India Midcaps

INITIATING COVERAGE

SUPREME INFRASTRUCTURE

In deep value zone

Edelweiss
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India Equity Research| Infrastructure - Construction

Supreme Infrastructure (SPII), an integrated infrastructure player, has delivered robust revenue and PAT CAGR of 41% and 27%, respectively, over FY09-14, underpinned by its derisked business strategy. Prudent backward integration and a cluster-based execution model have been propelling the company's profitability. Moreover, it also boasts of a robust portfolio of 11 BOT projects, majority of which are either operational or nearing completion. These projects' strategic location and a long residual life ensure sustained value creation. Though the mounting debt has impacted profitability, we anticipate healthy order book, diversified operations and a robust BOT portfolio to facilitate sharp recovery in FY16. Initiate coverage with 'BUY' and a SOTP-based target price of INR502.

EPC business well placed to overcome short-term hiccup

SPII's order book at Q2FY15 end (including L1 orders) stood at ~INR53bn, 2.5x TTM revenues, imparting healthy medium-term revenue visibility. The company's backward integration along with cluster-based execution model will sustain the strong operating margin and return ratios. While working capital issues have impacted execution in the short term, we anticipate revenue and profitability to catapult going ahead with PAT surging 4x over FY15-17E.

BOT portfolio gaining critical mass

Of SPII's 11 BOT projects, while 4 are already operational, 6 will be completed over the next year. These projects, situated on heavy traffic density stretches, ensure strong future growth. For e.g., while 2 projects are vital conduits for North-South traffic, 2 others connect major roads like NH-8 (Delhi-Mumbai) and NH-3 (Mumbai-Indore).

Outlook and valuations: Strong value proposition; initiate with 'BUY'

We have valued SPII's EPC business at INR243 (5x FY17E P/E; at 30% discount to other construction companies). BOT assets, adjusted for debt for equity infusion, have been valued at INR259 based on DCF valuation. Our SOTP value comes to INR502. We believe completion of BOT projects will trigger rerating of the EPC business along with value discovery of BOT business. We initiate coverage with **'BUY'** recommendation.

Financials (Standalone)

Year to March	FY14	FY15E	FY16E	FY17E
Revenue (INR mn)	21,586	16,442	21,104	25,540
Rev. growth (%)	*8.6*	*(23.8)*	*28.4*	*21.0*
EBITDA (INR mn)	3,113	2,552	3,191	3,760
Net profit (INR mn)	900	254	653	1,073
Shares outstanding (mn)	20	22	22	22
Diluted EPS (INR)	44.8	11.5	29.6	48.6
EPS growth (%)	*(31.6)*	*(74.4)*	*157.3*	*64.3*
Diluted P/E (x)	5.9	23.2	9.0	5.5
EV/ EBITDA (x)	4.8	6.9	4.9	4.5
ROAE (%)	16.2	3.8	9.1	13.5

EDELWEISS RATINGS

Absolute Rating	**BUY**
Investment Characteristics	Growth

MARKET DATA *(R: SIIL.BO, B: SPII IN)*

CMP	: INR 266
Target Price	: INR 502
52-week range (INR)	: 439 / 187
Share in issue (mn)	: 20.1
M cap (INR bn/USD mn)	: 5 / 84
Avg. Daily Vol.BSE/NSE('000)	: 20.4

SHARE HOLDING PATTERN (%)

	Current	Q1FY15	Q4FY14
Promoters *	55.0	55.0	55.0
MF's, FI's & BK's	3.5	3.3	1.3
FII's	13.9	13.8	13.2
Others	27.6	27.9	30.5
** Promoters pledged shares (% of share in issue)*	:		*31.85*

PRICE PERFORMANCE (%)

	Sensex	Stock	Stock over Sensex
1 month	(4.0)	13.9	17.9
3 months	3.1	(12.3)	(15.4)
12 months	29.4	23.4	(6.0)

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January 01, 2015

Investment Rationale

SPII has developed excellent credentials in the transportation, buildings, water/irrigation and power space over the past 3 decades

Diversified operations, healthy BOT portfolio: Potent growth catalysts

SPII is a well diversified and integrated infrastructure player with presence in transportation (roads, metro, bridges, railways and flyovers), buildings, water/irrigation and power T&D segments.

SPII was incorporated as Supreme Asphalts Pvt. Ltd in 1983 and started as a supplier of aggregates/asphalt to construction companies. It later moved up the value chain through forward integration into construction services. It changed its name to Supreme Infrastructure India Pvt. Ltd in 2002 and went public in 2007.

Initially, the company's operations were concentrated in Maharashtra, primarily in the roads & bridges segment. However, over the years, it has diversified, both geographically and segment wise, and now boasts of presence in more than 10 states in North, West and East India. In addition, it has ventured into the BOT space and currently has an enviable portfolio of 11 projects in its kitty.

SPII has been on a strong growth trajectory, posting revenue and PAT CAGR of 41% and 27%, respectively, over FY09-14. A healthy order book, diversified operations and a robust BOT portfolio will hold the company in good stead going ahead as well.

Robust order book imparts healthy revenue visibility

The company's order inflow has scaled up significantly over the past couple of years—order book (including L1 jobs) clocked an impressive 59% CAGR over FY09-14. Order book at Q2FY15 end (including L1 orders of INR7.8bn) stood at ~INR53bn, 2.5x TTM revenue, imparting healthy medium-term revenue visibility.

Chart 1: Robust revenue visibility

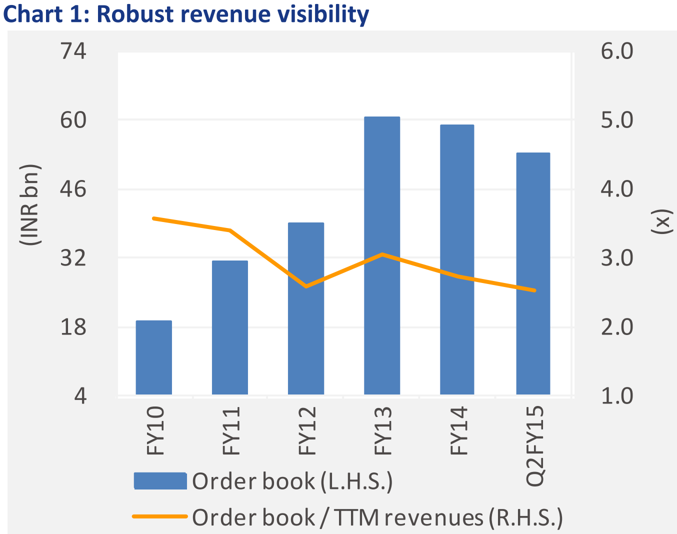
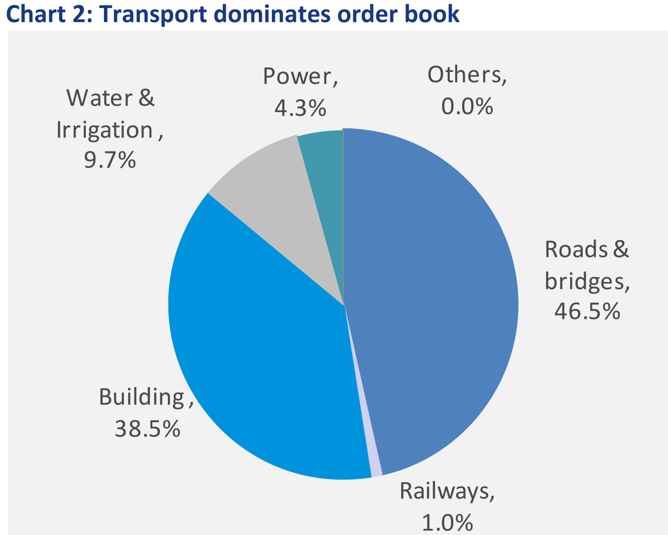


Chart 2: Transport dominates order book

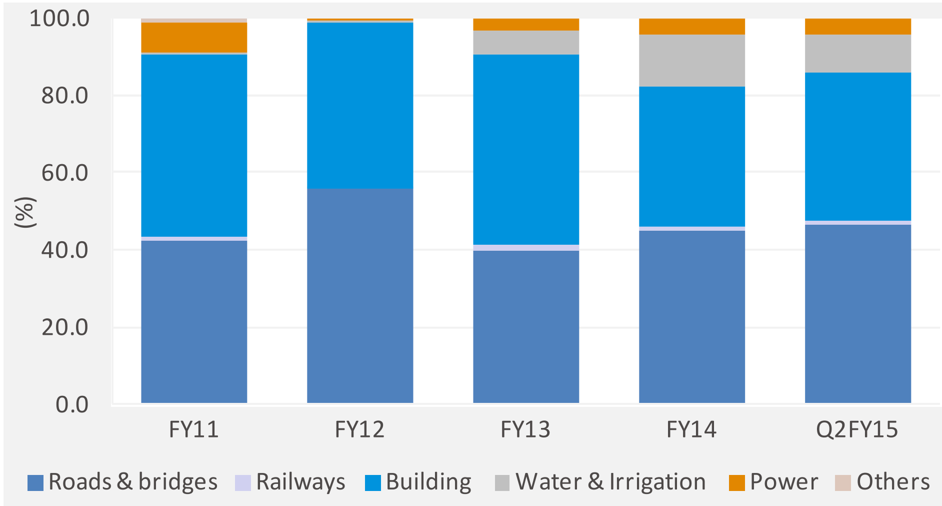


Source: Company, Edelweiss research

Note: Unless otherwise stated, order book in the note means orders unexecuted including L1 orders

The transportation segment (roads, bridges and railways) has historically been the most dominant sector as far as SPII's order book is concerned. This is followed by the buildings segment; water & irrigation and power T&D projects contribute majority of the balance.

Chart 3: Transportation and buildings have provided bulk of order book historically



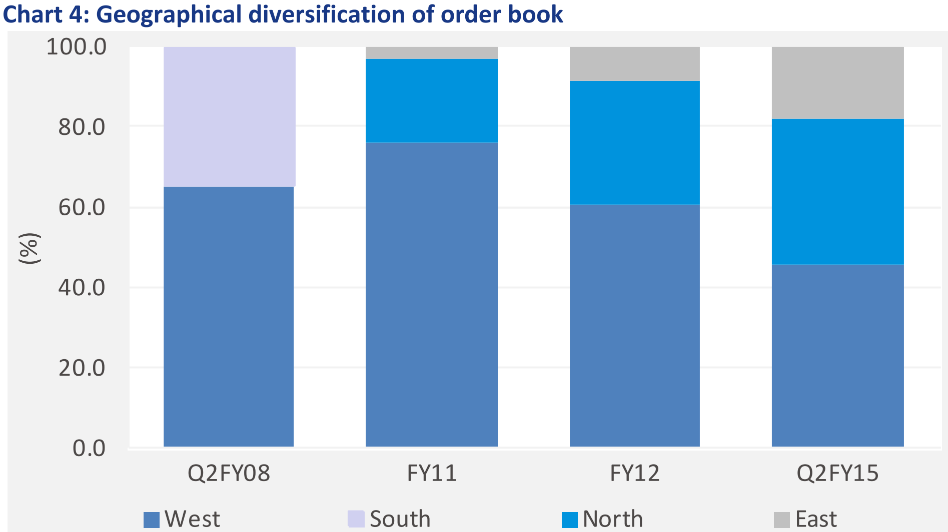
Source: Company, Edelweiss research

Diversification strategy derisks business

SPII has, over the years, consciously derisked its business model by ensuring adequate diversification in terms of segment of work, geographical area of operations along with prudent management of client risk. This has ensured a well diversified order book, eschewing concentration risk, improving sustainability of business and made the company more resistant to operational risks. We examine these factors in detail below:

- **Geographical risk:** SPII's operations were earlier limited to the Western part of India, particularly Maharashtra. The company has now spread wings to other regions as well. As a result, its operations are now spread in more than 10 states (refer Chart 4).

Chart 4: Geographical diversification of order book

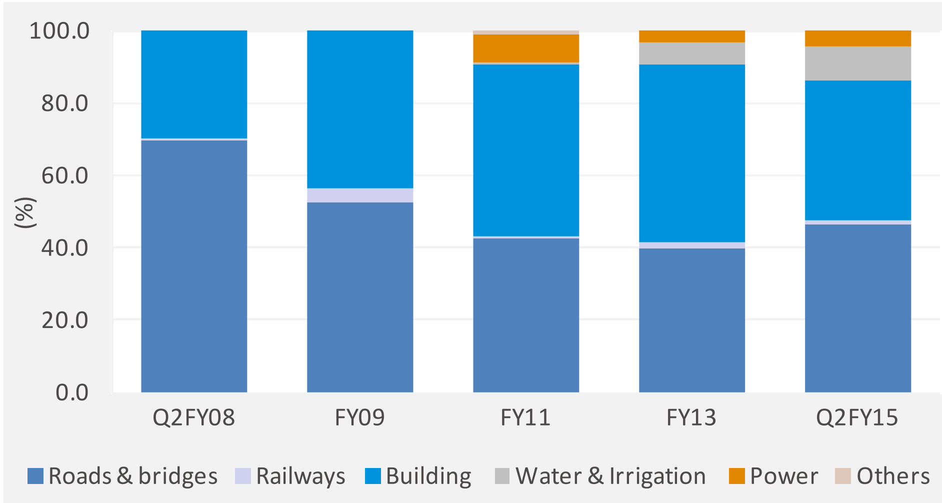


Source: Company, Edelweiss research

Order book is now spread across various regions in the country; also, its presence across multiple segments prevents sectoral concentration

- **Segmental risk:** SPII's order book initially was heavily geared to the roads & bridges segment. To reduce the concentration risk and expand growth opportunities, the company entered the water & irrigation and power T&D segments in FY10. Presence in multiple sectors has improved fresh order inflow avenues (refer Chart 5).

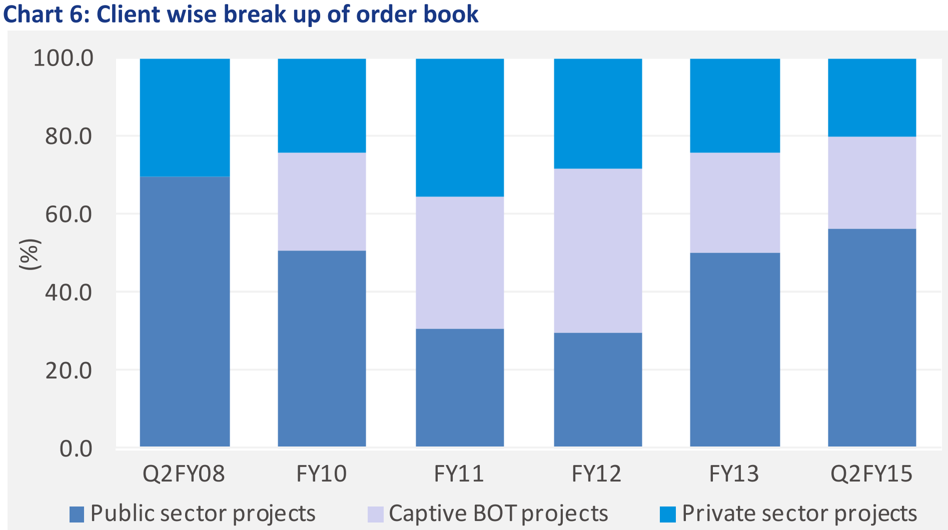
Chart 5: Segmental diversification of order book



Source: Company, Edelweiss research

- **Client concentration risk:** With transportation providing bulk of the order book initially, a majority of SPII's order book naturally emanated from the public sector. However, entry in the buildings space triggered increase in share of orders from the private sector. The company entered the road BOT space in FY09, opening up an additional order inflow avenue.

Chart 6: Client wise break up of order book



Source: Company, Edelweiss research

While these 3 sources (refer chart 6) contributed uniformly to the order book in FY11, the share of captive BOT peaked in FY12. With emergence of liquidity constraints in the past couple of years, SPII has deliberately shifted focus to public sector orders, resulting in a higher share of government orders currently.

Cluster based execution along with backward integration aids operating profitability

Thus, SPII has opened multiple avenues for order intake through diversification in terms of geography, segment and client specific parameters. This has not only strengthened the company's growth trajectory, but also equipped it with effective risk mitigation strategies.

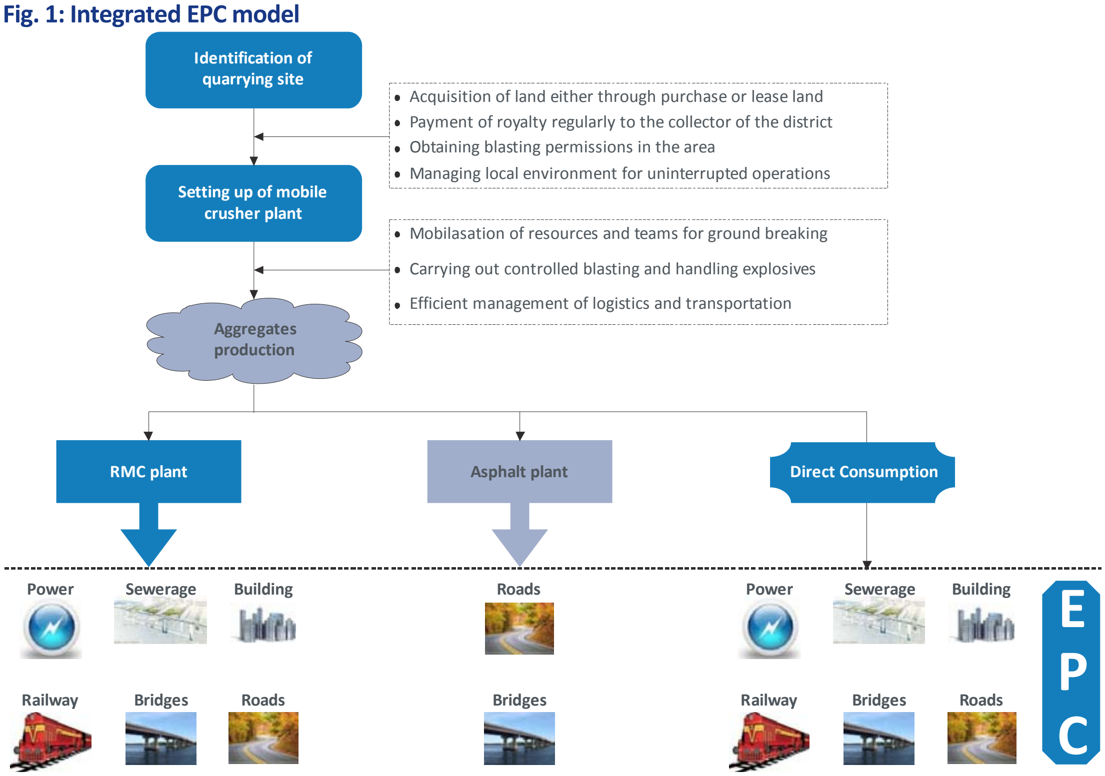
Integrated operations, cluster model drive outperformance

SPII's operations are fully integrated in terms of raw material availability through ownership of quarries, crusher plants, ready mix concrete (RMC) and wet mix plants. One of the key highlights of the company's operations is its strategy of securing access to key raw materials required for construction—aggregates, RMC and asphalt. This has been made possible by SPII's impressive capabilities in the quarrying business along with significant investment in equipment. Till date, the company has invested ~INR1.1bn in quarries and associated infrastructure/equipment. These have imparted raw material self reliance.

Aggregates form ~30-35% of the total raw material cost for any road project (raw material cost is ~70% of overall revenue). These aggregates are sourced from quarries. Most construction companies source these from third party entities i.e., local quarry owners. However, SPII follows a strategy of owning/leasing these quarries, providing a ready supply of aggregates, which are then processed via the company's RMC plants/asphalt plants or are directly consumed. It saves ~25% margin through this (compared to third party sourcing), resulting in 3-4% additional operating margin for the company.

In addition, the company follows a 'cluster based' execution strategy wherein it bids for a large number of projects in proximity to its quarries, saving cost of transportation of raw material. We analyse the company's integrated operations and its 'cluster based model' in greater detail below.

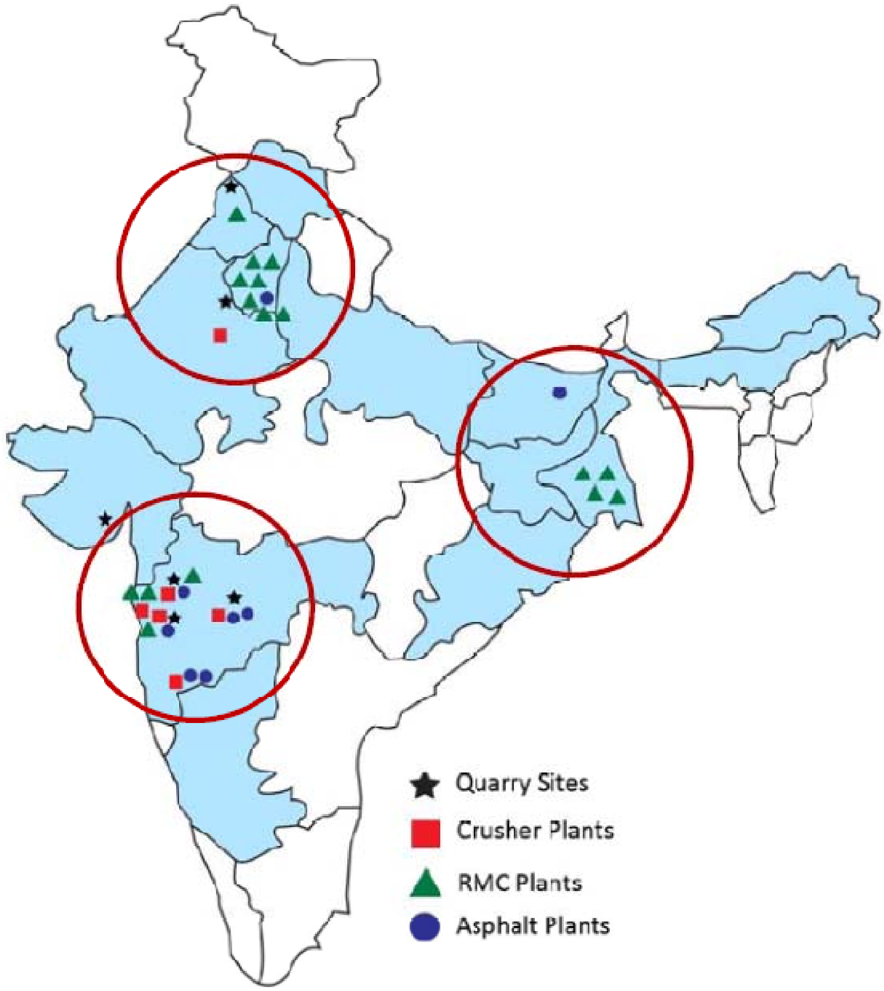
Fig. 1: Integrated EPC model



Source: Company, Edelweiss research

SPII first identifies quarries in its area of operations. Once access to such quarries is secured, the company bids for projects in the nearby 'cluster' i.e., in a 100-150km range. Its model is to have multiple projects nearby in such areas so as to fully leverage the assured raw material supply and also to benefit from economies of scale.

Fig. 2: Benefiting from backward integrated model



Source: Company, Edelweiss research

To further enhance operating efficiencies, the company uses its own construction equipment/machinery like RMC plants, asphalt plants, crusher plants, wet mix plants and paver block machines. Currently, SPII has access to 6 quarries, 9 crusher plants, 10 RMC plants and 6 asphalt plants. It has quarries in Padga, Panvel and Raigad in Maharashtra; Kotputli in Rajasthan; Bhuj in Gujarat and Pathankot in Punjab.

This supporting infrastructure significantly reinforces the company's operating abilities. Currently, more than 90% of SPII's order book accrues from states where it has captive availability of raw material.

Advantages of a backward integrated business model:

- Tax saving due to captive material transfers.

SPII has strong operating margins and return ratios

- Uninterrupted and timely supply of raw material to project sites, boosting timely execution.
- Cushion against commodity price fluctuations.
- Assurance on raw material quality.
- Savings on transportation cost, ensuring higher competitiveness during bidding.

Captive availability of raw material along with the associated benefits of uninterrupted flow, logistic cost savings in conjunction with inherent efficiencies involved have resulted in the company clocking 14-16% EBITDA margin, much higher than the industry average of 9-10%. This, along with efficient working capital management, has ensured that its return ratios are healthy in spite of the company being in growth stage.

Table 1: SPII has strong operating margins

	EBITDA margins (%)			
Company	**FY11**	**FY12**	**FY13**	**FY14**
SPII	17.1	16.2	15.5	14.4
MBL Infra	12.9	12.4	9.8	10.0
JKIL	15.1	16.1	16.7	17.3
Simplex	10.2	8.9	9.2	10.6

Source: Company, Edelweiss research

Table 2: SPII has robust return ratios

	RoAE (%)			
Company	**FY11**	**FY12**	**FY13**	**FY14**
SPII	34.8	28.1	25.9	16.2
MBL Infra	24.1	22.9	15.1	17.6
JKIL	21.4	16.7	16.1	15.6
Simplex	12.0	7.8	4.8	4.5

Source: Company, Edelweiss research

Enviable BOT portfolio with excellent growth prospects

SPII boasts of a robust BOT portfolio with majority of projects likely to become operational over the next year

SPII had prudently foreseen that privatisation will be an important theme in the Indian infrastructure space. Hence, it ventured into the BOT space in FY09 when it emerged as the lowest bidder for the Haji Malang project in Thane. Also, apart from doing EPC work on the Kasheli bridge BOT project (developed by Kalyan Toll Infrastructure), the company also took a 10% equity stake in it.

Starting with these baby steps, the company's BOT operations have grown exponentially; currently, SPII boasts of an enviable portfolio of 11 BOT projects costing ~INR47bn. Of these, 4 projects are already operational and the balance are in various stages of implementation.

The under construction BOT projects are at an advanced stage of completion and the company has already infused more than 80% of the equity commitment for the entire BOT portfolio. Of the 7 under construction BOT projects, 6 are likely to be completed over the next year. This implies that SPII will have 10 operational BOT projects in FY17 with only the Jaipur Ring Road project still under implementation in FY17.

Table 3: BOT portfolio achieving critical mass

Project	Project cost (INR mn)	Debt (INR mn)	Total Equity (INR mn)	Supreme's Economic interest	Status	Concession period end	Client	Length (km)	Mode
Nagar Kopargaon [1]	2,340	1750	590	100%	Operational	Oct-19	Mah. PWD	55	Toll
Manor Wada Bhiwandi	5,540	3943	1598	100%	Operational	Apr-39	Mah. PWD	64	Toll
Patiala -Malerkotla	945	650	295	100%	Operational	Jul-24	PIDB	56	Toll
Vasai Bhiwandi	2,140	1540	600	100%	Operational	Nov-33	Mah. PWD	26	Toll
Ahmednagar-Karmala-Tembhurni [2]	5,400	4050	1350	100%	Under Devp.	Dec-34	Mah. PWD	62	Toll
Sangli Shiroli [3]	3,300	2475	825	90%	Under Devp.	Jul-35	Mah. PWD	51	Toll
Haji Malang	800	500	300	100%	Under Devp.	Dec-36	Mah. PWD	1	Service fee
Panvel Indapur	12,235	9000	3235	90%	Under Devp.	Dec-32	NHAI	84	Toll
Kotkapura Muktsar	1,080	800	280	100%	Under Devp.	May-32	Punjab PWD	30	Toll
Jaipur Ring Road	10,448	7900	2548	74%	Under Devp.	Dec-42	JDA	47	Toll
Nagar Kopargaon Phase I [4]	2,360	1560	800	100%	Under Devp.	Mar-23	Mah. PWD	41	Toll
Total	**46,588**	**34168**	**12421**					**518**	

Source: Company, Edelweiss research

Note: 1. SPII holds 51% stake in the project with 49% being held by 3i.

2. SPII holds 51% stake in the project with 49% being held by 3i.

3. SPII holds 46% stake in the project with 44% being held by 3i.

4. End of concession in Mar 2023 is after considering expected extension of concession period

Mah. PWD = Maharashtra PWD, PIDB = Punjab Infrastructure Development Board, JDA = Jaipur Development Authority

3 of the company's BOT projects, viz., Ahmednagar Karmala Tembhurni, Sangli Shiroli and Nagar Kopargaon have been housed in a separate holding company, Supreme Infrastructure BOT Holdings (SBHPL). In 2012, SPII had sold 49% stake in SBHPL to the renowned global PE firm, 3i Group, for INR2bn

BOT projects have a long residual life

Most of SPII's projects have a long residual life. While Manor Wada Bhiwandi has 25 years left for end of concession, Jaipur Ring Road has 28 years left till the end of concession. Similarly, Vasai Bhiwandi and Ahmednagar Karmala Tembhurni have ~19-20 years left. Thus, it is imperative that SPII will benefit from surplus cash flow from these projects over a longer duration.

Strategic location of BOT projects: A goldmine of opportunity

SPII's BOT projects are strategically situated on stretches with heavy traffic density. This is likely to prove very lucrative for the company with strong toll collection growth expected in future. For e.g., the Nagar-Kopargaon project and Ahmednagar Karmala Tembhurni projects are important conduits for North-South traffic in India, whereas the Manor Wada Bhiwandi and Vasai Bhiwandi projects provide connectivity between major highways like NH-8 (links Delhi and Mumbai) and NH-3 (links Mumbai and Indore).

We take a look at the various BOT projects of the company:

- **Nagar Kopargaon**: The project involves 4 laning of a 55km stretch between Ahmednagar and Kolar of SH-10. This state highway connects Kopargaon and Ahmednagar in Maharashtra. This project had been initially awarded to a separate company which had later expressed its inability to complete the project. SPII then took over the partially completed project in June 2011, completed the construction and then started tolling in September 2011.

  Importance of the stretch: SH-10 is an important highway connecting North and South India. ~80% of the traffic plying on the stretch is through traffic with the balance 20%

BOT projects are likely to witness strong traffic growth due to their strategic locations

belonging to local traffic. Majority of the traffic on the stretch pertains to heavy vehicles.

Ahmednagar is the largest district of Maharashtra, home to 19 sugar factories. The district also boasts of industries in the electronics, automobile and agricultural sector. Kopargaon is a town in the Ahmednagar district which has 3 sugar factories and an industrial estate with 52 small scale industries.

The strong traffic potential on the stretch is evident from the fact that SPII has already been able to refinance the project and has managed an extension of the repayment tenure of the loan by 2 years, thereby improving the project's cash flows.

- **Manor Wada Bhiwandi:** The project involves 4 laning of the Manor-Wada (24.25km) and Wada-Bhiwandi (40.07km) stretches on SH-34 and SH-35, respectively, in Maharashtra. The project was initially awarded to Ram Infrastructure and Tapi Prestressed Products in September 2009. However, SPII took over the project due to funding constraints of these companies.

  The concession agreement was signed in March 2010 and SPII commenced tolling in March 2013.

Fig. 3: Location of Manor Wada Bhiwandi project

Source: Google maps, Edelweiss research

Importance of the stretch: The project is one of the most lucrative in SPII's BOT portfolio and has an excellent strategic location. It connects Manor (which lies on NH-8) to Wada and Bhiwandi.

Bhiwandi is known for its textile industry and has the largest number of power looms in India. It is the highest octroi paying city in the country. It also has storage facilities in forms of godowns which have been leased by various pharmaceutical, retail chains and logistics companies.

Manor Wada Bhiwandi project benefits from industrial development in Bhiwandi along with its ability to provide connectivity to other important NHs

Wada benefits from the presence of numerous industries such as chemicals, pipes etc. To benefit from the availability of large tracts of land at low costs, various small and medium-scale industries have set up shop here.

Starting from Manor, the stretch connects traffic coming from North India and Southern Gujarat to industrial areas of Bhiwandi, Thane and Ulhasnagar. It enables this traffic to save a distance of ~90km, conserving fuel and time.

The project also provides an alternative route for traffic coming from NH-8 for entering NH-3, NH-4 (which connects Mumbai, Pune, Bengaluru and Chennai), NH-17 (connecting Panvel, Goa and Kochi) and JNPT without entering either Mumbai or Thane. This saves them from congestion, helping save time.

Majority of the traffic plying on the stretch is through traffic, whereas ~25% of the traffic is local. For the latter, there is limited risk since there is no alternative route for the Wada–Bhiwandi stretch. The through traffic reaching Manor has a choice of taking either this project route or continuing on NH-8 for the onward journey. However, the toll on NH-8 is substantially higher than on this project, providing an incentive for traffic to choose this road and thereby minimize the alternate route risk for the project.

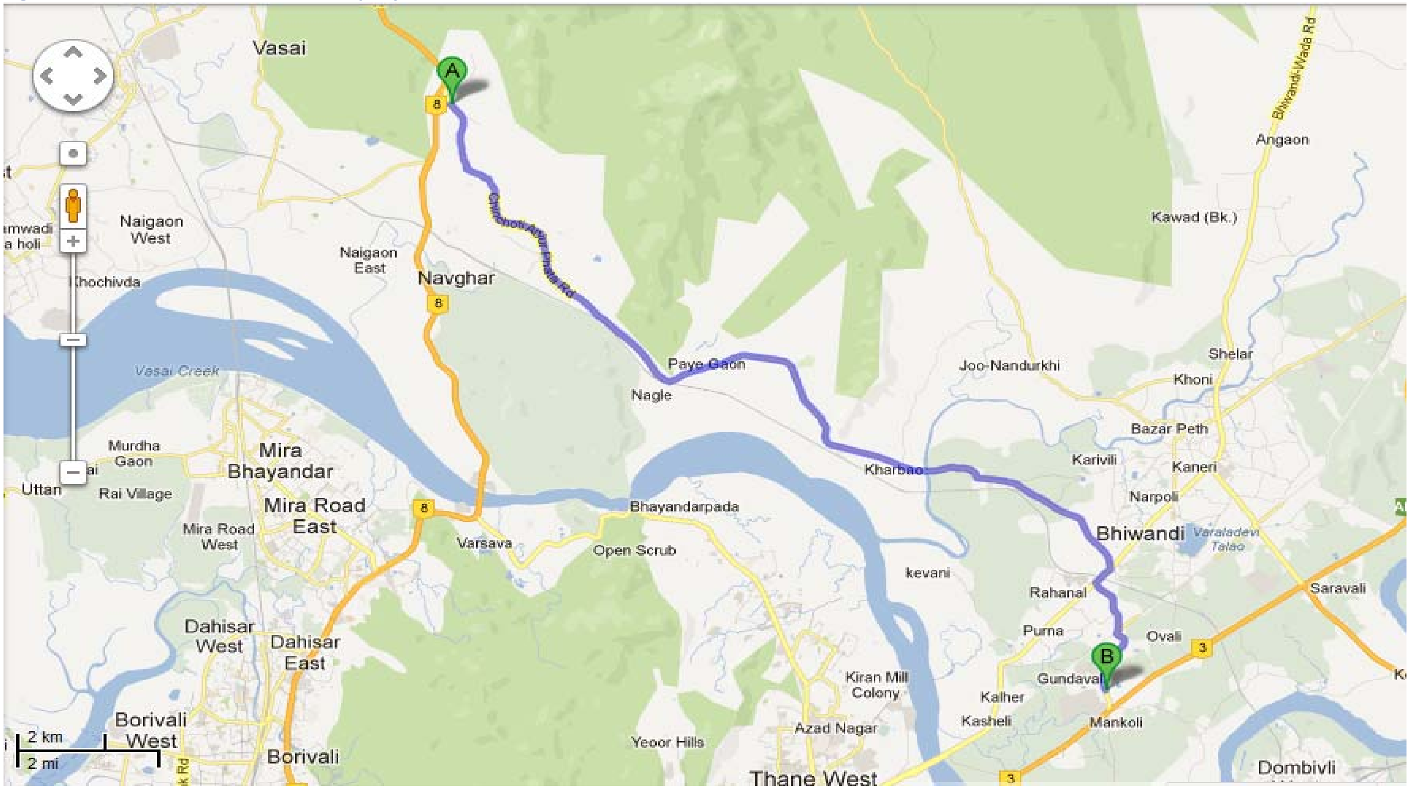
Currently, trucks are not allowed in Bhiwandi between 8 a.m. and 10 p.m. SPII is constructing a bypass (about 8km long) on SH-35 at Vishwabharati Phata–Bhinar-Vadpa Junction. Once the bypass is completed, it will allow round the clock passage of trucks and will also improve connectivity to JNPT. In addition, due to flyover construction in Bhiwandi city and the resultant congestion, many vehicles are currently taking the alternate NH-8 route; once the flyover gets completed, vehicles are expected to revert to the Manor Wada stretch. SPII hopes that completion of the bypass as well as the flyover will lead to higher traffic growth on the stretch.

- **Patiala Malerkotla:** The project is a 2 lane project involving upgradation of the state highway stretch Patiala–Nabha–Malerkotla in Punjab. It was initially awarded to IDEB Projects. The partially completed project was taken over by SPII in 2011. The company completed the project and commenced toll collection in June 2012.

  Importance of the stretch: Patiala is the fourth largest district in Punjab and is a renowned tourist destination. It boasts of one of the highest per capita vehicle densities in the country. The city is situated on NH-64 (connecting Chandigarh to Dabwali via Rajpura, Patiala, Sangrur and Bathinda). It is also well connected to cities like Ludhiana, Jalandhar and Amritsar (situated on NH-1) via SH-8.

- **Vasai Bhiwandi:** The project involves 4 laning of the Chinchoti-Kaman-Anjurphata to Mankoli stretch on major SH-4 in Maharashtra. This operational project was acquired by SPII in October 2013 for an equity consideration of ~INR600mn after the erstwhile owner had defaulted.

Fig. 4: Location of Vasai Bhiwandi project



Source: Google maps, Edelweiss research

Vasai Bhiwandi project benefits from dedicated traffic due to presence of storage facilities like warehouses.

Importance of the stretch: Apart from the local traffic, the stretch benefits from traffic plying on NH-8 (mainly Gujarat) and going to Bhiwandi and Kalyan. Due to presence of large number of warehouses, the road has dedicated traffic traversing it.

It is also used as a connecting link between NH-8 and JNPT which handles cargo traffic destined to the states of Madhya Pradesh, Maharashtra, Karnataka and Gujarat, along with most of North India.

The road also attracts traffic from industries located in Surat (major centre for the textile and diamond cutting industry) and Silvassa (major industrial hub boasting of a large number of manufacturing set ups and which has over 3,500 small and medium scale industries in FMGC, electronics, paints, textiles and chemicals.

- **Ahmednagar-Karmala-Tembhurni:** The project involves 4 laning of the Ahmednagar Karmala Tembhurni (AKT) section of SH-141 in Maharashtra's Solapur district. The concession agreement for the project was signed in December 2011 and construction commenced in March 2012. The project is currently more than 80% complete.

Importance of the stretch: SH-141 traverses the districts of Solapur and Ahmednagar. The road commences from Ahmednagar and ends at Tembhurni which lies on NH-9 in Solapur district. The stretch thus acts as a link between Ahmednagar and NH-9 (which passes through Pune, Solapur, Hyderabad, Vijayawada and Machilipatnam).

Like the Nagar Kopargaon project, it is a major route for transport of commodities between North and South India. It also benefits from the presence of sugarcane plantations and sugar factories in nearby areas.

Solapur is the largest city in southern Maharashtra and the sixth largest in Maharashtra. It is renowned for chaddars, handloom, power loom and beedi industries. An important junction on the North–South railway line, it boasts of numerous medium and small scale industries. It also attracts tourist traffic due to presence of various pilgrimage centres.

Projects like AKT and Sangli Shiroli benefit from significant industrial activities in neighbouring regions

- **Sangli Shiroli:** The project involves 4 laning of the stretch between Shiroli (near Kolhapur) and Sangli on major SH-3 in Maharashtra. The concession agreement was signed in December 2011 and construction commenced in October 2012. SPII holds 46% stake in the project with 44% held by 3i and 10% by Best Value Infratech. The project is ~60% complete currently.

  Importance of the stretch: Kolhapur, renowned for its footwear industry, benefits from the presence of textile manufacturing sector, handicrafts and numerous foundries. In addition, it is also a significant tourist centre with ~3mn tourists visiting the city. On the other hand, Sangli is a major industrial hub and has numerous sugar factories. Traffic going to Ichalkaranji, a major textile center and one of the fastest growing industrial areas in Maharashtra, also uses this stretch.

  The stretch is likely to witness traffic emanating from construction-related industries, transport of agricultural commodities along with tourist and pilgrimage traffic.

- **Haji Malang:** The project involves construction of a funicular ropeway system at Haji Malang shrine in Ambernath, Thane on BOT basis. While the project was awarded in 2008, construction started only in February 2012 due to delays in receiving environmental clearance. The project is ~80% complete currently.

  Currently, devotees have to climb 2,600 steps over 5km to reach the shrine which takes ~2-3 hours. Once construction is complete, devotees will have access to 2 passenger trolleys each with capacity of carrying 60 passengers. These trolleys will transport devotees and luggage from the foot of the hill Malangwadi to top of the Haji Malang hill. The system will be able to carry ~1,000 passengers up and down the hill per hour. SPII will be able to collect service fee from passengers for use of the system.

  Importance of the project: Haji Malang is a famous shrine in Thane which receives devotees from across India as well as abroad. The shrine is more than 300 years old.

- **Panvel Indapur:** The project involves 4 laning of Panvel-Indapur section of NH-17 in Maharashtra. The concession agreement was signed in January 2011 and construction commenced in December 2011. SPII won the project by promising to pay a premium of INR339.5mn to NHAI in the first year post COD, which will thereafter increase by 5% p.a.

  Work on the project was delayed due to delay in receipt of clearance for work to be done in the Karnala bird sanctuary which lies along the way. However, all clearances have been received now and work is on in full swing. SPII holds 90% stake in the project; Mahavir Infra holds the balance. The project is ~65% complete currently. SPII can commence partial tolling on the project once 75% work has been completed.

Fig. 5: Location of Panvel Indapur project

Source: Company, Edelweiss research

NH-17 is one of the most important highways providing connectivity to numerous cities located along the Western coast

Importance of the stretch: NH-17 is one of the busiest highways in the country and runs roughly North–South along the West coast of India, parallel to Western Ghats. Panvel (near Mumbai) is the starting point of the road which runs through Maharashtra, Goa, Karnataka, and Kerala and ends in Kochi.

It plays an important role in connecting Goa and other southern states to North India. Lying in close proximity to JNPT, it passes through various important cities like Khed, Sangameshwar, Ratnagiri, Panaji, Margao, Karwar, Udupi, Surathkal, Mangalore, Kasaragod and Kozhikode.

The stretch benefits from both local and inter-state traffic. The traffic on the road is varied and consists of both tourist as well as commercial traffic.

With ~50% of the traffic on the road coming from passenger cars, the project is well insulated from volatility due to economic cycles. It is used by tourists going to popular destinations like Goa, Alibagh, Harihareshwar, Raigad Fort, Mahabaleshwar, Wai, Panchgani, Ganpatipule, Ratnagiri, Kolhapur, Belgaum, Udupi, Guruvayur and Munnar.

Commercial traffic on the route is due to the connectivity provided by the road to major ports on the Western Coast such as Mumbai, JNPT, Mormugao, New Mangalore, Ratnagiri Port and Kochi.

- **Kotkapura Muktsar:** The project involves 2 laning of the stretch between Kotkapura and Sri Muktsar Sahib on SH-16 in Punjab. The concession agreement was signed in December 2012 and construction commenced in January 2014. The project is ~35% complete currently.

  Importance of the stretch: Kotkapura is a historic city which is the largest town in the Faridkot district of Punjab. It boasts of a sizeable cotton market. It is a central city on the route to other important cities like Sri Ganganagar, Ludhiana, Bathinda and Firozpur. Sri Muktsar Sahib is an important pilgrimage center.

  The road connects cities like Hanumangarh and Sri Ganganagar in Rajasthan which are important industrial centers for sugar mills and mineral industries in the region. Due to inadequate train connectivity, the road stretch is the preferred mode of transport.

  Majority of the traffic (60%+) on the route is passenger traffic which indicates heavy local usage and makes the stretch resistant to vagaries of economic cycles.

- **Jaipur Ring Road:** The project involves construction of a 6 lane access controlled ring road around the city of Jaipur covering the section between Ajmer Road and Agra Road. The concession agreement was signed in June 2011. However, start of work was delayed due to land acquisition issues; 'appointed date' for the project is expected shortly. The project is ~20% complete currently. SPII holds 74% stake in the project and the balance is held by Constructora San Jose.

  Importance of the stretch: Jaipur Outer Ring Road is a proposed 150km, 6 lane ring road, encircling the city of Jaipur, being developed by Jaipur Development Authority.

  Currently, SPII is constructing a 47km section in the South of Jaipur, connecting Ajmer Road (NH-8), Tonk Road (NH-12) and Agra Road (NH-11). Later, a ~98km section will be built in the northern part of Jaipur connecting Agra Road, Delhi Road, Sikar Road and Ajmer Road.

  Increasingly, a trend is being seen that various state governments are building ring roads around major cities, particularly those which are situated on junction of numerous NHs. A large number of commercial vehicles plying on these NHs do not have their end destination in these cities, but still pass through them in course of their journey, to reduce pollution and congestion in these cities, ring roads are being developed to ensure that vehicles which do not have the city as their end destination do not enter the city and instead use these ring roads for their journey; for e.g., the under construction Kundli Manesar Palwal (KMP) Expressway and the proposed Eastern Peripheral Expressway around New Delhi are being developed to reduce congestion in the city. Jaipur Ring Road is one such project.

  An important feature of this project is that unlike a typical BOT project which involves development of a particular road stretch and consequent tolling on that section, this project is a play on multiple roads intersecting the ring road. For e.g., vehicles plying on NH-11, NH-12, NH-8 and SH-12 (Malpura road) will use this stretch. Thus, the stretch will benefit from traffic on all these roads.

Jaipur Ring Road is a play on traffic plying on multiple roads like NH-11, NH-12, NH-8 and SH-12

NH-8 is one of the busiest highways in the Indian subcontinent since it connects the national capital Delhi to the financial capital Mumbai. Along the way lie important cities like Gurgaon, Jaipur, Ajmer, Udaipur, Ahmadabad, Vadodara, Bharuch and Surat. Already a busy road, it is expected to further benefit from development of the Delhi-Mumbai Industrial Corridor, aimed at developing industrial zones spanning across 6 states in India.

NH-11 passes through cities like Bharatpur, Dausa, Jaipur, Sikar and Bikaner. Apart from Jaipur, another tourist attraction on the route is the Keoladeo National Park at Bharatpur, a UNESCO World Heritage site.

NH-12 connects Jabalpur and Jaipur and passes through cities like Bhopal, Kota, Bundi and Tonk.

SH-12 connects Jaipur to Kankroli in the Rajsamand district. Rajsamand is one of the major suppliers of marble, granite and other valuable varieties of stone in India. In addition, it has several prominent large and medium scale industries including tyres, zinc and cottage and artisan units based on handloom, leather, terracotta & livestock.

- **Nagar Kopargaon Phase I:** The project involves 4 laning of a 41 km stretch between Kolar and Kopargaon of SH-10. The highway connects Kopargaon and Ahmednagar in Maharashtra. Construction began in March 2014. The project is currently 80% complete.

Nagar Kopargaon Ph I project benefits from pilgrim traffic going to Shirdi

Importance of the stretch: SH-10 provides connectivity between North and South India and attracts significant traffic from heavy vehicles. Another important source of traffic on this road are the pilgrims coming to the holy town of Shirdi which is located on this stretch, ~14 km from Kopargaon.

Valuation

Improvement in execution, working capital cycle to propel EPC earnings

We believe SPII's profitability, dented by execution slowdown and high interest costs, will rebound in FY16. The improvement will be driven by traction in revenue booking due to faster decision making by the government and resolution of client-specific issues. The same will also boost the company's working capital cycle. In addition, achievement of certain thresholds on under execution projects will trigger milestone-based payments, improving the company's receivables position, leading to dip in debt, further boosting SPII's profitability.

We, thus, perceive FY15 as a temporary blip in an otherwise strong growth trajectory over the years. Over a low base in FY15, SPII's profits will jump 4x by FY17E; in addition, its RoE will touch ~14%.

BOT projects completion: A game changer

EPC operations to recover in FY16E; completion of BOT projects to trigger re-rating of the stock

On the BOT front, a majority of SPII's projects are likely to be completed over the next one year. The completion will be a significant value driver of the company's stock price. Over the past couple of years, investors have assigned a significant discount while valuing under construction BOT projects due to uncertainty over completion timelines (as a result of delays in receiving right-of-way and other statutory clearances) and traffic performance of the road (due to economic slowdown). We believe, once these BOT projects get completed, this discount will be eliminated, leading to significant rerating of the stock.

In addition, completion of these BOT projects will also lead to a multiple expansion for the EPC business. Currently, SPII's EPC operations' profitability is under a cloud due to the equity commitment for BOT operations and the consequent dilution threat. With completion of the BOT projects, investors will have greater clarity on the funding needs of the overall business. Also, it is much easier to monetise operational BOT projects through stake sale/securitisation compared to under development projects. Any such exercise will not just help unlock value of the BOT business, but will also help deleverage balance sheet of the EPC business, further providing comfort to investors.

We, thus, believe SPII is on the cusp of a significant up move in its operational performance and consequently the stock price. While we do not rule out a few short-term hiccups, the company's EPC and BOT operations will be in a fairly stable and profitable state by FY16 end.

Sum-of-the-parts approach indicates strong valuation upside

As SPII's business operations span EPC and BOT businesses, we have valued the company using the sum-of-the-parts (SOTP) approach, applying the following methodology across its 2 business segments:

EPC segment: We have valued the EPC business using P/E approach, in line with our methodology for valuing construction companies. We have assigned P/E of 5.0x to SPII's FY17E EPS of INR48.6. Our target price for the EPC business is INR243/share, 48% of the company's overall SOTP value.

BOT segment: BOT projects have been valued using DCF methodology. We have used the 'free cash flows to equity' method by using a cost of equity of 13%. For projects under development, we have used an equity cost of 13.5% to factor in execution risks.

The total DCF value for BOT projects comes to INR463/share (implied price to book multiple for projects is 1.0x). While ongoing projects contribute INR240/share, balance INR223/share is contributed by under development projects. Against this, SPII has taken an INR4.5bn loan for equity infusion (INR204/share). Adjusting for this, BOT valuation comes to INR259/share.

Our SOTP-based target price for the stock is INR502. We initiate coverage on the stock with '**BUY**' recommendation.

Table 4: SOTP valuation table

Particulars	Basis	Total value (INR mn)	Value per share (INR)
Overall EPC business	5x FY17E EPS	5,366	243
BOT projects	DCF	5,727	259
Total		**11,093**	**502**

BOT business contributes a significant portion to overall SOTP value

BOT Projects	
DCF Value of Projects	**(INR/share)**
Operational	**240**
Nagar Kopargaon	7
Manor Wada Bhiwandi	176
Patiala -Malerkotla	5
Vasai Bhiwandi	52
Under development	**223**
Ahmednagar-Karmala-Tembhurni	25
Sangli Shiroli	10
Haji Malang	31
Panvel Indapur	73
Kotkapura Muktsar	(4)
Jaipur Ring Road	86
Nagar Kopargaon Phase I	2
Total BOT value	**463**
Value of debt taken	204
Adjusted BOT value	**259**

Source: Edelweiss research

Table 5: Peer comparison table

Company	Market cap	EPS CAGR (%)	Diluted P/E (X)			EV/EBITDA (X)			ROAE (%)		
	(INR bn)	(FY15E-FY17E)	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E	FY15E	FY16E	FY17E
SPII	5.3	106	23.2	9.0	5.5	6.9	4.9	4.5	3.8	9.1	13.5
MBL Infra *	8.4	29	8.9	6.6	5.3	6.7	5.2	4.5	15.5	16.4	17.1
JKIL *	16.5	28	16.1	12.3	9.9	7.7	6.4	5.3	14.5	14.9	16.3
Simplex *	17.8	73	25.8	15.4	8.6	7.8	6.8	6.0	4.8	7.8	12.3

Source: Bloomberg, Edelweiss research

*Note: * Consensus Bloomberg estimates*

Key Risks

Equity dilution risk

SPII has exposure to the road BOT space, which entails upfront investments with returns generally being back ended. Currently, the company has 7 under construction BOT projects. Equity commitment for these projects can stretch SPII's balance sheet and may lead to equity dilution.

Inherent risks associated with toll projects

The company's focus on toll road projects exposes it to risks associated with gaining right-of-way on land stretches, execution risk, 'force majeure' risk, unpredictability of traffic growth etc.

Execution risk

While SPII has done well over the past couple of years, entry in new segments and geographies exposes it to execution risks. Also, the average size of projects is increasing and they also involve higher level of complexity than what the company has encountered so far. Completion of such projects within the stipulated time and cost will be paramount to maintain profitability.

Profitability risks

Historically, SPII's operating profitability has been higher than peers due to its backward integration model and cluster-based execution. With entry in new geographies, it may not always have access to quarries. Alternatively, it may not always be able to win numerous projects in nearby regions. With expansion in operations, particularly to new geographies, the company may face challenges in maintaining similar level of profitability.

Competition risk

With expanding size of projects, SPII will face competition from bigger, more experienced and established players, which could lead to margin dilution.

Company Description

Incorporated in 1983, SPII is a civil engineering and infrastructure development company focussing on development of roads, flyovers, bridges, railways & metro projects, water & irrigation projects, commercial & residential buildings, power transmission & distribution projects, etc.

Starting as a supplier of aggregates and asphalt, the company also ventured into the EPC space. SPII received its first contract for roads and bridges in Amravati from MSRDC in 2002. Since then, it has forged a unique business model characterised by backward integration of EPC operations and a cluster-based execution strategy.

In addition, it entered the asset development space in FY09 and has developed a robust portfolio of 11 BOT projects. While some BOT projects are directly held by SPII, others are held by 2 step down subsidiaries—Supreme Infrastructure BOT (SBPL) and Supreme Infrastructure BOT Holdings (SBHPL). Global PE fund 3i invested INR2bn for 49% stake in SBHPL (which holds 3 BOT projects) in 2012.

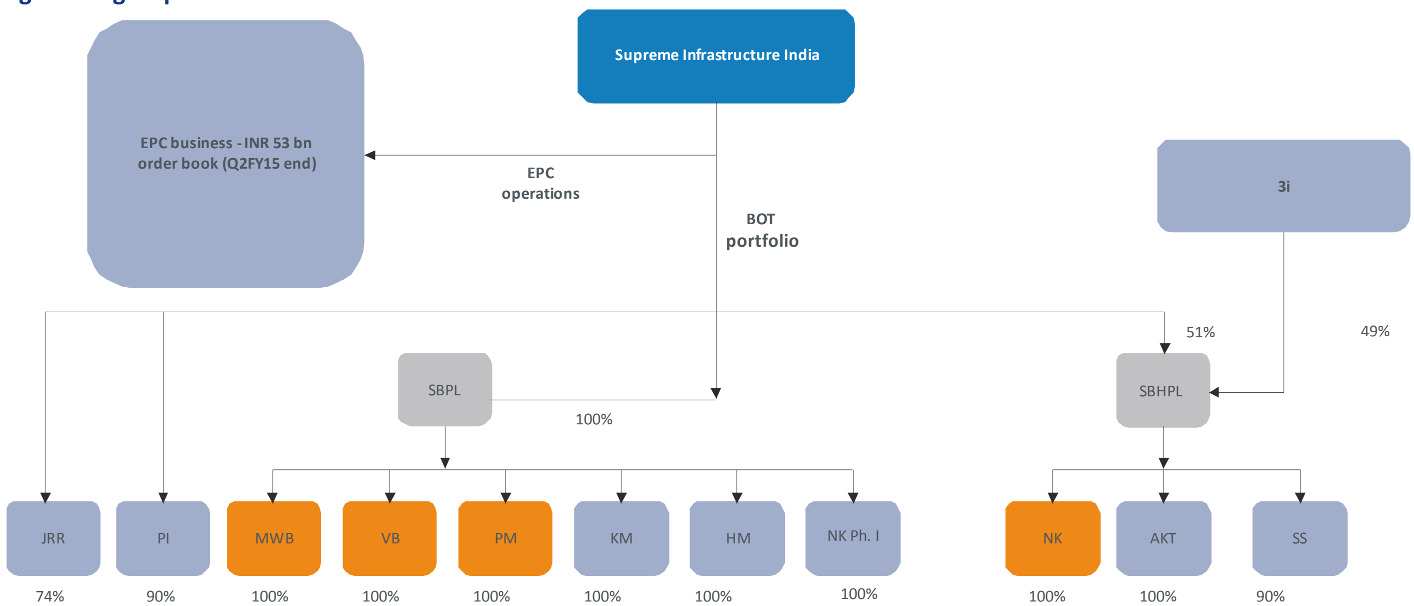
The company went public in October 2007, with public issue of ~3.5mn shares at a price of INR108/ per share aggregating ~INR375mn. Issue proceeds were utilised for meeting the company's capex and working capital requirements.

Fig.6: SPII's growth journey

1983	2002	2003	2007	2009	2010	2011	2012	2014
Incorporated as Supreme Asphalts	Received first contract for roads and bridges from MSRDC	Established first RMC plant in Powai	Went public with a public issue of ~3.5mn shares at a price of INR 108/ per share aggregating INR 375 mn Received contract for Powai IT Park, service apartments and residential Tower worth INR 3,500 mn	Entered the BOT space by winning Haji Malang project Operationalised regional office at Delhi with order book of INR 13bn Awarded EDGE Towers complex at Ramprastha City, Gurgaon (INR2.4bn)	Received first BOT project from NHAI-Panvel, Indapur Operationalised regional office at Kolkata with order book of INR700mn Wins first power transmission project of INR770mn	Receives Nagar-Kopargaon BOT project which also becomes the first operational BOT project for the company	Receives INR2bn investment from 3i in 3 BOT assets Revenues cross INR10bn	Revenues cross INR 20bn Average daily toll crosses INR4mn

Source: Company, Edelweiss research

Fig.7: SPII group structure



Legend:

Operational projects

Under development projects

Project SPVs:

JRR: Jaipur Ring Road
PI: Panvel Indapur
MWB: Manor Wada Bhiwandi
VB: Vasai Bhiwandi
PM: Patiala Malerkotla
KM: Kotkapura Muktsar
HM: Haji Malang

NK: Nagar Kopargaon
AKT: Ahmednagar Karmala Tembhurni
SS: Sangli Shiroli
NK Ph. I: Nagar Kopargaon Phase I

Source: Company, Edelweiss research

Management Overview

Table 6: Board of directors

Name	Position	Remarks
Mr. B. H. Sharma	Executive Chairman	He is the founder of the company. A Science graduate from Rajasthan University, he started as a quarry owner in Mumbai in 1970s. In 1983, he along with the other promoters, formed the company and commenced quarrying and asphalting. In 1988, he took over the management and ownership of the company.
Mr. Vikram B Sharma	Managing Director	He has done his Bachelor of Engineering in Civil from Bombay University. He joined the company as a Director in August 1998.
Mr. Vikas B Sharma	Whole Time Director	He is a Commerce graduate from Bombay University and also holds a Masters in Management Studies (MMS) degree with specialisation in Finance. He joined the company in August 1998 as a Director, taking over responsibilities of Accounts, Administration and Finance Departments.
Mr. Dakshendra Agrawal	Non-Executive Director	He has rich and varied experience in finance, banking and corporate taxation. He is a Chartered Accountant by profession and started his career as the Finance Head at Raj Rajendra Synthetics (RRPL). After serving four years in RRPL, he started practicing independently in 2001.
Mr. V. P. Singh	Independent Director	He is a Master of Commerce, Bachelor of laws and Certified Associate of Indian Institute of Bankers. He has more than 40 years of cross functional experience in financial services and is a former CMD of IFCI.
Mr. Vinod Agarwala	Independent Director	He is a Science and Law graduate, a Solicitor & Advocate of High Court, Bombay, Solicitor, Supreme Courts of England & Wales and Advocate of Supreme Court of India. He is a partner of Vigil Juris, Solicitors & Advocates, Mumbai.
Mr. Mukul Agrawal	Independent Director	He is a Commerce graduate from Bombay University. He is a Director of Namah Capital Resources, Param Capital Research and Pranam Reality. He is also a member of the Multi Commodity Exchange.
Mr. Pramod Kasat	Independent Director	He is a post graduate in MBA Finance & an Electronics Engineer from BITS Pilani with 18 years of experience in the field of infrastructure finance and economics. He has rich and valuable experience in the field of investment banking, private equity, international financing and corporate cinancing.

Table 7: Major clients in each segment

Segment	Client
Transportation	National Highways Authority of India (NHAI), Maharashtra State Road Development Corporation (MSRDC), Mumbai Metropolitan Region Development Authority (MMRDA), Municipal Corporation of Greater Mumbai (MCGM), Maharashtra PWD, Punjab PWD, Thane Municipal Corporation (TMC), Kolkata Municipal Corporation (KMC), Jaipur Development Authority (JDA), Delhi Metro Rail Corporation (DMRC), City and Industrial Development Corporation of Maharashtra (CIDCO)
Buildings	Central Public Works Department (CPWD), Vodafone, Rolta, Orissa PWD, Directorate General of Married Accommodation Project (DGMAP), Rajiv Gandhi Rural Housing Corporation
Water and Irrigation	Maharashtra Industrial Development Corporation (MIDC), Kolkata Municipal Corporation (KMC), Coca Cola
Power	Maharashtra State Electricity Distribution Company (MSEDCL), Maharashtra PWD

Source: Company, Edelweiss research

Table 8: Major projects currently under execution **(INR mn)**

Segment	Project	Project size*	Client
Transportation	Jaipur Ring Road	9,450	Supreme BOT
Transportation	4 Laning of Panvel - Indapur Section of NH - 17	5,940	Supreme BOT
Transportation	4 Laning of Ahmednagar - Karmala - Tembhurni road	3,950	Supreme BOT
Transportation	4-Laning of road along Sidhwan Canal	2,520	Punjab PWD
Transportation	Design and Construction of New Creek Bridge between Thane and Kalwa	1,836	Thane Municipal Corp
Transportation	Work for Construction of Major Bridge across Bankot Creek, Thane	1,830	Maharashtra PWD
Transportation	Elevated Metro Stations, Navi Mumbai	1,420	CIDCO
Transportation	Flyover at Rajnoli and Mankoli Junction, Thane	1,240	MMRDA
Transportation	Widening and improvement of Shirsad- Ambadi road on SH-40	948	MMRDA
Transportation	Construction of Roads and Canals, Siwan, Bihar	887	Bihar PWD
Buildings	Redevelopment (SRA) Goregaon	4,400	Reddy Builders
Buildings	NBCC Greens in Gurgaon, Haryana	2,149	NBCC
Buildings	Housing for Army welfare, Sector 95, Gurgaon	1,942	Army Welfare Housing Organisation (AWHO)
Buildings	EWS houses for Urban poor slum rehab, Delhi	1,790	Delhi Urban Shelter Improvement Board (DUSIB)
Buildings	Hex City	1,375	Armstrong Group
Buildings	Construction of Mahanadi Institute of Coal	1,220	NBCC
Water and Irrigation	Regional Water Supply Scheme, Bharatpur	2,270	SPML Infra
Water and Irrigation	Bhayender water project	1,500	SPML Infra
Water and Irrigation	Centralized Water supply scheme for Shendra and Jalna	640	MIDC
Water and Irrigation	Drainage system at Digha, West Bengal	414	Digha Sankarpur Development Authority
Power	Work for supply, test, transport, construction , erection of sub transmission lineson Turnkey basis at Thane	1,454	MSEDCL
Power	Turnkey contract for electrification work for Mahavitran Infrastructure plan at Panvel, Zone Bhandup	656	MSEDCL
Power	Turnkey contract for electrification work for Mahavitran Infrastructure plan at Panvel, Zone Bhandup	638	MSEDCL

Source: Company, Edelweiss research

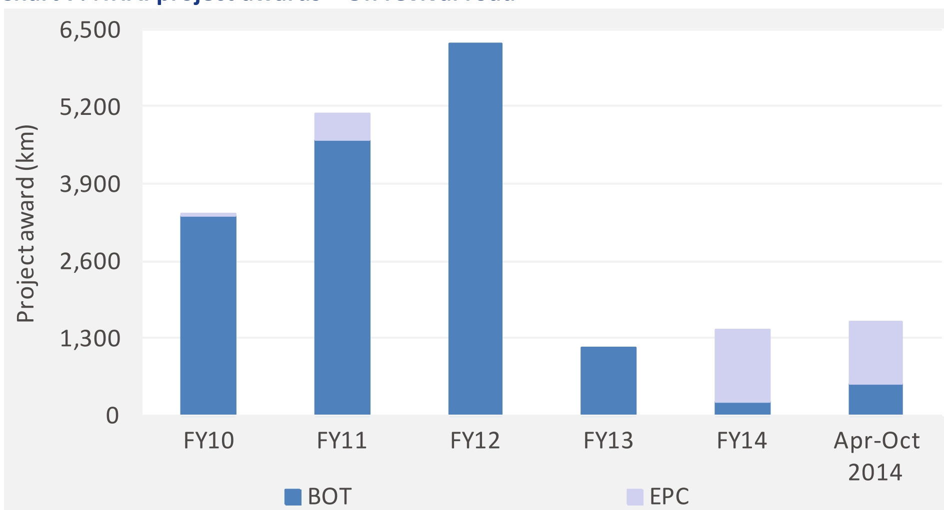
*Note: * SPII's share in the order*

Industry Overview

Roads and highways

Over the past few years, project award at the National Highway Authority of India (NHAI) end has been tardy due to issues with land acquisition, delays in environment & forest clearances and stressed balance sheets of infra companies. However, awarding of national highway projects has gathered momentum during the current year. The NHAI has already awarded 1,566km projects during April-October 2014 (versus <1,500km in FY13 and FY14). An additional 300km is estimated to have been awarded by the Ministry of Roads during the same period.

Chart 7: NHAI project awards—On revival road



Source: Government documents, Edelweiss research

Table 9: EPC projects awarded between April and October 2014

Name	LoA issued	Length (Km)	Project cost (INR bn)	NHDP Phase	Contractor
Jaisalmer-Barmer	Apr-14	131.4	3.0	IV	GR Infra Projects
Jodhpur - Pachpadra	Apr-14	85.6	2.1	IV	Sadbhav Engg
Bagundi - Barmer	Apr-14	74.1	1.7	IV	GR Infra Projects
Tirumayam - Manamadurai	Apr-14	77.7	2.5	IV	Dilip Buildcon
Bridge at Delhi/Haryana border	May-14	0.3	0.7		Gawar Construction
Chappra – Rewaghat – Muzaffarpur	Jun-14	73.1	3.4	IV	Supreme Infra
Thanjavur - Pudukottai	Sep-14	55.2	1.6	IV	Gayatri Projects - SPL Infra
Patna-Gaya-Dobhi	Oct-14	127.2	12.3	III	IL & FS Engg
Sitarganj - Tanakpur	Oct-14	52.0	2.4	IV	H.G Infra Engineering (P)
Talchar -Dubari-Chandikhole	Oct-14	132.4	8.6	III	Corson Corviam Construction SA
Karaikudi - Ramanathapuram	Oct-14	80.0	2.8	III	Transstroy (India)
Phalodi -Jaisalmer	Oct-14	160.5	4.3	IV	Corson Corviam Construction
Total		**1,049**	**45**		

Source: Government documents, Edelweiss research

Table 10: BOT projects awarded in FY15 so far

Name	LOA	Length (Km)	Project cost (INR bn)	NHDP phase	Concessionaire	Mode	Premium/VGF (INR)
Aurangabad-Yedeshi	Apr-14	190	18.8	IV	IRB Infra	Toll	VGF - 5580 mn
Kaithal – Rajasthan border	May-14	166	13.9	IV	IRB Infra	Toll	VGF - 2340 mn
Bikaner-Phalodi	Aug-14	160	8.2	IV	IRCON	Toll	VGF - 3270 mn

Source: Government documents, Edelweiss research

In addition, 58 projects spanning ~4,400km costing ~INR550bn are at various stages of bidding. We expect these to be awarded over the next 6-9 months, heralding significant opportunities for road players (refer table 11 for details).

Table 11: NHAI projects for which bidding process has been initiated

Particulars	No of projects	Length (km)	Cost (INR bn)
EPC projects	41	2,673	305
BOT projects	17	1,701	244
Total	**58**	**4,374**	**549**

Source: Government documents, Edelweiss research

While some of these projects have already reached the bidding stage (RfP), in case of others the awarding process has just begun with invitation of prequalification (RfQ) (refer table 12 and 13 for details).

Table 12: NHAI projects at RfQ stage (pre-qualification)

Particulars	No of projects	Length (km)	Cost (INR bn)
EPC projects	34	2,088	261
BOT projects	10	1,103	174
Total	**44**	**3,191**	**435**

Source: Government documents, Edelweiss research

Table 13: NHAI projects at RfP stage (bidding)

Particulars	No of projects	Length (km)	Cost (INR bn)
EPC projects	7	584	44
BOT projects	7	599	70
Total	**14**	**1,183**	**114**

Source: Government documents, Edelweiss research

For some of EPC projects, bids had earlier been invited on BOT mode. When they failed to evince bidder interest, these were converted into EPC mode and are now being bid out again.

Table 14: Status of NHDP and other NHAI projects (as on October 31, 2014)

Phase	Total length (km)	Already 4/6 laned (km)	Under implementation	Balance for award (km)
GQ	5,846	5,846	0	0
NSEW	7,142	6,325	400	417
Phase III	12,109	6,300	4,464	1,345
Phase IV	14,799	776	5,509	8,514
Phase V	6,500	1,919	2,162	2,419
Phase VI	1,000	0	0	1,000
Phase VII	700	22	19	659
Misc projects	2,522	1,882	363	277
Total	**50,618**	**23,070**	**12,917**	**14,631**

Source: Government documents, Edelweiss research

Apart from NHAI, the Ministry of Roads is also awarding highways. Over the next 5 years, Crisil expects ~25,000km of national highway projects to get awarded. A significant proportion of these will come from the National Highways Development Programme (NHDP).

Railways

The railway segment has started witnessing substantial action over the past few years. Work on the Dedicated Freight Corridor (DFC), India's largest-ever infrastructure project, has picked pace with 3 major contracts worth ~INR100bn getting awarded in H1CY13 and 2 contracts worth INR77bn being awarded recently.

Table 15: DFC—Project pipeline

Stretch	Corridor	Kms	Scope of work
Ikbalgarh - Vadodara	Western	297	Civil, structural and track works
JNPT-Vaitarana	Western	102	Civil, structural and track works
Vaitarana-Vadodara	Western	320	Civil, structural and track works
Dadri-Rewari	Western	125	Integrated package for civil, structural and track works and systems contract
JNPT-Vadodara	Western	422	Electrical and mechanical works
JNPT-Vadodara	Western	422	Signalling and telecom works
Khurja - Kanpur	Eastern	343	Systems
Kanpur - Mughalsarai	Eastern	393	Electrical works
Kanpur - Mughalsarai	Eastern	393	Signalling and telecom works
Ludhiana-Pilkhani and Dadri – Khurja	Eastern	175 46	Integrated package for civil, structural and track works

Source: Government documents, Edelweiss research

In addition, the pre-qualification process is already underway for award of multiple contracts on Eastern and Western corridors. Civil construction contracts to be awarded will include the Khurja-Ludhiana section (447km) on Eastern DFC, while on the Western DFC, projects for the Iqbalgarh-Vadodara (297km), JNPT-Vaitarana (102km) and Vaitarana-Vadodara (320km) sections will be awarded. On the systems front, contracts for JNPT-Vadodara (422km) on the Western corridor and Khurja-Kanpur (343 km) and Kanpur-Mughalsarai (393km) sections on the Eastern corridor will be awarded.

Apart from this, metro rail projects have also started gaining significant traction. As part of developing the metro network in Mumbai, the Maharashtra government has approved 3 metro lines—40km underground Dahisar-Charkop-Bandra-Mankhurd Metro II (~INR256bn), 32.5km Colaba-Bandra-SEEPZ underground Metro Line 3 project (~INR231bn) and 32km underground and elevated Wadala-Ghatkopar-Thane-Kasarvadavali Metro project (~INR191bn). Apart from these, work has already commenced on Lucknow Metro. Other metro rail projects which are expected to see project award over the next couple of years include Ahmedabad Metro, Delhi Metro Phase IV, Bengaluru Metro Phase II, Pune Metro and Nagpur Metro.

Financial Outlook

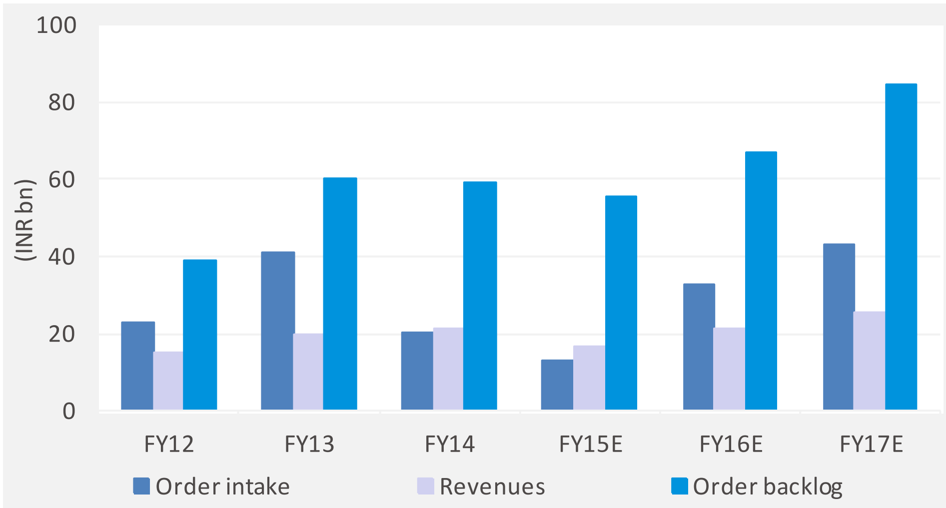
Government boost, spurt in project awards to spur revenue

Order intake revival and resolution of client specific issues to ensure that FY15E revenue decline remains a temporary blip

We expect SPII's order intake to pick up spurred by the government's thrust on improving infrastructure. The company will benefit from the upsurge in road project award from NHAI as well as emerging opportunities in railways and metro. With expectations of an interest rate cut going ahead, orders from the building construction segment too are likely to pick up.

We estimate SPII's revenue to post 6% CAGR between FY14 and FY17. We anticipate the top line to fall in FY15 as a stretched balance sheet and client-specific issues compel the company to cut down execution to prevent further working capital build up. However, these issues are likely to be resolved by FY15 end, post which revenue growth should rebound; we estimate 25% revenue CAGR over FY15-17.

Chart 8: Revenue growth to revive post FY15



Source: Company, Edelweiss research

Soft input prices, working capital improvement to aid profitability

Declining bitumen prices and improvement in working capital cycle to improve PAT margins in future

While SPII's EBITDA margins have held firm, PAT margins have declined as debt build up due to working capital deterioration and equity infusion in BOT projects have burgeoned interest costs. We expect the company's EBITDA margin to remain strong driven by its backward integration policy; decline in bitumen prices (25-30% of road project cost) should also help margin on captive BOT work going ahead.

The resolution of client-specific issues along with improvement in receivables position due to release of milestone-based payments should bring working capital cycle, and consequently overall debt, down. This, along with expected softening of interest rates, should lower the company's interest costs, leading to PAT margin surge.

Chart 9: EBITDA margins to remain strong

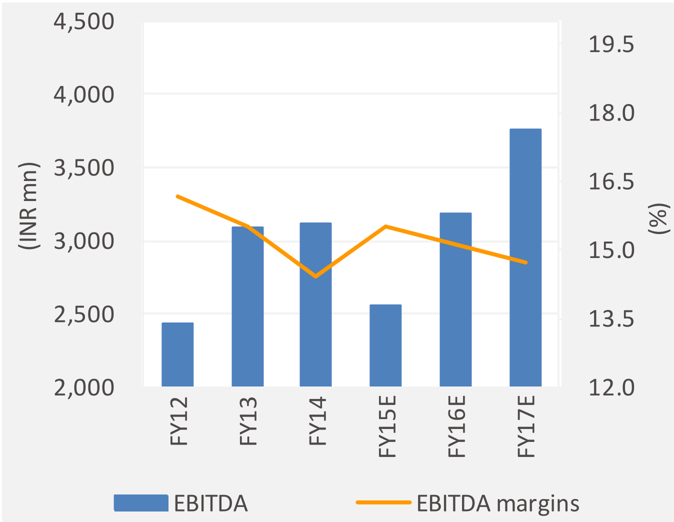
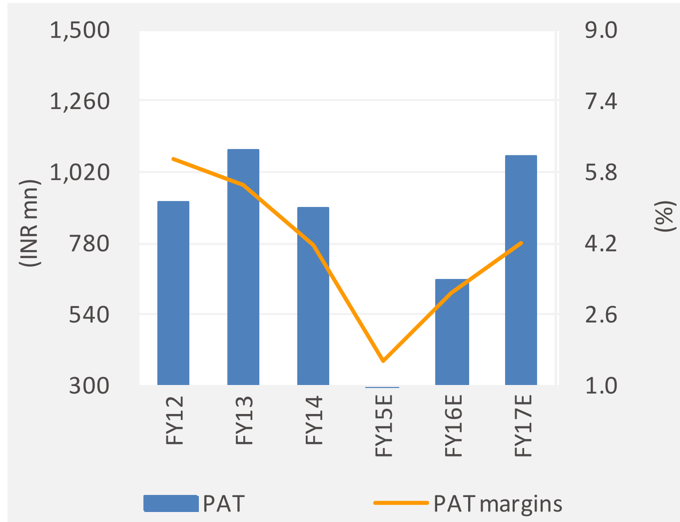


Chart 10: PAT margins to improve going ahead



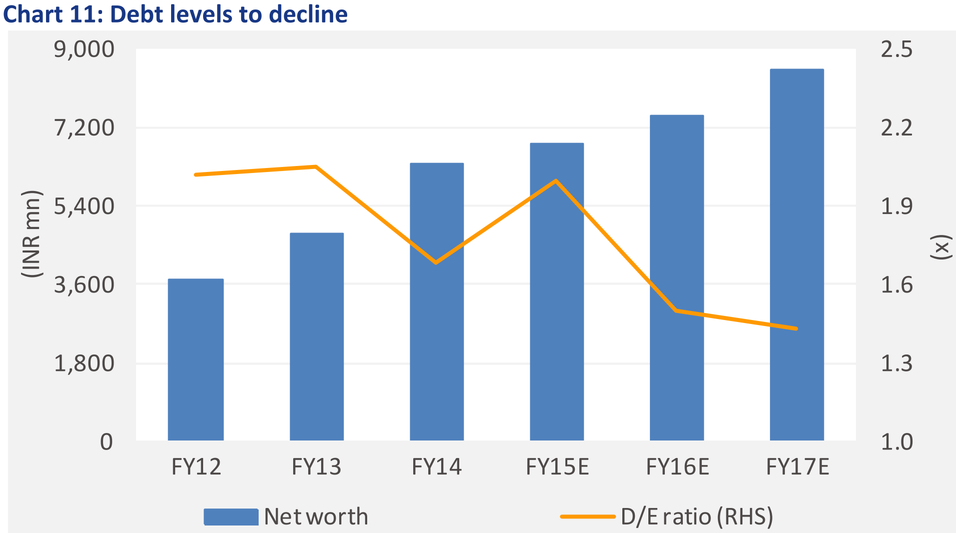
Source: Company, Edelweiss research

Working capital improvement and BOT projects' completion to lead to decline in leverage levels

Dip in debt to lend balance sheet comfort

SPII's leverage has jumped due to capex, working capital needs for the EPC business and equity infusion in BOT projects. Going ahead, with working capital expected to improve and majority of BOT projects getting completed, we expect the company's debt to trend lower. This should alleviate investor concerns about rising D/E levels in the balance sheet.

Chart 11: Debt levels to decline



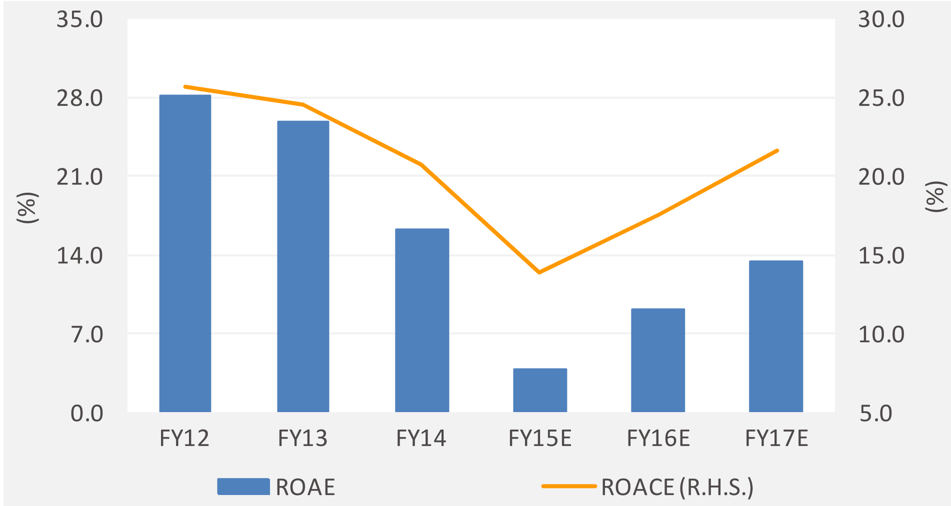
Source: Company, Edelweiss research

Robust margins, tight leash on working capital to boost return ratios

Despite being in growth stage, SPII has posted excellent return ratios due to strong margins and tight control on working capital cycle.

While in FY15 return ratios will decline due to lower profitability, we believe this will only be temporary and be reversed in FY16 and FY17. Improvement in revenue visibility along with higher margin will help the company improve its return ratios.

Chart 12: Return ratios to improve post a dip in FY15



Source: Company, Edelweiss research

Financial Statements (Standalone)

Key assumptions

Year to March	FY14	FY15E	FY16E	FY17E
Macro				
GDP(Y-o-Y %)	4.7	5.4	6.3	7.3
Inflation (Avg)	9.5	6.8	5.5	5.5
Repo rate (exit rate)	8.0	7.8	6.8	6.3
INR/USD	60.5	60.0	59.0	59.0
Company				
Order intake (INR bn)	23	13	33	43
Y-o-Y growth (%)	(37)	(44)	155	30
Book-to-bill ratio (x)	2.7	3.4	3.2	3.3
Order backlog (INR bn)	59	55	67	84
Order backlog growth (%)	(2)	(6)	21	26
Revenue growth (%)	8.6	(23.8)	28.4	21.0
Raw material costs (as % of sales)	35.4	34.8	35.2	35.5
Job work costs (as % of sales)	38.7	38.4	38.4	38.4
Salary costs (as % of sales)	3.4	3.2	3.2	3.3
Other admin costs (as % of sales)	2.6	2.6	2.6	2.6
Depreciation (as % of fixed assets)	8.1	8.5	8.5	8.5
Tax rate (%)	38.3	34.0	34.0	35.0
Dividend per share	1.5	1.4	1.4	1.4
Capex (INR mn)	181.2	105.0	105.0	405.0
Increase in investments (INR mn)	707	500	500	500
Debtor days	124	179	151	141
Inventory days	37	43	33	31
Loans and advances (as % of rev.)	28.3	50.0	35.0	35.0
Creditors days	46	50	50	65
Incremental debt (INR mn)	875	3,000	(2,500)	1,000
Interest rate (%)	12.0	13.8	13.3	12.8

Income statement (INR mn)

Year to March	FY14	FY15E	FY16E	FY17E
Income from operations	21,586	16,442	21,104	25,540
Direct costs	17,172	12,931	16,682	20,266
Employee costs	739	530	680	849
Other expenses	563	429	550	666
Total operating expenses	18,474	13,890	17,913	21,781
EBITDA	3,113	2,552	3,191	3,760
Depreci. and amortisation	365	397	407	430
EBIT	2,748	2,155	2,784	3,329
Interest expenses	1,350	1,855	1,873	1,738
Other income	61	85	79	60
Profit before tax	1,458	385	990	1,651
Provision for tax	558	131	336	578
Core profit	900	254	653	1,073
Profit after tax	900	254	653	1,073
PAT before minority interest	900	254	653	1,073
Adjusted net profit	900	254	653	1,073
Eq. shares outstanding (mn)	20.1	22.1	22.1	22
EPS (INR) basic	44.8	11.5	29.6	48.6
Diluted shares (mn)	20.1	22.1	22.1	22
EPS (INR) fully diluted	44.8	11.5	29.6	48.6
CEPS (INR)	57.0	29.5	48.0	68.0

Common size metrics- as % of net revenues

Year to March	FY14	FY15E	FY16E	FY17E
Operating expenses	85.6	84.5	84.9	85.3
EBITDA margins	14.4	15.5	15.1	14.7
Depreciation	1.7	2.4	1.9	1.7
Interest expenditure	6.3	11.3	8.9	6.8
Other income	0.3	0.5	0.4	0.2
Tax	2.6	0.8	1.6	2.3
EBIT	12.7	13.1	13.2	13.0
Net profit margins	4.2	1.5	3.1	4.2

Annualised growth metrics (%)

Year to March	FY14	FY15E	FY16E	FY17E
Revenues	8.6	(23.8)	28.4	21.0
EBITDA	0.9	(18.0)	25.0	17.8
Net profit	(17.9)	(71.8)	157.3	64.3
EPS	(31.6)	(74.4)	157.3	64.3

Balance Sheet				(INR mn)
As on 31st March	**FY14**	**FY15E**	**FY16E**	**FY17E**
Share capital	201	221	221	221
Preference share capital	25	25	25	25
Reseves and surplus	6,119	6,599	7,215	8,251
Shareholder funds	6,345	6,845	7,461	8,497
Long term borrowings	1,578	4,078	4,078	4,078
Short term borrowings	9,084	9,584	7,084	8,084
Loan funds	10,662	13,662	11,162	12,162
Deferred tax liability/asset	(14.8)	(14.8)	(14.8)	(14.8)
Sources of funds	**16,992**	**20,492**	**18,608**	**20,644**
Tangible assets	2,875	2,579	2,275	2,247
Intangible assets	9	8	5	3
CWIP (incl. intangible)	-	5	10	15
Total net fixed assets	2,884	2,592	2,290	2,265
Non current investments	2,935	3,435	3,935	4,435
Current investments	17	17	17	17
Cash and cash equivalents	1,083	1,852	1,240	1,113
Inventories	1,808	1,264	1,785	1,697
Sundry debtors	7,796	8,368	9,141	10,650
Loans & advances	6,100	8,221	7,386	8,939
Other assets	2	2	2	3
Total current assets (ex cash)	15,705	17,854	18,314	21,288
Trade payable	2,115	1,417	3,154	4,064
Other curr. lia. and provisions	3,517	3,843	4,035	4,411
Total current liabilities & prov.	5,631	5,259	7,189	8,475
Net current assets (ex cash)	10,073	12,595	11,125	12,813
Application of funds	**16,992**	**20,492**	**18,608**	**20,644**
Book value per share (BV)	316	310	338	385

Cash flow statement				(INR mn)
Year to March	**FY14**	**FY15E**	**FY16E**	**FY17E**
Net profit	900	254	653	1,073
Add: Depreciation	365	397	407	430
Add: Deferred tax	(119)	0	0	0
Gross cash flow	1,146	651	1,060	1,503
Less: Changes in W. C.	2,024	2,522	(1,470)	1,688
Operating cash flow	(878)	(1,871)	2,530	(184)
Less: Capex	181	105	105	405
Free cash flow	**(1,059)**	**(1,976)**	**2,425**	**(589)**

Cash flow metrices

Year to March	FY14	FY15E	FY16E	FY17E
Operating cash flow	(878)	(1,871)	2,530	(184)
Financing cash flow	1,587	3,283	(2,500)	1,000
Investing cash flow	(889)	(605)	(605)	(905)
Net cash flow	(180)	806	(575)	(89)
Capex	(181)	(105)	(105)	(405)
Dividends paid	(35)	(36)	(36)	(36)
Sh./Warrents issuance/(buyback)	712	283	0	0

Ratios

Year to March	FY14	FY15E	FY16E	FY17E
ROAE (%)	16.2	3.8	9.1	13.5
ROACE (%)	20.8	13.9	17.6	21.6
Current ratio	3.0	3.7	2.7	2.6
Debtors (days)	124	179	151	141
Inventory days	37	43	33	31
Interest coverage ratio (x)	2.0	1.2	1.5	1.9
Avg. working capital turnover (x)	2.1	1.3	1.6	1.9
Average capital turnover ratio (x)	1.6	1.1	1.3	1.7
Net debt/ Equity	1.5	1.7	1.3	1.3
Debt/Equity	1.7	2.0	1.5	1.4
Creditor days	46	50	50	65
Cash conversion cycle	116	173	135	108
Debt/EBITDA	3.4	5.4	3.5	3.2
Adjusted debt/Equity	1.7	2.0	1.5	1.4

Operating ratios

Year to March	FY14	FY15E	FY16E	FY17E
Total asset turnover	1.4	0.9	1.1	1.3
Fixed assets t/o (x)	7.3	6.0	8.7	11.3
Equity turnover	3.9	2.5	3.0	3.2

Valuation parameters

Year to March	FY14	FY15E	FY16E	FY17E
Diluted EPS (INR)	44.8	11.5	29.6	48.6
Y-o-Y growth (%)	*(31.6)*	*(74.4)*	*157.3*	*64.3*
CEPS (INR)	57.0	29.5	48.0	68.0
Diluted P/E (x)	5.9	23.2	9.0	5.5
Price/BV(x)	0.8	0.9	0.8	0.7
EV/Sales (x)	0.7	1.1	0.7	0.7
EV/EBITDA (x)	4.8	6.9	4.9	4.5
Dividend yield	0.6	0.5	0.5	0.5

Additional Data

Directors Data

Mr. B. H. Sharma	Executive Chairman	Mr. Vikram B. Sharma	Managing Director
Mr. Vikas B. Sharma	Whole Time Director	Mr. Dakshendra Agrawal	Non-Executive Director
Mr. V. P. Singh	Independent Director	Mr. Vinod Agarwala	Independent Director
Mr. Mukul Agrawal	Independent Director	Mr. Pramod Kasat	Independent Director

Auditors - Walker Chandiok & Co LLP, Shah & Kathariya

**as per last annual report*

Holding – Top 9

	Perc. Holding		Perc. Holding
Kitara Piin 1101	8.21	Sudarshan Securities Pvt Ltd	4.13
Kotak Mahindra (International) Ltd	3.56	Gyanmay Investment Advisors LLP	2.99
Aviva Life Insurance	2.36	SBI Asset Management	2.26
IDBI Federal Life Insurance	1.33	UTI Asset Management	1.28
Max Life Insurance	1.09		

**as per last available data*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
No Data Available				

**in last one year*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
14-Jan-14	BHS Housing Private Limited	B	1350000
10-Jun-14	Bhawanishankar Sharma	B	250000

**in last one year*

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Coverage group(s) of stocks by primary analyst(s): Infrastructure - Construction

Consolidated Construction Co., Hindustan Construction Co., IL&FS Transportation Networks, IVRCL Infra, J Kumar Infraprojects, Nagarjuna Construction Co, Ramky Infrastructure, Sadbhav Engineering, Simplex Infrastructures Ltd

Recent Research

Date	Company	Title	Price (INR)	Recos
25-Nov-14	**Construction**	Dedicated Freight Corridor: Back on track; *Sector Update*		
17-Nov-14	**Simplex Infra.**	Margin improvement negated by high interest costs; *Result Update*	312	Buy
17-Nov-14	**IVRCL Infra.**	Relief in sight; *Result Update*	18	Hold

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

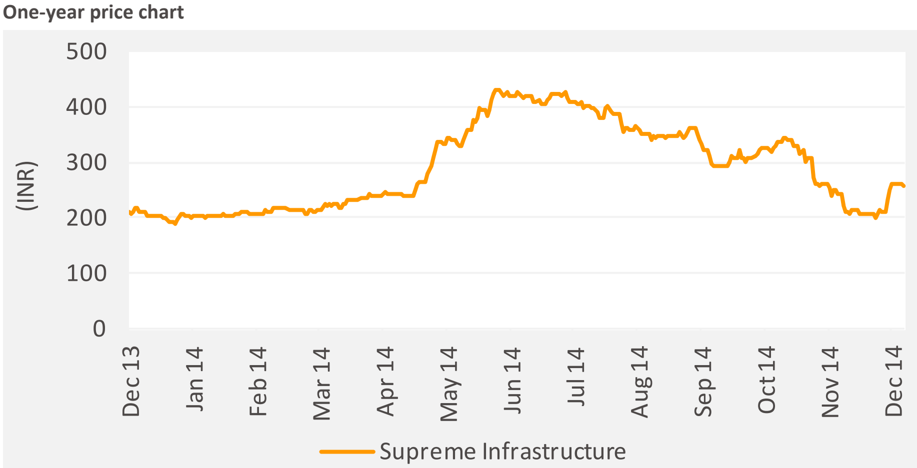
	Buy	Hold	Reduce	Total
Rating Distribution* * 1 stocks under review	150	46	10	207

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	143	58	6

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One-year price chart



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