

Road runner

Sadbhav Engineering is exploiting the BOT road business well, apart from trying its luck in mining

Deepak Chitroda

As you walk into Vishnubhai Patel's imposing office it's difficult to believe that the 67-year-old began his sojourn as a small-time road sub-contractor and now runs a Rs 800 crore empire from Ahmedabad. If Patel has made his riches, so have the company's investors. Investors, who have stuck with company since 2006 when it went public, have seen their investments gain more than four times. Despite the massive meltdown in the market, Sadbhav's share -- which was priced at Rs 185 -- is now quoting at Rs 790.

While Sadbhav Engineering's business primarily involves constructing roads/highways and canals, what is interesting is the way Patel scaled up his business by capitalising on the government's rising spend on infrastructure, especially for road and irrigation.

Several mid-sized companies, which were earlier sub-contractors of larger road operators, have now entered the sector on their own. Early entrants in built-operate-transfer (BOT) road projects were typically established companies such as Larsen & Toubro and Gammon. But as the economy grew, these top-notch construction players moved on to bigger infrastructure proj-

ects and started cherry-picking road project, thus leaving the field open to smaller companies such as Sadbhav Engineering, Era Constructions and Unity Infrastructure.

In 1993, Sadbhav made its debut in the construction segment with the contract for strengthening and widening of Sambalpur-Rourkela Road from Larsen & Toubro. Says Patel, "After working as a sub-contractor for L&T's road project, we realised this was going to be a big business in the years to come." Thereafter, the company successfully completed eight other road projects -- including the widening of the two-lane of NH-8A from Samakhiali to Bhachau in Gujarat.

After executing over 26 projects in 16 years, Sadbhav went public in 2006, "It was imperative for us to go public as we realized that we needed more funds if we were to emerge as a key player," adds Patel.

Today, apart from beefing up its core BOT road business Sadbhav wants to hit paydirt in mining. The strategy, being put in place by Nitin Patel, the company's executive director, entails Sadbhav Engineering being positioned as a construction company, while its newly formed subsidiaries, Sadbhav Infrastructure and Sadbhav Natural Resources, will steer the BOT and mining businesses respectively. "We have

created a structure that will ensure that Sadbhav Engineering remains a predominant construction company, while the developmental, revenue sharing and fund raising will be done by the subsidiary concerned," says Nitin Patel.

Though Patel is unwilling to comment, market sources suggest that the company has signed a term sheet with a private equity investor for sale of approximately 14 per cent stake in Sadbhav Infrastructure for Rs 100 crore. This would indicate a valuation of Rs 700 crore for the subsidiary, around 70 per cent of its parent's current market capitalisation.

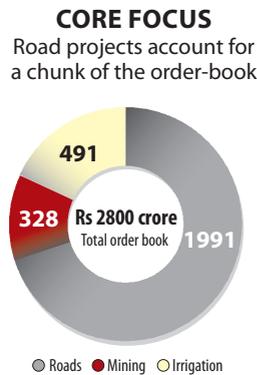
Widening the frame

Toll-based projects have emerged as a lucrative opportunity for developers and Sadbhav has been aggressively targeting such projects to enhance its profitability. While Sadbhav has four toll-based BOT projects that are highly profitable, it also has a suitable mix of government contracts that ensure steady revenues. Unlike BOT projects, where the developer has to design, formulate, raise funds and execute the project, in government contracts, the developer's role is limited only to the execution part.

Usually, since risks are higher in BOT projects, most small companies tend to partner larger peers or financial institutions to limit their funding and execution risks. Besides, large-sized projects often require higher net worth that can be achieved only through tie-ups with bigger players. Sadbhav Engineering too has put the model to use and quite well. It has Gammon, Patel Infra, PBA Infra and also Srei Infrastructure as its partners in BOT projects.

Of the four BOT projects that Sadbhav holds in consortium with other players, three are toll-based and one is annuity type (See table). Sadbhav has committed an investment of Rs 144 crore in the four projects, of which it has already invested Rs 105 crore. The company is now in the process of transferring the four projects to subsidiary Sadbhav Infrastructure. Nitin Patel, without detailing the revenues expected from the BOT projects, says he expects the company to have a return on equity of around 25-30 per cent.

For now, the order-book looks pretty robust at Rs 2,800 crore, 65 per cent of which is accounted by road projects. Currently, roads and highways account



PATH BREAKING?

BOT projects	Type	Size (Rs cr)	Joint venture partner	Sadbhav's share (%)
Mumbai- Nashik Expressway	Toll	753	Gammon, Billimoria	20
Sardar Patel Ring Road (Ahmedabad)	Toll	515	Patel Infra	80
Aurangabad Jalna Road Project	Toll	289	PBA Infra	51
NH-7, MP North-South Corridor	Annuity	589	Srei Infra	51





Vishnubhai Patel, CMD, is fancying his chances in mining following the buyout of the Hong Kong-based Ocean Bright, which holds prospecting licences in Mozambique

SANJIT KUNDU

for more than 65 per cent of the company's revenues. Besides, Sadbhav has also submitted five bids worth Rs 2,200 crore, of which three are government contracts and two are BOT projects. "We have also pre-qualified for tenders worth Rs 9600 crore," points out Nitin Patel.

Despite noises about project delays amid an economic slowdown and political uncertainty ahead of elections, if there is one thing that inspires confidence in Sadbhav, it's the company's track record in execution. "We have executed 36 projects, and all are completed on or before time, which is greatly appreciated by our clients," boasts the executive director.

Rupa Shah, who tracks the stock at Finquest, points out: "A decent number of cash contract projects are funded by the World Bank which carries less risk of default, SEL has approximately 25 per cent of its order book in cash road contact and 45 per cent in road BOTs."

Beyond roads, Sadbhav has a fair deal of experience in irrigation projects. After bagging a chunk of orders from the Sardar Sarovar Nigam project in Gujarat, the company has branched out to other states such as Andhra Pradesh, Karnataka and Rajasthan. SEL recently won a Rs 216 crore order in Andhra Pradesh. Sadbhav has to its credit the world's largest concrete lined Narma-

THE WAY AHEAD

BOT projects to drive topline in coming years

Rs cr	FY07	FY08e	FY09e	FY10e
Revenues	491.8	858.0	1275.9	1472.8
Net profit	29.5	51.1	82.3	95.3
EBITDA margin (%)	11.25	11.50	12.05	12.03

da Main Canal having a capacity of 40,000 cusecs.

Gold mine?

Mining, which accounts for 12 per cent of Sadbhav's revenues, is the trump card that Sadbhav hopes will catapult the company into the big league. Though Sadbhav's expertise in mining is limited to excavation operations for companies such as GHCL, GMDC, GIPCL, it has set its sight on becoming a full fledged mining company.

Says Vishnubhai, "After three years of rigorous scouting, we identified a company with operations in the Mozambique." The company, on June 9, through its subsidiary, Sadbhav Natural Resources, picked up 74 per cent in Ocean Bright Corporation (OBCL) of Hong Kong for \$25 million.

OBCL holds 100 per cent stake in rights and licences for prospecting iron ore & copper, lime stone, and coal in Mozambique. All above concession areas have been carefully selected and are based on reports and studies con-

ducted by World Bank in Mozambique. Sadbhav has roped in Holtec Consulting, a consultant from India, to conduct a feasibility study for limestone deposits. "The report is expected by September, while production should start from FY12," says Nitin Patel. The company is looking at supplying the limestone to cement companies. The mines also enjoy a locational advantage: the closest port, Nacala, is just 6 kms away. Simultaneously, feasibility study for coal mining is expected by the year end and Sadbhav hopes to start mining operations by April 2009.

The road ahead

Financially, SEL has managed a decent performance. For the year ended March 2008, revenues surged past Rs 850 crore, a growth of 70 per cent, while net profit too was over Rs 50 crore. The overall EBITDA margin for the fiscal was similar to last year's 11.25 per cent.

The stock has declined more than 41 per cent since its 52-week high of Rs 1,600 in January 2008. At its current market price, Sadbhav is trading at 12.1x FY09 earnings and 10.5x its FY10 earnings. Though meaningful revenues from the mining business are expected only after a couple of years, investors – bullish on the domestic infrastructure story – can enter the stock at current levels. ■