Construction of Residential Building at Mulund, Mumbai	HDIL Ltd	Residential	3,269
Construction of International Convention Centre at Patna	BCD Patna	Institutional	1,494
Construction of Police Head Quarters at Patna	BCD Patna	Infrastructure	2,921
Construction of Residential Building on design & built basis at Narela, Delhi	DDA	Residential	3,389
Construction of Indian Institute of Management, Rohtak, Haryana	IIM Rohtak	Institutional	3,097
Construction of PNB Head Office Building at Dwarka, Delhi	CPWD	Institutional	1,581
Construction of OPD Block & Other Associates Services in AIIMS Campus Ansari Nagar New Delhi	HSCC	Hospital	2,930
Construction of Mother & Child Block & Other Associates Services in AIIMS Campus Ansari Nagar New Delhi	HSCC	Hospital	2,044
Civil & Structural work of the proposed multistory group housing Project Parteek Grand City Ghaziabad	Prateek Group	Residential	1,652
Construction of Office Building of Income Tax Dept. at BKC Mumbai	CPWD	Institutional	1,631
Construction of Infrastructure Building for National Intelligence Grid	NBCC	Infrastructure	1,542
Construction of Monde De Housing at Gurgaon	Jasmine Buildmart	Residential	1,251
Group Housing Project "Winter Hills" at Sector -77 Gurgaon	Umang Realtech	Residential	464
Construction of Emergency Block of Safdarjung Hospital	HSCC	Hospital	985
Total			28,250

Source: Company, Systematix Institutional Research

To cater to the large opportunity in the affordable housing segment where the government has announced large investments, ACIL has tied up with a Russian company to build structures using a patented high-speed pre-cast construction technology. This technology will lower reliance on labour.

Kota BOT project

ACIL ventured into asset development and ownership by bagging BOT project from Rajasthan State Road Transport Corporation for developing Kota bus terminal and commercial complex. The construction for retail space is complete with project cost of ~Rs800mn. 60% of the area is leased out of the 3, 50,000 sq ft and ACIL expects to launch and collect rentals Rs5-6mn/month from Nov'15. An operator is yet to be finalized for a 50 room hotel which is a part of FSI for which the structure is made.

OPM expansion, generation of FCF to boost return ratios to pre-FY11 levels

During FY07-FY11, ACIL reported superior financial performance compared to industry - operating margins between 9-12%, working capital cycle negative to < 40 days, net debt/equity of < 0.2 and ROE/ROCE in excess of 25% led by benign operating environment and healthy private sector capex cycle. However during FY12-FY14 ACIL faced severe execution challenges due to worsening private sector capex, volatility in prices of raw material and labour along with fixed price contracts impacted operating margins and financial crunch with developers elongated payment cycle which hit the cashflows. Operating margins contracted to -2.3%/4.3% in FY13/FY14 and higher debt drawdown(net debt/equity at 0.8x in FY14) to meet working capital requirements led to higher interest outgo and resulted in loss of Rs406mn/Rs762mn in FY12/13 respectively.

Led by series of corrective measures undertaken by ACIL, the operating margins recovered to 10.8%/12.4% in FY15/1QFY16. These measures include 1) renegotiation of contracts with clients to include escalation of input costs (raw material + labour) 2) near completion of legacy fixed price contracts (Rs250mn) 3) discontinuation to provide bank guarantees to private sector clients and 4) new bids to include price variation clause.

The new government contracts have much better bid margins since these are awarded on composite EPC basis vs separate packages for civil works, electrical works, fire-fighting etc. Given that only few companies have these capabilities, the competition is limited resulting into higher margins for the contractors. Thus, we expect limited competition and better margin government orders to expand OPM to 11.9%/12.9%/13.1% for FY16e/FY17e/FY18e respectively, levels last seen before FY11. Add ratings improvement and cost of debt reducing

Equity infusion of Rs500mn by promoters in Dec'14 along with internal accruals aided in reduction of debt to Rs1.7bn in FY15 from Rs2.4bn in FY14 thereby improving net gearing to 0.3x vs 0.8x respectively. With this, the credit rating for fund and non-fund based limits is expected to improve which will reduce interest cost, LC and BG charges. We 30% PAT CAGR over FY15-FY18e. Lower working capital cycle for government contracts at 45-50 days vs 90 days for private contracts, minimal capex requirement will generate FCF and aid in further debt repayment. We expect net gearing to reduce to XXX in FY17 and ROE/ROCE to improve to XXXX for FY17, one of the best in the industry compared to 7-17% for peer construction EPC players.

Chart 16: OPM to recover back to pre-FY11 levels, FCF +ve

Source: Company, Systematix Institutional Research

Chart 17: Net gearing to improve, ROE/ROCE back to pre-FY11

Source: Company, Systematix Institutional Research

Table 3: Concerns on litigation fade

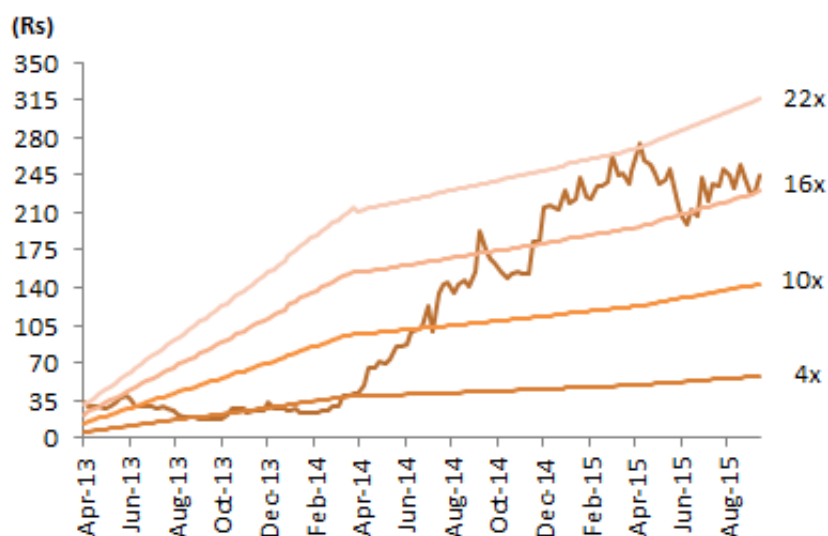
	Particulars	Outstanding	Status
1	Dues outstanding from Talkatora Stadium project	Realised Rs120 mn of the total dues of Rs250 mn; outstanding dues Rs130 mn	Expects to receive in two to three months
2	Payment to be received from Emmar MGF for CWG village project	Made claims of Rs4.2bn against actual debtors of Rs470mn	Under litigation. Management is confident on receiving these dues and hence did not write off debtors as bad
3	Service tax demand on wrong availment of abatement	Rs1.9bn in FY15 on account of free supply of material by client	Case is under the trial of the Tribunal of Service Tax. Similar case was decided in favour of ACIL in the past
4	Employees PF demand	Management believes the demand of Rs546mn is arbitrary	ACIL has been granted a stay by the respective Tribunal

Source: Company, Systematix Institutional Research

Valuation

ACIL's strong execution capabilities, healthy balance sheet and active involvement of management in every stage from ordering to recovery of payments places it in a favorable position to bid and win lucrative projects from government's robust ordering activity. Execution of orderbook over 2.5-3 years provides revenue visibility along with better margin profile and one of the best return ratios in the industry.

At CMP, ACIL trades at 20.3x/14.6x FY16/FY17 earnings respectively. We initiate coverage on Ahluwalia Contracts with a Buy rating and target price of Rs303 (18x FY17). Using similar multiple for FY18, the implied target price is at Rs380.

Chart 18: PE Band: 1 year rolling forward

Source: Company, Systematix Institutional Research

Key risks

Sluggish recovery from private sector debtors can keep working capital at elevated levels and slowdown further debt repayment.

Lack of approvals and clearances in current orders can hamper the execution and revenue growth.

Delay in conversion of government bid pipeline to orders may slow down the order inflow traction.

Any major liability arising out of litigation

Key Management Team

Mr. Bikramjit Ahluwalia (Founder, Promoter and CMD)

- A Civil Engineer, involved in the construction activities for last 41 years.
- Awarded by the Government of India for his valuable services in the Asian Games, 1982 & was also awarded by the Finance Minister of India for the successful completion of the Finance Ministry's Building Complex in New Delhi.
- The deep domain knowledge & industry experience has enabled him hold leadership positions such as the office of President of Builders Association of India.

Mr. Shobhit Uppal (Promoter & Deputy Managing Director)

- Shri Shobhit Uppal is President of the Indian Buildings Congress (IBC).
- An Electrical Engineer, instrumental in bagging and executing many mega projects for the company.

Mr. Vikaas Ahluwalia (Promoter & Chairman-Project Monitoring Committee)

- A Civil Engineer, involved in the construction business since 1996.
- Played a key role in the successful implementation of many big projects for the company and is currently chairing the Project Monitoring Committee.

Institutional Equities Team

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