the last fortnight, the stock has made a comeback, aided by the steep price hike taken by the company in end-Decem-

lion to $800 million, which would translate into a per share value of around Rs 370 to Rs 490. At the current

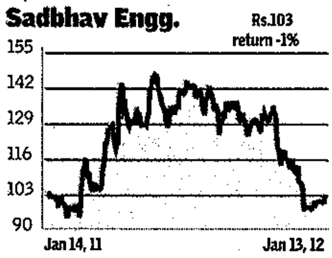
volumes though needs to be seen. In the medium term, LNG prices are expected to moderate which should help the

debt, and also yields high dividend (dividend yield was more than 3 per cent in 2009 and 2010).

Sadbhav Engineering is on the right track

High-value projects, diversified order book and steady working capital cycle have helped the company sustain profits.

BUY



Bhavana Acharya

The past six months has seen the stock of Sadbhav Engineering slip 29 per cent, leaving it at an attractive level for investors with a three-to-five year perspective. Buoying prospects are Sadbhav's strong order book, healthy growth in toll collections from road projects, a good track record of completing projects well ahead of time, earning it early-completion bonuses and consistent growth in revenues and profits.

Sadbhav has nine road projects on a build-operate-transfer basis, of which three are operational. Three more are set to be complete by the end of this fiscal, all of which are ahead of the expected completion date. Road projects constitute 71 per cent of the order book, irrigation projects form 17 per cent, with the rest coming in from mining.

At Rs 103, the stock trades at a PE multiple of 11.5 times the trailing 12-month earnings and 9.6 times the estimated earnings for 2012-13. While at a premium to other road construction/infrastructure companies such as Ashoka Buildcon, Sadbhav has managed better earnings growth.

STRONG ORDER BOOK

Order inflow in the first half of this fiscal has been sedate; outstanding orders at end-September '11 stood at Rs 6,259 crore against Rs 6,956 crore at end-March '11. Even so, the current order book is a good 2.9 times the revenues for FY-11, which will help Sadbhav tide over the tepid inflow of road projects.

Road projects constitute a majority of the company's order book.

New orders in the June quarter were in irrigation projects, with Rs 212 crore likely to flow in by the end of this fiscal.

Sadbhav has bids worth over Rs 2,000 crore in the mining space and Rs 1,139 crore in irrigation projects, though these may not all be won by the company. Awarding of road projects has recently begun to pick up, with the company securing a Rs 101 crore project in the September '11 quarter.

TOLL REVENUE GROWTH

Sadbhav has a combination of pure construction as well as developer contracts in roads. Of its nine BOT road projects, two have been operational for the past two years. Toll revenues from these two have been clocking steady growth.

In 2010-11, revenues grew 36 per cent, while the June '11 quarter saw toll revenues grow 22 per cent. Traffic on these roads has also risen a good 13-15 per cent, auguring well for sustained toll income. Its third BOT project turned operational in 2010-11.

With three more projects scheduled to turn revenue-generating in the next financial year, toll revenues are set to increase. Successful completion of large-scale projects will help improve Sadbhav's technical and financial qualification for larger contracts.

CONSISTENT EARNINGS GROWTH

Revenues' grew at a compounded annual rate of 36 per cent over the past three years, while net profits expanded 23 per cent in the same period. For the six months ending September '11, revenues rose 52 per cent and net profits 32 per cent. Sadbhav has managed consistent revenue and profit growth over the past several quarters unlike peers. Projects have not been stalled due to problems with land or funds. The company has focused on a small number of high-value projects, has a degree of diversification in order book and has maintained its working-capital cycle.

WHY BUY

- Steady growth in revenues and earnings ahead of peers
- Stock at attractive level after recent price fall
- Strong portfolio of road, irrigation and mining projects
- Sizeable order book

Execution of road BOT contracts is undertaken by Sadbhav itself, leading to better margins. Irrigation projects, which inherently have higher margins than road projects, have helped Sadbhav maintain operating margins well above 10 per cent over the past several years. For 2010-11, operating margins stood at 16 per cent, though higher labour and material costs have brought margins down to 12 per cent for the six months ending September '11. Margins are still on a par with peers.

Further, according to the company, it will receive Rs 100 crore in bonus spread over the current fiscal and the next for the early completion of two road projects. Though this is a one-time income, Sadbhav has completed most of its projects ahead of the scheduled time, and could well do the same for its other projects as well.

The bonus could give Sadbhav a reprieve from interest costs, which currently take up about 4 per cent of revenues. Interest and depreciation together have resulted in net margins at 4 per cent, despite the high operating margins. With three more projects becoming operational in the next fiscal, debt could also reduce in conjunction with a rise in revenues. Consolidated debt-to-equity at end-March '11 stood at two times, though current interest cover is at a satisfactory 4.3 times.