STALLION ASSET
CREATING ALPHA

HG INFRA ENGINEERING LTD.

CMP: Rs. 271.80 Weight: 5%

13/03/2018

HGIEL
We Make People Move...

HG INFRA ENGINEERING LTD.

Thesis –

At Stallion Asset we have a consistent investment philosophy of buying companies that can:

1) **Grow more than 25%**
2) **Huge Opportunity Size**
3) **High Return on Equity**
4) **Smart and Ethical Management**

HG Infra is a Rajasthan based pure EPC Company with interest in construction of roads, bridges for Government and Private Players. It is a new company on the block which got listed on the stock exchanges on 9th March, 2018 to raise 462 Cr out of which 300 Cr. was fresh issue. It has grown exponentially between 2014-2017 by reporting sales and profit growth of 30% and 70% CAGR respectively. Its current total order book stands at 4,870 Cr.

Is HG Infra another Dilip Buildcon in making?

- Strong Revenue Visibility
- 100% equipment are owned
- Shift from Sub-contracting model to Independent Developer
- Sector Tailwinds intact
- High ROCE compared to peers
- Low working capital days cycle
- Debt Reduction on its way via IPO money

HG Infra is standing at the same place where Dilip Buildcon was few years back with low Revenue base, shift from being a sub-contractor to independent developer, strong execution history with all projects completed on time or before time and high growth. The unique part is that it has generated the highest Industry ROCE of 36% v/s industry Average of 14% in FY2017.

Road Construction Sector has strong sector tailwinds in form of large order inflow, we believe with new IPO money coming in, the company would be able to go to the next level of Growth.

STOCK DATA

Market Cap(Rs. cr)	1772
Debt	141
Cash	3
Enterprise Value	1910
Promoters Holding	73.74%
52 week high/low	276/252
Shares outstanding (In Cr.)	6.52

KEY FINANCIALS **(Rs. in cr)**

Y/E March	2014	2015	2016	2017
Revenue	471	365	741	1055
Operating exp	411	321	663	935
EBITDA	60	44	78	120
Depreciation	13	17	18	26
Interest Expense	14	16	16	19
PBT	35	14	46	79
Taxes	15	9	11	26
PAT	20	5	35	53

VALUATION – The Company should do a EBITDA of 175-200 Crores for FY2018 and is trading at 10-11x EV/EBITDA. There is a lot of visibility of Revenue growth as the company has a order book of 4870 Crores. We Believe the company can grow at 30%+ for next 2-3 years as the tailwind for road construction in India remains very strong. The Company has the Highest Industry ROCE of 36% in FY2017 and is in Scale up mode.

Understand the Infrastructure Cycle – The history from a Stock Market Perspective

Learnings from the Past infrastructure boom, the pre-requisite of Valuations in Infrastructure companies are the Following

1) **Company Should have a Good Execution Track record**
2) **There has to be Big Delta (Growth) of Order Book**
3) **There has to be Balance Sheet Strength to Execute these orders.**

If you get all this in Infrastructure sectors, odds are that markets will Extrapolate Stock price based on order wins and not necessarily Revenue or Profit Growth.

We strongly believe that valuations of these companies peak out when order book peaks out and not profits. HG Infra is in a sweet spot as it can certainly maintain the growth momentum due to its lower base and that this can be a potential repeat of what we saw in Dilip buildcon.

Small Base = Higher growth

We have complied the sales numbers of the winners of the last Infra cycle. We observed that after a certain level of sales (5000 Cr.) it becomes difficult for the company to grow. HG Infra enjoys a very small base of only 1000 Cr. and hence have ample scope to grow. We believe that this is one of the company's strongest strength.

	High Growth Phase In Infrastructure					Huge Competition Phase			Decline of the Sector/Balance Sheet Problems			
Sales	Mar-06	Mar-07	Mar-08	Mar-09	Mar-10	Mar-11	Mar-12	Mar-13	Mar-14	Mar-15	Mar-16	Mar-17
NCC	1,840	2,949	3,635	4,786	5,897	6,230	6,665	6,968	7,463	9,513	9,527	9,001
HCC	1,958	2,301	2,995	3,560	3,975	7,156	8,158	8,510	9,668	10,353	8,540	9,867
IRB Infra	-	306	733	992	1,705	2,438	3,133	3,687	3,732	3,849	5,128	5,846
Gammon Infra	78	148	159	190	328	336	423	690	454	542	1,577	663
IVRCL	1,713	2,496	3,850	5,064	5,832	6,838	7,557	4,495	4,945	3,820	2,987	2,589
Simplex Infra	1,343	1,708	2,808	4,713	4,564	4,824	6,010	5,897	5,615	6,202	5,894	5,612
Total Sales (Cr)	6,932	9,907	14,180	19,306	22,301	27,821	31,946	30,249	31,878	34,279	33,652	33,578
Growth	NA	42.9%	43.1%	36.2%	15.5%	24.8%	14.8%	-5.3%	5.4%	7.5%	-1.8%	-0.2%

Just like Every Cycle after the decline Stage, only few of the Old players would be able to survive, stand up and Run, though the new players will lead the order book inflow for next 1-2 years as they have better balance sheets and no backlog.

About the Company –

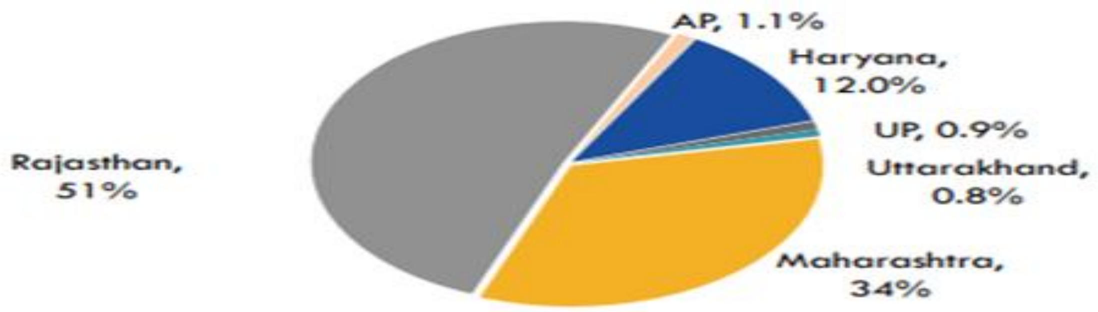
HG Infra is a Rajasthan based pure EPC player with 76% of their total order book of 4870 Cr coming from Government Clients like MORTH, NHAI and rest 23% from Private clients. In last 5 years they have completed 13 projects. They have reported revenue of 1055 Cr. for FY17 and have shown a robust Growth in sales and Profit in last 5 years.

IPO - HG Infra, a newly listed company raised 462 Cr via IPO route out of which 300 Cr was Fresh Issue. Company's promoters diluted stake bringing their stake down from 100% to 73.74%. Out of the total capital raised (300 Cr.), 115 Cr will be used to repay debt, 90 Cr to purchase more equipment and rest for the general corporate purpose.

Company Journey –

- Started with projects as small as 2-5 Cr in state of Rajasthan in villages
- 2003 - Incorporated as a private limited company from a partnership firm
- 2007 – This was a game changer for the company when the company bagged its sub-contracting project of 10 km worth 11 Cr from Punj Lloyd which was just a small part of total 360 Cr project. Since then the company has not looked back.
- 2010-2014 – Inspite of the size of the project remained small, but they started getting more and more number of sub- contracting projects from various private players. During this period the company's turnover increased from meagre 153 Cr to 439 Cr.
- 2014 and Beyond – Over the past few years they had continuously made investments to increase their fleet size of the equipment. In 2014, they were eligible to bid for a project size of 245 Cr. as a single entity as against 800 Cr in 2018.

Order Book – Break Up



1) Strong Revenue Visibility –

Company has executed 13 projects in last 5 years and has total 21 ongoing projects worth 3708 Cr as on 30th November 2017. Post November they have announce L1 in one project worth 1170 Cr thus bringing their total order book to 4870 Cr. Management has said in the analyst meet that the 3700 Cr of order book will be executed within 1.5 to 2 years against revenue of just 1055 Crores for FY2017.

Particulars	2015	2016	2017
Order Book (Cr)	1068	1446	4019
Revenue (Cr)	365	741	1055
Order Book/Revenue (x)	2.93	1.95	3.81

Company has reported 550 Cr. of sales for H1FY18, the current order book to sales would be 4.6x FY2017 Sales which gives us enough visibility of Growth going forward.

2) Strong Growth in sales and Profits –

Company has reported strong growth numbers on the top line front and has done well on operational front as well. We strongly believe that the company will continue to post strong growth numbers as they will execute the current order book within next 2 years. The average size of the projects they can bid for as a single entity has increased from 245 Cr in 2014 to 806 Cr in 2018 which is still very low as compared to its peers (1200-1500 Cr average for Dilip) which show ample opportunity for the company to scale up. As and when the company executes its projects on time, its average bidding size will increase thus its sales will increase at a faster pace.

In Cr.	FY14	FY15	FY16	FY17	H1FY18	3 Years CAGR
Sales	471	365	741	1055	567	30%
EBITDA	51	44	78	120	80	33%
PAT	11	4.6	35.3	53.3	29.2	70%

We believe the company can do sales of 1400 Crores for FY2018 while maintain its EBITDA Margin of 14% i.e. reporting 196 Crores of EBITDA for FY2018.

3) Change in Business Model –

At one point of time 70% of company's revenue were sub- contracting revenue, today this number is reversed in favour of non-sub-contracting revenue. **They have smartly shifted their business model from a sub-contractor to an independent construction player and have prudently increased their project size year over year.** They have invested 300 Cr in Plant and Machinery in last 4 years and have an in house equipment fleet of more than 1000. **We strongly believe that this company is potential candidate to be a repeat of Dillip Buildcon if they execute their projects in a timely manner. The idea is to become operationally efficient with 100% in house labour and equipment. Dilip Buildcon has maintained its operating margins at 18% whereas HG Infra has 14% margins. We believe that these margins will head northwards going forward in the next 2-3 years. Now whether they would be as high as Dilip or not is difficult to say but they should definitely improve from heron.**

Here is an extract from our Dilip Buildcon Report

3) No Sub Contracting Business Model

The Secret to Dilip buildcon's success is that it is fully vertically integrated; all equipment's are owned by them instead of leasing them from third parties. It has the biggest fleet of 8500 equipment's which are tracked centrally via GPS system. Dilip's culture is that of a sub-contractor i.e. it hires even labours and hence it has higher employee base whereas other companies hire top engineers and outsources labour work to subcontractors.

FY2016	Employees	Revenue	Rev/Employee	SubContract/ Revenue
Dilip	19746	4349	0.22	0%
PNC	3700	2395	0.65	27%
KNR	854	995	1.17	19%
Ashoka	2565	2614	1.02	27%
Sadbhav	938	3878	4.13	51%

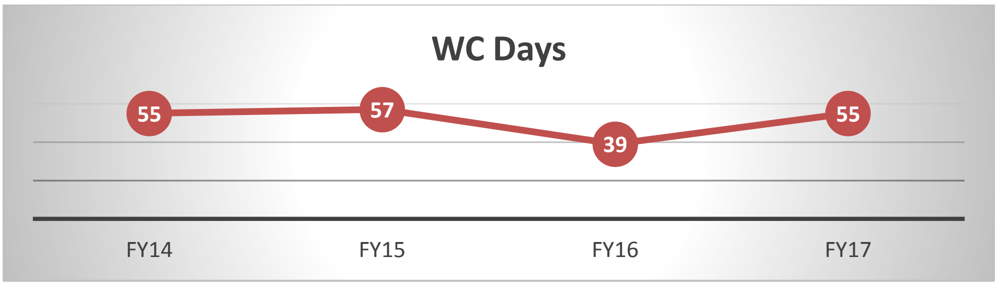
DBL gives 0% Work to subcontractors whereas Sadbhav gives 51% of Revenue to subcontractor. This strategy of inhouse labour has worked in the company's favour.

3) Low Working Capital Cycle –

Company Name	Net WC Days*
KNR Construction	45
PNC Infratech	139
Gayatri Projects	104
Dilip Buildcon	136
Ashoka Buildcon	167
H.G. Infra	55

*Except H.G. Infra (Sept 2017) all figures for Dec 2017

We believe that working capital cycle is an important parameter to look for in an Infra Company. KNR Construction has the lowest WC Cycle in the Industry. **HG Infra has a very good WC Cycle though we believe that it will go higher going forward as the company's average time to complete a project will go higher along with rising project size. It will still remain below the Industry average.**



5) High ROCE in the Industry –

Company Name	ROCE - FY17
KNR Construction	18.91%
PNC Infratech	11.08%
Gayatri Projects	8.71%
Dilip Buildcon	17.97%
Ashoka Buildcon	12.30%
H.G. Infra	36.00%

Here we have used FY17 data to make it more comparable and useful for our analysis. HG Infra's recent dilution of shares is not taken into account in this ratio. Post that adjustment the ratio will still remain at 30% levels. Point here is that it has one of the best return on capital employed among all the EPC players in the industry. **We believe that they can maintain high ROCE going forward as well.**

6) Sector Tailwinds intact –

- Bharatmala is a 4 lakh Cr opportunity out of which Govt. is targeting to give away orders worth 1 lakh Cr by March 2018 itself.
- Orders worth 20,800 Cr are awarded in Q3FY18 i.e. 115% growth from last year same period. Q4FY18 is expected to be stronger with highest receipt of orders in history.
- Since Elections are just round the corner, like any other election year we believe that even this time there will strong pressure from the Govt. to execute projects on time.
- We have seen a reduction in no. of stuck projects in the industry. PNC and HCC are the only players with stuck projects above 10% of their order book.
- Under EPC Segment, the no of eligible bidders have reduced to half as compared to last cycle back in 2008. Few players will take the market share of others who are unable to bid further due to lack of Balance sheet Strength.

7) Debt Reduction post IPO –

Company Name	Debt to Equity*
KNR Construction	0.13
PNC Infratech	0.06
Gayatri Projects	1.86
Dilip Buildcon	1.39
Ashoka Buildcon	0.08
H.G. Infra**	less than 1

Out of the total fresh issue of 300 Cr, 115 Cr of funds are earmarked for debt repayment which will reduce their debt to 141 Cr. This will bring the company's debt to comfortable levels. Company's strong cash flow generation will ensure lesser debt requirement going forward. Company's new debt to equity post dilution and repayment of debt will go below 1.

*standalone data except HG Infra **estimate

Rs in Cr.	FY14	FY15	FY16	FY17	H1FY18
Equity	80	84	123	176	205
Total Debt	101	53	87	156	256
Debt/Equity	1.26	0.63	0.71	0.89	1.25

8) EBITDA Margins -

(%)	H1FY18	FY17	FY16	FY15	FY14
EBITDA	14.1	11.4	10.5	12.1	10.8
PAT	5.1	5.0	4.7	1.4	2.3

Company Name	EBITDA (%)*
KNR Construction	20.12
PNC Infratech	16.02
Gayatri Projects	16.33
Dilip Buildcon	18.72
Ashoka Buildcon	15.65
H.G. Infra	14.11

EBITDA Margins for the company are lower than the Industry average. We believe that the margins will improve as the company attains scale. Currently the company has a small base of 1000 Cr turnover with a lot of capex done in past few years. They have spent 300 Cr in last 4 years for plant and machinery. As they will achieve economies of scale, their margins will move northwards.

9) No tax benefits to the peers (Important Factor seen by Institutional Investors)

From past many years all the large infra companies were getting the benefit of tax exemption under section 80IA. They could reverse their MAT Credit to pay low or no taxes. Dillip Buildcon, PNC Infra, KNR etc. have all enjoyed these benefits. In Union Budget 2017, Government have removed all these benefits and we believe that the MAT Credits of most of the companies will get over by FY19-20. This will result in increase in taxes, lower earnings and lower cash flows for other players. Many companies will report lower growth in earnings as compared to previous years. HG Infra would be unaffected unlike other listed peers as they already pay higher taxes as they were sub-contractor and not directly bidding in NHAI.

	H1FY18	FY17	FY16	FY15	FY14
PBT	45	79	46	14	35
Taxes	16	30	16	4	9
Tax Rate	35.56%	37.97%	34.78%	28.57%	25.71%

Risks –

1. **Execution Risk** – This is the biggest risk that we foresee for HG Infra. Among all the different Business Models in Infrastructure space like HAM, EPC, BOT the maximum competition is in the EPC space where HG Infra has its presence. In order to stay competitive and be eligible to bid for more projects, it is very important for the company to execute its current projects on time.
2. **Election Risk** – Elections round the corner can turn out to be negative for the Industry if BJP does not win the next general elections. Usually the markets start factoring the result well in advance and these companies might get de-rated

Valuation –

At the current market cap we are getting HG Infra at exactly same valuation as Dilip Buildcon when we had initiated coverage with the same or better growth expectation, lower debt and better working cycle and lastly massive sectorial tailwind. HG Infra has an Enterprise Value of 1900 Crores whereas we Expect it do an EBITDA of 175-200 for FY2018. HG Infra is available at 10-11 EV/EBITDA as against industry average of 13x. The valuations are not substantially cheap but have strong growth prospects as it is a relatively placed better in the cycle as compared to others.

HG Infra has huge Visibility of Growth with 4.6x Order Book to FY2017 Revenue. We believe that the company may trade at a premium to other Players as it has the Highest ROCE and Low Working Capital Cycle. Institutional investors like companies which pay full taxes and that's the advantage for HG infra, and may get in higher valuations against other road construction companies.

We don't know if it will be a repeat of Dilip, but we will ride the trend till the cycle is in our favour. As the order books tops out for the industry i.e. we see decline in the momentum of awarding projects by NHAI, we will consider that as an important signal for an exit. As of now we do believe that we are away from that stage and can ride the upcycle.

Standalone - In Cr	Turnover	EBITDA	EV	Debt	Market Cap	EV/EBITDA	Networth	Order Book*
KNR Construction	1,789	360	4291	133	4176	12	1014	3333.00
PNC Infratech	1448	232	3972	89	4022	17	1603	7976.00
Gayatri	2,792	456	5270	1821	3651	12	981	12700.00
Dilip Buildcon	6,938	1300	16293	3110	13390	13	2239	12357.00
Ashoka Buildcon	2,370	371	4426	164	4304	12	1941	5942.00
H.G. Infra **	1,300	175	1902	140	1765	11	216	4870.00

*Order Book as on 31ST Dec 2017 except HG Infra (March 2018) **All figures except order book are estimates

Conclusion –

HG Infra is relatively new company so not a lot of information of the same is available to all especially their execution history. Hence it become very important for the company to prove its execution capabilities for the next few quarters for its ongoing projects which will be considered as the benchmark for the company to get better valuation going forward. Their ability to bid for larger projects for NHAI will also depend on this. So here we have taken a bet on past execution track record and management integrity and if the execution pans out as expected we can see a massive rerating in the counter.

Analyst Positions – Amit Jeswani and Family have no positions.

Analyst Disclosures – Juhi Shah - No Positions

Gaurav Khanna – No Positions

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