

Nagarjuna Construction Co.

Q4FY11/ Estimate Change

2 June 2011

Buy

Target Price: Rs108

CMP: Rs87*

Upside: 24%

*as on 1 June 2011

Maintain Buy Despite Disappointing Q4

NCC's Q4FY11 results were the most disappointing among peers with high variance between actual revenue and net profit vs expectations. Though no guidance for FY12 was given, we believe 15-20% revenue growth, which was mentioned in the con-call, is achievable. Order-intake should be better in FY12 with internal power projects alone contributing Rs50bn. We believe constraints for NCC are limited compared to IVRCL (which has to tie-up funding arrangements for BOT projects). But NCC's increasing D/E ratio, before equity infusion in power project and absence of any road asset in the pipeline, makes it a riskier play than IVRCL. The only comfort is the high promoter holding vs IVRCL. We prefer IVRCL over NCC. We have cut our FY12/FY13 earnings estimates by 17%/18%, mainly by lowering revenue estimates. We maintain our Buy rating as we believe the stock still presents a good 24% upside potential from CMP of Rs87.

- **Q4 results disappoints:** Though revenue was expected to be lower than expectations by around 10%, the variance has been the highest at 21%. Operating margin at 9% was also below estimate. Net profit was impacted by the revenue miss, and to some extent lower-than-expected operating margin.
- **Strong order-book:** Order-book is strong at 2.5x book-to-bill, with lower proportion of slow-moving orders vs IVRCL's order-book, which is almost 4x FY11 revenue.
- **Earnings estimates sharply lowered:** We have lowered our FY12/FY13 revenue estimates by 10%/7%, **marginal raised operating margins to 9.8%/9.9% (vs guidance of 11%)** and cut net profit estimates by 17%/18% for FY12/FY13, respectively. ROE is now at 7%/7.4% for FY12/FY13.
- **Maintain Buy, But Prefer IVRCL on risk-reward profile:** We maintain Buy on NCC. We believe the stock still presents a decent upside of 24% from current levels. However, on a risk-reward pay-off, we prefer IVRCL.

Manish Kayal

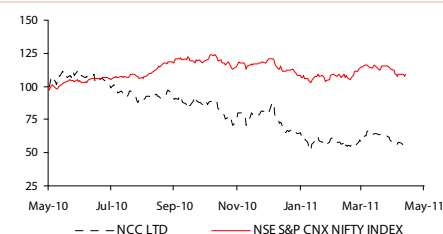
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Key Data

Bloomberg Code	NJCC IN
Reuters Code	NGCN.BO
Current Shares O/S (mn)	256.6
Diluted Shares O/S(mn)	256.6
Mkt Cap (Rsbn/USDmn)	22/490.9
52 Wk H / L (Rs)	197/79
Daily Vol. (3M NSE Avg.)	1,272,619
Face Value (Rs)	2

USD = Rs44.8

One Year Indexed Stock Performance



Price Performance (%)

	1M	6M	1Yr
NJCC	(16.0)	(38.2)	(50.5)
NIFTY	(2.7)	(6.2)	12.5

Source: Bloomberg, Centrum Research
*as on 31 June 2011

Y/E March (Rsmn) (Standalone)	Q4FY11	Q4FY10	YoY (%)	Q3FY11	QoQ (%)	Q4FY11E	Var (%)	FY11A	FY10A	YoY%
Net sales	14,504	10,670	35.9	12,013	20.7	18,442	(21.4)	50,737	47,778	6.2
Consumption of RM	12,331	8,871	39.0	9,817	25.6	15,535	(20.6)	42,221	40,133	5.2
% of sales	85.0	83.1		81.7		84.2		83.2	84.0	
Employee costs & SG&A	864	711	21.5	963	(10.3)	1,127	(23.4)	3,640	2,811	29.5
% of sales	6.0	6.7		8.0		6.1		7.2	5.9	
EBITDA	1,309	1,089	20.3	1,234	6.1	1,780	(26.4)	4,876	4,834	0.9
EBITDA Margin (%) / bps	9.0	10.2	118bps	10.3		9.7		9.6	10.1	51bps
Dep and amortisation	186	129	44.0	168	10.2	198	(6.2)	698	525	32.8
Interest	575	322	78.5	375	53.6	536	7.3	1,682	1,322	27.2
EBT	548	637	(14.0)	691	(20.6)	1,045	(47.6)	2,497	2,987	(16.4)
Other income	56	8	574.0	54	3.7	36	55.2	146	48	204.0
PBT	605	646	(6.4)	745	(18.9)	1,082	(44.1)	2,644	3,035	(12.9)
Provision for tax	248	206	20.2	285	(13.1)	368	(32.6)	1,021	1,204	(15.2)
Effective Tax Rate %/bps	41.0	32.0		38.3		34.0		38.6	39.7	
PAT (reported)	357	439	(18.8)	460	(22.5)	714	(50.1)	1,622	1,831	(11.4)
PAT (adjusted)	357	439	(18.8)	500	(28.7)	714	(50.1)	1,702	1,831	(7.0)
NPM (%) / bps	2.5	4.1		4.2		3.9		3.4	3.8	
EPS (adjusted)	1.4	1.9	(24.9)	1.95	(28.7)	2.8	(50.1)	6.6	7.8	(14.8)

Source: Company, Centrum Research

Y/E Mar (Rsmn)	Revenue	YoY (%)	EBITDA	EBITDA (%)	Adj PAT	YoY (%)	EPS (Rs)	RoE (%)	RoCE (%)	P/E (x)	EV/EBITDA (x)
FY09	41,514	19.4%	3,737	9.0%	1,539	-5.0%	6.7	9.4	11.9	12.9	8.6
FY10	47,778	15.1%	4,834	10.1%	1,998	29.9%	7.8	11.8	12.9	11.1	7.8
FY11E	50,737	6.2%	4,876	9.6%	1,780	-10.9%	6.9	7.1	9.7	12.5	9.7
FY12E	58,219	14.7%	5,730	9.8%	1,708	-4.0%	6.7	7.0	9.6	13.0	8.9
FY13E	69,889	20.0%	6,948	9.9%	1,918	12.3%	7.5	7.4	10.4	11.6	8.1

Standalone; Source: Company, Centrum Research Estimates

Please refer to important disclosures/disclaimers in Appendix A

Centrum Equity Research is available on Bloomberg, Thomson Reuters and FactSet

Q4FY11 results: Shocker after a smooth Q3FY11

- NCC's Q4FY11 results were a complete shocker after a smooth Q3FY11. Revenue at Rs14.5bn was 21% below our estimate of Rs18.4bn and 16% below street's expectation of Rs17bn. The revenue loss was attributed to: (1) Rs1.73bn – Adverse weather condition; (2) Rs2.17bn - Delay in release of payment which eventually halted execution on those specific projects; (3) Rs2.5bn - Delay in handing over land, etc, and other regulatory issues; and (4) Rs1.2bn - Low order-booking during the year. The total revenue loss as said by the company is Rs7.6bn.
- Order-intake was lower than expected in FY11. The company had expected Rs100bn of orders in FY11, which was achievable till Feb'11, but was not met. The actual order-intake came in at Rs68bn.
- Lower margin for FY11 was on account of lower revenue booking. Overall operating margin in FY11 came to 9.6% vs 10.1% for FY10.
- Depreciation, Interest Expenses and other income were broadly inline with expectations.
- Adjusted net profit at Rs422mn was 41% below our estimate of Rs714mn. The variance was mainly on account of lower revenue booking and to some extent lower operating margins.

Exhibit 1: NCC's Q4FY11 Result Analysis

Particulars	Q4FY11A	Q4FY10A	YoY%	Q3FY11A	QoQ%	Q4FY11E	Variance %	FY11A	FY10A	YoY%
Net sales	14,504	10,670	35.9	12,013	20.7	18,442	(21.4)	50,737	47,778	6.2
Consumption of RM	12,331	8,871	39.0	9,817	25.6	15,535	(20.6)	42,221	40,133	5.2
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PBT	605	646	(6.4)	745	(18.9)	1,082	(44.1)	2,656	3,035	(12.5)
Exceptional item (reported)										
Provision for tax	248	206	20.2	285	(13.1)	368	(32.6)	1,021	1,204	(15.2)
Effective Tax Rate %	41.0	32.0		38.3		34.0		38.5	39.7	
JV partner's share in profit										
PAT (reported)	357	439	(18.8)	460	(22.5)	714	(50.1)	1,635	1,831	(10.7)
PAT (adjusted)	422	439	(4.0)	500	(15.7)	714	(41.0)	1,780	1,831	(2.8)
NPM (%)	2.9	4.1		4.2		3.9		3.5	3.8	
EPS (adjusted)	1.6	1.9	(11.2)	1.95	(15.7)	2.8	(41.0)	6.9	7.8	(10.9)

Source: Company, Centrum Research

Key takeaways from the conference call

Guidance not given, but management alluded to revenue growth of 15%-20% for FY12: Though the management elaborated on a business plan for FY12, it also alluded to 15%-20% revenue growth for FY12E, which we believe is reasonable.

Power plant update: The company is likely to complete the financial closure for its 1,320MW power plant at Krishnapatnam, Andhra Pradesh, by the month of July 2011 (earlier target was March 2011, then pushed back to May 2011). The company expects Rs50bn worth of EPC order from this project. The total equity requirement on the project is Rs9bn, out of which NCC's share would be Rs5bn. Management indicated that Rs2.5bn would be required as the company's contribution at the time of financial closure. The source of funds, as per company would be internal accruals.

Update on Road BOT Projects

- **Bangalore Elevated project:** This project is generating Rs1.9mn/month currently vs Rs1.4mn in April 2011. The level to reach break-even is Rs2.5mn and the company is confident to reach that figure in the next 6-9months. **Cost has increased by Rs1.5bn, which is fully financed by the promoters (NCC's share is 38%).**
- **OB Infra project:** CoD is expected anytime as the project is fully completed.
- **Western UP:** Achieved CoD, and is generating Rs1.8mn per day pro-rata (for 51Km out of the total 79Km). **Cost has increased by Rs1.1bn, which is financed by banks to the extent of Rs700mn and rest from promoters.**
- **Pondicherry –Tindivanam:** Project will achieve its CoD in the month of July'11.

Update on Power Projects

- **1,320MW thermal power project:** The management is confident of achieving financial closure of 1,320MW (acquired from Nelcast Energy for Rs1.5bn) by June 2011. The SPV has obtained all clearances (including environmental).
- **Himachal Sorang:** This project is moving as per schedule. The company has already invested Rs1.2bn and would need to invest a further Rs100mn. It is expected to achieve CoD by the month of March 2012.
- **Himalayan Green:** Nothing is happening in this project. It will take at least 1-2years before the project could move forward.

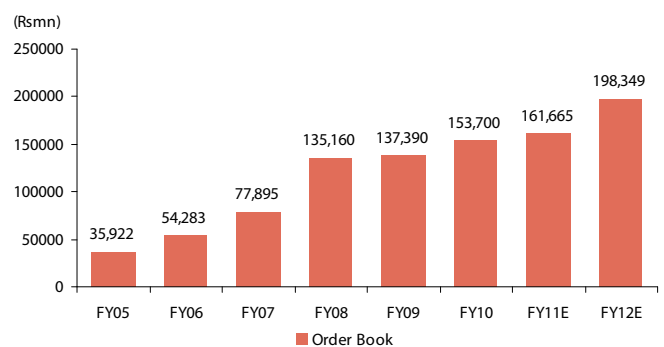
Order-Intake scenario bleak: During Q3FY11, company surprisingly booked orders higher than market expectation and everyone on the street was under impression that the trend would continue. However, the actual order-intake was disappointing. The order-book as on FY11 stands at Rs162bn v/s Rs173bn by the end of Q3FY11.

Exhibit 2: Quarterly order-Intake Trend



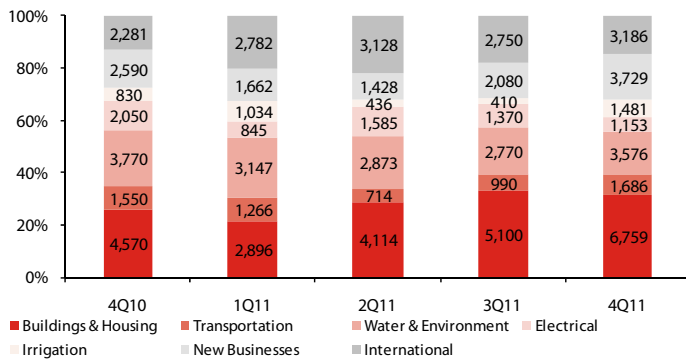
Source: Company, Centrum Research

Exhibit 3: Yearly order-book trend



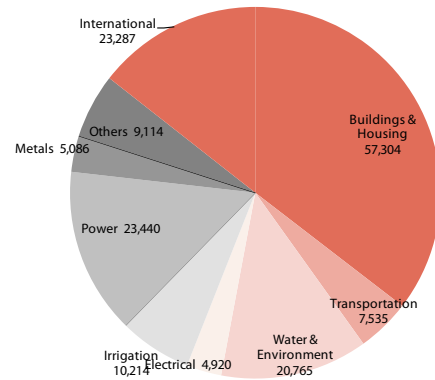
Source: Company, Centrum Research

Exhibit 4: Order-Book Mix over last 4 quarters



Source: Company, Centrum Research

Exhibit 5: Order-book as on FY11



Source: Company, Centrum Research

Estimates revised

We have sharply downgraded our estimates. Though we have modeled in revenue growth in line with the management commentary, we are skeptical of its guided operating margins of 11%. Revenue estimates for FY12/FY13 have been lowered by 10%/7% from Rs65bn and Rs75bn to Rs58bn and Rs70bn, respectively.

We have also factored in margins lower than company's guidance of 11%. Margins have already seen erosion in FY11 (actual was 9.6% vs expected 10.5%). We have modeled in 9.8% and 9.9% for FY12 and FY13, respectively.

Interest expenses have also been revised for FY13 from Rs2.9bn earlier to Rs3.3bn. The eventual impact is a downward revision of 17% and 18% for FY12 and FY13, respectively.

Exhibit 6: Revised estimates

Particulars	Previous Estimates		Revised Estimates			
	FY12E	FY13E	FY12E	Var (%)	FY13E	Var (%)
Income from Operations	64,564	75,398	58,219	(9.8)	69,889	(7.3)
<i>Growth (in % YoY) / bps</i>	18.1	16.8	14.7		20.0	
EBITDA (Rsmn)	6,273	7,250	5,730	(8.7)	6,948	(4.2)
<i>EBITDA Margins (in %)</i>	9.7	9.6	9.8		9.9	
Depreciation	801	954	822	2.6	975	2.2
Interest Expenses	2,505	2,925	2,507	0.1	3,292	12.5
Other Income	146	171	187	28	224	32
Profit Before Tax (Rsmn)	3,113	3,543	2,587	(16.9)	2,906	(18.0)
<i>PBT Margin</i>	4.8	4.7	4.4		4.2	
Tax Expenses	1,058	1,204	879	(16.9)	988	(18.0)
<i>Effective Tax Rate (in %)</i>	34.0	34.0	34.0		34.0	
Reported Profit After Tax (Rsmn)	2,055	2,339	1,708	(16.9)	1,918	(18.0)
Adj. Profit After Tax (Rsmn)	2,055	2,339	1,708	(16.9)	1,918	(18.0)
<i>Net Profit Margin (in %)</i>	3.2	3.1	2.9		2.7	
EPS – Diluted	8.0	9.1	6.7	(16.9)	7.5	(18.0)

Source: Company, Centrum Research Estimates

NCC presents decent upside of 24% from CMP of Rs87, But We Prefer IVRCL

After revising our numbers, we derive a revised target price of Rs108 from the earlier target price of Rs134. We have lowered the P/E multiple ascribed to domestic construction business from 12x to 10x and derive a fair value of Rs75. Other businesses, which include BOT, Real Estate and power projects are valued at Rs33. We believe IVRCL's risk-reward profile at CMP is better than that of NCC. Hence, we prefer IVRCL over NCC, despite the latter giving a decent upside of 24% from CMP.

Exhibit 7: NCC's Valuation Table

Particulars	Method	Multiple	Discount	EPS	Book Value	Total Value
NCC Domestic Operations	P/E	10.0	NA	7.5	NA	75
NCC International Ops	P/E	6.0	NA	0.9	NA	5
BOT Projects	DCF & BV					19
Power - Under Construction	BV	1.0	50%	NA	3,000	6
NCC Urban	BV	1.0	50%	NA	1,257	2
Total SOTP Value						108
Current Market Price						87
Upside / Downside						24%

Source: Centrum Research Estimates

Financials (Standalone)

Exhibit 8: Income Statement

Y/E March (Rsmn)	FY09	FY10	FY11E	FY12E	FY13E
Revenues	41,514	47,778	50,737	58,219	69,889
<i>Growth in revenue</i>	19.4%	15.1%	6.2%	14.7%	20.0%
Cost of Raw Material	34,972	40,133	42,221	48,572	58,308
<i>% of Revenue</i>	84.2%	84.0%	83.2%	83.4%	83.4%
Employee cost	1,885.9	1,841.3	2,438.4	2,672.1	3,138.1
<i>% of Sales</i>	4.5%	3.9%	4.8%	4.6%	4.5%
O&M expenses	919.5	969.4	1,201.4	1,245.2	1,494.8
<i>% of Sales</i>	2.2%	2.0%	2.4%	2.1%	2.1%
EBITDA	3,737	4,834	4,876	5,730	6,948
<i>EBITDA Margin (%)</i>	9.0%	10.1%	9.6%	9.8%	9.9%
Depreciation	533	525	685	822	975
PBIT	3,204	4,309	4,191	4,907	5,973
Interst expenses	964	1,322	1,682	2,507	3,292
PBIT from operations	2,240	2,987	2,509	2,400	2,681
Other non operating income	42	48	146	187	224
PBT before ext.od items	2,282	3,035	2,656	2,587	2,906
Extra-ordinary income/(exp)		495.6			
PBT	2,282	3,530	2,656	2,587	2,906
Provision for tax	743	1,204	1,021	879	988
<i>Effective tax rate (%)</i>	32.6%	34.1%	38.5%	34.0%	34.0%
Minority interest					
PAT	1,539	2,326	1,635	1,708	1,918
Adj. for Ext.Od items		328	145	-	-
Adjusted PAT	1,539	1,998	1,780	1,708	1,918
<i>Growth in PAT (%)</i>	-5.0%	29.9%	-10.9%	-4.0%	12.3%
<i>PAT margin (%)</i>	3.7%	4.2%	3.5%	2.9%	2.7%

Source: Company, Centrum Research Estimates

Exhibit 9: Balance Sheet

Y/E March (Rsmn)	FY09	FY10	FY11E	FY12E	FY13E
Share Capital	458	513	513	513	513
Stock Options	-	-	-	-	-
Reserves	16,398	21,943	23,274	24,594	26,139
Shareholders' fund	16,856	22,457	23,787	25,107	26,652
Debt	12,439	15,302	24,841	28,941	34,041
Deferred Tax Liability	188	255	308	308	308
Minority Interest					
Total Capital Employed	29,482	38,013	48,935	54,355	61,000
Gross Block	6,233	7,561	9,398	11,110	12,994
Accumulated dep.	1,641	2,023	2,708	3,530	4,505
Net Block	4,592	5,538	6,690	7,580	8,489
Capital WIP	281	434	524	594	665
Total Fixed Assets	4,873	5,972	7,215	8,174	9,154
Investments	7,402	9,412	12,008	13,208	14,208
Deferred Tax Asset					
Inventories	7,495	7,539	8,960	9,720	11,374
Debtors	10,260	12,995	14,536	16,424	19,271
Cash & bank balances	1,345	1,997	1,397	1,360	1,432
Loans and Advances	14,484	18,520	24,469	27,903	30,140
Other Current Assets	30	32	93	122	147
Total current assets	33,615	41,083	49,455	55,530	62,364
Current lia & provisions	16,408	18,453	19,743	22,557	24,726
Net current assets	17,206	22,629	29,712	32,973	37,638
Total Assets	29,482	38,013	48,935	54,355	61,000

Source: Company, Centrum Research Estimates

Exhibit 10: Cash flow Statement

Y/E March (Rsmn)	FY09	FY10	FY11E	FY12E	FY13E
CF from operating					
Profit before tax	2,282	3,530	2,656	2,587	2,906
Depreciation	533	525	685	822	975
Interest expenses	964	1,322	1,682	2,507	3,292
OP profit before WC change	3,786	4,886	5,023	5,917	7,172
Working capital adjustment	(3,955)	(3,345)	(7,683)	(3,298)	(4,594)
Gross cash from operations	(169)	1,541	(2,660)	2,619	2,579
Direct taxes paid	(1,319)	(1,302)	(869)	(879)	(988)
Cash from operations	(1,488)	238	(3,529)	1,740	1,591
CF from investing					
Capex	(75)	(1,628)	(1,928)	(1,782)	(1,955)
Investment	(1,107)	(2,148)	(2,596)	(1,200)	(1,000)
Others	100	12	-	-	-
Cash from investment	(1,082)	(3,763)	(4,524)	(2,982)	(2,955)
CF from financing					
Proceeds from sh cap & prem.	0	3,580	-	-	-
Borrowings/ (Repayments)	3,501	2,863	9,539	4,100	5,100
Interest paid	(1,567)	(1,972)	(1,682)	(2,507)	(3,292)
Dividend paid	(348)	(294)	(404)	(388)	(373)
Cash from financing	1,586	4,177	7,453	1,205	1,435
Net cash increase/ (dec)	(985)	652	(600)	(37)	71

Source: Company, Centrum Research Estimates

Exhibit 11: Key Ratios

Y/E March	FY09	FY10	FY11E	FY12E	FY13E
Margin Ratios (%)					
<i>EBITDA Margin</i>	9.0%	10.1%	9.6%	9.8%	9.9%
<i>PBIT Margin</i>	7.7%	9.0%	8.3%	8.4%	8.5%
<i>PBT Margin</i>	5.4%	6.3%	4.9%	4.1%	3.8%
<i>PAT Margin</i>	3.7%	4.2%	3.5%	2.9%	2.7%
Growth Ratios (%)					
<i>Revenues</i>	19.4%	15.1%	6.2%	14.7%	20.0%
<i>EBITDA</i>	2.5%	29.4%	0.9%	17.5%	21.3%
<i>Net Profit</i>	-5.0%	29.9%	-10.9%	-4.0%	12.3%
Return Ratios (%)					
<i>ROCE</i>	11.9	12.9	9.7	9.6	10.4
<i>ROIC</i>	17.9	18.5	14.0	14.7	15.7
<i>ROE</i>	9.4	11.8	7.1	7.0	7.4
Turnover Ratios					
Asset turnover ratio (x)	1.4	1.3	1.0	1.1	1.1
Working Capital Turnover (x)	2.4	2.1	1.7	1.8	1.9
Avg collection period (days)	90	99	105	103	101
Avg payment period (days)	156	149	151	151	149
Per share (Rs)					
Fully diluted EPS	6.7	7.8	6.9	6.7	7.5
CEPS	9.1	9.8	9.6	9.9	11.3
Book Value	74	88	93	98	104
Solvency ratios (%)					
<i>Debt/ Equity</i>	0.7	0.7	1.0	1.2	1.3
<i>Interest coverage ratio</i>	3.9	3.7	2.9	2.3	2.1
Valuation parameters (x)					
P/E	12.9	11.1	12.5	13.0	11.6
P/BV	1.2	1.0	0.9	0.9	0.8
EV/ EBITDA	8.6	7.8	9.7	8.9	8.1
EV/ Sales	0.8	0.8	0.9	0.9	0.8
M-Cap/ Sales	0.5	0.5	0.4	0.4	0.3

Source: Company, Centrum Research Estimates

Appendix

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