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DALAL STREET INVESTMENT JOURNAL

DEMOCRATIZING WEALTH CREATION

VALUE PICK

CHASING VALUE, NOT PRICES

November 2018

Company Name	:	**HG INFRA ENGINEERING**
BSE Code	:	**541019**
Time Duration	:	**1 year**
CMP	:	**₹216.20 (as on 06 Nov., 2018)**
Target Price	:	**₹267**

The value pick for the month of November is HG Infra, a company which is an Engineering, Procurement and Construction (EPC) player engaged in building highways, roads and bridges in addition to civil works and water supply projects. It is also building its HAM portfolio. The company has evolved from being just a subcontractor to an independent bidder and has been able to hold margins in a highly competitive environment.

Company has ROCE of 23.9 per cent and RoA of 11.9 per cent which is comparable to its peer KNR Construction and this alone goes a long way to say about its focus on execution and margins.

Key levers which we think will drive the growth of the stock are

1) Strong order book and execution: Company currently has Rs. 4,882.2 crore of order book translating into book to bill of 2.8x with order mix of 88 per cent EPC and 12 per cent HAM. Its geographical mix includes 39 per cent is from Rajasthan, followed by 24 per cent in Maharashtra and 24 per cent from Uttar Pradesh and remaining from Uttarakhand, Haryana and Arunachal Pradesh.

It has 41 per cent order book which comprises private companies (L&T, Tata Projects and IRB Infra) while the rest 59 per cent is from Others. In others category, it majorly bids for state PWDs & Others (40 per cent), NHAI 14 per cent and Ministry of Road Transport and Highways 5 per cent.

Company is currently executing 31 projects of which 19 are in Rajasthan, 7 are in Maharashtra and the rest in Haryana, Andhra Pradesh, Uttar Pradesh and Uttarakhand. It stands in an advantageous position as it is pre-qualified to bid independently on an annual basis for EPC bids by NHAI and MoRTH for contract values up to Rs. 1,120 crore and HAM of Rs. 1680 crore based on its technical and financial capacity.

Company is also registered as grade AA Class contractor with PWD, Rajasthan, and SS Category with Military Engineering Services (MES).

Company has been able to meet timelines effectively and timely and has strengthened its capabilities in highways and civil construction. This can work to an advantage where companies able to meet timeline will be preferred for bidding for new projects.

We expect pick up in NHAI orders going forward to strengthen the orderbook further. Also, its focus on road building sector can reap benefits considering its capability and pipeline of projects in offering.

2) Own equipment and fleet : Company wanted to meet the timeline of projects and wanted to reduce the dependence of any external factor impeding the same. Hence it invested Rs. 370 crore over the last two years in construction equipment ownership, making it possible to accelerate project progress and moderate costs. This has helped the company to rotate equipment more efficiently across construction sites and moderate rentals.

3) Sectoral messages are different this time : The government's policy of building infrastructure has been different as the focus on execution and delivery is equally placed as the announcement of new projects. This has led to a change in the way contracts are awarded and reviewed. Also, the ticket size of contracts has increased due to aggressive and large-scale infrastructure projects such as Bharatmala which alone is Rs. 5,35,000 crore project entailing the building of more than 35,000 km of highways and roads across the country by 2022. Correspondingly, the total capital outlay of the country's infrastructure sector increased 20.8 per cent to Rs. 5.97 lakh crore during FY2018-19 from an estimated Rs. 4.94 lakh crore in FY2017-18. The need for highway building also picked up due to a skewed ratio of highways to the cargo carried through it. India's national highway network is expected to cover 50,000 kilometres by 2019, with ~20,000 kilometres of works scheduled for completion over the next couple of years, the highest increment in that period of time. Also, the introduction of HAM model is the best PPP model for highway construction which balances the capital requirement as well as execution capabilities.

Also, companies carrying the old luggage of debt makes them unattractive to bid for new projects which creates opportunities for small to mid-cap companies like HG infra.

Encouraging financial performance

Total revenue Q2FY19 was Rs. 236.3 crore up 82 per cent yoy on

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account of traction in order book and higher execution. EBITDA in Q2FY19 stood at Rs. 62.3 crore vs Rs. 33.8 crore in Q2FY18 leapfrogging by up 84 per cent YoY. EBITDA margin improved from 14.3 per cent in Q2FY18 to 14.5 per cent in Q2FY19 due to better operational efficiency.

For 1H FY19, revenue stood at Rs. 879.28 crore up 55 per cent yoy and EBITDA stood at Rs 129.4 crore jumping by 73 per cent YoY translating into EBITDA margin of 14.7. The company's PAT came in at Rs. 24.6 crore for Q2FY19, as compared to Rs. 10 crore, up 147 per cent. PAT margin improved from 4.2 per cent in Q2FY18 to 5.7 per cent in Q2FY19.

Total debt as of September 30, 2018 was Rs. 394.6 crore including working capital debt of Rs. 137.6 crore and term loans of Rs. 180 crore and the balance amount of Rs.76.9 crore is unsecured Loan received from promoters. The company utilised its IPO proceeds to repay debt of Rs. 33.13 crore in FY18 out of Rs. 115 crore.

Valuation and Outlook

Company is trading at an attractive valuation of P/E of 12.5x and EV/EBITDA 5.7x which is a good entry point considering its expected growth and order book. We see that the company with 1HFY19 achieved 75 per cent of the FY19 year-end target. Management is confident of surpassing its yearly revenue target of Rs. 2,000 crore revenue.

We urge investor to stagger their investment in three tranches and expect company to give returns of 22.5 per cent over the period of a year to reach a target price of Rs. 267.

Inc/Exp Statement(Standalone) (Rs in Crore)

Description	201803	201703	201603	201503	201403
Net Sales	1392.72	1056.03	712.43	329.21	439.98
Total Income	1398.30	1059.72	714.80	331.73	441.89
Total Expenditure	1185.56	931.86	634.36	285.27	389.33
PBIDT	212.74	127.85	80.45	46.46	52.55
PAT	84.26	53.42	30.18	9.22	17.17
Dividend %	500.00				
Adj. EPS(Rs)	12.93	29.64	16.75	6.05	11.26

Quarter On Quarter (Standalone) (Rs in Crore)

Particulars	201809	201806	Q on Q Var%	201709	Y on Y Var%
Net Sales	429.11	450.17	-4.68	236.34	81.56
Total Expenditure	366.79	383.09	-4.25	202.53	81.11
PBIDT (Excl OI)	62.32	67.08	-7.10	33.82	84.29
PAT	24.57	27.01	-9.04	9.96	146.71
PBIDTM% (Excl OI)	14.52	14.90	-2.55	14.31	1.47
PBIDTM%	15.21	15.58	-2.37	15.16	0.33
PATM%	5.73	6.00	-4.50	4.21	36.10
Adj. EPS(Rs)	3.77	4.14	-8.94	1.84	104.89