

## **National Building Construction Corporation (NBCC)**

Current Market Price: Rs. 36.6 (closing price as on 31/1/2023)

Market Capitalization: Rs. 6,597 crores

<https://www.screener.in/company/NBCC/consolidated/#top> (Financials)

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### **Investment Summary**

- **Business Model:** Asset-light business model and negative working capital cycle resulting in a debt-free balance sheet with sizable “cash float.” Most orders won on a ‘nomination basis.’
- **Redevelopment of Government Properties:** Large projects, higher operating margins and rising share in order book.
- **Revenue Visibility:** Consolidated order book of Rs. 55,000 crores, with an order book-to-revenue ratio of 6.5x.
- **Major Execution Headwinds Subsiding:** Improvement has started to show up in the recent results; continued improvement in execution and reversion-to-mean in operating margins could lead to doubling/tripling of earnings in the next 3-4 years.
- **Valuation:** At current prices, stock is available at an attractive 0.8x revenue. Stock peaked at 3x revenue in the last cycle, leaving sufficient scope for re-rating from current valuations.

### **Introduction**

NBCC is a Central Government Enterprise under the Ministry of Urban Development, mainly focused on Project Management Consultancy (constituting 91% of FY 22 revenues), with EPC and Real Estate verticals accounting for the balance. The company acts as a “coordinating agency” for various government agencies and ministries. Under this arrangement, projects are awarded to NBCC on a nomination basis and the company assigns the projects to sub-contractors for execution while supervising project completion.

### **Key Business Segments**

**Conventional PMC Segment:** In the conventional Project Management Consultancy (PMC) business model, NBCC acts as the nodal contractor for most government building projects and outsources the construction of the project to sub-contractors.

This is an asset-light business model - the Ministry gives NBCC a sizable cash advance of the value of the project and NBCC pays the sub-contractor on a milestone basis. NBCC therefore enjoys the cash "float" until the project is completed, earning interest on it.

**Redevelopment Segment:** Recently, redevelopment projects based on the self-financing business-model has become a new focus area. Essentially NBCC redevelops (again playing the role of a Project Management Consultant and outsourcing the construction to a sub-contractor) government properties like housing colonies by demolishing and reconstructing buildings on the same land in such a way that it significantly increases the Floor Area Ratio (FAR) – thus improving the utilization of land.

Instead of cash payment, the company receives a portion of the built-up commercial/residential space (which shows up as inventory on the balance sheet) in each of these projects, which it can either lease or monetize. The redeveloped apartments go to the government at no cost; the commercial space goes to NBCC and the difference is NBCC’s profit margin when it monetizes/leases out the commercial space. This model ensures there’s no funding support required from the government.

NBCC currently has Rs. 30,000 crores of “redevelopment projects” in its orderbook, including 3 housing colonies in Delhi (Sarojini Nagar, Nauroji Nagar and Netaji Nagar). These projects are much larger than NBCC’s earlier redevelopment projects in Delhi and with higher operating margins than the conventional PMC vertical.

## So Why Isn't the Market Interested?

NBCC has been hit by various headwinds since 2019 – delay in execution of large projects (Sarojini Nagar and Netaji Nagar), pending approvals and litigation, Covid-19, lack of labour availability, lack of funds for the Amrapali project. Further, weak real estate scenario meant that NBCC couldn't monetize the commercial real estate in the self-revenue generating projects, constraining execution.

After many quarters, the large projects (Amrapali/Netaji Nagar/Sarojini Nagar/Nauroji Nagar etc.) which have been an overhang on the stock are seeing a meaningful pick-up in execution.

- Funding arrangements are in place for the stuck Amrapali project, which Government had sent NBCC to complete in 2019. NBCC has been able to complete and sell more flats in recent months – 3400 flats had been completed up to August 2022 and 6000 by October 2022.
- The turning of the Real Estate cycle is aiding monetization of NBCC's Real Estate inventory and unlocking of funds - Commercial Real Estate inventory worth Rs. 1000 crores sold in Nauroji Nagar in Q2, compared to Rs. 340 crores in Q1. Likewise, the company has also started selling commercial Real Estate inventory in the Sarojini Nagar project.

## Valuation and Outlook

In the last cycle, revenue and earnings nearly doubled and the stock peaked at a valuation multiple of 3.4x revenue, significantly re-rating from 0.4x revenue when it got listed in April 2012. NBCC went from being virtually unknown to wildly popular, giving a 20x return.

Currently, the stock is trading at 0.8x revenue. Considering revenue, operating margins and valuation multiples are depressed, the downside looks limited at current prices. Improving execution will aid revenue growth, reversion-to-mean in operating margins and can lead to significant re-rating.

## Key Risks

- Being a PSU, NBCC was asked to coordinate the construction of the stalled projects of the Amrapali group, where the government had to step in and do something for the hapless home-buyers. Private players mostly stay away from bidding for these projects. Lack of funding support from the government becomes a real challenge. Government sending out NBCC to take over more such projects in the future would be an overhang on the stock and negatively impact valuation multiples.
- While the commercial real estate market is reviving, any slowdown will reduce monetization of real estate in the redevelopment projects, thereby constraining execution.
- Contingent Liabilities worth Rs. 3,391 crores. The top 3 constituents are – Rs. 1524 crores for “Claims against the Group not acknowledged as debts,” Rs. 630 crores for “Bank Guarantees for performance, Earnest Money Deposits and Security Deposits” and Rs. 542 crores for “Value Added Tax Including Interest & Penalty as per demand notice order.” The first and third constituents are likely a result of certain stuck projects, so better execution and handing over the completed projects to these entities should protect NBCC from these risks. The second is required in the normal course of business in this particular industry and hence is not really a concern.

## Miscellaneous

- NBCC is a lumpy business and is subject to vagaries (budgetary allocations made to various ministries, the state of the real estate market, execution delays). Hence, overlooking volatility in quarterly results and focusing on the overall trajectory would be important.
- The Indian Armed Forces (the largest landowner in the country), Indian Railways and PSUs have large parcels of unutilized/poorly utilized land across the country. Their redevelopment ensures availability of a larger housing pool on the same piece of land, without the original land owner having to spend money. At a time where the government is cash starved, such a model is ideal. Further, private real estate developers cannot participate and NBCC is the only PSU with the required expertise.
- The company is also involved in the modernization & redevelopment of Railway Stations on a self-financing basis, which can be an important business vertical in the future.