ANANDRATHI

India I Equities

Construction

Company Update

12 April 2018

PSP Projects

Rating: **NR**

Sturdy growth momentum to continue

Share Price: ₹531

Work is progressing satisfactorily at PSP Projects' largest single order, the Surat Diamond Bourse, and the lengthened working-capital cycle has recovered from the GST shock. With these, we see the healthy growth momentum continuing. The opportunity landscape in its area of expertise (institutional buildings) is bright. All combined make it an interesting proposition. Currently, we do not have a rating on the stock.

The Surat Diamond Bourse project. Work on its largest single order (valued at ~₹15.8bn, excl. GST) is progressing satisfactorily. Foundation work for all the nine towers is going well and, consequently, has paved the way for the company to commence revenue recognition in Q4 FY18. Mobilisation advances (5% of the project value) have already been received. The project is good for PSP by helping to strengthen its pre-qualification eligibility.

Bank-guarantee limit raised, post-IPO. Post-IPO (net-worth augmented), the company has seen a favourable change in bank-guarantee funding. Against the earlier practice of bank guarantees against 40% cover/mortgages, the requirement is now down to 25%. The bank-guarantee limit has been raised from ₹1.7bn to ₹4.1bn, post-IPO.

Exploring other areas. For further opportunities, the company is exploring Amravati (a High Court building to be completed in nine months), Hyderabad and Vijayawada. However, expansion would be tempered as it still sees more than enough scope in its home area (Ahmedabad/ Gujarat).

In-house equipped. Except for excavation machines, the company does not hire any equipment in Gujarat. For work outside this state, it may hire the required equipment to begin with.

Valuation. At the CMP, the stock trades at a PE of 31x TTM EPS of ~₹17.1. We believe the strong order backlog, continuous focus on execution, healthy balance sheet and better return ratios warrant high valuation. **Risks.** Failure to maintain prudence.

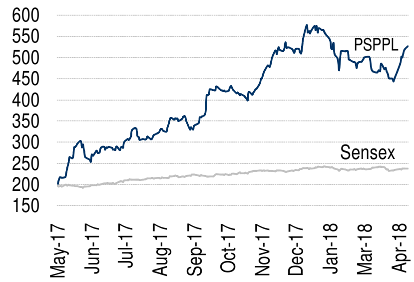
Key financials (YE Mar)	FY13	FY14	FY15	FY16	FY17
Sales (₹ m)	2,572	2,104	2,805	4,580	4,008
Net profit (₹ m)	123	101	141	249	413
EPS (₹)	4.3	3.5	4.9	8.7	14.3
Growth (%)	46.7	-17.8	39.6	77.4	65.7
PE (x)	49.4	60.1	43.0	24.3	14.6
EV / EBITDA (x)	26.2	33.1	24.2	13.5	8.1
PBV (x)	22.7	17.4	12.9	9.2	5.6
RoE (%)	58.5	32.8	34.4	44.1	47.6
RoCE (%)	53.3	34.3	33.8	44.2	50.2
Net debt / equity (x)	-1.1	-1.5	-1.3	-1.1	-0.7

Source: Company *Note: Standalone financials*

Key data	PSPPL IN / PSPP.BO
52-week high / low	₹595 / 189
Sensex / Nifty	33940 / 10417
3-m average volume	$0.6m
Market cap	₹19.1bn / $293m
Shares outstanding	36m

Shareholding pattern (%)	Dec'17	Sep'17	Jun'17
Promoters	72.0	72.0	72.0
- of which, Pledged	-	-	-
Free float	28.0	28.0	28.0
- Foreign institutions	1.4	1.2	1.1
- Domestic institutions	9.4	10.5	13.6
- Public	17.2	16.3	13.4

Relative price performance



Source: Bloomberg

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m) - standalone

Year-end: Mar	FY13	FY14	FY15	FY16	FY17
Order backlog	NA	4,472	4,877	3,381	7,292
Average order size	NA	244	198	192	351
Net revenues (₹ m)	2,572	2,104	2,805	4,580	4,008
Growth (%)	*44.0*	*-18.2*	*33.3*	*63.3*	*-12.5*
Direct costs	2,232	1,858	2,489	4,032	3,188
SG&A	121	79	92	155	161
EBITDA	**220**	**167**	**224**	**393**	**658**
EBITDA margins (%)	*8.5*	*8.0*	*8.0*	*8.6*	*16.4*
Depreciation	37	37	52	71	76
Other income	37	44	65	97	132
Interest Exp	38	20	25	34	75
PBT	182	154	213	386	639
Effective tax rate (%)	*32.7*	*34.6*	*33.9*	*35.4*	*35.4*
+ Associates / (minorities)	-	-	-	-	-
Net income	123	101	141	249	413
Adjusted income	123	101	141	249	413
Growth (%)	46.7	-17.8	39.6	77.4	65.7
FDEPS (₹ / sh)	*4.3*	*3.5*	*4.9*	*8.7*	*14.3*

Fig 2 – Balance sheet (₹ m) - standalone

Year-end: Mar	FY13	FY14	FY15	FY16	FY17
Share capital	8	8	8	32	288
Net worth*	266	348	469	661	1,076
Total debt	150	260	334	452	677
Minority interest	-	-	-	-	-
DTL / (assets)	-2	-3	-5	-9	-11
Capital employed	**414**	**605**	**798**	**1,105**	**1,742**
Net tangible assets	185	185	332	519	513
Net intangible assets	-	-	0	3	5
Goodwill	-	-	-	-	-
CWIP (tang. & intang.)	-	-	2	-	-
Investments (strategic)	35	8	8	50	76
Investments (financial)	-	81	118	130	140
Current assets (ex cash)	342	401	550	513	1,158
Cash	446	684	848	1,064	1,250
Current liabilities	594	755	1,060	1,174	1,399
Working capital	-252	-354	-511	-661	-241
Capital deployed	**414**	**605**	**798**	**1,105**	**1,742**
Contingent liabilities	177	183	457	727	1,178

Fig 3 – Cash-flow statement (₹ m) – standalone

Year-end: Mar	FY13	FY14	FY15	FY16	FY17
PBT	182	154	213	386	639
+ Non-cash items	37	37	52	71	76
Oper. profit before WC chg.	219	191	264	457	715
- Incr. / (decr.) in WC	-120	-102	-157	-150	420
Others including taxes	61	55	74	140	224
Operating cash-flow	279	238	348	466	71
- Capex (tang. + intangibles)	42	37	201	258	71
Free cash-flow	237	201	146	208	-0
Acquisitions	-	-	-	-	-
- Dividend*	9	19	19	58	-
+ Equity raised	-	-	-	-	-
+ Debt raised	-110	109	72	115	222
- Fin. investments	32	54	37	53	36
- Misc. items (CFI + CFF)	-1	-1	-2	-4	-0
Net cash-flow	87	238	164	216	186

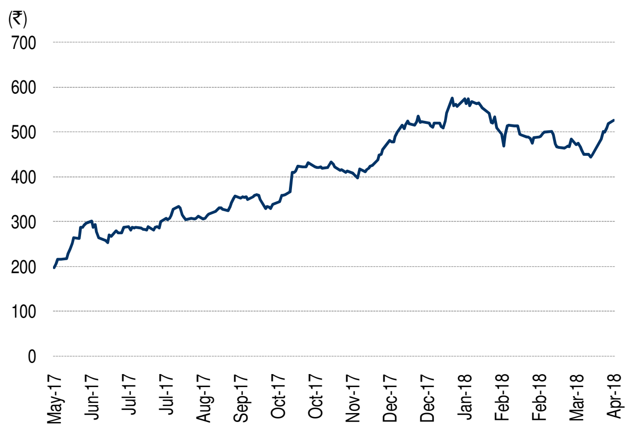
Source: Company

Fig 4 – Ratio analysis

Year-end: Mar	FY13	FY14	FY15	FY16	FY17
P/E (x)	49.4	60.1	43.0	24.3	14.6
EV / EBITDA (x)	26.2	33.1	24.2	13.5	8.1
EV / sales (x)	2.2	2.6	1.9	1.2	1.3
P/B (x)	22.7	17.4	12.9	9.2	5.6
RoE (%)	58.5	32.8	34.4	44.1	47.6
RoCE (%)	53.3	34.3	33.8	44.2	50.2
Sales / FA (x)	13.9	11.4	8.4	8.8	7.7
DPS (₹ / sh) *	0.3	0.6	0.6	1.7	2.5
Dividend yield (%)*	0.1	0.3	0.3	0.8	1.2
Dividend payout (%) - incl. DDT*	7.6	18.6	13.7	23.1	26.2
Net debt / equity (x)	-1.1	-1.5	-1.3	-1.1	-0.7
Receivables (days)	17	24	31	8	49
Inventory (days)	3	3	5	3	3
Payables (days)	50	69	82	55	63
CFO:PAT %	227.4	236.3	247.3	187.0	17.2

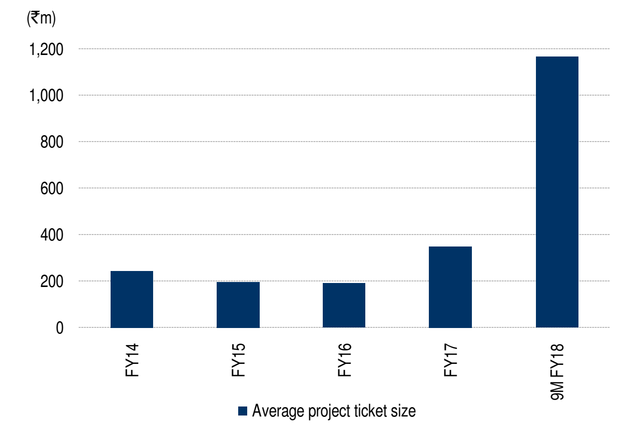
*Source: Company ; * Dividend for FY17 proposed after IPO; considered in ratio analysis*

Fig 5 – Price movement



Source: Bloomberg

Fig 6 – The Surat Diamond Bourse aids average order size



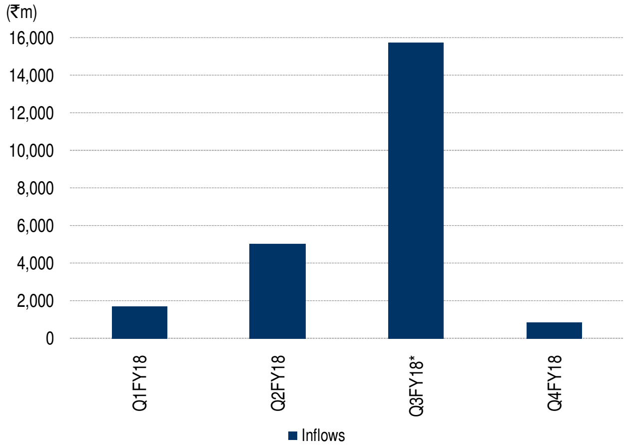
Source: Company Note: The Surat Diamond Bourse project of ~₹15.8bn received in Q3FY18

Key takeaways from the meet

Order backlog / inflows

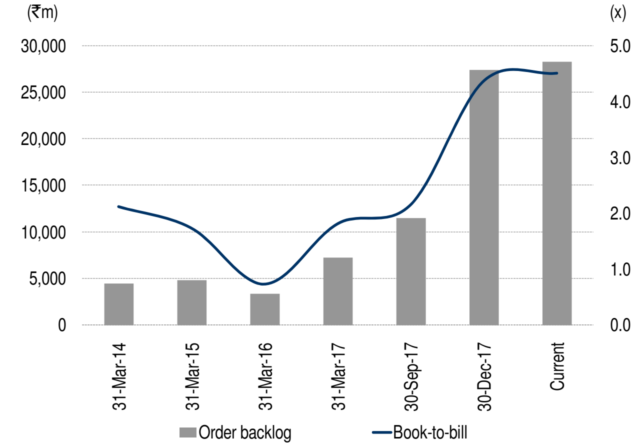
- The company's end-Dec'17 order backlog of ~₹27bn, augmented by inflows of ~₹25bn in 9M FY18 (incl. the Surat Diamond Bourse (SDB)) implied healthy revenue assurance (4.4x book-to-bill). With the order backlog to be executed in the next 24-30 months and PSP's proven execution record, its growth momentum is expected to be strong.
  - The average order size has increased from ~₹450m in Sep'17 to ~₹1,166m in Dec'17. This implies the management is better placed to optimally utilises resources and reap the benefits of economies of scale.
  - In Q4 FY18, it further secured orders of ~₹873m, taking inflows for the year to over ₹25bn, incl. the SDB.
  - Even at ~₹9.7bn of inflows (on excluding the lumpy SDB project), the figure is no less inspiring. Excl. the SDB, the quarterly inflow run-rate is very much in line with management's guidance of ~₹2bn--2.5bn a quarter.

Fig 7 – FY18 inflows at ~₹25bn



Source: Company

Fig 8 – Strong order backlog = Strong revenue assurance



Source: Company

- The management is very watchful of exploring opportunities outside its home state. It emphasises that it does not intend to take up orders merely for the sake of doing so and a number of things go into decision making. The key criteria include:
  - client profile - from existing or from new; quality of client
  - Size of order - minimum ~`250m for Ahmedabad, ~`500m for projects outside the city but in Gujarat and ~`1bn for those outside the state.
  - Nature of the project – prestigious or not; it goes for prestigious projects to help build its brand, but without compromising on margins.
  - Segment – Only if it is in the area of its expertise.

- Outside Gujarat, the company is implementing two dairy projects in Karnataka (one on the outskirts of Bengaluru, the other on the road to Mysuru), two in Rajasthan (a medical college and a hospital). It has recently completed one interior project in Delhi. The nature of these projects (in its area of expertise) led it to consider them.
  - It intended bidding for IIT, Hyderabad, but did not pass the pre-qualification stage as it couldn't meet the stringent qualification requirement (primarily of having implemented a District Cooling Plant).
  - For further opportunities, it is constructing the High Court building in Amravati (to be completed in nine months; a prestigious and challenging project), and exploring opportunities in Hyderabad and Vijayawada.

The Surat Diamond Bourse

- Work on the SDB was started in mid-November and is progressing well. Excavation was started in mid-Dec, with ~1.3m cubic metres excavated till now. Foundation work has commenced for all the nine towers. At present, ~2,000 workers have been deployed at the site.
- For timely completion, structural work needs to be completed in ~18 months. Besides, there is MEP (mechanical, electrical, plumbing) work of ~₹5bn and the facade of ~₹3bn. The project entails completion timeline of 30 months.
- On its client's capacity to pay, management identifies that it is a self-funding project with construction cost to be funded from the area to be sold to diamond merchants/ end-users.
  - Management has been given to understand by its client that 90% of this 6.6m sq.ft. project has already been booked / sold.
  - Cash-flows from the area already committed (by The SDB Association) seem adequate to cover the EPC costs.
  - The client is expected to receive payments on a milestone basis and, consequently, extend them to PSP.
  - Management highlights that it has already obtained a 5% mobilisation advance of ~`780m and receives 75% of the regular bill raised in 3-7 days.
- Management does not see the SDB project as a drag on cash since it is an activity-linked monthly-payment scheme. The mobilisation advances helped it achieve the first payment milestone and kick-start the payment cycle. It does not see more than ₹0.6bn exposure to the project at any time. Mobilisation advances for this project are adjustable against receipts over the entire project (5% to be deducted from every payment due).
- The project has a clause to keep 5% retention money, of which 2.5% would be received on completion of the project, with the balance to be converted into a bank guarantee.
- Revenue recognition is on the quantum of work done monthly and the minimum billing amount required is ~₹0.2bn. The maximum monthly billing for the structural work is expected at ~₹0.2bn--0.3bn a month; for MEP, ~₹0.5bn--0.6bn.

- Management had earlier said that ~₹0.3bn--0.4bn revenue was expected from the project in Q4 (with ~₹4.5bn in FY19 and ~₹7bn in FY20). The balance revenues are likely to be booked after that.

Gujarat International Finance Tec-City, Gandhinagar

- The GIFT-City in Gandhinagar is expected to have 110 buildings; only ~10% has been taken up for development. With a number of buildings yet to be taken up, the company's early-mover advantage and access to infrastructure (site) for resource mobilisation, management believes, offers it exciting growth potential.
- However, it alludes to the fact that the project has been moving slower than the SDB project.
- The company has obtained access to six projects, from marquee names such as Hiranandani, Brigade Enterprises, Prestige Estates, BSE and WTC. Hiranadani and the first tower for Brigade Enterprises are already complete.
- Some building orders from SBI, LIC and Reliance Capital are expected to come up for tendering. Repeat orders from previous clients are likely.

Newer opportunities / Keener competition

- Competition is not very keen for projects of ~₹1.5bn to ₹2bn. Management sees this as its sweet spot.
- The company can now bid for a single government contract of ~₹5bn--6bn but it is not vigorously exploring this as yet.
- Regarding private residential real estate, the company sees a minimum order size of ~₹1.5bn--2bn as ideal for it to bid. It is more positive regarding commercial than residential orders in the short to medium term. Though it sees huge potential in residential real estate, it reckons that it would take time fructify.

Capex / cash flows / credit limits

- Except for excavating machines, the company strives to own the equipment it requires. For new areas, it could look at equipment leasing to begin with and, based on success in those areas or scope of work, could decide on owing the equipment.
- In 9M FY18, receivables days jumped considerably. Management attributed this to GST-driven issues, with billing and *adhoc* payments by clients until GST calculations are firmed up. Now, receivables are normal as the GST issues are done with and payments largely secured.
- Of the IPO proceeds of ~₹1.4bn, the company has utilised ~₹966m (working capital ~₹630m, capex ~₹166m, general purposes ~₹170m). The balance of the IPO proceeds (~₹453m) has been parked in fixed deposits with scheduled banks.
- The company has ~₹4.1bn of bank limits available (fungible between CC/WC and bank guarantees), of which ~₹1.5bn is yet unutilized. This will help for the working capital it requires. Pre-IPO, the company had a bank-guarantee limit of ~₹1.7bn.

Others

- The US subsidiary has commenced working on the first of its two residential developments. It expects to finish this project in six months. The second project (in San Fransisco) is at the approval stage. The company already has an exposure of ~₹0.16bn. Management does not see investing more than ~₹0.02bn--0.03bn gradually. It does not intend to invest any more in owning assets.
- It guided to FY19 revenue of ~₹9bn--10bn, with ~12-14% EBITDA margins.
- It expects to reduce the number of sites to ~25 gradually, from ~34 now. The idea is to look at larger projects and reduce the present count to the above figure, without however reducing the overall backlog.
- The company has been using ERP software since 2013 and started using "CANDY" software to better forecast project execution. Forecasts are then reviewed regularly to ascertain variance and the reason therefore.

Valuation

At the CMP, the stock trades at PE of 31x TTM EPS of ~₹17.1. We believe PSP's strong order backlog, its continuous focus on execution, healthy balance sheet and better return ratios justify such a high valuation.

Risks

- Failure to maintain prudence.

Appendix

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