PSP Projects
NOT RATED

VISIT NOTE	PSPPL IN EQUITY	April 13, 2018

Gujarat Lion

PSP's tightly run operations (best-in-class WC and PAT margin) provide it industry-best RoIC of 35%. This is driven by laser focus on core geography (Gujarat: 91% of order book), core clientele (institutional: 85%), strong local relationships (bulk of projects around Ahmedabad) and centralised control. Strong growth prospects (49% consensus PAT CAGR over FY18-20E) are backed by strong order book (6x book to FY17 revenue) but depend on clean execution of one project that contributes 57% to the book. Risks emanate from industry-low employee cost (including key ones), sustenance of benefits from operating in a single geography and investments in technology/people if they foray outside Gujarat. Multiple of 21x FY19E consensus P/E, a premium to peer set, may seem warranted but also factors in Surat project earnings to be replaced by FY20E. History suggests maturity comes at a cost for young promising building contractors.

Competitive position: MODERATE   Changes to this position: STABLE

Ample opportunities in Gujarat?

Investors worried about limited definable opportunities in Gujarat should not worry about inflows – history shows mid-sized contractors were able to scale up to ₹15-25bn of order book even without a Surat Diamond Board project. PSP is a play on Gujarat's industrialization; Gift City, Dream City and Dholera development should feed inflows. Residential and Government projects are potential domains that can boost the order book.

Surat project execution and margin sustenance are key variables

The Diamond Bourse project constitutes 57% of the order book and its timely and efficient execution is paramount. We like the management's approach thus far in managing a project far larger than anything done in the past. Driver of industry-premium EBITDA margin – low employee cost at 4.6% of revenue vs peers at 6-10% – needs to be tracked. Ability to maintain low employee cost may be crucial in sustaining the industry-best profitability levels.

Best-in-class return metrics

Low fixed overheads (8.2% of revenue vs peers' 7-16%), limited debt (0.2x 1HFY18 D/E) and higher than peers fixed asset turns (8.5x vs peers' 5x-7x) result in premium RoIC (35% vs peers' 9-23%). This may be linked to centralized control that helps it to keep costs low. Investments in equipment are likely to increase henceforth as the company undertakes larger projects.

What is the right multiple?

Current valuation of 21x FY19E EPS is at a premium to peers that trade at 19x. Superior profit growth (~48% CAGR over FY18-20E) and RoE may justify it but ~40% of the company's FY19E EPS may be driven by the Surat Project. Should an investor assign a company multiple to this project that may or may not repeat? A tightly family-run business attempting to expand operations and key man risk are the other major risks.

Key financials

Year to March	FY13	FY14	FY15	FY16	FY17
Net Revenues (₹ mn)	2,572	2,104	2,805	4,760	4,569
EBITDA(₹ mn)	220	167	224	349	668
EBITDA margin	8.5%	8.0%	8.0%	7.3%	14.6%
Net profit (₹ mn)	123	101	141	229	414
RoE (%)	46.1%	32.8%	34.4%	41.3%	49.0%
RoCE (%)	29.7%	16.8%	16.2%	18.7%	26.4%
P/E (x)	125	152	109	67	37

Source: Company, Ambit Capital research

E&C/ Infrastructure

Recommendation

Mcap (bn):	₹19/US$0.3
6M ADV (mn):	₹43/US$0.7
CMP:	₹531
TP (12 mths):	NA
Downside (%):	NA

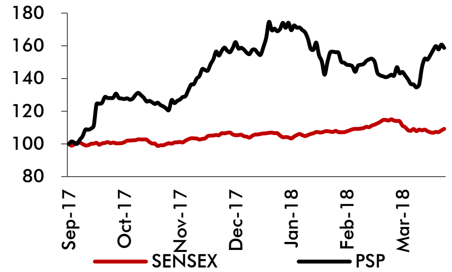
Flags

Accounting:	AMBER
Predictability:	AMBER
Earnings Momentum:	GREEN

Things to watch out for

- Will the Surat project be executed without a hitch?
- Can the company maintain its margins or will employee costs rise?

Performance (%)



Source: Bloomberg, Ambit Capital Research

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A play on Gujarat's industrialisation

Gujarat is PSP's core market, accounting for 91% of the company's order book. Whilst the company is looking to expand its footprint in other states, we believe Gujarat may remain the core market as mid-sized buildings contractors do not find it easy to expand geographically. Our analysis indicates that Gujarat government-based projects have not witnessed a material uptick in tendering. Large opportunities therefore exist in structural, industrialization-driven programmes such as GIFT City, Dream City, DMIC and Smart City. However, lack of visible near-term opportunities should not be construed as lack of opportunity – building construction is a large market and, historically, peers have had no issues scaling up to ₹20bn+ order book without chunky orders like the Surat Diamond Board.

Exhibit 1: Mid-sized players' fortunes are linked to the region they have a larger footprint in; building contractors can't expand their geography easily

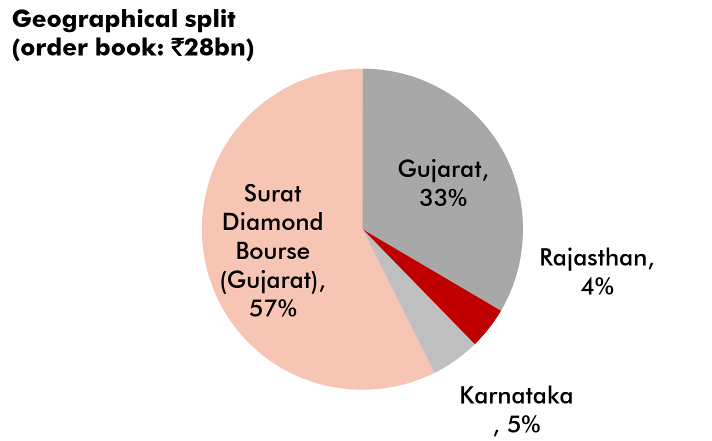
	Mid-sized local players				Pan-India				
	Ahluwalia	Capacit'e	JMC Projects	PSP Projects	Simplex Infra	SP Ltd	Tata Projects	NCC Ltd	L&T
Order book (₹ bn)	**40.1**	**52.4**	**76.0**	**27.5**	**176.5**	**230.0**	NA	**316.3**	**2,586.0**
Buildings & factories	91%	100%	76%	100%	27%	100%	NA	50%	NA
Non- B&F	9%	0%	24%	0%	73%	0%	NA	50%	NA
Government	68%	<5%	32%	4%	73%	NA	NA	NA	NA
Private	32%	95%+	68%	96%	27%	NA	NA	NA	NA
Pvt Residential	29%	92%	62%	2%	21%	NA	NA	NA	NA
Non-residential	71%	8%	38%	98%	79%	NA	NA	NA	NA
Geographical mix	Mainly North India	Mainly West India	Mainly South India	Mainly Gujarat	Pan-India	Pan-India	Pan-India	Pan-India	Pan-India

Source: Company, Ambit Capital research

Gujarat to remain the core market for now; order sizes to increase

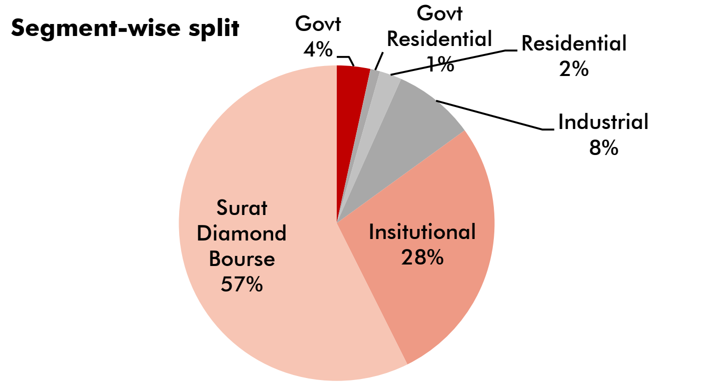
The company's order book of ₹27.5bn mainly consists of 1 large site (Surat Diamond Bourse; ₹15.8bn) with the remaining ₹11.7bn spread across 33 sites. Moreover, 91% of the total order book is based out of Gujarat with only 5 sites (contributing 9% of the order book) outside. Whilst the company has been trying to spread its footprint outside Gujarat, we believe that focus may continue to remain on Gujarat. For one, there are ample industrial private sector opportunities in Gujarat (Gift City, Dream City, riverfront) and the company has strong private sector relationships. Moreover, historically, companies have found it difficult to expand rapidly outside of their core areas in the buildings segment.

Exhibit 2: PSP's Gujarat base is evident in its order book mix



Source: Company, Ambit Capital research

Exhibit 3: Its exposure to Government and residential projects is negligible



Source: Company, Ambit Capital research

The management is also looking to increase its order ticket size. As exemplified over the past few years, the company has concentrated on undertaking larger projects in which competitive intensity is lower.

Exhibit 4: Management is looking to increase average ticket size per project

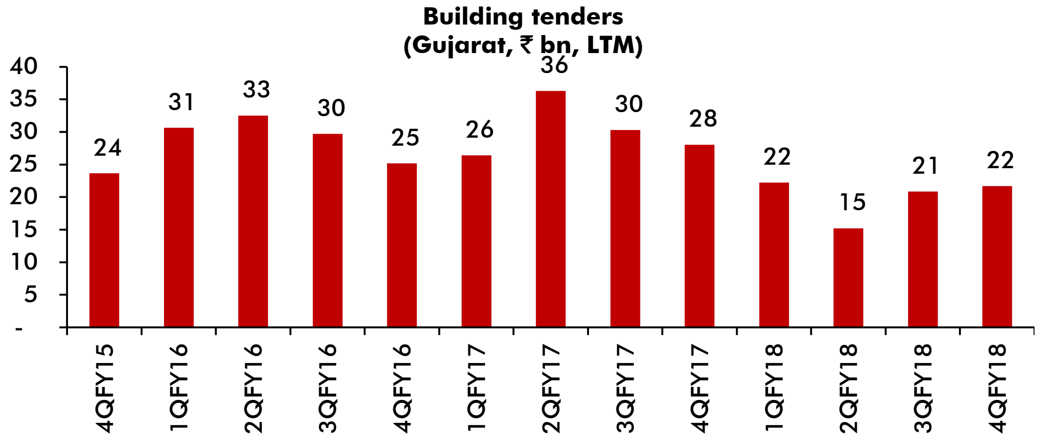
Presently our active sites is 34 and on an average we can see is… now what we are doing after getting larger size project we are now trying to reduce (limit) our project size to ₹250mn in and around Ahmedabad and if I am going out of Ahmedabad we have limited to ₹500mn and if we are going out of Gujarat we have limited ₹1bn.

Source: Company

Government opportunity is limited but industrial opportunity is large

Our analysis of the tendering data (only state and Central Government) indicates that Government opportunities are limited in Gujarat and have not materially increased over the last few years. This reflects in PSP's order book mix where Government accounts for only 4.4% of the order book.

Exhibit 5: Government building tenders in Gujarat have declined over the last 18 months



Source: ProjectsToday, Ambit Capital research

PSP's core segment is institutional buildings. It has a strong footprint in the industrials space with prominent customers that include Torrent Pharma, Zydus Cadila, Amul and Nirma. PSP is a play on increasing industrialisation of Gujarat. The management highlights upcoming opportunities in GIFT City, Dream City, and the development of Kandla as an industrial center.

GIFT City: As per media reports, it is an integrated development on 886 acres with 62 million square feet of built-up area that includes office space, residential, schools, and hospitals. It also has a dedicated multi-services special economic zone (SEZ) for international operations for the services sector. The SEZ also has the status of India's first International Financial Services Centre (IFSC). It is located near Ahmedabad.

Exhibit 6: GIFT City is strategically located on the outskirts of Ahmedabad, PSP's bastion

Source: Google

Of the 62mn square feet of development, the development authority has allotted 15mn sq ft. Of this, ~10mn square feet is in the planning stage with 3mn sq ft under construction. Amongst marquee projects, SBI is planning to build its offices there. There is committed investment of Rs110bn. This is a sizeable opportunity for PSP.

Exhibit 7: GIFT City has large investment commitments and could be a sizeable opportunity of Rs110bn+

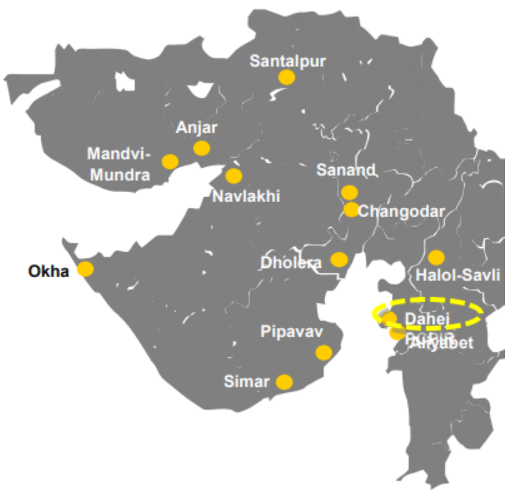
Source: Media

Other special investment zones and DMIC: The Gujarat State Government has identified multiple special zones to attract investments. These zones are designed to attract industry. Development of these zones could lead to more orders for PSP. Dholera, a new city planned under the Delhi Mumbai Industrial Corridor is planned once the Dedicated Freight Corridor comes through. Development here could result in more orders. Dholera has started to invite bids from large manufacturers by offering incentives, as per media reports. (Link)

Exhibit 8: Gujarat has planned multiple special investment zones that are likely to attract significant investments…

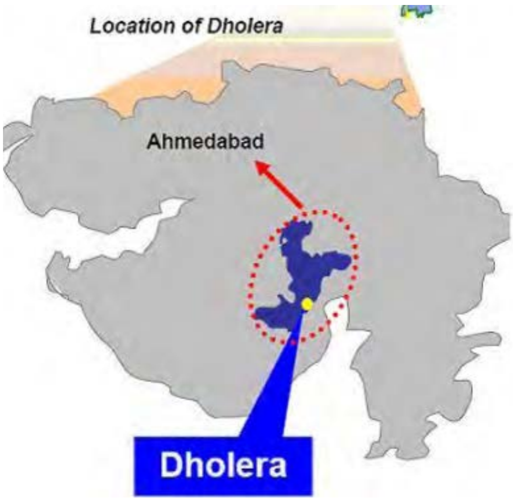
14 Special Investment Regions (SIRs) planned in the State

Gujarat Infrastructure Development Board (GIDB)	
Dholera Special Investment Region	879 sq kms
Becharaji – Mandal Special Investment Region	509 sq kms
Gujarat Industrial Development Corporation (GIDC)	
Petroleum Chemicals & Petrochemicals Investment Region	**453 sq kms**
Halol-Savli Special Investment Region	123 sq kms
Santalpur Special Investment Region	186 sq kms
Viramgam Special Investment Region	190 sq kms
Changodar Special Investment Region	319 sq kms
Navlakhi Special Investment Region	182 sq kms
Simar Special Investment Region	84 sq kms
Pipavav Special Investment Region	147 sq kms
Anjar Special Investment Region	237 sq kms
Okha Special Investment Region	196 sq kms
Aliya Bet Entertainment and Eco PCPIR	169 sq kms
Gujarat Maritime Board (GMB)	
Mundra-Mandvi Special Investment Region	502 sq kms



Source: GIDC

Exhibit 9: One of them, Dholera, is also a part of the Centre's ambitious DMIC programme and is close to Ahmedabad



Source: GIDC

Lack of definable opportunities doesn't mean growth may be hindered

Even though there are no direct drivers of incremental order inflows for the company, there is ample headroom in the building construction space. The opportunity pie is large (and fragmented) and mid-sized companies in the past have not had an issue achieving an order book of ₹15-25bn. Government contracts within Gujarat and private residential are two areas that the company has not fully expanded into.

Exhibit 10: Mid-sized contractors had ₹15-20bn in order book in FY09

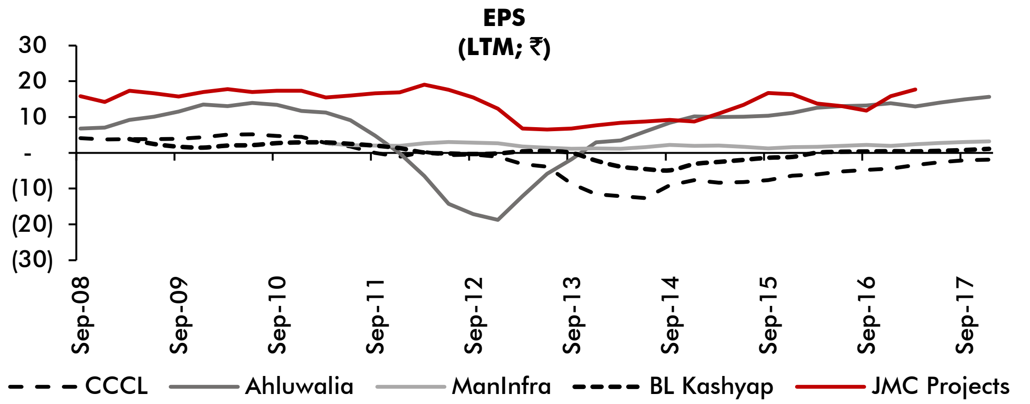
Order book (₹ mn)	Government	Private	Total bldg. OB
CCCL	-	14,620	14,620
Ahluwalia	8,465	17,989	26,454
Man Infra	4,509	15,701	20,209
Unity Infra	10,971	1,356	12,327

Source: Company, Ambit Capital research

We believe that investors should focus on whether the company can maintain its discipline and not try and expand too much too soon. Historical analysis of building contractors suggests that excessive expansion is a bigger threat than lack of orders when the capex cycle picks up.

The building contractors struggled post the slowdown in 2010-11. Companies had reasonably high exposure to private sector clients that in turn found it hard to pay contractors due to falling sales and industry malpractices. However, there were varying extenuating factors that exacerbated the earnings decline in these companies. These factors, at the core, were to do with growth ambitions of the players but manifested in different ways.

Exhibit 11: Almost all building contractors went into losses with the slowdown in the real estate industry in FY10



Source: Company, Ambit Capital research

The key aspects that can be learnt from the downfall and the subsequent recovery:

- **Limited reliance on a few customers**: A player such as Man Infra had high reliance on a few customers for its order book. So, the company had to contend with lower profits though it remained low on leverage and did not report losses through this period.
- **Limit expansion into allied segments**: CCCL expanded into non-building segments, which turned out to be a poor decision. Even a company like BL Kashyap decided to foray into asset ownership that saddled the balance sheet with debt. JMC Projects also spread its wings into infra and asset ownership.
- **Poor customer selection**: A company like Ahluwalia had a large exposure to a poor clientele in the NCR region that created an issue in the downturn. Receivables were locked and debt spiraled. Post that, a more careful selection of contracts (more Government, less fixed price) aided recovery.

Few large competitors may also aid order book growth

As per the management, competitive intensity is low in large projects. For instance, only L&T and SP Ltd are invited for large sized (₹3bn+) tenders in the Surat market. Indeed, post the slowdown over the last few years, many players have shrunk geographies (Ahluwalia), gone bankrupt (Era Infra, Unity, CCCL) or have become marginal players (Man Infra, Pratibha).

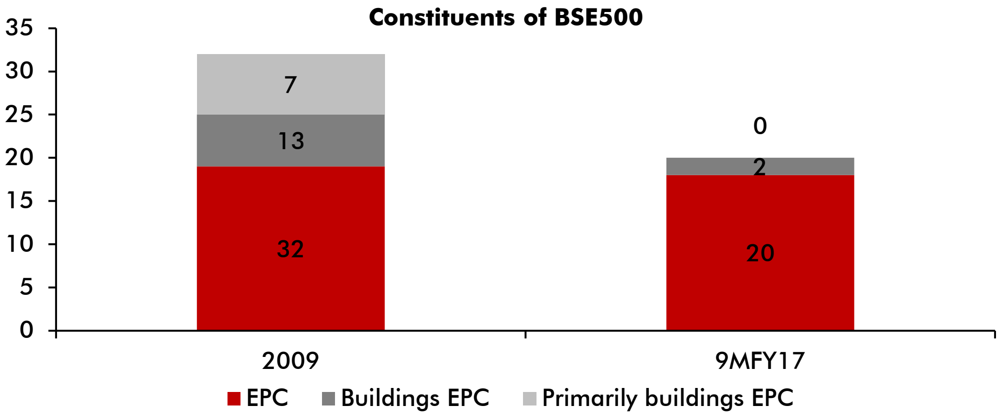
Exhibit 12: Management commentary indicates limited competition may aid order book accretion

So when we talk about project from ₹.250mn to ₹1,500mn, really speaking there is a very big vacuum. The companies like L&T Shapoorji are bidding for projects for more than ₹.2bn, ₹.3bn, ₹.5bn. When they are forced by client to quote for a project ₹.1.5bn, they are always going to quote more and as these two companies are more concentrating on larger size projects, they do not have their concentration on smaller size project. … I do not see there is a big competition as far as our company is concerned for a smaller size project of ₹1.5bn.

Source: Company

In 2009, at the peak of the investment cycle, 32 construction companies were part of the BSE500 index. Of these, 13 used to provide building construction services to third-party players with a few more running captive real estate projects. The real estate cycle was at its peak and, therefore, projects were plenty. Moreover, building construction was the larger proportion of the order book for 7 of these companies.

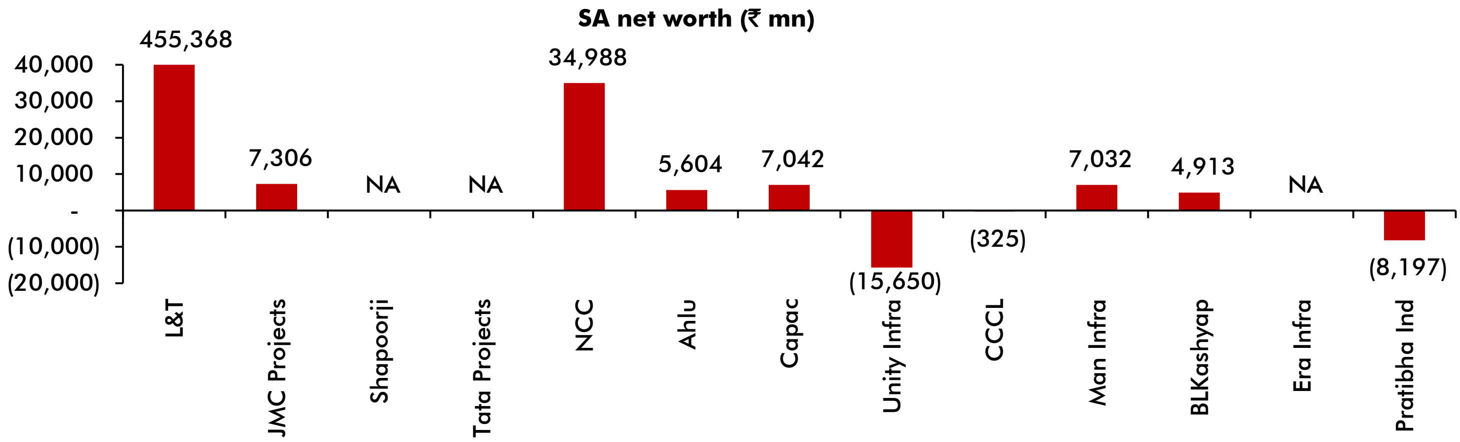
Exhibit 13: There has been a sharp fall from grace for building contractors



Source: Bloomberg, Ambit Capital research

However, over the last few years, as realty prices cracked, many of the building contractors faced financial stress due to higher working capital and lower growth. A few contractors also diversified into other infra segments, resulting in further diversion of resources and ballooning capital employed. Fast forward to 9M2017, only 2 contractors provide third-party building construction services in the BSE500 (of the 20 in all). Of these, buildings is the largest segment for none of them (we have excluded NBCC from this count given that it's a consultant).

Exhibit 14: The sectors' net worth barring the top-10 is limited



Source: Company, Ambit Capital research

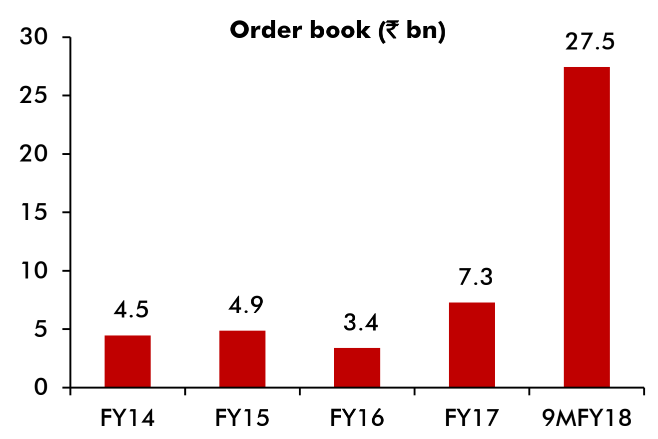
Surat project execution, margins to be the main focus

Over the next 2 years, investors' area of focus should be on: (1) timely execution of the Surat project (₹15.8bn; 57% of order book) and (2) whether the company's EBITDA margin can sustain at the guidance range. PSP's PAT margin is significantly ahead of peers driven by premium EBITDA margin and limited finance costs (due to a negligible debt). EBITDA margin has stepped up from 7.3% in FY16 to 14.6% in FY17. In 9MFY18, the company reported margins of 14%. The uptick in margin was driven by: (1) exit from low-value projects and (2) specific contracts that boosted margins. The management expects margins to stabilize at ~13%.

All eyes on Surat Diamond Bourse project

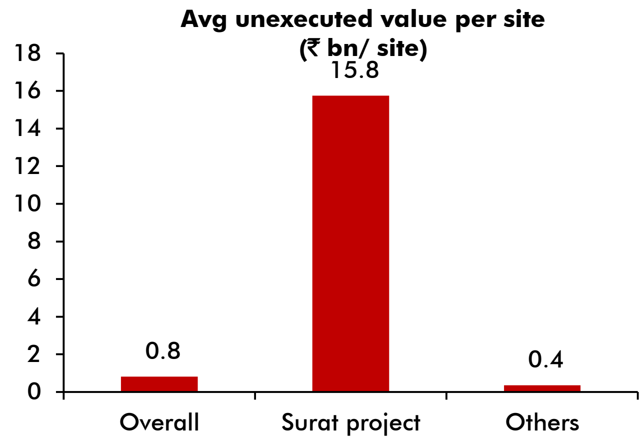
Surat Diamond Bourse is a ₹15.75bn project won by the company in 3QFY18 and has a completion timeline of 30 months. This project is the largest in the company's history and is a significant step-up than any project in its history. Its average project size in FY17 was ₹351mn and its previous largest project was ~₹4bn. As per the management, this project is likely to contribute ₹4.5bn to FY18 revenue (largely in line with its FY17 top-line). To ensure that the company can complete a project of this scale in an efficient manner, it has replicated its organisational structure at Surat to ensure that oversight is strong; total employees have increased from 489 in FY17 to 728 in 3QFY18. It is treating this project as an amalgamation of 3 different projects.

Exhibit 15: Order book has increased materially on the back of the ₹15.8bn Surat project



Source: Company, Ambit Capital research

Exhibit 16: It will be a challenge for PSP given the vast differential in its average ticket size and this project



Source: Company, Ambit Capital research

The project kicked off largely on time and the company has already received ₹500mn as customer advance (of a total of ₹780mn) for the project. The company expects ₹300-400mn of billing in FY18. ~₹6bn of the project value is for the structure and the rest is divided between MEP (₹6bn) and façade (₹4bn). Therefore, a bulk of the company's work will be done over the next 18 months.

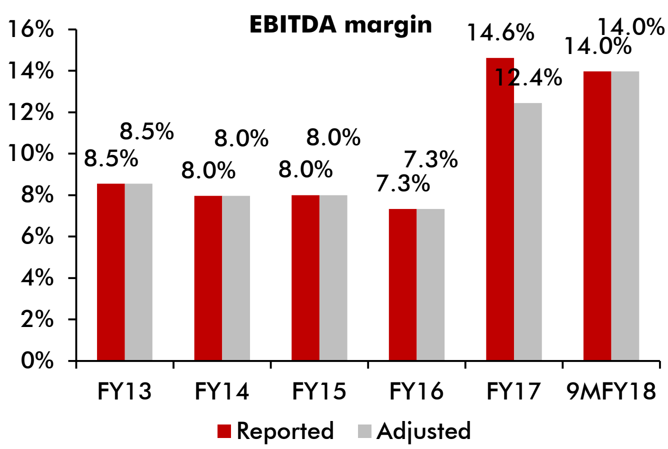
Exhibit 17: The Surat project is the largest and the most complex project undertaken by the company

Source: Company

Can these margins sustain over the next few years?

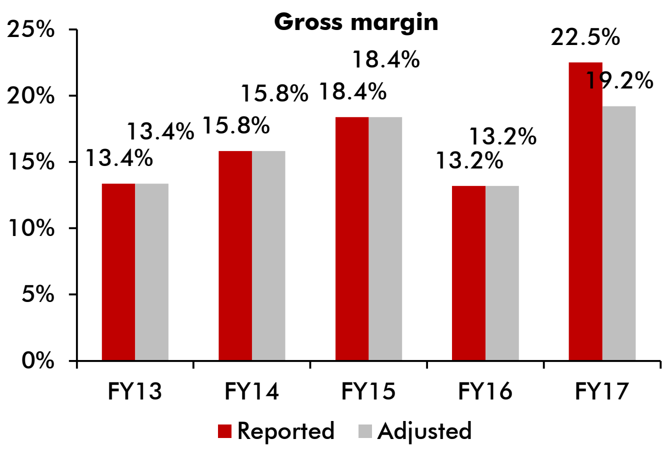
The company's EBITDA margin has expanded materially in the last two years. As shown in the exhibit below, the company had a consistent 7-9% EBITDA margin range in FY17 (consolidated figures). This was led by 4-5 contracts in which clients had undertaken the responsibility to supply the materials. As a result, the material component wasn't a part of revenue and cost of materials, thereby boosting margins optically. When adjusted for this ₹800mn, EBITDA margin was ~12.5% in FY17. EBITDA was also suppressed in FY16 due to low-margin projects that led to gross margin erosion.

Exhibit 18: EBITDA margin stepped up in FY17 on the back of better fixed cost absorption



Source: Company, Ambit Capital research

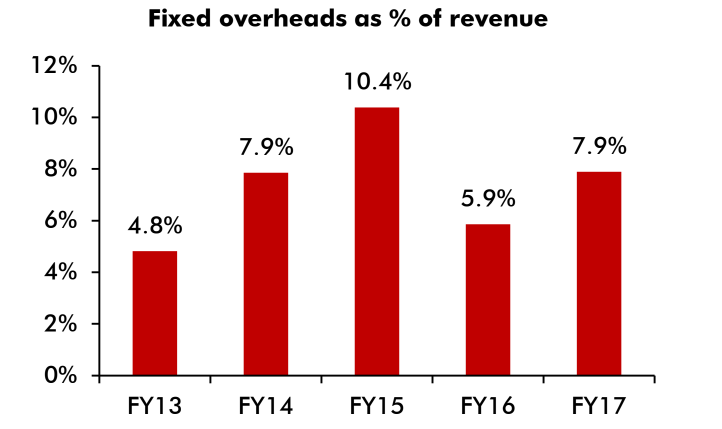
Exhibit 19: Gross margins have expanded with increasing ticket sizes



Source: Company, Ambit Capital research

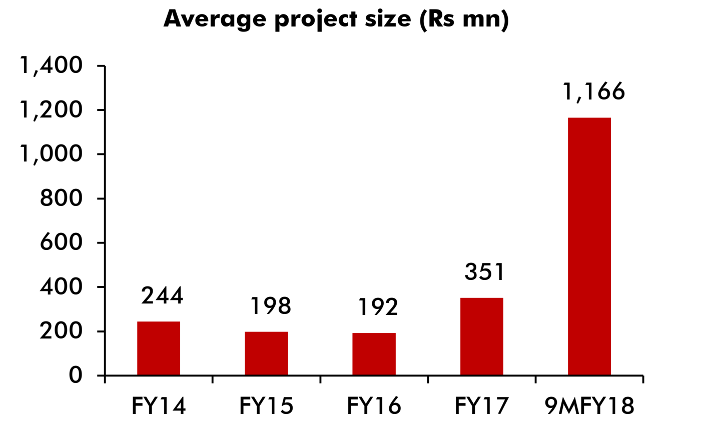
As the company's scale increased in the last 5 years, its fixed overheads absorption improved significantly. As per the management, the focus is on profitable growth and maintaining EBITDA margin at current levels. However, this would be highly dependent on its ability to maintain employee costs at current levels.

Exhibit 20: Overhead absorption has improved as revenue has increased



Source: Company, Ambit Capital research

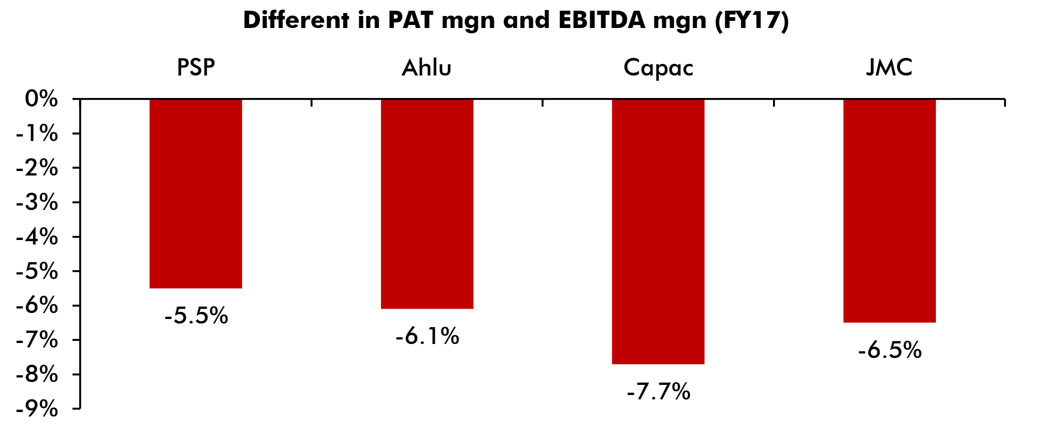
Exhibit 21: Larger ticket sizes should further aid margin expansion



Source: Company, Ambit Capital research

There is limited headroom, however, to improve margins below the EBITDA line. Finance charges are amongst the lowest in the industry, debt is almost negligible and depreciation costs are also in line with peers. Moreover, other income may also wind down as more cash is reinvested into working capital. Therefore, unlike peers, the company's financial leverage is small.

Exhibit 22: The company has limited room for financial leverage



Source: Company, Ambit Capital research

Fixed costs amongst the lowest in the industry

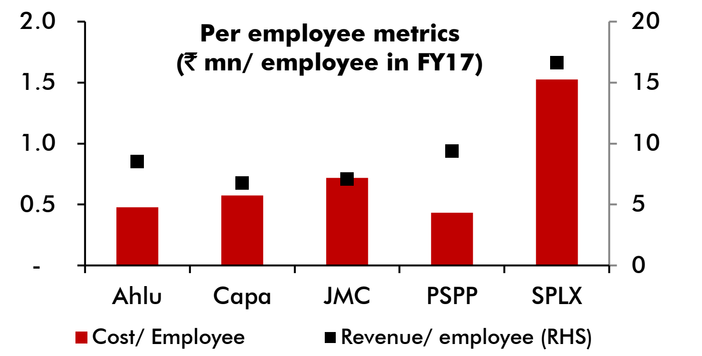
PSP's fixed costs (SG&A plus employee cost) are amongst the lowest in the industry. In particular, its employee cost at 4.6% of revenue is at least 100bps lower than that of its closest competitor. The differential is even starker when compared to employee costs excluding senior management salaries. PSP's cost per employee is the lowest in the industry (perhaps expectedly so given its Gujarat focus vs punchier salaries doled out by peers based in metro cities).

Exhibit 23: PSP's employee cost as a proportion of revenue is amongst the lowest in the industry

₹ mn	Ahluw	Capacite	JMC	PSP	Simplex
Revenue	14,257	11,570	23,284	4,569	56,075
Employee cost	801	984	2,357	212	5,143
% of revenue	**5.6%**	**8.5%**	**10.1%**	**4.6%**	**9.2%**
Paid to senior mgmt	31	42	44	59	27
Net	770	984	2,314	153	5,116
% of revenue	**5.4%**	**8.1%**	**9.9%**	**3.3%**	**9.1%**

Source: Company, Ambit Capital research

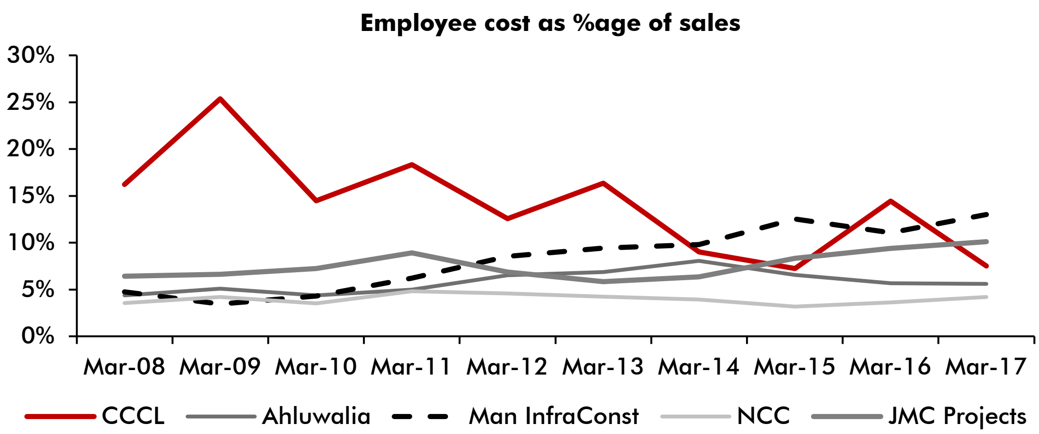
Exhibit 24: PSP's cost per employee is amongst the lowest in its peer set



Source: Company, Ambit Capital research

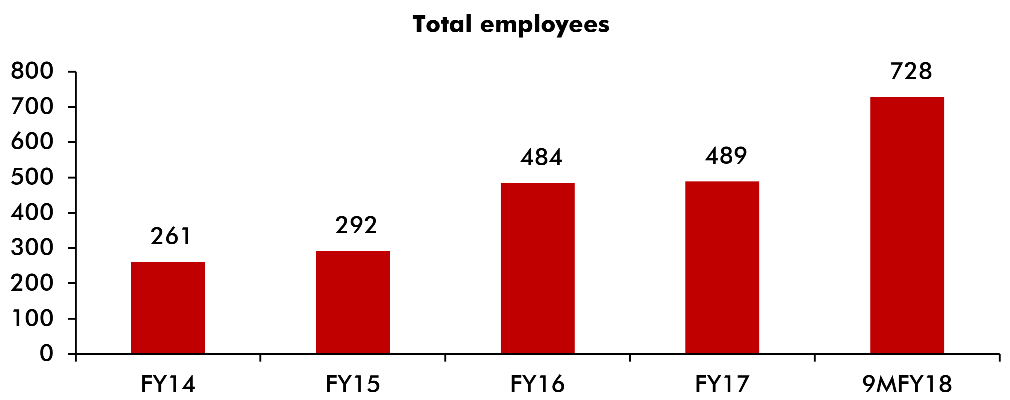
The key to maintaining its margins at ~13% would be ability to keep employee costs at current levels or able to pass-through costs to its client base. Historically, no contractor in this space has been able to maintain employee costs at such low levels. As shown in the exhibit below, no peer has such employee costs barring NCC Ltd.

Exhibit 25: PSP's employee costs may be the lowest that peers have ever achieved in their history bar NCC



Source: Company, Ambit Capital research

Exhibit 26: Total employees have increased due to big order wins; key question is whether the overall cost as a percentage of revenue remains at current levels

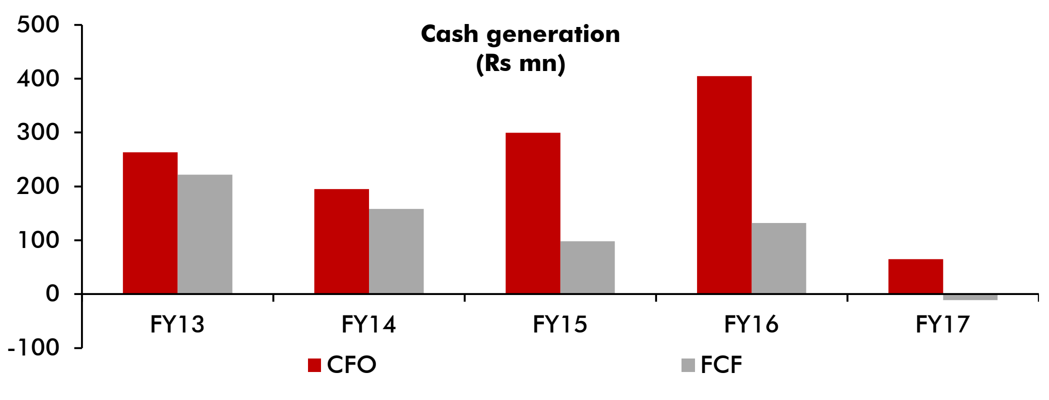


Source: Company, Ambit Capital research

Investments to continue

Over the last 5 years, PSP has invested 3.6% of its revenue in capital expenditure. As per the management, the Surat Diamond Bourse project will require ~4% of total project cost as capex and therefore investments are likely to continue at the same peg. Depending on whether PSP wins another large project, this figure could vary.

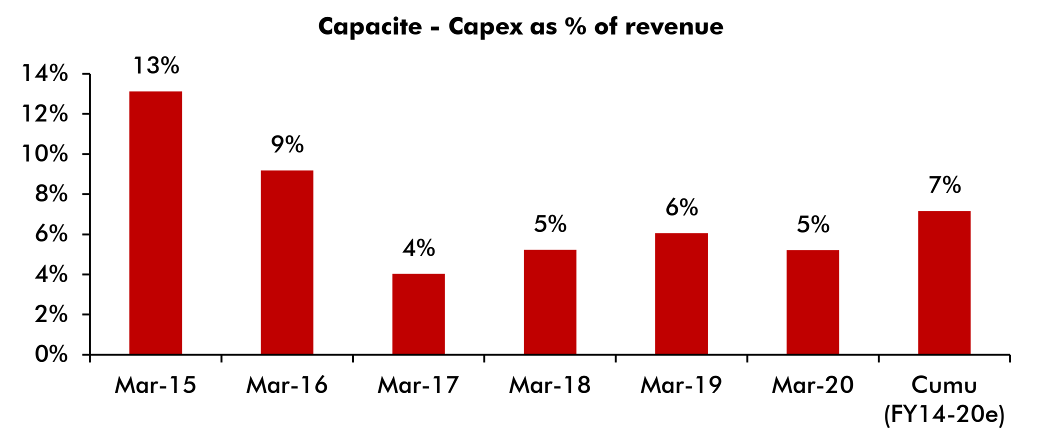
Exhibit 27: Investments in machinery is likely to continue



Source: Company, Ambit Capital research

However, investments may increase further, if the company gets involved in the building high-rises. Bigger residential complexes and high rises need specialized equipment and typically have lower asset turns. For instance, Capacit'e, a similar mid-sized player that started operations in FY13, has invested and is likely to invest ~7% of revenue in capex vs ~4% for PSP.

Exhibit 28: Capacit'e invests and is likely to invest ~7% of revenue in capex vs ~4% for PSP; the gap can be explained by the project type – more high-rises for Capacit'e; PSP may also need to invest more if it expands into complex buildings

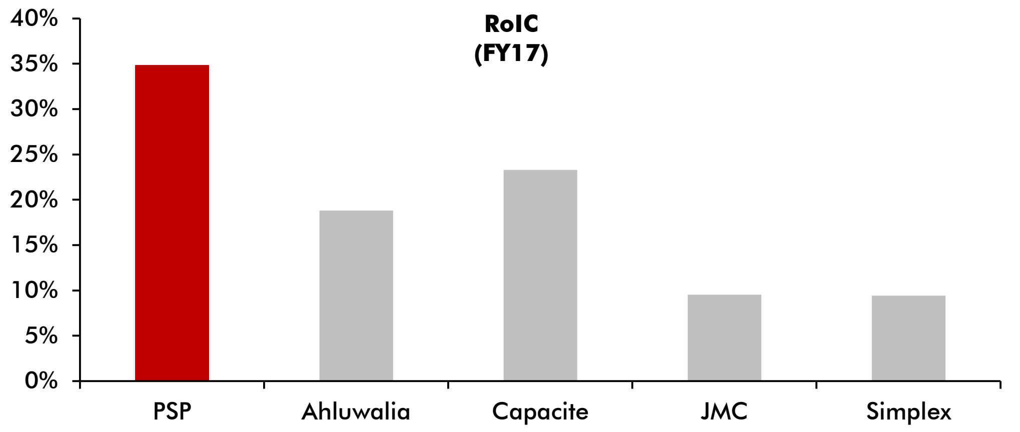


Source: Company, Ambit Capital research

A tightly-controlled ship

PSP is a tightly run ship with strong centralized control over operations. The promoters' direct involvement in almost all projects has resulted in efficient operating ratios. It has high return ratios as it has been able to garner higher margins (through lower employee costs) and maintain low working capital. This is highly akin to how Techno Electric earns premium returns compared to KECI and KPTL. As shown in the exhibit below, PSP's RoIC is ahead of peers. The key question is – can the company scale up its operations, add new manpower, machinery and skill whilst maintaining a similar control over operations and profitability? Contractors over the last decade have struggled to make this transition.

Exhibit 29: PSP has higher RoIC than peers



Source: Company, Ambit Capital research; Note: PSP's and Capacite's RoIC may be impacted once equity rises post IPO

Exhibit 30: The business is tightly run by the promoter group

Name	Designation	Background
Prahaladbhai Shivrambhai Patel	Chairman, Managing Director and CEO	▪ Bachelor's degree in civil engineering, ▪ Over 30 years of experience in construction
Shilpaben Patel	Director	▪ Bachelor's degree in commerce from Gujarat University ▪ Experience in administration
Pooja Patel	Executive Director	▪ Bachelor's degree in civil engineering from Gujarat Technological University ▪ Pursuing a diploma in financial management
Chirag Shah	Independent Director	▪ Bachelor's degree in pharmacy from Gujarat University. ▪ Experience in the pharmaceutical industry.
Sandeep Shah	Independent Director	▪ Bachelor's degree in commerce and bachelor's degree in law from Gujarat University ▪ Over 20 years of experience in information technology
Vasishtha Patel	Independent Director	▪ Bachelor's degree in business administration from Sardar Patel University and a master's degree in business administration from South Gujarat University. ▪ Over 20 years of experience in management and exports
Mahesh Patel	Vice President - Operations	▪ Degree of diploma in civil engineering ▪ 25 years of experience in project execution the construction industry.
Maulik Patel	Director – Procurement	▪ Bachelor's Degree in Commerce.
Hetal Patel	Chief Financial Officer	▪ Master's degree in commerce from Gujarat University. Chartered Accountant of India ▪ Certified internal auditor from the Institute of Internal Auditors, USA. ▪ 18 years of experience in accounts and finance.
Ramjibhai Parmar	General Manger – Tender	▪ Diploma in Civil Engineering ▪ 30 years' experience in Contracts & Tendering in Construction.
Pratik Thakkar	Senior Manager - Business Development	▪ Bachelor's Degree in Commerce Diploma in Marketing Management. ▪ 10 years' experience in Business Development in Construction

Source: Company, Media, Ambit Capital research

Results in strong RoE

PSP's RoE of ~30% can be attributed to its high margins and better asset turns. The company has outperformed its peers in terms of operational and asset efficiency with PAT margin double the peer median. Others such as JMC are hindered by investments in road projects whilst Simplex has burgeoning working capital. Capacit'e and Ahluwalia are the next best in line with high RoE.

Exhibit 31: The company's return ratios are higher than that of peers

Companies	RoE						RoCE					
	FY13	FY14	FY15	FY16	FY17	LTM 1H18	FY13	FY14	FY15	FY16	FY17	LTM 1H18
PSP Projects	**59%**	**33%**	**34%**	**40%**	**49%**	**30%**	**30%**	**17%**	**16%**	**18%**	**26%**	**23%**
Peers												
Simplex Infra	5%	5%	4%	7%	8%	10%	6%	6%	6%	7%	9%	10%
JMC Projects	4%	5%	6%	8%	9%	12%	12%	8%	9%	10%	9%	10%
Capacit'e Infra	-116%	29%	82%	43%	30%	16%	-43%	7%	27%	25%	23%	18%
Ahluwalia Con.	-30%	10%	23%	22%	18%	19%	-14%	2%	18%	19%	17%	19%
Peer median	**5%**	**17%**	**20%**	**24%**	**19%**	**14%**	**9%**	**8%**	**13%**	**14%**	**16%**	**14%**

Source: Company, Ambit Capital research

Exhibit 32: PSP's PAT margin is ahead of almost all peers with best-in-class asset turns

Companies	PAT margin					Asset turns					Leverage				
	FY14	FY15	FY16	FY17	LTM 1H18	FY14	FY15	FY16	FY17	LTM 1H18	FY14	FY15	FY16	FY17	LTM 1H18
PSP Projects	**4.8%**	**5.0%**	**4.6%**	**9.1%**	**9.2%**	**4.1**	**4.0**	**5.0**	**3.1**	**2.9**	**1.7**	**1.7**	**1.7**	**1.7**	**1.2**
Peers															
Simplex Infra	1.1%	1.1%	1.8%	2.1%	2.5%	1.3	1.2	1.2	1.2	1.2	3.1	3.2	3.3	3.3	3.3
JMC Projects	0.9%	1.2%	1.8%	2.6%	3.2%	3.1	2.4	1.9	1.7	1.8	1.9	2.2	2.3	2.0	2.0
Capacit'e Infra	1.9%	5.8%	5.7%	6.0%	6.2%	3.4	4.0	3.3	2.9	2.2	4.5	3.6	2.3	1.7	1.1
Ahluwalia Con.	2.3%	6.0%	6.8%	6.0%	6.0%	2.0	2.2	2.3	2.5	2.8	2.2	1.7	1.4	1.2	1.1
Peer median	**1.5%**	**3.1%**	**3.2%**	**4.3%**	**4.7%**	**3.3**	**3.2**	**2.6**	**2.3**	**2.0**	**2.5**	**2.7**	**2.3**	**1.9**	**1.6**

Source: Company, Ambit Capital research

Driven by high margins...

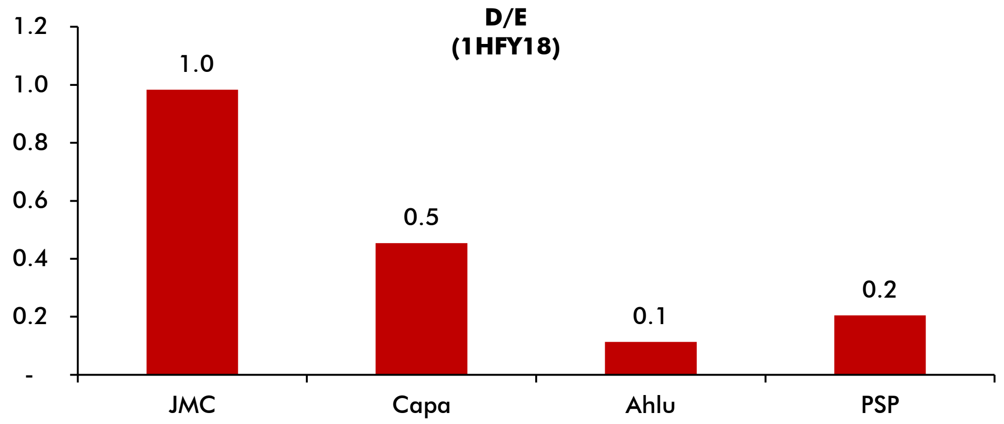
While almost all players have EBITDA margins of 10%+, PSP's ability to maintain low fixed overheads has been key to its high profit margins. Even though it subcontracts less than peers, PSP's gross margins are lower, indicating pricing flexibility. However, it is worth noting that PSP's fixed expenses - SG&A and employee costs - are materially lower, enabling it to maintain premium EBITDA margin. Moreover, finance costs are lower as the company has lower debt levels (debt-equity ratio of ~0.2x)

Exhibit 33: PSP's higher margins are a function of its low fixed overheads and low finance costs vis-à-vis peers

₹ mn	Ahluwalia		Capacit'e		JMC Projects		PSP Projects		Simplex Infra	
	FY16	FY17	FY16	FY17	FY16	FY17	FY16	FY17	FY16	FY17
Revenue	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
COGS	49	51	44	43	36	36	43	37	33	29
Sub-contracting exp	20	20	24	25	33	29	15	13	29	31
Other constn exp	11	10	6	6	8	9	28	28	7	8
Gross profit	**20**	**20**	**27**	**26**	**23**	**25**	**14**	**23**	**30**	**32**
Employee cost	5.7	5.6	8.6	8.5	9.4	10.1	2.9	4.6	8.7	9.2
SG&A	1.6	1.7	4.8	4.1	4.8	6.2	3.2	3.6	9.8	10.5
EBITDA	**12.9**	**12.4**	**13.4**	**13.7**	**8.9**	**9.1**	**7.3**	**14.6**	**11.6**	**12.3**
Depreciation	1.6	1.7	1.8	1.6	2.2	2.5	1.5	1.7	3.4	3.5
Interest cost	2.2	1.3	2.3	2.2	3.9	3.4	0.4	1.4	7.2	7.9
Other finance charges	0.6	0.5	1.4	1.4	0.5	0.2	0.3	0.4	0.1	-
Interest income on FD	0.4	0.3	0.4	0.3	0.1	0.1	1.6	2.5	0.8	0.5
PBT-ex other income	**8.8**	**9.1**	**8.2**	**8.8**	**2.4**	**3.1**	**6.7**	**13.6**	**1.7**	**1.3**
Other income	0.7	0.3	0.4	0.4	0.3	0.5	0.6	0.4	0.9	1.1
PBT	**9.5**	**9.4**	**8.6**	**9.2**	**2.7**	**3.6**	**7.3**	**14.0**	**2.5**	**2.4**
Tax	2.8	3.1	2.9	3.2	0.9	1.0	2.7	4.9	0.7	0.3
PAT	**6.8**	**6.3**	**5.7**	**6.0**	**1.8**	**2.6**	**4.6**	**9.1**	**1.8**	**2.1**

Source: Company, Ambit Capital research; Note, in the calculation above, we have reclassified labour charges reported by Ahluwalia under employee cost into other construction costs since they are direct project costs; however, these are permanent labourers on the company's books

Exhibit 34: PASP has amongst the lowest D/E in the industry; Ahluwalia, despite lower D/E, has higher interest cost due to interest paying customer advances



Source: Company, Ambit Capital research; JMC is standalone

...and best-in-class working capital

The entire building pack has a relatively benign working capital cycle, especially when customer advances are taken into account. Indeed, on a net cycle basis, most players ranged between 48-79days in FY17 barring Simplex that has legacy problems. PSP's FY17 working capital has ₹ 765mn as deposit for overdraft limits, excluding which WC is only 10 days. The company can withdraw this margin money at its discretion. Its limited working capital requirements are driven by limited retention money, quick turnaround time of receivables and no unbilled receivables.

Exhibit 35: Adjusted for FDOD limits, PSP's working capital in FY17 was 10 days, the lowest in the industry

	Ahluwalia		Capacit'e		JMC Projects		PSP Projects		Simplex Infra	
	FY16	**FY17**	**FY16**	**FY17**	**FY16**	**FY17**	**FY16**	**FY17**	**FY16**	**FY17**
Inventory	19	20	17	16	24	28	8	5	45	49
WIP/ unbilled revenue	41	31	78	75	68	78	-	-	185	209
Retention	40	38	31	33	-	-	14	18	33	36
Receivables	123	116	88	77	109	109	16	47	80	100
Advances to contractors	4	3	-	-	22	25	6	6	-	-
Govt advances	6	-	14	13	23	19	3	4	21	23
Other current assets	14	18	24	20	14	17	8	11	32	36
Margin money	18	14	18	16	0	1	71	91	0	0
Payables	*86*	*90*	*133*	*101*	*124*	*135*	*63*	*61*	*94*	*111*
Subcontractor retention	-	-	*4*	*5*	-	-	*3*	*4*	*16*	*19*
Govt/ Tax dues	*4*	*6*	*12*	*11*	*4*	*2*	*1*	*5*	*6*	*1*
Other liabilities	*9*	*8*	*15*	*13*	*5*	*10*	*2*	*2*	*9*	*16*
Working capital	**164**	**137**	**106**	**119**	**127**	**129**	**55**	**111**	**270**	**304**
Customer advances	72	58	52	50	63	81	37	39	59	65
Net working capital	**92**	**79**	**54**	**68**	**64**	**48**	**18**	**71**	**211**	**239**

Source: Company, Ambit Capital research; Note: PSP's 71 day cycle in FY17 includes 61 days impact of cash kept as fixed deposit for overdraft limits; When adjusted, its working capital is 10 days

The key question here is whether the company can maintain its working capital cycle at ~10 days (ex FDOD limits) even as order sizes increase. In 1HFY18, the receivable days increased mainly due to impact of GST. The management has guided for a reversion to 40-45 days.

High asset turns

PSP's working capital forms the major chunk of its capital employed. The company also has high level of cash balances which if unused, may dilute ROE. Building contracting can be a machinery heavy process with varying life of critical assets (like shuttering systems) and, therefore, net block turnover is a reliable ratio to judge efficiency/ under-investment. PSP's fixed asset investments are lower than Ahluwalia and Capacit'e. This contributes to high asset turnover ratios compared to its peers.

JMC's turnover is impacted by investments in subsidiaries that are barely yielding any benefits while Simplex has a gargantuan working capital (Simplex Infra).

Exhibit 36: Ahluwalia's asset turnover is better than peers due to a superior net block turnover

	As % of total capital employed (FY17)					Turnover				
	Ahluwalia	**Capacit'e**	**JMC Pro**	**PSP Pro**	**Simplex**	**Ahluwalia**	**Capacit'e**	**JMC Pro**	**PSP Pro**	**Simplex**
Gross block	76	66	34	47	32	3.5	4.1	5.5	5.6	3.7
Net block	**33**	**56**	**28**	**29**	**24**	**7.2**	**4.5**	**6.5**	**8.5**	**4.6**
Working cap	**52**	**48**	**23**	**49**	**75**	**4.6**	**6.7**	**6.4**	**8.1**	**1.6**
Investments	0	0	48	2	5					
Cash & Bank	14	3	2	20	1					
CWIP	0	1	0	-	0					
Provisions	(1)	(1)	(4)	(7)	(0)					
Cap Emp	**100**	**100**	**100**	**100**	**100**	**2.5**	**2.9**	**1.7**	**3.1**	**1.2**

Source: Company, Ambit Capital research

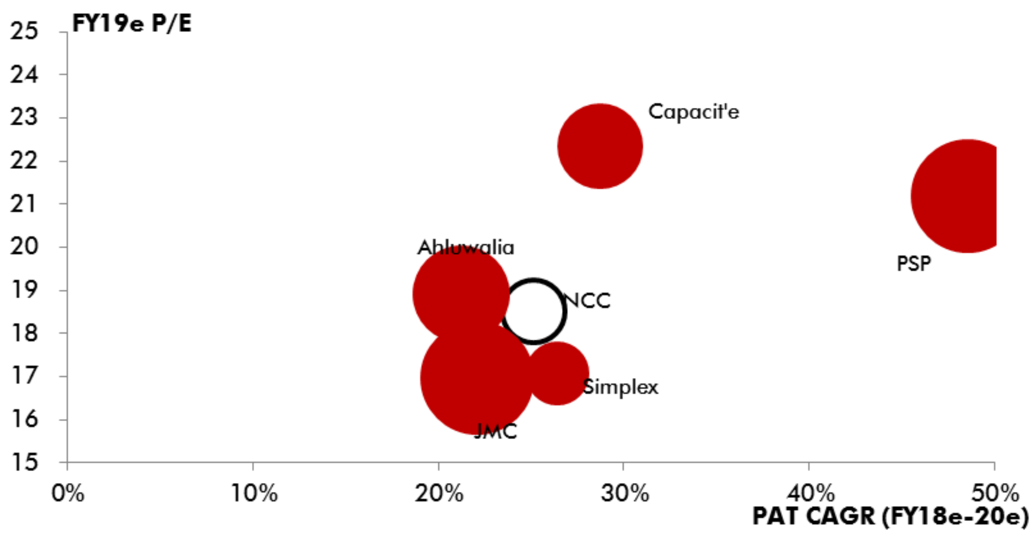
Punchy valuations

PSP is currently valued at 21x FY19E consensus earnings estimates. This factors in earnings growth of 48% over FY18-20 vs peer median of 25%. Diamond Bourse project may contribute 40% of revenue in FY19 based on management's guidance and consensus revenue estimates. Should an investor consider the Diamond Bourse profits as ongoing business earnings and provide it a similar multiple as the rest of the business, or treat it as a one-time project and ascribe a lower multiple? Consensus seems to be following the former. In a way, PSP is akin to Techno Electric, a tightly promoter-driven transmission contractor that earns superior returns than peers. It garners a premium. Only one major difference – Techno has a significantly longer listed track record.

Trading at a premium to peers

As shown in the exhibit below, PSP trades at 13% premium to peers. Higher RoIC and superior growth prospects due to a larger book to bill are likely to be the drivers of the premium valuations.

Exhibit 37: PSP trades at a premium to peers but has higher RoE and superior growth prospects



Source: Bloomberg, Ambit Capital research

Consensus expects the company's revenue and profits to increase at ~50% CAGR over the next two years. Consensus expectations are likely driven by the large order book; but this doesn't factor in any material expansion in PAT margin in line with management's guidance.

Exhibit 38: Consensus estimates factor in ~50% bottom-line growth in the next 2 years

₹ mn (standalone)	FY17	FY18	FY19	FY20
Revenue	4,008	6,588	11,303	15,111
EBITDA	658	834	1,390	1,892
EBITDA margin	16.4%	12.7%	12.3%	12.5%
PAT	413	548	902	1,209
PAT margin	10.3%	8.3%	8.0%	8.0%

Source: Company, Ambit Capital research

Factoring in the Diamond bourse upside

Assuming that the company's profit margin for Surat project and non-Surat projects is similar and based on management's guidance of ₹4.5bn revenue from Surat in FY19e, the project may contribute ~40% of FY19e EPS. Therefore, current valuations are assuming that projects like Surat may keep recurring to perpetuity as the company scales up.

Ahluwalia and Capacit'e rated BUY in this sector

Ahluwalia Contracts (TP: ₹510; 23% upside; click here for initiation note)

Government investments in social infra, NBCC's large tendering pipeline, and a private real estate sector demanding a more professional approach are underpinned by tougher contract norms and lower competitive intensity (NBCC ₹1bn+ tenders have 3-8 bidders). With a near debt-free balance sheet (only client advances of ₹1.5bn) and 10% exposure to legacy slow projects, Ahluwalia is unhindered. The stage is set for order inflows to grow (FY11-17: -8%; FY17-20E: 20%) with revenue and EPS to follow (18% and 25% CAGR; FY18-20E). Valuation of 17x FY19E and 19% RoE may seem steep but should be looked at in the context of the growth runway, balance sheet and median peer-set valuation/RoE of 18x/16%.

Capacit'e Infra (TP: ₹410; 24% upside; click here for initiation note)

Capacit'e managed to hold its ground despite a shrinking target market with order inflows of ₹25bn in FY18E (flat YoY) even as residential new launches in Mumbai fell 32% in CY17. Focus on client selection (80%+ top-category clients), geographical concentration (75%+ West zone), technical capability (45% high rises) and strong promoter track record (ex-Pratibha) meant an almost meteoric rise to ₹13bn+ topline. RERA, a catalyst of the fall in launches, will soon become a boon – developer market consolidation, importance of delivery timelines and protection of project cashflows may all benefit established contractors. Capacit'e is well-placed. Strong order book (4x book to bill) may drive 20%+ revenue/ earnings growth over the next 2 years. In that context, valuation of 9x FY19E EV/ EBITDA is reasonable even when keeping cognizance of lower-than-peer depreciation rates.

Key risks

Technical challenges in the Surat Project: Surat Diamond Bourse contributes 57% of the order book and is likely to be a large earnings component over the next 2 years. Whilst the management may have accounted for multiple exigencies to handle a project of this size (PSP has never handled a Rs5bn+ project in the past), there are always uncertainties in execution. Given the scale of the project, any cost overruns not compensated by the client may cause a material drag on the balance sheet.

Promoter salary vs peers: As highlighted earlier, management remuneration of Rs59mn is the highest in the industry despite PSP being one of the smallest by revenue. The company's employee cost, post management remuneration, is materially lower than peers and could impact margins in the future.

Wanton expansion of geography: Historical analysis of building contractors points to wanton expansion of geography, segment and size as primary drivers of financial stress. A rapid expansion of business outside Gujarat may not come through at similar RoIC.

Investment in US – insignificant but unnecessary: PSP has an investment of ~Rs160mn in a subsidiary that has invested in a project in the US. This project was undertaken by PSP in conjunction with some family members when it was still a private organisation. Poor capital allocation decisions in the future are a key risk.

Key man risk: Given that the company has highly centralized control with of the promoter group, there is a key man risk w.r.t. to the MD, Mr. PS Patel. Whilst his daughter is involved, he has been the main driver of the business.

Exhibit 39: Explanation for the flags on the front page

Head	Flag	Reason
Accounting	**AMBER**	The company figures in the fifth decile of our internal accounting framework; it performs well on cash conversion, limited CWIP, cash yield and stable depreciation rate
Predictability	**AMBER**	The management provides qualitative guidance; however, given the inherent unpredictability of the contracting business, quarterly earnings may deviate significantly from expectations
Earnings momentum	**GREEN**	Limited consensus estimates show sharp earnings growth expected over the next 24 months; earnings estimates have also been upgraded in the last 3 months

Source: Bloomberg, Ambit Capital research

Balance Sheet

₹ mn	Mar-13	Mar-14	Mar-15	Mar-16	Mar-17
Share capital	8	8	8	32	288
Total reserves	258	340	461	608	764
Shareholder's Funds	**266**	**348**	**469**	**640**	**1,052**
Minority Interest	-	-	-	5	6
Total Debt	**150**	**260**	**334**	**468**	**771**
Deferred tax liability (net)	(2)	(3)	(4)	(25)	(26)
Source of funds	**414**	**605**	**799**	**1,088**	**1,803**
Gross Block	272	308	510	782	856
Accumulated Depreciation	87	123	175	246	323
Net block	**185**	**185**	**335**	**536**	**533**
Goodwill	-	-	-	0.1	65
Investments	35	8	8	9	34
Inventories	18	16	42	98	68
Sundry debtors	122	138	239	202	589
Cash and Bank	241	206	328	330	371
Other assets	32	41	54	90	131
Loans and advances	170	207	215	315	373
Margin money deposits	205	559	638	920	1,144
Trade Payables	356	400	631	822	766
Other current liabilities	223	330	399	551	610
Provisions	15	25	30	40	128
Net current assets	**194**	**412**	**456**	**543**	**1,171**
Application of funds	**414**	**605**	**798**	**1,088**	**1,803**

Source: Ambit Capital research, Company

Income Statement

₹ mn	Mar-13	Mar-14	Mar-15	Mar-16	Mar-17
Revenue	**2,572**	**2,104**	**2,805**	**4,760**	**4,569**
EBITDA	**220**	**167**	**224**	**349**	**668**
EBITDA margin	**8.5%**	**8.0%**	**8.0%**	**7.3%**	**14.6%**
Depreciation	37	37	52	71	80
EBIT	**182**	**131**	**172**	**277**	**588**
Interest	38	20	25	34	81
Other income	37	44	65	103	133
PBT	182	154	213	347	640
Provision for tax	59	53	72	126	225
Profit After tax	123	101	141	221	415
Minority Interest	-	-	-	8	(1)
Consolidated Net Profit	123	101	141	229	414
Adjusted EPS	4	3	5	8	14

Source: Company, Bloomberg

Cash Flow

₹ mn	Mar-13	Mar-14	Mar-15	Mar-16	Mar-17
Profit before tax	**182**	**154**	**213**	**347**	**640**
Adjustment	35	12	6	6	12
Changes in working capital	315	248	366	538	210
Cash From Operating Activities	**264**	**195**	**300**	**405**	**65**
Purchase of fixed assets	(42)	(37)	(201)	(273)	(76)
Investment	28	(410)	(113)	(273)	(118)
Interest Income	36	43	61	95	128
Others	(4)	(2)	(3)	(0)	(65)
Cash Flow from Investing Activities	**19**	**(406)**	**(256)**	**(450)**	**(131)**
Debt movement	(107)	118	78	130	293
Equity raise	-	-	-	-	-
Interest paid	(29)	(14)	(14)	(17)	(59)
Dividend paid	-	(9)	(24)	(58)	-
Minority Interest	-	-	-	5	1
Cash from Financing Activities	**(136)**	**94**	**41**	**60**	**235**
Net Cash Inflow / Outflow	147	(116)	85	15	169

Source: Ambit Capital research, Company

Ratios

₹ mn	FY13	FY14	FY15	FY16	FY17
Growth (YoY)					
Revenue		-18%	33%	70%	-4%
EBITDA		-24%	34%	56%	92%
EBIT		-28%	32%	61%	112%
PBT		-15%	38%	63%	84%
PAT		-18%	40%	57%	88%
Margin					
EBITDA	8.5%	8.0%	8.0%	7.3%	14.6%
EBIT	7.1%	6.2%	6.1%	5.8%	12.9%
PBT	7.1%	7.3%	7.6%	7.3%	14.0%
PAT	4.8%	4.8%	5.0%	4.6%	9.1%
Profitability					
RoE	46%	33%	34%	41%	49%
PAT margin	5%	5%	5%	5%	9%
Asset turnover	6.2	4.1	4.0	5.0	3.2
Leverage	1.6	1.7	1.7	1.7	1.7
RoCE	30%	17%	16%	19%	26%
Other ratios					
WC turnover	(81.0)	9.1	17.8	18.8	4.9
GB Turnover	9.5	6.8	5.5	6.1	5.3
Net block turnover	13.9	11.4	8.4	8.9	8.6
Debt/ equity	0.6	0.7	0.7	0.7	0.7
Net debt/ equity	(1.1)	(1.5)	(1.3)	(1.2)	(0.7)
Valuation					
P/E	122	149	107	66	36
P/B	56	43	32	23	14
EV/EBITDA	67	87	64	41	21

Source: Ambit Capital research, Company

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