

BUY

TP: Rs 385 | ▲ 99%

**HG INFRA
ENGINEERING**

Infrastructure

11 November 2019

Solid quarter; growth momentum to pick up in H2

HG Infra's (HGIEL) Q2FY20 PAT grew ahead of estimates at 57% YoY, led by gross margin expansion, softer interest cost and a lower tax rate. Revenue was in line (+10.5% YoY) and EBITDA margin expanded 95bps YoY to 15.5% (14.9% est.) due to better operating efficiencies. Gross debt stood at Rs 3.4bn (0.3x net D/E). Order backlog totalled Rs 62.7bn (incl. L1), 2.9x TTM revenues. We increase FY20/FY21 earnings by 6-7% each and roll over to a revised Sep'20 TP of Rs 385 (vs. Rs 395).

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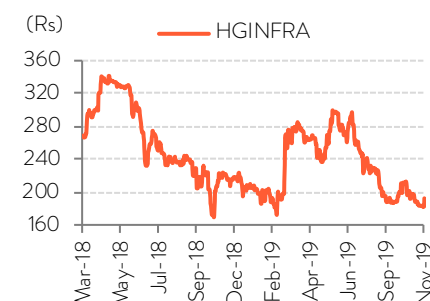
Revenue in line; operating efficiencies aid margin expansion: Q2 revenue grew 10.5% YoY to Rs 4.7bn, subdued by the heavy monsoons. Gross margin expansion of ~75bps YoY and various cost efficiency measures resulted in EBITDA margin expansion of 95bps YoY to 15.5% and EBITDA growth of 18% YoY to Rs 733bn. PAT increased 57% YoY to Rs 386mn supported by reduced interest cost and a lower tax rate at 18.6% (22.4% est.; moved to new tax regime). FY20 revenue/EBITDA margin guidance remains at Rs 25bn/~15%.

Ticker/Price	HGINFRA IN/Rs 194
Market cap	US\$ 176.9mn
Shares o/s	65mn
3M ADV	US\$ 0.2mn
52wk high/low	Rs 308/Rs 173
Promoter/FPI/DII	74%/0%/16%

Source: NSE

Order inflows subdued: As against a strong Rs 39bn print in FY19, order inflows remain subdued at ~Rs 9.5bn in FY20 YTD. FY20 guidance stands at Rs 35bn-40bn and management expects a pickup in ordering from NHAI by end-Dec'19. We assume inflows of Rs 29.5bn in FY20 building in delays due to funding constraints and land acquisition hurdles.

STOCK PERFORMANCE



Source: NSE

Maintain BUY: We increase our FY20/FY21 earnings estimates by 6-7% each led by revenue/margin expansion and lower interest costs. At the same time, we pare our target P/E for the EPC business from 10x to 9x due to near-term headwinds to order inflows and also high competition and aggressive bidding in the EPC space. On rolling valuations forward, our TP stands at Rs 385.

KEY FINANCIALS

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (Rs mn)	13,927	20,098	24,992	30,454	33,571
EBITDA (Rs mn)	2,081	3,032	3,772	4,552	5,018
Adj. net profit (Rs mn)	843	1,236	1,933	2,381	2,623
Adj. EPS (Rs)	20.3	19.0	29.7	36.5	40.2
Adj. EPS growth (%)	(31.7)	(6.4)	56.4	23.2	10.2
Adj. ROAE (%)	23.5	20.6	25.6	24.7	21.6
Adj. P/E (x)	9.6	10.2	6.5	5.3	4.8
EV/EBITDA (x)	6.8	4.8	4.1	3.4	3.0

Source: Company, BOBCAPS Research

BOB Capital Markets Ltd is a wholly owned subsidiary of Bank of Baroda

Important disclosures, including any required research certifications, are provided at the end of this report.



FIG 1 – STANDALONE QUARTERLY PERFORMANCE

Particulars (Rs mn)	Q2FY20	Q2FY19	YoY (%)	Q1FY20	QoQ (%)
Net Sales	4,742	4,291	10.5	5,261	(9.9)
Cost of material consumed	1,732	1,999	(13.4)	2,275	(23.9)
Contract and site expenses	1,912	1,331	43.7	1,856	3.0
Employee Expenses	264	291	(9.3)	289	(8.6)
Other expenses	100	46	115.3	46	116.2
Total Expenses	4,009	3,668	9.3	4,466	(10.2)
EBITDA	733	623	17.6	795	(7.8)
EBITDA margin (%)	15.5	14.5	94bps	15.1	35bps
Other Income	29	30	(0.3)	31	(3.6)
Depreciation	181	177	2.3	176	3.0
EBIT	581	475	22.3	650	(10.5)
EBIT margin (%)	12.3	11.1	118bps	12.3	(9bps)
Interest	108	96	12.0	123	(12.4)
PBT	474	379	24.9	527	(10.1)
Total tax	88	134	(34.0)	183	(51.7)
Current Tax	79	116	(31.9)	184	(57.1)
Deferred Tax	9	18	(47.9)	(1)	(930.1)
Tax Rate (%)	18.6	35.2	(1,662bps)	34.7	(1,608bps)
Adjusted PAT	386	246	56.9	344	12.1
Extra ordinary items	-	-	-	-	-
Reported Profit After Tax	386	246	56.9	344	12.1
Adjusted PAT margin (%)	8.1	5.7	240bps	6.5	159bps
EPS (Rs)	5.9	3.8	56.9	5.3	12.1

Source: Company, BOBCAPS Research

Earnings call highlights

- **FY20 guidance:** Revenue at ~Rs 25bn, EBITDA margin over 15%, capex at ~Rs 500mn (~Rs 170mn in H1FY20), H2FY20 tax rate at 25.2%, gross debt as on Mar'20 at Rs 2.5bn-2.75bn, and order inflows of Rs 35bn-40bn (including order win of Rs 9.5bn in Oct'19).
- **FY21 guidance:** Revenue at Rs 30bn-31bn and EBITDA margin over 15%. We have conservatively assumed margins of 14.9%.
- **Revenue guidance from key projects in FY20:**
 - Gurgaon-Soha (HAM): 50% of the EPC value of Rs 5.2bn
 - Hapur-Moradabad (subcontracting work from IRB): ~Rs 3bn (6% of the work completed up to Sep'19; pickup in execution expected in H2FY20)
 - Delhi-Vadodara (Pkg 4): ~Rs 2bn
 - Rewari and Narnaul (HAM): ~Rs 2bn (combined)

- Mancherial-Repallewada (subcontracting work from Adani Road Transport): Rs 500mn
- Execution on subcontracting work awarded by Tata Projects is likely to be complete by Q3/Q4 of FY20 while that awarded by IRB is likely to be completed by end-Q1FY21.
- **ADs in remaining two HAM and one EPC project:** Management expects award of appointed dates (AD) for (a) the remaining two HAM projects of Rewari/Narnaul by end-Nov'19/mid-Dec'19 (over 70% land available; delayed due to recent Haryana state election), and (b) one EPC project of Delhi-Vadodara (Pkg 4) by mid-Nov'19 (~90% land available; delayed by 10-15 days from original date of 25 Oct due to recent construction ban in the NCR).
- **Equity requirement in HAM projects:** Balance equity requirement for HAM works stands at Rs 2.4bn (total requirement of Rs 2.9bn) to be invested as under:
 - FY19: Rs 200mn invested
 - FY20: Rs 1.9bn (Rs 280mn invested so far)
 - FY21: Rs 813mn
- **Monetisation of HAM projects:** HGIEL will look to monetise HAM projects on achieving substantial execution levels – ~50% on Gurgaon-Soha and ~30% each on Rewari/Narnaul. The divestment process is likely to commence from Q1FY21.
- **New subcontracting job:** In Oct'19, the company won back-to-back subcontracting road EPC work from Adani Road Transport worth Rs 9.5bn. The total length stands at 43km (four lanes), of which >80% of the land is available on the existing alignment of 26km and land acquisition for the balance is expected in a couple of months.

The company has guided for an EBITDA margin of >15%, with capex requirement at Rs 50mn-60mn to set up at hot mix plant at the project site. AD is likely by end-Jan'20.

- **Diversification into new segments:** To maintain growth momentum, HGIEL is planning to diversify into the water supply (executed one project in the past) and railway (civil work) segments. Such projects have a lower retention period of six months as against road works where dues are retained for two years or more. Hence, the diversification will ensure better margins and steady cash

flows. The company may bid independently as well as in joint venture, and is targeting contracts from the states of Maharashtra and Rajasthan.

- **Pick-up in execution from Rajasthan state PWD road projects (World Bank funded); receivables remain elevated:** Of the original contract value of Rs 6bn (three projects), revenue of ~Rs 2.7bn has been booked so far. HGIEL has realised ~Rs 1.2bn while the balance payment of ~Rs 1.5bn is likely to be realised in H2FY20. Delays in payments were caused by state elections last year and other contractual issues. As per management, the issues stand resolved and execution is progressing smoothly. The company expects execution of ~Rs 3bn in FY20 (Rs 1.3bn in H1FY20).
- **Goa airport runway:** Work on the Goa airport is likely to commence from the end of Dec'19 – it comprises an order backlog of Rs 1.9bn which is stuck due to environmental issues (12-month execution period).
- **Gross debt reducing:** As on Sep'19, gross debt stood at Rs 3.4bn (Rs 3.5bn as on Jun'19) which is further broken down into term loans of Rs 1.9bn, working capital loans of Rs 1.1bn and interest-free promoter loans of Rs 444mn. Net D/E stood at 0.3x as of Sep'19 as against 0.4x as on Mar'19.

FIG 2 – HAM PROJECTS: BALANCE EQUITY REQUIREMENT OF RS 2.4BN

Projects	State	BPC (Rs mn)	EPC (Rs mn)	Equity requirement (Rs mn)	Balance equity requirement (Rs mn)	Status
Gurgaon-Soha (Pkg-II)	Haryana	6,060	5,150	730	250	AD: 30-Jan-19; 23% execution completed up to Sep'19 and 31% so far; Rs 480mn of equity invested out of the total requirement of Rs 730mn
Rewari-Ateli Mandi	Haryana	5,800	4,880	765	765	CA signed on 27-May-19; FC documents submitted to NHAI (with HDFC Bank at 10.1% pa) and likely by mid Nov'19; over 70% land available; AD likely by end Nov-19; 50% equity to be invested in FY20 and balance in FY21
Ateli Mendi-Narnaul	Haryana	9,521	8,010	1,381	1,381	CA signed on 27-May-19; FC documents submitted to NHAI (with SBI at 10.05% pa) and likely by end Nov'19; over 75% land available; AD likely by mid-Dec'19; Rs 950mn of equity to be invested in FY20 and balance in FY21
Total		21,381	18,040	2,875	2,395	

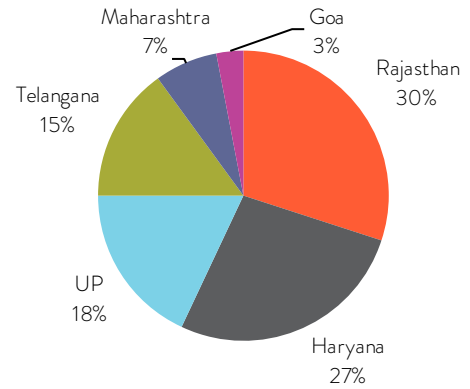
Source: Company, BOBCAPS Research | Note: BPC – Bid Project Cost, CA – Concession Agreement, FC – Financial Closure

FIG 3 – CURRENT ORDER BACKLOG OF RS 62.7BN



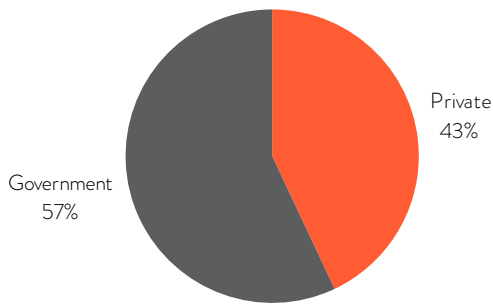
Source: Company, BOBCAPS Research | *Includes L1 projects of Rs 9.5bn

FIG 4 – ORDER BACKLOG BREAKUP BY STATE



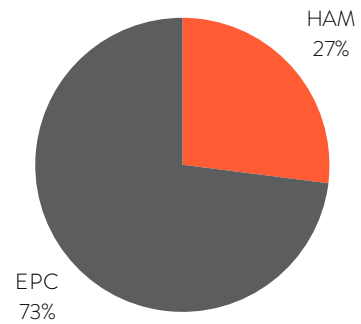
Source: Company, BOBCAPS Research

FIG 5 – ORDER BACKLOG BREAKUP BY CLIENT



Source: Company, BOBCAPS Research

FIG 6 – ORDER BACKLOG BREAKUP BY SEGMENT



Source: Company, BOBCAPS Research

Valuation methodology

A strong order backlog of Rs 62.7bn (2.9x TTM revenue) and a favourable revenue mix lend visibility for a 19%/29% revenue/earnings CAGR over FY19-FY22. Backed by a well-managed balance sheet, we expect HGIEL's net D/E to improve to 0.1x by Mar'22 as against 0.3x as on Sep'19.

Key near-term catalysts for the company include the award of pending ADs in its HAM/EPC/airport projects, improvement in receivables from the Rajasthan state PWD project (will support debt reduction), and pickup in awarding activity from NHA and states. Led by award of ADs, we expect the current order backlog to become 100% executable by end-Jan'20 – this should fuel higher execution from Q4FY20 (current executable order backlog stands at ~45%).

The stock is trading at 5x/4.1x FY20E/FY21E standalone earnings, which excludes Rs 44/sh for the value of its HAM projects. We increase our earnings estimates by 5.7%/6.7% for FY20/FY21 led by revenue/margin expansion and lower interest costs. Reiterate BUY as we roll forward to a Sep'20 SOTP-based target price of Rs 385 (against Rs 395 earlier).

FIG 7 – REVISED ESTIMATES

(Rs mn)	FY20E			FY21E		
	Old	New	Change (%)	Old	New	Change (%)
Revenue	24,748	24,992	1.0	29,660	30,454	2.7
EBITDA	3,693	3,772	2.1	4,423	4,552	2.9
EBITDA margin (%)	14.9	15.1	17bps	14.9	14.9	4bps
Adjusted PAT	1,829	1,933	5.7	2,232	2,381	6.7
PAT margin (%)	7.4	7.7	34bps	7.5	7.8	29bps

Source: Company, BOBCAPS Research

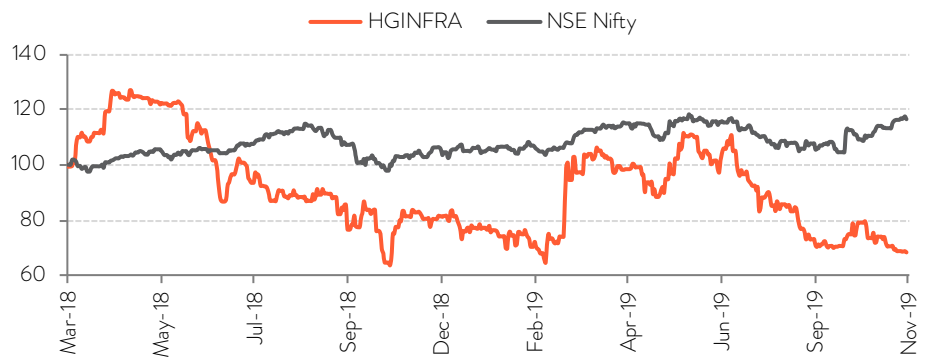
For our SOTP model, we value (1) the EPC business at Rs 341/sh (9x Sep'21E earnings; we pare the EPC business P/E multiple from 10x to 9x due to near-term headwinds to order inflows and also high competition and aggressive bidding in the EPC space), and (2) HAM projects at Rs 44/sh (1x P/BV for investments made up to Mar'21E).

FIG 8 – SOTP-BASED SEP'20 TARGET PRICE OF RS 385

(Rs mn)	Basis of valuation	Value	Multiple (x)	Valuation	Per share (Rs)
Standalone business (EPC)	P/E on Sep'21E earnings	2,478	9	22,224	341
Value of subsidiaries	Equity investment as on Mar'21E - P/BV	2,875		2,875	44
-Gurgaon-Sohna (HAM)		730	1	730	11
-Rewari-Ateli Mandi (HAM)		765	1	765	12
-Ateli Mendi to Narnaul section		1,381	1	1,381	21
Total		5,353		25,099	385
Shares outstanding (mn)				65	

Source: Company, BOBCAPS Research

FIG 9 – RELATIVE STOCK PERFORMANCE



Source: NSE

Key risks

- Political risk:** HGIEL has a strong presence in its home state of Rajasthan. Any slowdown in state government spending may affect the company’s growth prospects.
- Downturn in road sector capex:** Capex in the road sector has witnessed some revival over the last two years. Any slowdown in project awarding would impact the company’s growth and our estimates.
- Execution risk:** While HGIEL has strong execution skills, the planned entry into new segments and geographies exposes it to execution risks. Also, as the average size and complexity of projects increases, the company faces the challenge of completing large works within the stipulated time and cost. Execution delays due to land acquisition hurdles or other regulatory bottlenecks (such as delays in AD) could further affect HGIEL’s revenue.
- Profitability risk:** Historically, HGIEL’s operating profit has been higher than peers due to its backward integrated model and concentration in the high-growth roads space in northern and western India. Any adverse development in these regions may lead to challenges in sustaining profitability. Further, any delay in payments from private clients can materially affect working capital levels, impacting the company’s balance sheet and earnings.

FINANCIALS

Income Statement

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue	13,927	20,098	24,992	30,454	33,571
EBITDA	2,081	3,032	3,772	4,552	5,018
Depreciation	(539)	(755)	(799)	(958)	(1,098)
EBIT	1,542	2,278	2,973	3,594	3,921
Net interest income/(expenses)	(401)	(490)	(499)	(537)	(544)
Other income/(expenses)	47	115	121	125	129
Exceptional items	0	0	0	0	0
EBT	1,188	1,902	2,594	3,182	3,505
Income taxes	(345)	(667)	(661)	(801)	(882)
Extraordinary items	0	0	0	0	0
Min. int./Inc. from associates	0	0	0	0	0
Reported net profit	843	1,236	1,933	2,381	2,623
Adjustments	0	0	0	0	0
Adjusted net profit	843	1,236	1,933	2,381	2,623

Balance Sheet

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Accounts payables	3,281	3,994	4,507	5,423	5,978
Other current liabilities	1,556	873	1,804	1,941	2,081
Provisions	93	163	205	250	276
Debt funds	4,058	3,804	3,401	3,301	2,506
Other liabilities	447	257	341	417	460
Equity capital	652	652	652	652	652
Reserves & surplus	4,757	5,940	7,834	10,176	12,759
Shareholders' fund	5,409	6,592	8,486	10,827	13,411
Total liabilities and equities	14,844	15,682	18,743	22,160	24,712
Cash and cash eq.	2,289	1,002	464	811	1,754
Accounts receivables	4,366	6,244	6,350	7,760	8,554
Inventories	1,068	1,161	1,366	1,669	1,840
Other current assets	2,010	1,596	1,775	2,169	2,391
Investments	0	200	2,060	2,875	2,875
Net fixed assets	4,119	4,619	4,319	4,161	4,314
CWIP	86	0	0	0	0
Intangible assets	0	0	0	0	0
Deferred tax assets, net	61	84	76	76	76
Other assets	846	776	2,333	2,639	2,908
Total assets	14,844	15,682	18,743	22,160	24,712

Source: Company, BOBCAPS Research

Cash Flows

Y/E 31 Mar (Rs mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income + Depreciation	1,382	1,990	2,733	3,339	3,720
Interest expenses	401	490	499	537	544
Non-cash adjustments	0	0	0	0	0
Changes in working capital	(1,708)	(1,601)	(469)	(1,238)	(692)
Other operating cash flows	0	0	0	0	0
Cash flow from operations	74	879	2,763	2,639	3,572
Capital expenditures	(2,693)	(1,169)	(500)	(800)	(1,250)
Change in investments	0	(200)	(1,860)	(815)	0
Other investing cash flows	0	0	0	0	0
Cash flow from investing	(2,693)	(1,369)	(2,360)	(1,615)	(1,250)
Equities issued/Others	3,166	0	0	0	0
Debt raised/repaid	2,022	(255)	(403)	(100)	(795)
Interest expenses	(401)	(490)	(499)	(537)	(544)
Dividends paid	(39)	(39)	(39)	(39)	(39)
Other financing cash flows	(361)	(14)	0	0	0
Cash flow from financing	4,386	(798)	(941)	(677)	(1,379)
Changes in cash and cash eq.	1,767	(1,287)	(538)	347	944
Closing cash and cash eq.	2,250	1,002	464	811	1,754

Per Share

Y/E 31 Mar (Rs)	FY18A	FY19A	FY20E	FY21E	FY22E
Reported EPS	20.3	19.0	29.7	36.5	40.2
Adjusted EPS	20.3	19.0	29.7	36.5	40.2
Dividend per share	0.5	0.5	0.5	0.5	0.5
Book value per share	83.0	101.2	130.2	166.1	205.8

Valuations Ratios

Y/E 31 Mar (x)	FY18A	FY19A	FY20E	FY21E	FY22E
EV/Sales	1.0	0.7	0.6	0.5	0.5
EV/EBITDA	6.8	4.8	4.1	3.4	3.0
Adjusted P/E	9.6	10.2	6.5	5.3	4.8
P/BV	2.3	1.9	1.5	1.2	0.9

DuPont Analysis

Y/E 31 Mar (%)	FY18A	FY19A	FY20E	FY21E	FY22E
Tax burden (Net profit/PBT)	71.0	65.0	74.5	74.8	74.8
Interest burden (PBT/EBIT)	77.0	83.5	87.3	88.5	89.4
EBIT margin (EBIT/Revenue)	11.1	11.3	11.9	11.8	11.7
Asset turnover (Revenue/Avg TA)	135.4	131.7	145.2	148.9	143.2
Leverage (Avg TA/Avg Equity)	2.9	2.5	2.3	2.1	1.9
Adjusted ROAE	23.5	20.6	25.6	24.7	21.6

Source: Company, BOBCAPS Research | Note: TA = Total Assets

Ratio Analysis

Y/E 31 Mar	FY18A	FY19A	FY20E	FY21E	FY22E
YoY growth (%)					
Revenue	31.9	44.3	24.3	21.9	10.2
EBITDA	67.2	45.7	24.4	20.7	10.2
Adjusted EPS	(31.7)	(6.4)	56.4	23.2	10.2
Profitability & Return ratios (%)					
EBITDA margin	14.9	15.1	15.1	14.9	14.9
EBIT margin	11.1	11.3	11.9	11.8	11.7
Adjusted profit margin	6.1	6.1	7.7	7.8	7.8
Adjusted ROAE	23.5	20.6	25.6	24.7	21.6
ROCE	23.4	23.1	26.9	27.8	26.2
Working capital days (days)					
Receivables	114	113	93	93	93
Inventory	28	21	20	20	20
Payables	86	73	66	65	65
Ratios (x)					
Gross asset turnover	3.9	3.6	3.9	4.3	4.2
Current ratio	2.0	2.0	1.8	1.9	2.0
Net interest coverage ratio	3.8	4.6	6.0	6.7	7.2
Adjusted debt/equity	0.3	0.4	0.3	0.2	0.1

Source: Company, BOBCAPS Research

Disclaimer

Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

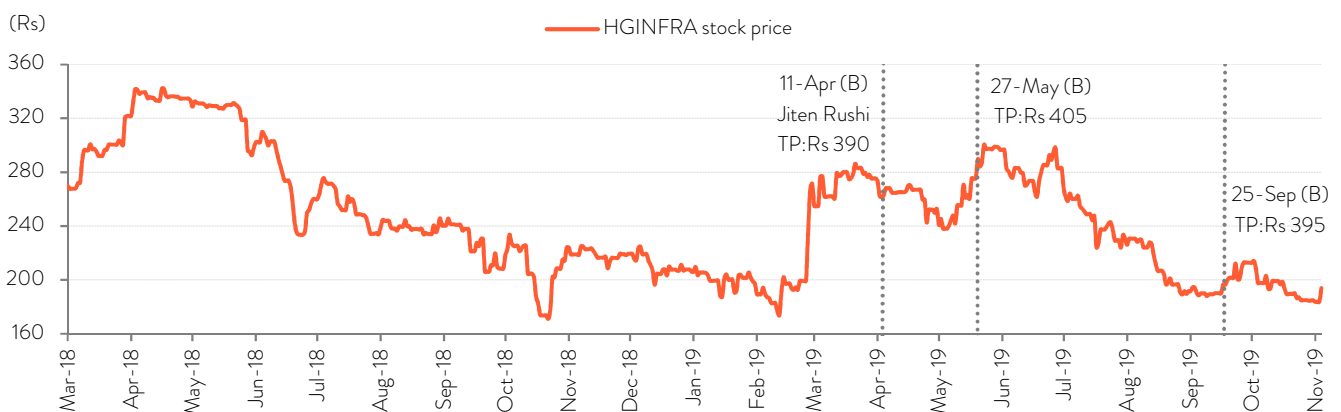
ADD – Expected return from >+5% to +15%

REDUCE – Expected return from -5% to +5%

SELL – Expected return <-5%

Note: Recommendation structure changed with effect from 1 January 2018 (Hold rating discontinued and replaced by Add / Reduce)

HISTORICAL RATINGS AND TARGET PRICE: HG INFRA ENGINEERING (HGINFRA IN)



B – Buy, A – Add, R – Reduce, S – Sell

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