APR Constructions Limited

CRISIL IPO Grade 2/5 (Below Average)

August 03, 2011

Grading summary

CRISIL has assigned a CRISIL IPO Grade **2/5** (pronounced "two on five") to the proposed initial public offer (IPO) of APR Constructions Ltd (APR). This grade indicates that the fundamentals of the IPO are **below average** relative to the other listed equity securities in India. However, this grade is not an opinion on whether the issue price is appropriate in relation to the issue fundamentals. The grade is not a recommendation to buy, sell or hold the graded instrument, or a comment on the graded instrument's future market price or its suitability for a particular investor.

The assigned grade reflects the company's strong order book position of Rs 14.2 bn as of February 2011, amounting to 5x FY10 revenues. The grade also factors in the construction opportunities that will arise with the government's thrust on irrigation projects, a segment which comprises 85% of APR's order book. APR's foray into the high-margin railways segment (13% of order book) also bodes well for revenues and profits, since tendering in railways is expected to be robust.

The grade is moderated by the fact that despite a long-standing presence in construction, APR has remained a mid-sized player. Further, 66% of APR's overall irrigation projects are concentrated in Andhra Pradesh and most of these projects have been progressing slowly because of delays in land acquisition and environmental clearances. Significant delays in payment are also stretching the company's working capital. While the company is foraying into the road construction segment given its good growth prospects, we believe bagging orders and successfully executing them in this highly competitive segment will be critical. Moreover, APR, although professionally run at present, has not grown in line with other construction companies due to limited focus by the promoter.

APR's financial performance in the past three years has been driven by strong growth in order inflows. Although the irrigation segment comprises a large portion of the order book, railways registered higher revenue growth due to comparatively faster execution. APR's operating revenue has grown at 27.4% CAGR over FY07-10 with EBITDA margin and adjusted PAT margin averaging 13.2% and 6.2%, respectively. APR's FY10 net profit was Rs 152 mn and RoE was 27.0%.

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About the company

Incorporated as a partnership firm in the name of A. Prabhakar Reddy & Co. in 1983, APR Constructions Ltd was later converted into a public limited company in 2004. APR is a mid-sized construction player, focusing mainly on irrigation and railway projects. As of February 2011, it had an order book of Rs 14.2 bn with irrigation projects contributing to 85.1% of the order book.

Issue details

Shares offered to public	Not available at the time of grading
As per cent of post issue equity	Not available at the time of grading
Object of the issue	• Finance the procurement of construction equipment • Meet long-term working capital requirements • General corporate purposes
Amount proposed to be raised	Rs 1,040 mn
Price band	Not available at the time of grading
Lead managers	BOB Capital Markets Limited, Karvy Investor Services Limited, Saffron Capital Advisors Private Limited

Source: DRHP

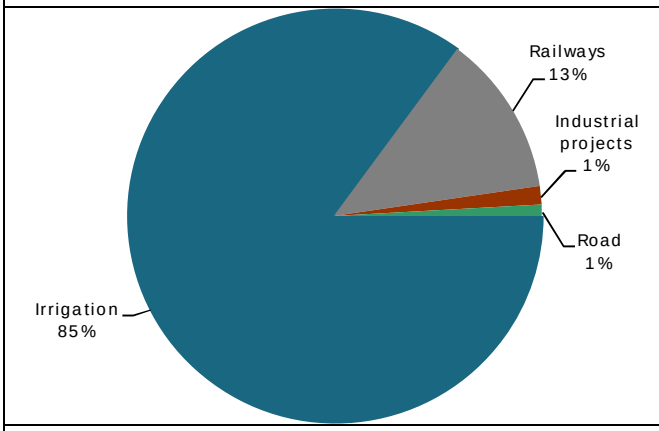
Detailed Grading Rationale

A. Business Prospects

- ***Strong order book of Rs 14.2 bn; ~5X FY10 revenues***

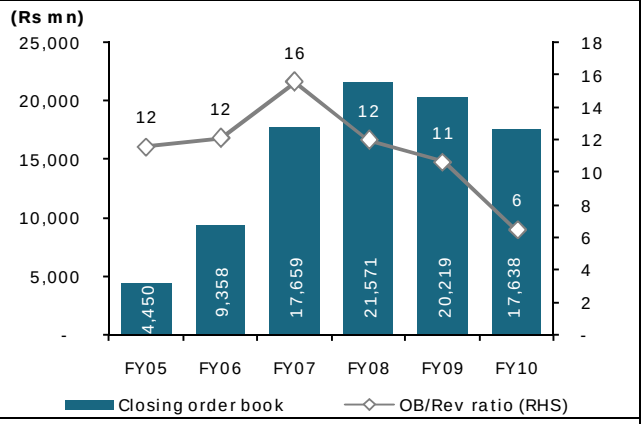
  APR is a mid-sized construction player present in the irrigation, railways and industrial segments. As of February 2011, APR has a healthy order book of Rs 14.2 bn with book-to-bill ratio of ~5x. Of the total order book, Rs 12.0 bn or 85% comprises irrigation projects; the balance comprises railways (13%), roads and industrial projects. **Revenues** from the railways segment, although a relatively new segment for the company, have increased five times in the past three years.

Current order book position – (Rs 14,162 mn)



Source: Company

Book-to-bill ratio



Source: Company

- ***Strong investments expected in irrigation sector***

  CRISIL Research expects that potential construction opportunity in the irrigation sector will be Rs 3,292 bn between FY10 and FY15 largely due to progressive states like Andhra Pradesh, Gujarat, Karnataka, Maharashtra, Madhya Pradesh and Uttar Pradesh increasing their investment spending. From FY12, the pace of growth in irrigation investments is expected to increase due to faster implementation of projects and an increase in the state governments' expenditure to improve irrigation infrastructure.

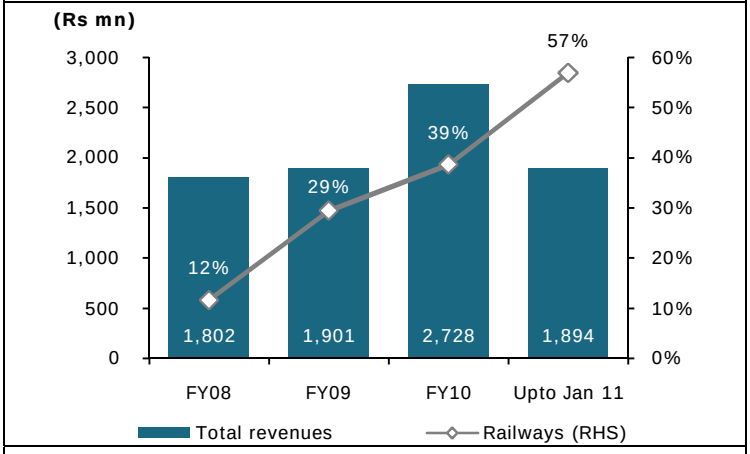
- ***Opportunities in railways are encouraging***

  As per the Vision Document 2020, Indian Railways is aiming for a major network expansion and plans to add 25,000 km of new lines by 2020. Indian Railways is also planning for a new dedicated freight corridor (DFC), initially covering about 2,700 km, for linking the ports of western and eastern India. While the progress on the DFC has been slow, a good number of projects are being tendered by the Northern, Eastern, Southern and South Central railways, creating enough opportunities within the segment. Of these, north-eastern India has attracted a great deal of interest due to more political thrust.

- ***APR to benefit from diversification into railways***

  Given the encouraging opportunities in railways and a more professional environment to work in, APR entered into railways in FY07. Railways currently account for 13% of APR's order book. Revenues from the segment have grown from Rs 210 mn in FY08 to Rs 1054 mn in FY10.

Railways' share in APR's total turnover is on the rise



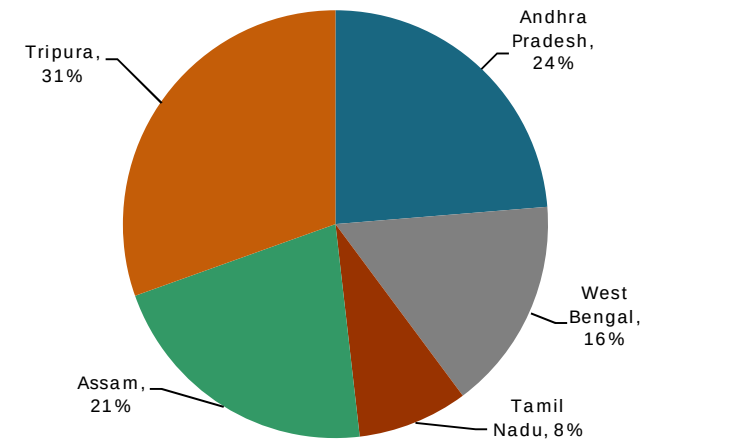
Source: Company

Being a mid-sized player in the railways segment, APR is targeting projects worth ~ Rs 500 mn; it has the capability to execute end-to-end projects including electrification, track-laying, doubling of existing lines and civil structures.

- ***North-eastern and eastern India focus to benefit APR***

APR is executing new tracks as well as doubling existing tracks in Assam, Tripura and West Bengal with the help of JV partners for technical qualification. North-eastern and eastern India account for 68% of the company's railway order book, making it well-placed to benefit from increasing tendering opportunities in the region.

State-wise order book for railways segment (Rs 1,779 mn)

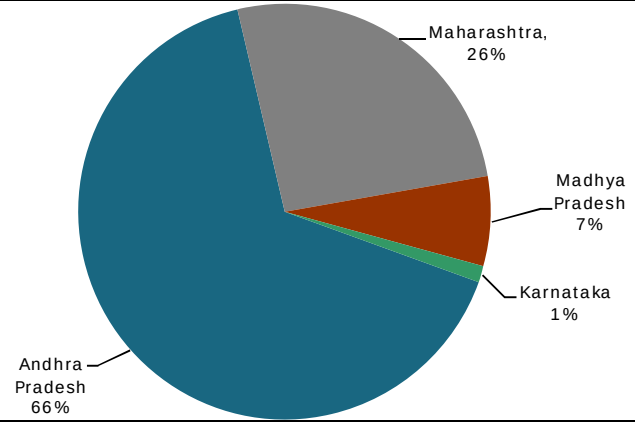


Source: Company

- ***Concentration of irrigation projects in Andhra Pradesh is a concern***

As of February 2011, APR has irrigation-related orders amounting to Rs 7,933 mn from Andhra Pradesh alone largely due to robust tendering activity driven by the state's Jalayagnam scheme and other centrally-funded schemes. Andhra Pradesh accounts for 66% of the company's irrigation order book followed by Maharashtra and Madhya Pradesh. Since the orders have a geographical concentration, any slowdown in tendering or execution will affect the company's revenues.

State-wise irrigation order book break up (Rs 12,057 mn)



Source: Company

- ***Execution problems and payment delays are slowing down projects***

  Although the ruling government in Andhra Pradesh has been focusing on huge irrigation projects for nearly six years, delays in funding and a change in the political environment have resulted in a cycle of non-payments and slowed down execution. Also, delays in land acquisition and environmental clearances have added to project delays. As a result, most of the company's projects have been progressing slowly.

  Therefore, despite an order book position of Rs 12,057 mn as of February 2011 for irrigation alone, there is limited revenue visibility for the company.

- ***Although an early mover, company is still a mid-sized player in the railways segment***

  APR is qualified to bid for mid-sized railway projects - the largest project it has executed is RVNL's Rs 425 mn Nellore railway network project. Despite being in the railway space since FY07, the company is still a mid-sized player. In the railways segment, the company competes with six to seven players (ARSS Infra, Kalindee Rail Nirman, etc.) that target similar sized projects. Bagging larger railway projects will be key for the company since orders have dried up in the irrigation segment.

- ***Foray into roads sector - likely to pose challenges***

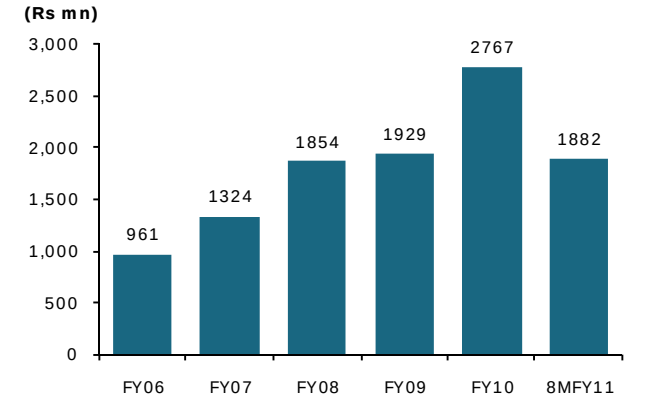
  The company plans to diversify into road projects and is increasingly concentrating in this space. Of the eight road projects for which the company has qualified, it has been awarded the road construction project in Coimbatore (project size ~Rs 5 bn), which was shelved due to regulatory delays. APR currently has two orders amounting to a total of Rs 170 mn of road EPC projects. The road segment presents good growth opportunities but is also an extremely competitive segment. Hence, we believe the company will face significant challenges in bagging new orders, and given its limited track record, timely execution by the company remains a key monitorable.

B. Financial Performance

APR registered three-year revenue CAGR of 27.4% from FY07-10 mainly due to strong growth in order inflows. Although the irrigation segment comprises a large portion of the order book, railways registered higher revenue growth due to comparatively faster execution. While irrigation registered three-year revenue CAGR of 18.6% to Rs 1,641 mn in FY10, the railways segment's revenue increased 5x in two years to Rs 1,055 mn in FY10.

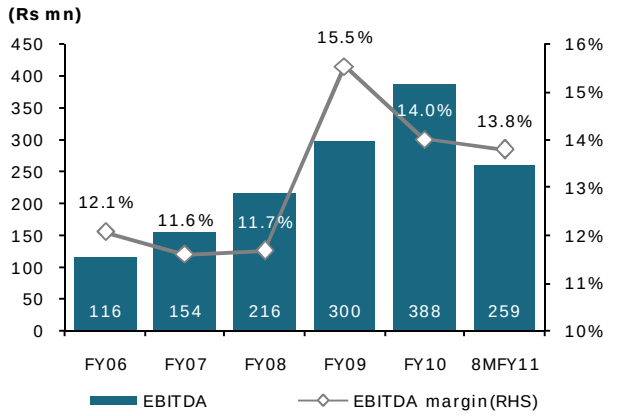
APR's EBITDA margins were in the 11-12% range until FY08. However, with increasing contribution from the relatively high-margin railways segment, EBITDA margins increased to 14-15% in FY09-10. The company had a debt-equity ratio of 1 time in FY10.

Order inflows drive revenue growth



Source: Company

EBITDA margin higher, led by railways segment



Source: Company

Financial performance snapshot

		FY08 Actual	FY09 Actual	FY10 Actual	8MFY11 Actual
Operating income	Rs mn	1,854	1,929	2,767	1,882
Operating margins	%	11.7	15.5	14.0	13.8
Net profits	Rs mn	103	106	152	88
Net margins	%	5.5	5.5	5.5	4.7
RoCE	%	32.2	28.8	28.3	16.4
RoNW	%	31.1	24.4	27.0	12.9
Basic EPS	Rs	8.4	5.8	8.3	4.8
Diluted EPS	Rs	8.4	5.8	8.3	4.8
No. of equity shares	mn	12	18	18	18
Net worth	Rs mn	381	486	638	726
Book value (FV Rs 10)	Rs	31.3	26.7	35.0	39.8
Current ratio	x	1.8	1.8	2.0	2.6

*Note: Numbers have been reclassified as per CRISIL standards

Source: DRHP

C. Management Capabilities and Corporate Governance

- ***Experienced management***

  The company was promoted by Mr Adala Prabhakara Reddy. Post his foray into politics in 1997 (he is at present Member of the Legislative Assembly of Andhra Pradesh legislative assembly), his involvement in the company's day-to-day affairs declined and the company's growth stagnated. In 2005, Mr Pulagam Harikrishna (son-in-law of Mr Reddy) managed to revive the operations by bagging new orders in the irrigation space and also entering into the railways segment. Currently, he is assisted by Mr Venkata Kumar, Business Head, Roads and Railways. Mr Venkata Kumar is an alumnus of IIT Chennai and has over 22 years of experience in Civil Engineering, including 15 years with Indian Railways. Mr Seshagiri Rao (CFO) has been with the company since April 2007 and has over 25 years of experience in the field of finance, taxation, corporate affairs and administration.

- ***Company has lagged behind other construction companies***

  The company has been slow in diversifying into areas other than irrigation (the first railways project was bagged in FY07). Although the share of railways in the overall revenues has been increasing, the management's low risk appetite has kept the growth fairly slow. Due to promoter Mr Adala Prabhakara Reddy's limited focus on the business, the company's management was unable to tap the increasing opportunities in the construction space. APR was still a ~Rs 3,000 mn company in FY10 (3x growth in 15 years) vs. other companies of similar size which managed to grow almost 50 times in the past 15 years.

- ***Corporate governance practices are good***

  APR's board consists of six members, of whom four belong to the promoter family. The board is chaired by Mr Hari Vittal Rao Chinthalapati, an independent director. Mr Rama Murthy Miduthuri Venkata is also an independent director. The board's composition is as per the minimum requirements stipulated in the Securities and Exchange Board of India's listing guidelines. Independent directors have a fair understanding of the overall business and their involvement in decision making is good.

- ***Group company in similar line of business but no significant business activity***

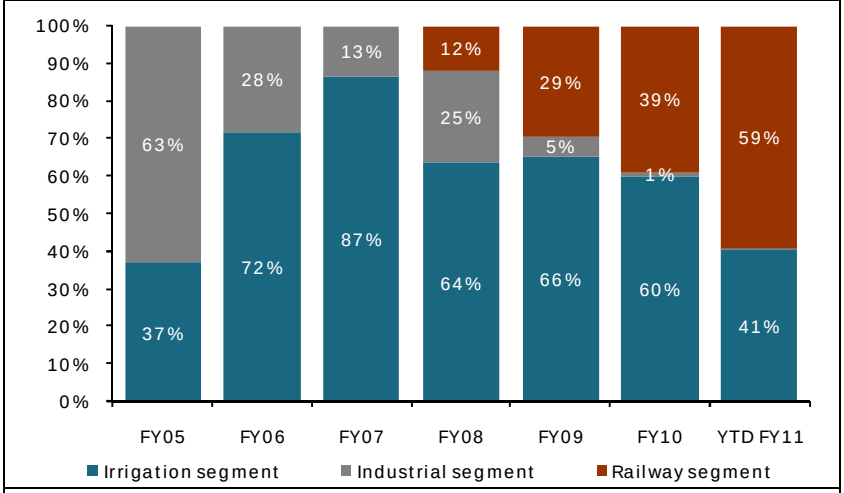
  Sreenivasa Associates, a company belonging to the promoter, is engaged in construction and development activities. Although the two companies do not have a formal non-compete agreement, there has been no significant activity by Sreenivasa Associates over the past two years.

Annexure I

Business Profile

APR is a mid-sized construction player, focusing mainly on irrigation and railway projects, with a steady increase in the share of the railways segment.

Segment-wise revenue break-down



Source: Company

The company's operations are spread across the states of Andhra Pradesh, Maharashtra, Madhya Pradesh, Assam, Tripura, Karnataka, West Bengal, Tamil Nadu and Bihar.

8

Major projects executed

	Name of the work	Nature of the work	Size of the work	Value of work (Rs mn)	Actual Date of Completion
1	Waghur left bank canal	Culvert works		117	31.03.2009
2	Waghur Dam	Dam Construction		650	31.03.2008
3	Construction of Spillway of Lower Wardha Project	Dam Construction	9.5 KM	417	31.03.2010
4	Krishna river project	Bridge cum barrage	3.9 KM	368	31.03.2007
5	RVNL-NELLORE railway work	New BG line Railway work	27.91 KM	425	30.06.2010
6	Expansion of IISCO steel plant	Site levelling & dressing work	80000 Cum	523	30.03.2009
7	NTPC BARH Super Thermal Power Project	Site levelling	3X660 MW	527	31.03.2007
8	Krishna river project	Bridge cum barrage	3.9 KM	368	31.03.2007

Source: Company

Major clients of APR

Segment	Major clients
Irrigation	• Government of Andhra Pradesh
	• Maharashtra Krishna Valley Development Corporation(MKVDC)
	• Karnataka Bhagya Jala Nigam (KBJNL)
Railway	• Rail Vikas Nigam Limited
Industrial	• NHPC
	• NTPC
	• SAIL

Source: Company

Annexure II: Profile of the Directors

Name of Directors	Designation	Occupation	Age (yrs)	Qualification	Exp. (yrs)	Directorships in other entities
Mr Hari Vittal Rao Chinthalapati	Chairman (Independent Director)	Ex-Banker	71	B.A. from Andhra University, Certified Associate of Indian Institute of Bankers. in Bank of Baroda	42	Gayatri Projects Limited
Mr Pulagam Harikrishna	Managing Director	Service	36	Bachelor's degree in Computer Science and Engineering from Bangalore Institute of Technology, Bangalore and Master's of Science degree from Bradley University, Peoria, Illinois, USA	11	Sreenivasa Associates (Project Works) Limited, APR Hotels Limited, Prarthana Inns Private Limited, APR Bridge Company Private Limited
Mrs. Adala Vindhyavali	Non- Executive Director	Business	56	Pre University Course, DMK College, Nellore, Andhra Pradesh	20	APR Hotels Limited, Prabhakar Investments Private Limited, APR Bridge Company Private Limited
Mr Gunapati Murali Krishna Reddy	Executive Director	Business	48	Bachelor's degree in Commerce, V.R. College, Nellore, Andhra Pradesh	30	-
Dr. Pellakuru Chandra Kiran Reddy	Non Executive Director	Business	37	Bachelor's degree in Dental Surgery, Ragas Dental College & Hospital	-	Sreenivasa Associates (Project Works) Limited, R.A.S. Infotech Limited, APR Hotels Limited
Mr Rama Murthy Miduthuri Venkata	Independent Director	Retired	77	Bachelor's degree in Engineering, Madras University	50	-

Source: DRHP

Disclaimer

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