Dilip Buildcon Ltd

Much ado about nothing

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In last few days Dilip Buildcon stock has corrected by more than 25%. There have been some concerns raised by investors. Through this note, we have tried to address some of these concerns.

Concern 1: The Company pays very little Tax.

Road construction companies are entitled to get tax benefits under 80-IA for all projects awarded till April, 2017. For this period companies were required to pay only MAT and could claim MAT credit subsequently.

DBL is paying the differential tax between the full tax liabilities adjusted for the MAT credit. As on date DBL has ~INR 400 cr tax credit in the books which will entitle it to pay lower taxes for the coming few years and subsequent to this DBL will become a full taxpaying company.

The tax provision of last few years for all road construction companies was nil due to Sec 80-IA benefit and the total MAT paid will become the MAT credit entitlement. This will result in low charging of Tax expense in books of accounts of all road companies for next two-three years.

A comparative analysis of peers suggest that all the road construction companies are low tax payers in the last three four years.

Comparative Tax payment and Net profit of road construction companies

INR Cr.		FY15	FY16	FY17	FY18
	PBT	72	130	163	268
KNR Construction	Tax Expenses	-1	-31	6	-4
	PAT	73	161	157	272
	PBT	146	165	190	216
Sadbhav Engineering	Tax Expenses	32	33	2	-4
	PAT	114	132	188	221
	PBT	96	200	194	234
PNC Infratech	Tax Expenses	47	-42	-16	-17
	PAT	49	243	210	251
	PBT	195	250	360	664
Dilip Buildcon	Tax Expenses	49	29	-1	43
	PAT	146	221	361	620

Source: Company Data, Edelweiss Investment Research

Bloomberg:	DBL:IN
52-week range (INR):	1,247.50 / 405.95
Share in issue (cr):	13.7
M cap (INR cr):	11,200
Avg. Daily Vol. BSE/NSE :('000):	14
Promoter Holding (%)	75.63

Date: 1st June 2018

Concern 2: DBL's Inventory cycle is higher than peers.

Majority of road constructors in India subcontract the construction work including mining and earthwork jobs. This leads to very little aggregate inventory on the books of the construction companies as it is resident on the subcontractors books. This gives a pretence of light working capital business. However in cases like DBL, which has no subcontracting dependence, the inventory resides on the balance sheet giving it a bloated look.

Our analysis of FY15, FY16, FY17 data indicates that the incremental working capital requirement for higher inventory and the resultant higher interest cost is majorly compensated by early completion bonus.

Early completion bonus to suffice incremental interest cost to fund higher inventory

INR Cr.	FY16	FY17	FY18
DBL Inventory days of aggregates	141	119	95
Industry average Inventory days	50	50	50
Extra inventory days	91	69	45
Revenue without Bonus	4085	4988	7646
Extra inventory compared to industry standard	1020	945	953
Debt to finance Inventory	1020	945	953
Extra interest cost @12%	**122**	**113**	**114**
Early completion bonus	**60**	**106**	**95**

Source: Company Data, Edelweiss Investment Research

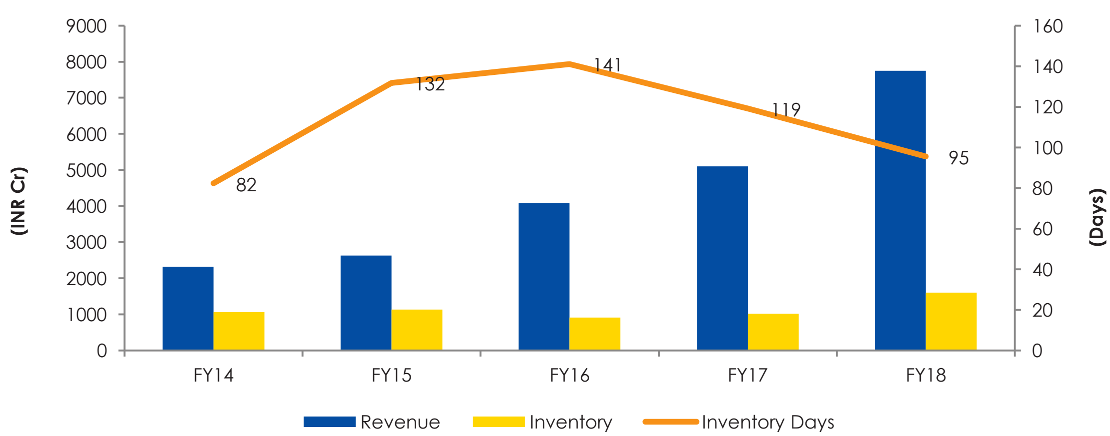
As the business scales up, the new projects in proportion to existing revenues normalise and hence built up inventory has continue to come down. This coupled with overall rationalisation efforts by the company is leading to lowering of the inventory cycle in the last 3 years.

Revenue growth higher than inventory growth

INR Cr.	FY14	FY15	FY16	FY17	FY18
Revenue	**2316**	**2624**	**4085**	**5098**	**7746**
Absolute Growth		*308*	*1461*	*1012*	*2648*
Inventory	**522**	**948**	**1579**	**1664**	**2026**
Absolute Growth		*426*	*632*	*85*	*362*

Source: Company Data, Edelweiss Investment Research

Inventory cycle improved consistently over last three years



Source: Company Data, Edelweiss Investment Research

Concern 3: DBL's Receivable cycle is very high

DBL was largely undertaking sub-contracting jobs prior to FY12. During the tough phase of FY12-13, the company's receivables cycle was affected as private players started delaying payments. Receivable days have jumped to 176 days in FY15 from 84 in FY12. A large chunk got stuck with 2 players—Pan Essel and Topworth Infra—during the period.

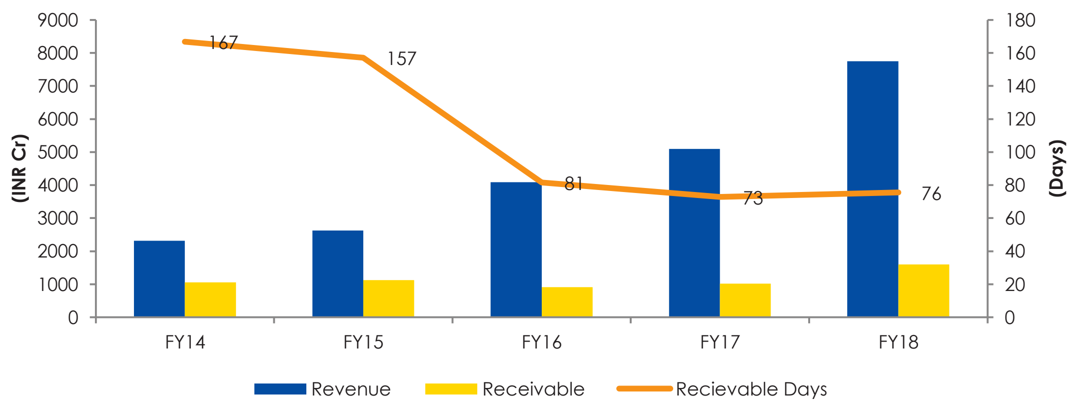
However, with improvement in the economic cycle and DBL's initiatives to collect outstanding dues, the situation has improved significantly post FY15. After peaking at 176 days in FY15, the company's debtor cycle has improved significantly to 76 days in FY18.

Revenue growth is higher than receivable growth

INR Cr	FY14	FY15	FY16	FY17	FY18
Revenue	**2316**	**2624**	**4085**	**5098**	**7746**
Absolute Growth		*308*	*1461*	*1012*	*2648*
Inventory	**1058**	**1129**	**912**	**1017**	**1604**
Absolute Growth		*71*	*-217*	*105*	*587*

Source: Company Data, Edelweiss Investment Research

Receivable days improved significantly



Source: Company Data, Edelweiss Investment Research

Concern 4: DBL's Cash flow generation is not strong

DBL's operating cash flow has improved significantly over last few years and operating profit's conversion to cash flow is the second highest in the industry after KNR and cash conversion is also most consistent. In FY18 cash conversion has deteriorated as compared to the previous two financial years as the company has added HAM projects in the recent past and initial investments requirements dented the performance.

DBL's EBITDA to Cash flow conversion issecond highest among peers and improving

		FY14	FY15	FY16	FY17	FY18	Cumulative FY14-18
Dilip Buildcon	CFO	52	229	426	653	518	1878
	EBITDA	470	566	799	992	1403	4230
	CFO as % of EBITDA	11%	40%	53%	66%	37%	44%
Sadbhav Eng	CFO	463	-36	162	-50	37	576
	EBITDA	211	302	315	356	415	1599
	CFO as % of EBITDA	219%	-12%	51%	-14%	9%	36%
PNC Infra	CFO	165	63	91	-9	10	321
	EBITDA	140	165	266	221	319	1111
	CFO as % of EBITDA	118%	38%	34%	-4%	3%	29%

Source: Company Data, Edelweiss Investment Research

Concern 5: Debt levels have increased in FY18

Even after strong cash flow generation from operation and receipt from asset sales, DBL's debt levels have increased in FY18 to INR 2,770 cr. The company made INR 518 cr of Cash flow from operation and got INR 571 cr from asset sales in FY18. However, DBL did a capex of INR 440 cr, which is related to mining projetcs and flyover projects, invested INR 713 cr in under-construction HAM projects and interest outgo for the year was INR 464 cr. This has resulted in a cash-flow mismatch and hence increase in debt levels.

Debt levels increased due to high capex and investments in HAM

INR Cr	FY18E	FY18E
Cash Inflow		
Cash flow from operation	518	
Receipt from Shrem Group	571	
Total Inflow		**1,089**
Cash Outflow		
Investment in Fixed Assets	444	
Equity investment in SPV	365	
Subordinate Debt to SPV	348	
Interest Expenses	464	
Total Outflow		**1,621**

Source: Company Data, Edelweiss Investment Research

However, due to strong growth in business and profitablity leverage ratios improved significantly in FY18 and that made us comfortable about the healthy growth the compnay is chasing.

DBL's leverage situtation improved significantly

	FY14	FY15	FY16	FY17	FY18
Overall Debt (INR Cr)	994	1957	2206	2206	2771
Gross D/E Ratio (x)	1.36	2.33	2.08	1.19	1.14
Gross Debt / EBITDA Ratio (x)	2.11	3.46	2.76	2.22	1.98
Interest Coverage Ratio (x)	3.03	2.19	2.10	2.38	3.02

Source: Company Data, Edelweiss Investment Research

Concern 6: Gross block of DBL is way higher than its peers

DBL with its strong execution focus is maintaining a large and high quality gross block majorly purchased from global top brands including Caterpillar and Volvo. The company maintains an inventory of ~10,000 equipments and trucks. Among the competitors, only KNR is a close comparison. We have compared the average price of machinery and Fixed asset turnover of both the companies to check whether the gross block is overstated and the result is satisfactory.

DBL and KNR's Gross block metrics are comparable

	KNR	Dilip
Plant & Machinery Gross Block (INR Cr)	760	2700
Equipment Bank (no. of units)	1812	10000
Average price of Machinery (INR)	4,194,260	2,700,000
Revenue in FY18	1541	7745
Fixed Asset Turnover (X)	2.03	2.87

Source: Company Data, Edelweiss Investment Research

Most importantly, DBL's Free Cash Flow (FCF) as percentage of revenue improved sginificantly over the recent three years, which explains judicial capacity expansion and better utilization of assets.

DBL's Free Cash Flow to Revenue Ratio improved significantly in FY18

	FY14	FY15	FY16	FY17	FY18
Cash flow from operation	473	575	836	1034	1535
- Interest	124	194	337	417	434
- Capex	169	667	411	485	421
Free Cash flow from Operation	**179**	**-286**	**88**	**132**	**679**
Revenue	**2316**	**2624**	**4085**	**5098**	**7746**
FCF as % of Revenue	*8%*	*-11%*	*2%*	*3%*	*9%*

Source: Company Data, Edelweiss Investment Research

Concern 7: There is a large intangible asset on the Consolidated Balnce sheet which for a construction company makes no sense.

In DBL's consolidated balance sheet, We have 'Capital work in progress' and 'intangible assets under development' which have grown significantly. These have raised doubts in investros' mind.

DBL's Consolidated Fixed Assets imcreased significantly

INR Cr.	FY17	FY18
Property, Plant & Equipment	1674	1842
Capital Work in Progress	106	848
Other Intangible Assets	202	287
Intangible Assets Under Development	354	774
Total	**3078**	**3964**

Source: Company Data, Edelweiss Investment Research

Intangible assets on the balance sheet of the construction company come if the companies own BOT or HAM projects. In case of DBL value of "intangible assets under developemt" of INR 774 cr points to the annuity value of the HAM projects that are under construction and are likely to go up as more HAM projects get bidded for and executed. Similarly " Other intangible assets" of INR 201 cr is the value of the BOT/HAM toll collections/annuity for the 24 projects which have been sold to Shrem Group. Which will go away once the transaction of the asset sales will complete in FY19. Again, Capital work in progress is basically capitalization of HAM construction cost in the books of SPVs which is mandated by the new accounting stndards.

Concern 7: Asset deal with Shrem Group- Why a INR15 cr impairement reported

DBL signed an acquisition cum investment agreement for all 14 completed, 4 under-construction and 6 HAM projects to Shrem group on August, 2017. DBL has already invested INR 1,166 cr in those 24 assets as on FY18. Going forward, DBL will not do any incremental investment in those projects.

Shrem has paid to DBL INR 571 cr till FY18 towards the said transaction and will further pay INR 610 cr in FY19. Apart from this, Shrem has directly invested Rs. 32 cr in Tuljapur Ausa HAM projects and will also invest ~INR 390 cr directly into 6 under construction HAM projects towards promoters' contribution in FY19. All the outstanding and future debt in all 24 assets shall be transferred to Shrem Group after FY19.

The portfolio of 24 assets has been sold at 1.05 x book value and there will be profit on the portfolio when it is eventually sold completely. However Individual projects have different sale values with respect to their book value and different projects are being sold at different times and there will be profit / loss which will eventually offset each other.

The impairment of INR 15 cr has come now in Q4FY18 due lower than book value deal in one specific project and later in FY19 this charge will be reversed.

Deal structure with Shrem Group

Amount already invested by DBL until FY18		**1,166**
Amount already paid by Shrem in FY18	571	
Amount to be paid by Shrem in FY19	610	
Overall recovery from Shrem Group (A)		1,181
Shrem's direct investment in HAM project in FY18 (B)		32
Shrem's further investment in HAM in FY19 (C)		390
Total Deal Value (A+B+C)		**1,603**

Source: Company Data, Edelweiss Investment Research

Concern 8: Auditors raised red flags and risigned

DBL's auditor Mukund M. Chitale & Co. is a reputed audit firm and the managing partner Mr. Mukund Chitale also serves on the Boards of Larsen & Toubro Ltd., Larsen & Toubro Infotech Ltd., L&T General Insurance Company ASREC (India) Ltd., Shriram Transport Finance Co. Ltd., ITZ Cash Card Ltd., ONGC Petro Additions Ltd., ONGC Petrochemicals Ltd., ONCG Mangalore Petrochemicals Ltd., and Atul Ltd. He is the Chairman of Principal PNB Asset Management Company Pvt. Ltd., Governing Council Member of Banking Codes and Standards Board of India and Chairman of The Ethics Committee of The Stock Exchange, Mumbai. He is also a member of the Advisory Board on Bank, Commercial and Financial Frauds, the Group for Amalgamation of Urban Co-operative Banks and the Board of Supervision of NABARD.

As filed on exchanges by the company, the auditor has not raised any red flags around the standalone and consolidated books of DBL and also not shown any interest to resign from the services. Our channel checks also indicated the same.

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