14 May 2018

PSP Projects

Rating: **NR**

Set for healthy growth

Share Price: ₹556

The Surat Diamond Bourse (SDB) aided PSP's Q4 FY18 revenue growth, but the inspiring growth even otherwise (excl. SDB) suggests execution is progressing equally swiftly on other than SDB orders. The healthy execution pace hints that in the foreseeable future the inspiring revenue growth would persist. The opportunity landscape is bright. A best-in-class working-capital cycle, lean balance sheet and industry leading return ratios make it an interesting proposition. We have no rating on the stock.

Strong revenue assurance. Backed by ~₹15.8bn of the Surat Diamond Bourse project, inflows for the year were a strong ~₹25.4bn. These strong inflows led to a considerable jump in the order backlog (to ~₹25.6bn, up from ~₹7.3bn at end-FY17) and, consequently, in revenue assurance (BTB: 3.5x). With the current backlog and a healthy pipeline, management sees ~30-35% revenue growth as easily possible.

Not averse to bidding for large projects. Though the company aims at ~₹10bn in inflows in FY19, it is not averse to taking up large projects that could lead to inflows being more than targeted. The company is evaluating one such project (commercial real estate in South India) of ~₹10bn. Management believes it has capacity and capability in place to scale up.

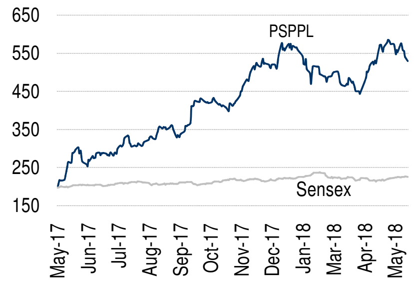
Inventory cycle lengthened owing to the SDB. It is keeping more than the usual key raw materials as it does not want execution at the SDB to suffer for want of raw material. Consequently, inventory days are up, resulting in a slightly protracted working-capital cycle. Management expects 7-15 as the new inventory days cycle, up from 3-5 earlier.

Valuation. At the CMP, the stock trades at a 31x FY18 EPS of ~₹17.9. We believe the strong order backlog, continuous focus on execution, healthy balance sheet and better return ratios help it command such a high valuation. **Risk.** Failure to maintain prudence.

Key data	PSPPL IN / PSPP.BO
52-week high / low	₹596 / ₹189
Sensex / Nifty	35557 / 10807
3-m average volume	$0.4m
Market cap	₹20bn / $298m
Shares outstanding	36m

Shareholding pattern (%)	Mar'18	Dec'17	Sep'17
Promoters	72.1	72.0	72.0
- of which, Pledged	-	-	-
Free float	27.9	28.0	28.0
- Foreign institutions	1.2	1.4	1.2
- Domestic institutions	8.3	9.4	10.5
- Public	18.5	17.2	16.3

Relative price performance



Source: Bloomberg

Key financials (YE Mar)	FY14	FY15	FY16	FY17	FY18P
Sales (₹ m)	2,104	2,805	4,580	4,008	7,298
Net profit (₹ m)	101	141	249	416	644
EPS (₹)	3.5	4.9	8.7	14.4	17.9
Growth (%)	-17.8	39.6	77.4	66.9	23.8
PE (x)	60.1	43.0	24.3	14.5	25.1
EV / EBITDA (x)	33.1	24.2	13.5	8.4	13.8
PBV (x)	17.4	12.9	9.2	5.6	5.3
RoE (%)	32.8	34.4	44.1	48.1	31.4
RoCE (%)	34.3	33.8	44.2	50.6	44.0
Net debt / equity (x)	-1.5	-1.3	-1.1	-0.4	-0.7

Source: Company *Note: P-Provisional*

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Quick Glance – Financials and Valuations

Fig 1 – Income statement (₹ m) - standalone

Year-end: Mar	FY14	FY15	FY16	FY17	FY18
Order backlog	4,472	4,877	3,381	7,292	25,590
Average order size	244	198	192	351	1,105
Net revenues (₹ m)	**2,104**	**2,805**	**4,580**	**4,008**	**7,298**
Growth (%)	*-18.2*	*33.3*	*63.3*	*-12.5*	*82.1*
Direct costs	1,858	2,489	4,032	3,255	6,199
SG&A	79	92	155	93	86
EBITDA	**167**	**224**	**393**	**659**	**1,014**
EBITDA margins (%)	*8.0*	*8.0*	*8.6*	*16.5*	*13.9*
Depreciation	37	52	71	76	112
Other income	44	65	97	134	184
Interest Exp	20	25	34	75	87
PBT	154	213	386	642	999
Effective tax rate (%)	*34.6*	*33.9*	*35.4*	*35.2*	*35.6*
+ Associates / (minorities)	-	-	-	-	-
Net income	101	141	249	416	644
Adjusted income	101	141	249	416	644
WANS	29	29	29	29	36
FDEPS (₹ / sh)	**3.5**	**4.9**	**8.7**	**14.4**	**17.9**

Fig 2 – Balance sheet (₹ m) - standalone

Year-end: Mar	FY14	FY15	FY16	FY17	FY18P
Share capital	8	8	32	288	360
Net worth*	348	469	661	1,071	3,027
Total debt	260	334	452	677	195
Minority interest	-	-	-	-	-
DTL / (assets)	-3	-5	-9	-15	-18
Capital employed	**605**	**798**	**1,105**	**1,733**	**3,203**
Net tangible assets	185	332	519	503	763
Net intangible assets	-	0	3	5	7
Goodwill	-	-	-	-	-
CWIP (tang. & intang.)	-	2	-	-	18
Investments (strategic)	8	8	50	76	77
Investments (financial)	81	118	130	141	151
Current assets (ex cash)	401	550	513	1,389	2,587
Cash	684	848	1,064	1,018	2,232
Current liabilities	755	1,060	1,174	1,399	2,633
Working capital	-354	-511	-661	-10	-45
Capital deployed	**605**	**798**	**1,105**	**1,733**	**3,203**
Contingent liabilities	183	457	727	1,178	-

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

Year-end: Mar	FY14	FY15	FY16	FY17	FY18P
PBT	154	213	386	642	999
+ Non-cash items	37	52	71	76	112
Oper. profit before WC chg.	191	264	457	718	1,111
- Incr. / (decr.) in WC	-102	-157	-150	651	-36
Others including taxes	53	72	137	226	355
Operating cash-flow	239	349	470	-160	791
- Capex (tang. + intangibles)	37	201	258	61	392
Free cash-flow	202	148	212	-221	399
Acquisitions	-	-	-	-	-
- Dividend*	19	19	58	108	216
+ Equity raised	-	-	-	-	1,419
+ Debt raised	109	72	115	219	-486
- Fin. investments	54	37	53	37	11
- Misc. items (CFI + CFF)	-0	0	-0	-102	-109
Net cash-flow	238	164	216	-46	1,214

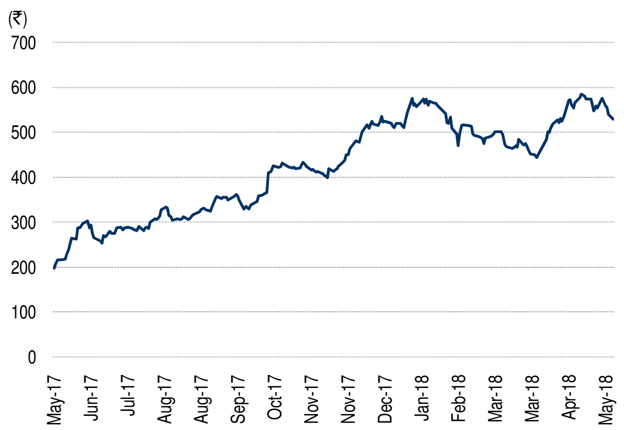
Source: Company *Note: p – provisional*

Fig 4 – Ratio analysis

Year-end: Mar	FY14	FY15	FY16	FY17	FY18P
P/E (x)	60.1	43.0	24.3	14.5	25.1
EV / EBITDA (x)	33.1	24.2	13.5	8.4	13.8
EV / sales (x)	2.6	1.9	1.2	1.4	1.9
P/B (x)	17.4	12.9	9.2	5.6	5.3
RoE (%)	32.8	34.4	44.1	48.1	31.4
RoCE (%)	34.3	33.8	44.2	50.6	44.0
Sales / FA (x)	11.4	8.4	8.8	7.9	9.3
DPS (₹ / sh) *	0.6	0.6	1.7	2.5	5.0
Dividend yield (%)*	0.3	0.3	0.8	1.2	1.1
Dividend payout (%) - incl. DDT*	18.6	13.7	23.1	26.0	33.6
Net debt / equity (x)	-1.5	-1.3	-1.1	-0.4	-0.7
Receivables (days)	24	31	8	49	58
Inventory (days)	3	5	3	3	17
Payables (days)	69	82	55	63	61
CFO:PAT %	237.7	248.5	188.6	-38.4	122.9

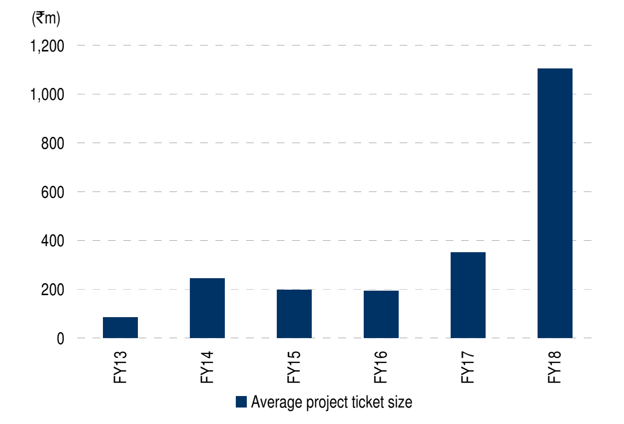
*Source: Company ; * Dividend for FY17 proposed after IPO; considered in ratio analysis*

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 Q3 FY18*

Result / Call Highlights

Financial performance

- PSP's revenue growth during the quarter is largely attributable to commencement of revenue recognition at its Surat Diamond Bourse project. It contributed ~₹0.6bn during the quarter. Even otherwise, growth was a strong ~27% y/y owing to the healthy pace of execution. Management emphasised that growth could have been even better but was contained because of the early Holi vacations in FY18. At ~82%, FY18 growth is more impressive.
- The margin contracted ~691bps y/y to 13.8% but was still better than the long-term median (~8.6% for the last six years). The margin contraction seems a function of the revenue mix as well as the project mix. The FY18 EBIDTA margin contracted ~256bps y/y to 13.9%.
- A healthy jump in Q4 revenue combined with higher other income (due to the higher cash balance) and lower tax incidence of ~34.1% (~37.4% a year ago, ~38.5% the previous quarter) helped earnings improve ~11.9% y/y. The contained finance cost to ~1.2% of sales (vs. ~1.9% a year ago) helped FY18 earnings grow ~54.7% y/y in FY18.

Fig 7 – Financial highlights

	Standalone								Consolidated		
(YE: Mar) (₹ m)	Q4 FY17	Q4 FY18	% Y/Y	Q3 FY18	% Q/Q	FY17	FY18	% Y/Y	FY17	FY18	% Y/Y
Sales	1,617	2,637	*63.1*	1,708	*54.4*	4,008	7,298	*82.1*	4,448	7,516	*69.0*
EBITDA	334	363	*8.6*	266	*36.7*	659	1,014	*53.8*	671	1,046	*55.9*
EBITDA margins (%)	*20.7*	*13.8*	*-691 bps*	*15.5*	*-178 bps*	*16.5*	*13.9*	*-256 bps*	15.1	*13.9*	*-117 bps*
Interest	20	30	*49.0*	23	*27.9*	75	87	*15.5*	79	93	*17.0*
Depreciation	21	43	*105.2*	28	*55.0*	76	112	*47.9*	79	115	*45.0*
Other income	34	59	*69.7*	32	*81.6*	134	184	*37.2*	134	186	*38.5*
PBT	328	349	*6.4*	247	*41.3*	642	999	*55.5*	647	1,024	*58.4*
Tax	122	119	*-2.8*	95	*25.3*	226	355	*56.9*	231	364	*58.1*
Tax rate (%)	*37.4*	*34.1*		*38.5*		*35.2*	*35.6*		35.6	*35.6*	
Adjusted PAT	205	230	*11.9*	152	*51.3*	416	644	*54.7*	416	660	*58.6*

Source: Company

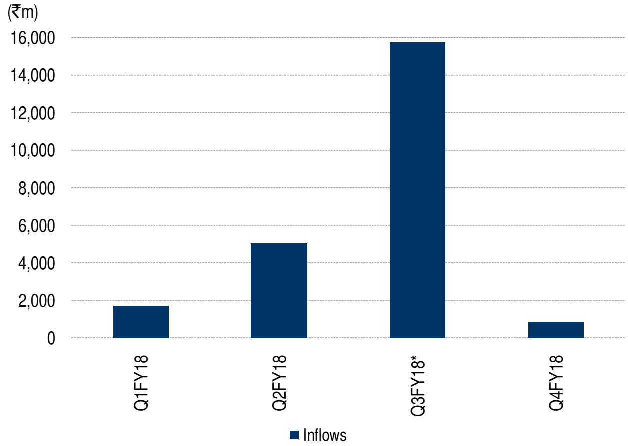
Order backlog / inflows / bid pipeline

- Though Q4 FY18 inflows, at ~₹873m, seem subdued, they could help management more or less deliver on inflow guidance of ~₹10bn (excl. the SDB). Full-year inflows of ~₹25.4bn include ~₹15.8bn of the SDB and ~₹9.7bn of others.
- The company's end-Mar'18 order backlog of ~₹25.6bn implies healthy revenue assurance (3.5x 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 robust.
  - Excl. the SDB, the order backlog of ~₹11.7bn, across 33 projects, comprises ~54.7% institutional, ~18.5% industrial, ~20.0% government, ~4.2% residential and the rest, government residential projects. All the projects are now with the materials component.
  - The pending-execution order book of the GDC-PSP JV and PSP

Projects & Proactive Constructions Pvt. Ltd (a subsidiary) is ~₹860m. From these two, management expects ~₹570m-600m revenue in FY19.

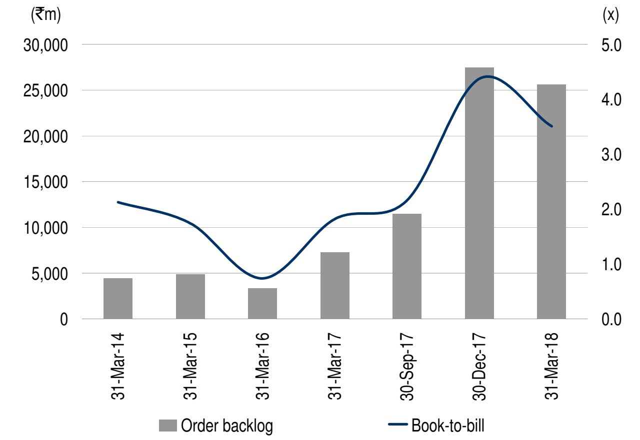
- In Q4 FY18, the company secured two orders (of ~₹873m) for a medical college and hospital in Bhavnagar and the LM College building in Ahmedabad.
- The average order size has risen from ~₹351m in FY17 to ~₹1,105m in FY18. This implies that management is better placed to optimally utilise resources and reap the benefits of economies of scale.
- Apart from the SDB, the company has two other relatively large projects: one of ~₹2.3bn (executable over 24 months), the other of ~₹1.3bn (executable over 18 months).

Fig 8 – FY18 inflows at ~₹25bn



Source: Company

Fig 9 – Strong order backlog = stout revenue assurance



Source: Company

- Outside Gujarat, the company is implementing two dairy projects in Karnataka (one on the outskirts of Bengaluru, the other on the road to Mysuru), and two in Rajasthan (a medical college and a hospital). These projects falling within its area of expertise led it to consider them.
- The company has submitted bids of ~₹20bn and its past success ratio has been ~25-30%. The bid pipeline includes one large commercial project of ~₹10bn in the south. The other projects are from 2-3 major developers in Ahmedabad and some institutional projects.
- 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. Key criteria include:
  - Client profile - existing or new; quality of client
  - Order size - 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; the company goes for prestigious projects to help build its brand but without compromising on margins.

- Segment - Only if within its area of its expertise. No plans to venture into road infra.

The Surat Diamond Bourse

- Management expects ~90-95% foundation work to be complete before the monsoon.
- Revenue of ~₹0.6bn was recognised from the project in Q4.
- Management highlights that it has already received a mobilisation advance of ~₹1.0bn, including taxes. It received the first bill of ~₹0.6bn and raised the second bill of ~₹0.2bn on 25th Apr'18. The second is already certified and the payment is expected anytime.
- The project has a pass-through structure for all building and finishing materials (cement, steel, marble tiles and granite).
- The project involves MEP of ~₹6bn and the other structural work of ~₹8bn-9bn (incl. ~₹3bn for facade). Earlier, management had guided to ~₹5bn revenue in FY19, ~₹8bn in FY20 and the rest in FY21.

Newer opportunities / keener competition

- Competition is not very keen for projects of ~₹1.5bn-2bn. This, management sees 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.
- It can participate in bids of ~₹25bn for government and industrial orders, once the Surat Bourse project is completed; the private sector requires no pre-qualifying bids.

Leverage / capex / cash flows / credit limits

- Inventory build-up of steel and cement for the SDB resulted in more inventory days during FY18. Management expects 15-20 days as the new normal in the near future. Receivable and payable days for FY19 are expected at respectively 35-45 and 50-60. The company has one of the shortest working capital cycle in the industry.
- Of the IPO proceeds (~₹1.4bn), it has utilised ~₹1.3bn (working capital ~₹630m, capex ~₹413m, general purposes ~₹269m). The balance (~₹107m) has been parked in fixed deposits with scheduled banks.
- The company incurred capex of ~₹370m in FY18 (incl. ~₹100m general capex, ~₹250m for the SDB). It guides a capex of ~₹500-600m for FY19. Generally, it incurs ~3-4% of a new project as capex.
- It has ~₹4.3bn of bank limits available (fungible between CC/WC and bank guarantees), of which ~₹1.5bn is yet unutilised. This would help for the working capital it requires and suffice for new orders of ~₹10-15bn.
- The company has unutilised FD/OD limit of ~₹0.4bn (total ~₹0.6bn) and unutilised cash of ~₹0.7bn.
- Finance cost increased despite a decline in debt. The increase is partly attributable to higher utilisation of BG limits for new orders and partly to utilisation of FD/OD limits to fund growth (OD gets adjusted at the end of the quarter). Debt is expected to be stable in FY19 as the company intends to continue to use FDs/ODs when required, rather

than CC limits.

- Other current liabilities of ~₹1.3bn (up from ~₹0.6bn in FY17) include mobilisation advances for the Surat Project to some extent.

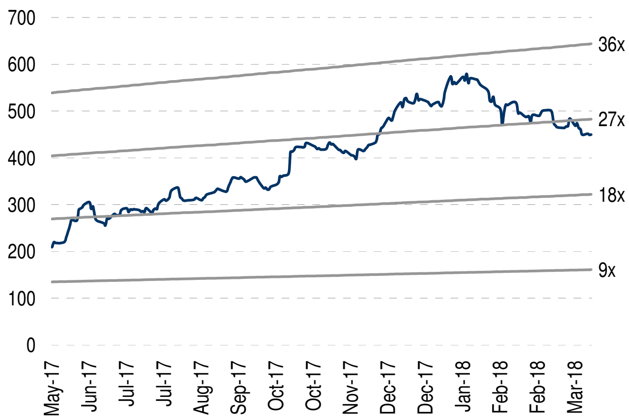
Guidance / others

- Its focus for the next 6-8 months would be towards aligning the work, especially the SDB and, simultaneously look at growth opportunities. It guided to ~30-35% revenue growth for FY19, with ~12-13% EBITDA margins.
- Management guided to quarterly inflows of ~₹2bn-2.5bn with overall addition of ~₹10bn for FY19

Valuation

At the CMP, the stock trades at 31x FY18 EPS of ~₹17.9. We believe PSP's strong order backlog, its continuous focus on execution, healthy balance sheet and better return ratios are the reasons behind such a high valuation.

Fig 10 – PE band



Source: Bloomberg, Anand Rathi Research

Risks

- Failure to maintain prudence.

Appendix

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Additional information on recommended securities/instruments is available on request.

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