Indbank Merchant Banking Services Ltd (A Subsidiary of Indian Bank)

Ahluwalia Contracts (India) Ltd.

EQUITY REPORT

February 21, 2014

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Ahluwalia Contracts India (ACL) is an engineering procurement- construction (EPC) company engaged in the civil construction business, which includes retail malls, residential complexes, offices, hotels, IT parks and hospitals. The company has a long history of more than four decades in civil construction and undertakes government and private contracts. ACIL has presence across the country, especially in North India and particularly in the Delhi and NCR region. ACIL has posted turnover of over ₹13.88 bn in FY'13.

Investor's Rationale

- ACIL continues to witness robust order inflows in FY'14 with the company bagging new orders worth ₹10.30 bn as compared to the total order inflows of ₹10.15 bn in FY'13. The company's order book comprises construction of Institutional, Hospital, Residential, including electrical plumbing & firefighting services. As soon as the order execution starts picking up, would aid to the company's higher earning visibility.

- The economic slowdown has taken a toll over the capital expenditures by the private sector. Monetary tightening over the past couple of months along with volatility in commodity prices has induced delays in Capital Expenditure (capex) decisions. With the general election round the corner, we expect the government to take steps to boost investment in infrastructure projects and expedite key construction projects that would lead the capex to soar, which in turn would spearhead to some improvement on margin front.

- In order to strengthen its presence in the infrastructure development space, the company has forayed into attractive BOT segment and Power sectors and also marks its entry across new & fast growing sectors. Apart from this, the company's focus towards operational efficiencies in light of the tough environment coupled with other operational executions will enable the company to register better performance going ahead.

- The outlook for the Indian Construction sector is stable compared to other Industry. Investment in the infrastructure sector plays a crucial role in the growth of economy and in turn the construction Industry. Initiative under by the government to expedite key mega projects coupled with addressing the key infrastructure bottlenecks are likely to boost infrastructure investments in general in the coming months. The 12^{th} five-year plan by India's Planning Commission envisaged an investments of around USD 1 trillion, of which ~48% of the planned investment spending in infrastructure to be contributed by the private sector.

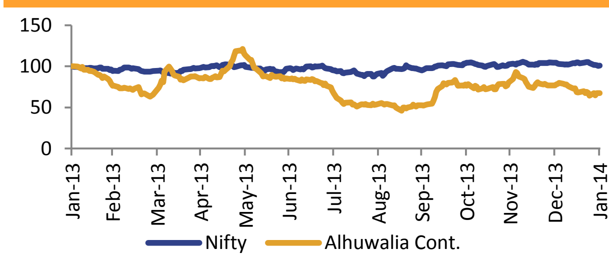
Market Data

Rating	**BUY**
CMP (₹)	24
Target (₹)	**30**
Potential Upside	~25%
Duration	Long Term
Face Value (₹)	2.0
52 week H/L (₹)	42/15.15
Adj. all time High (₹)	246
Decline from 52WH (%)	42.9
Rise from 52WL (%)	58.40
Beta	0.4
Mkt. Cap (₹bn)	1.5
Enterprise Value (₹bn)	3.14

Fiscal Year Ended

Y/E	FY12A	FY13A	FY14E	FY15E
Revenue (₹bn)	14.5	14.3	11.4	12.6
EBITDA (₹bn)	0.21	(0.32)	0.27	0.39
Net Profit (₹bn)	(0.46)	(0.71)	0.07	0.1
Adj EPS (₹)	(7.4)	(11.4)	1.1	1.9
P/E (x)	(3.2)	(2.1)	21.8	12.6
P/BV (x)	0.5	0.7	0.7	0.7
EV/EBITDA (x)	15.7	(9.9)	11.7	8.3
ROCE (%)	(5.7)	(10.4)	5.4	6.8
ROE (%)	(16.8)	(34.9)	3.3	5.3

One year Price Chart



Shareholding Pattern	Dec'13	Sep'13	Diff.
Promoters	72.61	72.61	-
FII	4.01	4.76	(0.75)
DII	13.69	14.12	(0.43)
Others	9.69	8.51	1.18

Ahluwalia Contracts India: Well diversified business portfolio

Construction is the company's core business, which focuses on residential, commercial, power, hotel, hospital and institutional and industrial construction projects.

ACIL also offers complete Engineering Procurement Services (EPC) services.

Ahluwalia Contracts India (ACIL) is a New Delhi based civil engineering contracting firm. It provides all construction related services including design on turnkey basis and assuring timely completion of projects within budget and with excellent quality. Construction is the company's core business, which focuses on residential, commercial, power, hotel, hospital and institutional and industrial construction projects. The business has been extended to offering complete Engineering Procurement Services (EPC) services. In addition to this, the company has a Sister Concern which is specializing in execution of Aluminium and Glass Facades as also Aluminium Doors, Windows and Partitions. The Ready Mix Concrete unit is functioning under the name of "Ahlcon Ready Mix Concrete" has the largest transit mixer fleet in Northern India. It is ACIL's wholly owned subsidiary Company. ACIL have also developed in house Plumbing Division to undertake complete marketing, Commercial Scrutiny, Costing, Designing, Basic and System Engineering.

The company has a robust in-house capabilities and offer turnkey solutions across the entire spectrum due to its strong competencies in design, civil, RMC, Electro-mechanical, Plumbing & Fire Fighting, HVAC and Aluminium Facades and Building Glasses. ACIL is developing a portfolio of assets from planning and conceptualization to execution, and retains ownership rights on the assets created. Returns are generated from utilization of the assets leading to expansion of value.

The Company's order backlog as on 31st March, 2013 was ₹54.25bn approx. The order backlog is well distributed across various sectors including industrial, commercial, institutional, residential, hotels, Hospitals, BOT, etc.

Service Portfolio

Construction	Design	Ready Mix Concrete (RMC)	Plumbing	Building facades– aluminum + glass facades	Electro-mechanical
Undertake all kinds of construction work from piling to pre-Cast–pre stressing work.	Exemplary In-house Design Cell comprising of Design Experts from architectural discipline.	Produce over 1800 cubic meters of concrete a day with self-owned transit mixers, stationery and boom pumps.	Provide procurement, execution, testing & commissioning services for Water Supply, Sanitary & Fire Fighting Works.	Undertake design, supply and installation of aluminum doors, windows, structural gazing, glass facade & aluminum cladding.	Provide supply, installation, testing & commissioning services for electrical works.

Robust order inflows

ACIL continues to witness robust order inflows in FY’14 with total order inflow of ₹10.30 bn. The strong order book gives visibility to future revenues.

ACIL is one of India’s leading EPC service provider in the construction sector with more than four decades of execution track record and healthy diversification across sectors, clients and geographies across India.

ACIL continues to witness robust order inflows in FY’14. The total order inflow of the company during FY’14 stand at ₹10.30 bn as compared to the total order inflows of ₹10.15 bn in FY’13. The new secured orders by the company in FY’14 for construction of institutional, hospital, residential, including electrical plumbing and fire-fighting services. Out of the total order value, orders worth ₹4.18bn bagged by the company was for construction of International Convention Centre at Patna in Bihar and another order worth ₹1.97bn for construction of Sufdarjung Hospital in Delhi NCR. In addition to this, the company awarded orders for construction of three residential building projects in Delhi NCR for ₹2.83bn. Apart from this, misc. projects for civil construction, residential, plumbing, electrical and maintenance work secured for ₹1.33bn. These large order finalizations are likely to be growth triggers for the company, going ahead. As soon as the order execution starts picking up, would aid to the company’s higher earning visibility.

Consistent effort to move into new areas of business- a robust strategy for growth

In order to strengthen its presence in the infrastructure development space, the company has foray into attractive BOT segment and Power sectors and also mark its entry across new & fast growing sectors.

Apart from being well established in the National Capital Region (NCR), the company has made a pan India presence. The company has forayed into attractive BOT segment and Power sectors and also marks its entry across new & fast growing sectors (SEZs, Aviation, Power Plants, Refineries, etc) in order to strengthen its presence in the infrastructure development space. The company has already initiated significant cost reduction efforts, optimizing of working capital requirements in order to minimize financing costs. These, coupled with other operational executions will enable the company to register better performance going ahead. In order to continually improve its position in the construction sector, the company needs to chalk out strategies to expand its business and to move into new areas of business to lead the company towards the next level of growth.

High interest costs and rise in inputs costs impacted profitability

At the end of FY’13, ACIL has a total Indian gross debt of ~₹2.50bn. Total interest expenditure on the above debt was ~₹0.37bn in FY’13. As the company is into a highly capital intensive sector, so in the current market scenario of high interest rates, high inflation, high current account deficit, fiscal deficit, stalled projects and economic slowdown provides challenges for the company to maintain its margins and market share. Further, with the rise in inputs costs like steel and cement over the last two years, its operating margins have shrunk during the time of execution. The company’s performance in the recent past has been adversely impacted by the slowdown in project awards, execution hurdles and rising interest rates. These all factors have led to stretched working capital and increased debt burden on the balance sheet.

The higher interest charges would continue to dent its profitability. Further, the slow project execution would result in higher operating costs which would lead to impact the operating margins. In the environment of rise in inputs costs like steel and cement over the last two years, would continue to adversely impact its operating margins and project cash flows.

With the general election round the corner, we expect that the government to take steps to boost investment in infrastructure projects and expedite key construction projects, which in turn would lead to some improvement on margin front.

Going forward, we expect the company is unlikely to see any material recovery in the financial performance due to the significant amount of fixed price contracts, coupled with interest rates seeing an uptick and continued weakness in the capex cycle. Further, the high working capital cycle will also continue to be a challenge for the company. However, with the general election round the corner, we expect that the government to take steps to boost investment in infrastructure projects and expedite key construction projects, which in turn would lead to some improvement on margin front.

Posted profit of ₹11.5 bn in Q2FY'14; while revenue disappoints

ACIL after posting a loss of ₹0.24bn in quarter ended September 2012 on standalone basis, the company has posted a profit of ₹11.5mn for the quarter ended September 2013. The 83% decline in the depreciation charges in Q2FY'14 to ₹17mn has assisted to the positive earnings and has offset the 24% decline in other income to ₹16mn and 8% rise in the interest charges to ₹94.0mn respectively. Sales during the quarter under consideration however declined 28.97% to ₹2.5bn as against ₹3.5mn during the previous quarter ended September 2012. The sharp decline in revenues may be impacted due to slower execution of projects.

Financial performance trend

₹ in mn	Q2FY'14	Q2FY'13	YoY (%)	Q1FY'14	QoQ (%)
Net Revenue	**2495**	**3520**	**29.1**	**2202**	**13.3**
EBITDA	**(32)**	**(76)**	**(58.5)**	**127**	**(125.0)**
EBITDA Margin (%)	**(1.3)**	**(2.2)**	**90bps**	**5.7**	**702bps**
Other Income	16	21	**(24.4)**	21	**(25.8)**
Depreciation	17	101	**(83.4)**	44	**(61.7)**
Interest	94	87	**7.9**	93	**0.9**
Exceptional Income	141	-	-	-	-
Tax	3.0	0.2	**1,905**	2.0	**28.9**
PAT	**12**	**(244)**	**104.7**	**9.0**	**33.9**
PAT Margin %	**0.5**	**(6.9)**	**-**	**0.4**	**7bps**
EPS (₹)	0.2	(3.9)	**-**	0.1	**100**

The company reported a loss at EBITDA level of ₹32mn in Q2FY'14 as against loss of ₹76mn in Q2FY'13. This was on account of lower operating expenses which declined by ~30% YoY to ₹2.52bn. However, the company has reported positive earnings of ₹1.27bn at the EBITDA level in Q1FY'14.

Slower execution of projects a major hindrance to the company's revenue growth, with the company posted a 33% decline in its revenues on standalone basis in H2FY'14.

Slow project execution; drag on revenues

The half-yearly performance is also not providing a rosy picture too in terms of revenues. In H2FY'14, the company posted a 33% decline in its revenues to ₹4.67bn on standalone basis as compared to ₹6.93bn in H2FY'13. However, ACIL has posted a profit of ₹20mn for the half-year ended September 2013 after posting a loss of ₹629mn for H2FY13, on better performance at the EBITDA level. Further, the 71% decline in the depreciation charges in H2FY'14 to ₹61mn also assisted to the positive earnings. However, 4% decline in other income to ₹37mn and 12% rise in the interest charges to ₹187mn has restricted the net profit growth in H2FY'14. On the EBITDA front, the company reported a profit of ₹95mn in H2FY'14 as against loss of ₹292mn in H2FY'13. This was on account of lower operating expenses which declined by ~37% YoY to ₹4.60bn.

Half-yearly financial performance trend

₹ in mn	H1FY'14	H1FY'13	YoY (%)
Net Revenue	**4698**	**6967**	**(32.6)**
EBITDA	**95**	**(29.2)**	**(132.5)**
EBITDA Margin (%)	**2.0**	**(4.2)**	**621bps**
Other Income	3.7	3.8	**(4.1)**
Depreciation	6.1	20.8	**(70.9)**
Interest	18.7	16.6	**12.3**
Exceptional Income	14.1	-	**-**
Tax	0.5	0.03	**1,680**
PAT	**2.0**	**(62.9)**	**(103.2)**
PAT Margin %	**0.4**	**(9.0)**	**-**
EPS (₹)	0.3	(10.0)	**-**

Investment in the infrastructure sector to turn the construction Industry

Construction sector is the second largest contributor to the Indian economy after agriculture. Indian economy grew by 5% in FY13 as compared to 6.2% in FY12, while the construction industry grew by 5.9% in FY13 against 5.6% in FY12. Indian construction sector continues to remain in the doldrums as a combination of high interest rates, elevated inflationary pressures, and the worst economic slowdown in a decade dampened consumer and business sentiment, taking toll on operating margins. The regulatory hurdles have led to muted new order inflows for construction companies. The increase in competitive pressure is taking a toll on operating margins while a rising cost of debt would further slowdown earnings. Further, the monetary tightening over the past couple of months along with volatility in commodity prices has induced delays in Capital Expenditure decisions. Once the macro environment begins to improve, we expect a gradual pick-up in the government sector and private sector activity.

The economic slowdown has taken a toll over the capital expenditures by the private sector. In order to provide a fillip to the economic growth, the government has lined up huge investments across various infrastructure segments. The 12th five-year plan by India's Planning Commission envisaged an investments of around USD 1 trillion, of which ~48% of the planned investment spending in infrastructure to be contributed by the private sector. Further, given the current sentiment post state election's outcome, we expect expects capital expenditure to soar, which in turn would lead to some improvement on margin front. The outlook for the Indian Construction sector is stable compared to other Industry. Investment in the infrastructure sector plays a crucial role in the growth of economy and in turn the construction Industry.

Efforts to address infrastructure bottlenecks gain momentum

Initiative under by the government to expedite key mega projects coupled with addressing the key infrastructure bottlenecks are likely to boost infrastructure investments in general in the coming months.

Realizing the need to boost investments and to address the key bottlenecks, the Cabinet Committee on Investment (CCI) and the Project Monitoring Group (PMG) were constituted by the government to expedite key mega projects. As on September 2013, CCI has helped in the resolution of logjams for around 300 projects, worth above ₹5 trillion. The PMG alone has accepted 411 projects worth ₹19 trillion for consideration; of these issues relating to projects worth ₹4.9 trillion (138 projects) have been resolved. A majority of these resolved projects are in power (86), coal (21), petroleum (7), roads and railways (6 each) and shipping (5). The new legislation for Land Acquisition, Rehabilitation and Resettlement has been enacted with an objective to fast track stalled infrastructure projects. In addition, a series of measures, including delinking of environmental clearance from forest clearances, initiated by the government during January-September 2013 are likely to boost infrastructure investments in general in the coming months.

Key risks

- ACIL's order-book is primarily inclined towards private sector. Any further slowdown in the real estate sector and the corporate capital expenditure would impact the order flows.
- High working capital cycle will also continue to be a challenge for the company.
- Demand for construction work is dependent on the overall economic conditions. In the current market scenario of high interest rates, high inflation, high current account deficit, fiscal deficit, stalled projects, overall economy's slowdown and poor liquidity conditions, Indian Construction industry are facing challenges to maintain their margins.
- Delay in project approval, land acquisition & environmental clearance related issue also remains a major challenge.
- Increase in prices of inputs and/or changes in assumptions may lead to higher operational costs, affecting the profitability.
- Uncertainties regarding Government policies can significantly affect operations of the company.
- Staff attrition and non-availability of key personnel also affect the Company's operations.
- Volatility in the prices of critical raw materials further impacts project profitability.

Balance Sheet (Consolidated)

Y/E (₹mn)	FY12A	FY13A	FY14E	FY15E
Share Capital	12.6	12.6	12.6	12.6
Reserve and surplus	263.1	191.8	198.7	210.6
Net Worth	**275.7**	**204.4**	**211.3**	**223.2**
Loan funds	226.4	250.2	263.0	276.0
Provisions	2.1	2.6	2.0	2.0
Current Liabilities	643.2	583.2	545.0	600.0
Other long term liabilities	22.1	33.1	47.7	47.7
Capital Employed	**1,169.5**	**1,073.5**	**1,068.7**	**1,148.2**
Fixed assets	225.8	200.4	213.2	234.5
Goodwill on Consolidation	1.38	1.4	1.4	1.4
Investments	2.1	0.1	1.5	1.5
Loans and Advances	84.8	113.2	128.4	143.9
Long Term Trade Receivables	57.3	55.0	54.3	54.3
Current Assets	728.4	678.21	648.0	690.8
Deferred tax assets (net)	16.2	16.2	16.2	16.2
Other Assets	53.6	9.0	5.7	5.7
Capital Deployed	**1,169.5**	**1,073.5**	**1,068.7**	**1,148.2**

Profit & Loss Account (Consolidated)

Y/E (₹mn)	FY12A	FY13A	FY14E	FY15E
Net sales	**1,445.9**	**1,430.9**	**1,144.7**	**1,259.2**
Expenses	1,425.0	1,462.6	1,117.4	1,220.2
EBITDA	**20.9**	**(31.7)**	**27.3**	**38.9**
Depreciation	47.5	40.5	13.0	15.6
Other Income	12.4	17.0	17.0	17.0
Exceptional Items	(3.2)	21.1	14.1	14.1
EBIT	**(17.4)**	**(34.2)**	**45.3**	**54.4**
Interest	31.0	37.1	37.4	38.1
Profit Before Tax	**(48.3)**	**(71.3)**	**8.0**	**16.3**
Tax	(1.9)	0.1	1.1	4.4
Net Profit	**(46.4)**	**(71.3)**	**6.9**	**11.9**

Key Ratios (Consolidated)

Y/E	FY12A	FY13A	FY14E	FY15E
EBITDA Margin (%)	1.4	(2.2)	2.4	3.1
EBIT Margin (%)	(2.1)	(3.6)	2.5	3.0
NPM (%)	(3.2)	(5.0)	0.6	0.9
ROCE (%)	(5.7)	(10.4)	5.4	6.8
ROE (%)	(16.8)	(34.9)	3.3	5.3
EPS (₹)	(7.4)	(11.4)	1.1	1.9
P/E (x)	(3.2)	(2.1)	21.8	12.6
BVPS (₹)	43.9	32.6	33.7	35.6
P/BVPS (x)	0.5	0.7	0.7	0.7
EV/Operating Income (x)	0.2	0.2	0.3	0.3
EV/EBITDA (x)	15.7	(9.9)	11.7	8.3

Valuation and view

ACIL has a well-diversified presence with the order backlog is well distributed across various sectors including industrial, commercial, institutional, residential, hotels, Hospitals, BOT, etc. The Company's strong order book provides higher earning visibility. With interest rates seeing an uptick and continued weakness in the capex cycle, we expect the H2FY14 performance to remain challenging. However, with the general election round the corner, we expect the government to take steps to boost investment in infrastructure projects and expedite key construction projects that would lead the capex to soar, which in turn would spearhead to some improvement on margin front.

At a current CMP of ₹24, ACIL is attractively placed at P/E of 12.6x FY15E. Considering the above aspects, we rate the stock as 'BUY' at a target price of ₹30, with a potential upside of 25% for the coming 12 months.

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