

Sadbhav Engineering Ltd

24 June, 2022

Reuters: SADE.NS; Bloomberg: SADE:IN

Liquidity issues at peak, asset monetization key to survival

We are withdrawing our estimates and rating on Sadbhav Engineering (SADE) and keeping the stock 'Under Review' for the time being. Our previous rating on the stock was Buy. Lack of bandwidth and review of coverage universe from our side has resulted in keeping the stock Under Review. We will revisit our thesis on SADE as well as the stock in due course.

SADE is at an important phase wherein it is trying to survive through asset monetization, raising of funds via all means possible and staying afloat so that it can push for its revival. Higher capital allocation to the asset business and staggered cash inflows from asset monetization till date has resulted in severe liquidity issues. The company has almost exhausted its working capital limits and meeting debt obligation this year will be a challenge unless significant cash infusion takes place in the balance sheet. SADE needs working capital as well as growth capital to improve its execution and it is expecting proceeds from the following: (1) sale of Maharashtra Border Check Post project (MBCPL) (2) sale of Ahmedabad Ring Road project (ARR) (3) arbitration awards from various projects and (4) mobilization advance from a couple of HAM projects and the Ahmedabad-Dholera project. While there are several measures that can lead the company towards a debt-free status, delay in cash inflows can also result in cancellation/termination of existing orders or disqualification from bidding, which will have strong repercussions on its operations.

Execution remains weak in FY22: SADE reported weak numbers for FY22 as revenue at Rs12.26bn declined by 25% YoY. EBITDA at Rs1.6bn was also down by 25% as margins were stable at 13%. While the reported margins were stable, the company undertook review of its contract assets and has made a provision of Rs6.9bn for impairment. The company recognises contract assets based on the actual cost incurred till reporting date and estimated cost to complete (CTC) the contract as per percentage of completion method. The CTC is reviewed at the balance sheet date and adjustments are done to the carrying value of contract assets since such review. In the last few years, there has been a substantial increase in the cost of construction. Further, there were delays in execution of work due to resource constraints. To overcome this situation during the year, the company sub-contracted or took exit from some of the works post final measurement. There is no pass-through of higher cost over-run as the contracts are fixed price contracts. The provision is the excess amount of work done compared to the actual contract value of work, which the company feels that it cannot be recovered.

Orderbook value uncertain, extended delays in execution: As on 3QFY22, SADE had an order book of Rs85bn, reflecting 7x TTM book to bill ratio. A sharp fall in revenue makes the book to bill ratio look optically higher. The OB is spread across HAM (24%), EPC (51%) and Irrigation & Mining (25%) segments. Multiple HAM, Irrigation & Mining projects are delayed and may get cancelled due to delay in execution. Hence, ascertaining the actual value of OB is challenging. There are delays in executing HAM projects due to working capital concerns and partly due to delay in handover of land by the NHAI. The authority has granted extension of time for these projects, but physical progress on these projects remains weak tilldate.

Leverage still remains high, liquidity issues persist: Net debt to EBITDA as on FY22 stood at 7x. Adjusting for the EBITDA as well as debt, including the current portion, the ratio is actually much higher at more than 9x. Even the reported interest costs are higher than reported EBITDA, suggesting deteriorating credit metrics. Delays in cashflows from asset monetization and lower operating cash flows, coupled with support required for BOT/HAM assets has resulted in weak liquidity position. Working capital limits have been exhausted and consequently, execution has remained weak. Receipt of cashflows from the sale of Ahmedabad ring road project to India InfraViT and the 3 HAM assets is likely to result in some relief in liquidity positions in future. Also, as on date, SIPL has Rs1.8bn worth of units of India Infra InViT. The company will look to monetize these at an appropriate time.

Proceeds from MBCPL delayed: During the year, SADE entered into an agreement with the Adani group for sale of its entire stake in Maharashtra Border Check Post Network Limited (MBCPL). The proceeds for the 49% stake sale amounting to Rs2.87bn has been received this year. The remaining tranche of ~Rs2.5bn was earlier estimated to be received in FY22 itself, but has now been pushed beyond 2QFY23. Further delay in receiving the said proceeds will also likely affect liquidity position.

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UNDER REVIEW

Sector: Construction

CMP: Rs16

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Key Data

Current Shares O/S (man)	171.6
Mkt Cap (Rsbn/US\$mn)	2.8/35.2
52 Wk. H / L (Rs)	97/13
Daily Vol. (3M NSE Avg.)	1,357,498

Price Performance (%)

	1 M	6 M	1 Yr.
Sadbhav Engineering	(39.7)	(58.5)	(79.1)
Nifty Index	(3.5)	(8.5)	(1.5)

Source: Bloomberg

Update on HAM assets: SADE has a total of 9 HAM SPVs, out of which 5 have received PCOD and are receiving annuity. The company expects 1 more PCOD to be achieved soon. The balance 3 HAM projects have been sub-contracted to a different entity, Gawar Constructions, as the company did not have enough resources to start construction. SADE will not book EPC revenue for the same. This will ensure that there is timely construction of projects and SIPL will start receiving annuity after the PCOD. The company is looking to monetise 3 HAM projects to reduce debt at SIPL level. Total inflow expected from the sale of these assets is ~Rs2.5-3bn. After the divestment, SIPL will still have 6 HAM assets where the total equity invested is Rs6.5-7bn. Equity investments in the HAM projects have largely been met.

Claims from projects affected due to farmers agitation awaited: Rohtak – Panipat project: The company has outstanding loan, trade and other receivables aggregating to ~Rs2bn from the Rohtak Panipat project (RPTPL). The net worth of RPTPL has fully eroded. The toll collection by RPTPL was forcefully suspended due to agitation and protest held by farmers and other unions against farm laws from Dec 25, 2020. Accordingly, RPTPL could not collect toll user fees from Dec 25, 2020. RPTPL had sent various communications to NHAI for such forceful suspension of toll. RPTPL has issued notice for termination of concession agreement on July 27, 2021 considering the above event as *Force Majeure* in terms of concession agreement. RPTPL has filed a claim amounting to Rs40bn relating to termination payments, O&M cost due to the *force majeure*, Covid claim and demonetization etc. with NHAI in terms of concession agreement. In respect of such claims, NHAI has approached RPTPL for settlement of all these claims by way of conciliation proceedings, which has been consented by it. Once it is completed, the entire debt of Rs9.5bn will be off the books of SIPL. The company has outstanding loan, trade and other receivables aggregating to Rs277mn from the Rohtak Hissar project (RHTPL). The toll collection here was also forcefully suspended due to agitation by farmers from Dec 25, 2020. RHTPL has issued notice for termination of concession agreement on August 27, 2021 considering the above event as *Force Majeure* in terms of concession agreement. Once the termination is completed, the entire debt of Rs10bn will be off the books of SIPL.

Financial statement

Exhibit 1: Income statement

Y/E (Rs mn)	FY18	FY19	FY20	FY21	FY22
Net sales	35,051	35,492	22,517	16,236	12,262
growth (%)	5.6	1.3	(36.6)	(27.9)	(24.5)
Operating expenses	30,899	31,213	19,722	14,123	10,677
EBITDA	4,151	4,279	2,795	2,114	1,586
growth (%)	16.7	3.1	(34.7)	(24.4)	(25.0)
Depreciation	979	958	1,084	942	692
EBIT	3,172	3,321	1,710	1,172	894
Interest paid	1,907	1,749	1,941	1,895	1,879
Other income	897	1,003	1,158	935	963
Pre-tax profit	2,163	2,575	927	211	(22)
Tax	(44)	714	246	(395)	66
Effective tax rate (%)	(2.0)	27.7	26.5	(186.8)	(304.9)
Minority Interest	-	-	-	-	-
Net profit	2,207	1,869	852	410	(7,163)
Exceptional items	-	8	170	(196)	(7,076)
Adjusted net profit	2,207	1,861	681	148	(87)
growth (%)	17.5	(15.3)	(54.4)	(51.8)	(1,845.5)
EPS	12.9	10.9	5.0	2.4	(41.8)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Key ratios

YE March	FY18	FY19	FY20	FY21	FY22
Adj EPS (Rs)	12.9	10.9	5.0	2.4	(41.8)
Adj EPS growth (%)	17.5	(15.3)	(54.4)	(51.8)	NA
EBITDA margin (%)	11.8	12.1	12.4	13.0	12.9
Pre-tax margin (%)	6.2	7.3	4.1	1.3	(0.2)
ROE (%)	12.5	9.6	4.1	1.9	(40.1)
ROCE (%)	12.2	8.9	6.0	17.7	24.9
Turnover & Leverage ratios					
Asset turnover (x)	0.8	0.8	0.5	0.4	0.3
Leverage factor (x)	2.3	2.3	2.2	2.1	2.6
Net margin (%)	6.3	5.3	3.8	2.5	-58.4
Net Debt/Equity (x)	0.8	0.7	0.7	0.5	0.4
Working Capital Ratio					
Inventory days	17	18	24	31	32
Receivable days	170	160	283	93	178
Payable days	71	51	102	132	160
Valuation (x)					
PER (x)	30.7	1.5	3.2	6.7	-0.4
Price/Book value (x)	3.6	0.1	0.1	0.1	0.2
PCE (x)	21.2	1.0	1.4	2.0	-0.4
EV/Net sales (x)	2.0	0.2	0.3	0.4	0.4
EV/EBITDA (x)	17.0	2.1	2.3	3.1	3.4
Dividend Yield (%)	0.8	0.1	0.1	0.0	0.0

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Balance Sheet

Y/E (Rs mn)	FY18	FY19	FY20	FY21	FY22
Equity Capital	172	172	172	172	172
Reserves and Surplus	18,496	20,165	20,868	21,282	14,114
Networth	18,668	20,337	21,040	21,454	14,285
Total Debt	14,847	15,873	12,383	13,184	11,439
Deferred tax liability	-	-	-	-	-
Other noncurrent liabilities	83	55	160	-	-
Trade Payables	5,990	4,353	5,529	5,091	4,666
Other Current Liabilities	3,945	3,398	5,094	3,550	3,809
Total Current Liabilities	10,109	9,712	12,775	11,172	11,145
Total liabilities	43,706	45,977	46,358	45,809	36,870
NB	5,004	4,939	4,304	2,920	1,929
CWIP	24	33	38	38	38
Investment	5,775	6,094	5,580	5,667	5,593
Other non-current assets	148	200	423	0	13
Inventories	1,643	1,792	1,472	1,391	1,075
Sundry Debtors	16,281	15,551	17,434	4,150	5,992
Cash and Bank	67	346	213	81	274
Other current assets	952	968	1,125	1,323	627
Total Current Assets	31,355	25,533	28,276	31,634	25,460
Total Assets	43,707	45,977	46,358	45,809	36,870

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 4: Cash flow statement

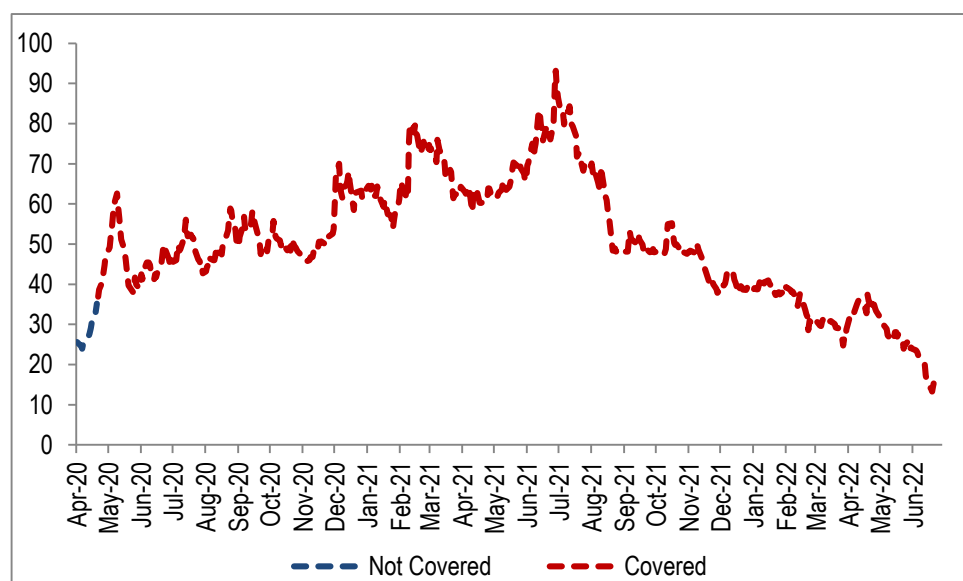
YE March, Rs mn	FY18	FY19	FY20	FY21	FY22
EBIT	4,069	4,325	2,869	2,106	1,857
Add: Depreciation & Impairment	979	958	1,084	942	692
Cash flow from operations b4 WC	4,239	5,290	4,123	2,853	(4,526)
Net change in Working capital	1,141	5,903	948	(6,097)	6,423
Tax paid	44	(714)	(246)	395	(66)
Net cash from operations	5,424	10,478	4,825	(2,849)	1,831
Capital expenditure	(778)	(902)	(454)	441	299
Sale of investments	(105)	(8,296)	1,310	3,332	1,389
Net cash from investing	27	(9,250)	634	4,196	1,675
Issue of shares	-	(0)	-	-	-
Increase in debt	(2,939)	999	(3,385)	641	(1,744)
Dividends paid incl. tax	(172)	(197)	(182)	-	-
Net cash from financing	(5,511)	(950)	(5,591)	(1,479)	(3,313)
Net Cash	(60)	278	(133)	(132)	193
Opening Cash	127	67	346	213	81
Closing Cash	67	346	213	81	274

Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
23 April 2020	BUY	35	63
27 May 2020	BUY	38	63
13 July 2020	BUY	49	91
4 September 2020	BUY	50	91
23 September 2020	BUY	51	91
24 September 2020	BUY	51	91
6 October 2020	BUY	53	91
17 November 2020	BUY	50	91
15 February 2021	BUY	80	98
5 July 2021	ACCUMULATE	87	89
18 August 2021	BUY	61	79
24 June 2022	UNDER REVIEW	16	-

Rating track graph



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Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

SELL < -5%

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