BUILT TO PERFORM

C&C Constructions Ltd., one of the leading construction companies in the country, has created a niche for itself by developing the ability to execute projects in adverse terrains, which has seen its fortunes rise over the years.

C&C Constructions Ltd (C&C) is a Delhi-based infrastructure project development company that provides engineering, procurement and construction services for infrastructure projects in India and abroad. C&C's project expertise is primarily in transportation engineering projects, which include construction of roads, bridges, flyovers airport runways, etc. C&C also has projects in commercial buildings, water sanitation and sewerage and transmission tower space.

C&C was incorporated in July 1996 by a group of professionals having experience in the field of infrastructure development. Since its incorporation, C&C has acquired expertise in EPC and, more recently, BOT contracts. In its bid to expand its presence across various other domains of infrastructure, C&C has entered in JV with various firms like BSCPL Infrastructures Pvt. Ltd. for construction of roads, and M/s Sukhmani Engineers Pvt Ltd for addressing opportunities coming across the water sewage and sanitation vertical of the infrastructure industry.

C&C has also recently forayed into urban infrastructure projects. The Company has four BOT projects on hand, of which one started commercial operations in January 2011.

As part of its international operations, C&C has been present in Afghanistan since 2003. After years of civil strife, various multilateral agencies such as USAID, World Bank, ADB, etc., took upon themselves the reconstruction of Afghanistan. C&C has, since 2003 executed projects funded by such agencies. C&C is also implementing a project in Afghanistan funded by the Indian Government.

Today, the Company has a large fleet of sophisticated construction equipment, which includes crushers, excavators, cranes, batching plants, pavers, hydraulic piling rigs, milling etc., all of which are owned directly by C&C or are owned through its joint ventures. The company believes that its employee resources and fleet of equipment, along with its engineering skills and capabilities, enable it to successfully implement a wide variety of construction projects that involve varying degrees of complexity.

C&C has also received accolades and appreciation certificates for some of its projects which include the resurfacing and extension of runway at Amritsar Airport; Kandahar-Spinboldak road project; Taluquan-Kshom road project in Afghanistan; Kandahar-Herat road project; Kabul-Kandahar road project; Jalalabad-Asmar road project; and Kandahar–Tirinkot road project.

C&C has been successfully operating in difficult terrains and adverse weather conditions. It has mobilized resources including equipment, raw material and personnel to its project sites at short notice. Over the years, C&C has successfully delivered on seven projects and is currently executing two projects worth Rs375-cr.

C&C has an edge over its competitors due to their own machinery and equipments in the region, which enables quick mobilization and excellent local contacts, thereby having smooth execution. Its operations in Afghanistan enjoy premium pricing because of the timely execution of their projects and it hardly witnesses any delays in receiving payments.

> C&C is an interesting play in the construction space, with a sizeable and growing order book. With the company diversifying into new segments, the company's stock is due for a rise.

The Company has also been successful in operating under adverse weather conditions and tough terrain within India and, in particular, in connection with its projects in Bihar, where the company is currently executing about 10 projects. This has resulted in repeat orders from some of its domestic and international clients.

Within India, the company focuses on the North and East (over 80 percent of current order book) and keeps away from the South where there are a number of established players and competition is high.

C&C's management places emphasis on the sourcing and logistics for raw material such as bitumen, steel and cement. It also has its own crushers, which ensure timely availability of good quality aggregates at reasonable price. C&C's ability to source key raw materials at competitive prices and on timely basis enables it to complete projects on time. However, this results in the company having lower than industry inventory turnover ratios (higher inventory days).

C&C has its own critical high end and modern construction equipment such as crushers, excavators, cranes, batching plants, pavers, etc. The company's asset base at the end of FY10 stood at Rs498-cr from 144.7-cr at the end of FY07. The gross block has grown at a CAGR of 51 percent over the past three years. Ownership of such high-end equipment enables quick mobilization besides ensuring continuous availability of critical equipment. Overall, the company believes in the policy of owning the assets rather than hiring it.

The share from roads in the company's current order book is about 56 percent vs. 63 percent as of June 2009 and 96 percent as of June 2008.

JV strategy to expand bid capacity, enter into new segments & geographies

C&C has entered into JVs in the past with players like B Seenaiah & Company (Projects) Limited (BSCPL) and M/s Sukhmani Engineers Pvt Ltd. More recently, it has also entered into a JV with Isolux Corsan of Spain wherein C&C has a 40 percent stake.

The Company has a 50 percent stake in the JV with BSCPL and a relationship that is over 10 years old. The JV with BSPCL is the largest functional JV currently. The JV mainly bids for projects in the roads sector. About 50 percent of C&C's current order book is with its JV partner.

C&C, in September 2010, tied up with Spanish firm Isolux Corsan of Spain to enhance their combined footprint in Asia, with plans to jointly bid for projects worth about Rs8,000-cr this fiscal. According to the management of C&C, in the past, the company has been able to grow at 50 percent y-o-y. Hence, it expects to maintain this growth rate for FY11.

C&C along with its JV partner is L1 for road projects in Patna (Rs800-cr, BOT project) and Shillong (Rs1,400-cr, EPC). The current order book does not include the Muzaffarpur-Sonbarsa Road BOT project (Rs656-cr) in which C&C has a 50 percent stake. While the current order book to sales ratio is lower than that in comparison to other infra players, the management is not worried at it expects more and more orders from leaders like Jaypee and L&T to get sub-contracted to players like itself. Larger players could focus on bigger orders or projects in new areas while certain orders could be outsourced to competent construction companies.

The company stands to benefit from its significant presence in north India, which has huge potential. The strong order book and huge live bids provide strong visibility to the company's revenues for the coming two to three years. The management expects the order book of the company to grow to Rs4,000-cr to Rs4,500-cr by the end of FY11.

C&C is said to be selective about accepting orders. The company does not accept/bid for orders wherein the margins are below its past track record of margins (about 17-18 percent). Hence, as per the company, given India's infrastructure growth story, getting orders is an easy task, it is getting profitable orders (EBITDA margins of >17 percent) that remains key.

Risks & Concerns

- Increase in raw material prices could impact operating margins. However, a large part of C&C's current order book is from the GoI and related parties wherein most contracts have price escalation clauses and, in case of the Jaypee contract it is executing, the raw material is being supplied by the company.
- Increase in interest rates could impact net profit margins as C&C is dependent on debt to fund its working capital (debt to equity is at 1.3x currently) and the company sees it in this range (1.2-1.6x) going ahead.
- C&C has a stretched working capital cycle due to high amount of inventory and work in progress. However, management has given indication for four months working capital cycle for the next two to three years.
- At the end of FY10, C&C's inventory has jumped 155 percent largely due to work in progress. C&C has recently started work on a number of projects for which the company is yet to bill the customer. This could translate into revenue in FY11, however, in the interim, it stretches the company's working capital cycle and reliance on debt.
- A significant part of C&C's operations are in adverse terrains, such as Afghanistan and Bihar, where risks like political and operational uncertainty and inclement weather besides law and order problems make its operations vulnerable.
- C&C's foray into BOT projects is likely to entail upfront investment, which can strain its already leveraged balance sheet.
- Delay in execution could impact topline growth and profits.
- C&C faces forex exposure as it derives 7-12 percent of revenue from overseas. The company also imports cement from Pakistan and Bitumen from Egypt from time to time.
- Slowdown in economy and award of projects could impact C&C adversely as it is mainly dependent on the GoI for orders.
- Competition in India and overseas could lead to pressure on margins.
- C&C has invested a lot of money in equipment in the past and could continue to do so in the future. This leads to a low sales to fixed asset turnover ratio for the company and could hurt the bottomline when execution slows down.
- Slowdown in growth of order book. The pace of order accretion appears to have slowed down in FY10. The current order book provides revenue visibility for about 18 months.
- Constant need for funds as sales grows. C&C has carried out a considerable dilution at the parent company level and could carry out more dilution at the subsidiary level/SPV level.

Conclusion

C&C is an interesting play in the construction space, with a sizeable and growing order book and exposure to high-margin markets like Afghanistan and Bihar. With the company diversifying into new segments, overall improvement in economic outlook and with the commencement of operations of its first BOT project by January 2011, the company's stock is due for a rise.

The upside of working in adverse terrains for C&C is that it has to face limited competition, which yields higher margins than the industry average; in these terrains, competition is limited to just 3-4 bidders against 8-10 bidders on an average for regular contracts elsewhere.

With ~50 percent of the company's future revenues expected to come from projects executed in adverse terrains, C&C is expected to continue operating at higher-than-industry margins.

According to research analysts, C&C could report a topline of Rs1,720.2-cr and Rs2,287-cr in FY11 and FY12 respectively, registering a growth rate of 47.2 percent and 32.9 percent. Operating margins are expected to be at 17.6 percent and 17 percent in FY11 and FY12.

We are geared up to fight all odds

G S Johar, Chairman of the Company speaks to **Shashidhar V.**

Broadly, how do you view the infrastructure development activity in the country that has taken place till now in the XI Plan period?

A good road network is the basic infrastructure input for socio-economic development of an emerging economy. It plays the key role in opening up backward and remote regions to trade and investment and in promoting national integration. The focus of the X Plan was to promote Private sector participation through decontrol and removal of restrictive practices by Government.

During the year, steps are being taken to expand and strengthen road system through emphasis on rural connectivity and expediting completion of Golden Quadrilateral work. We have also seen that the Target for widening to four lanes, widening to two lanes and strengthening weak two lanes was achieved to great extent. But, not to miss, there has been a significant shortfall, particularly in respect of various phases of NHDP and SARDP (NE) where the progress has been quite slow. So far, the 11 Plan period is going good and now we are looking forward to XII Plan period and new horizons.

In your assessment, what have been some of the core challenges?

Project execution has been an unsolved problem for too long. It is a challenge and the current situation is unsatisfactory, not only in the construction sector, but across all industries. Raw material availability, equipment shortage, land acquisition and environment clearance, manpower shortages are some major issues faced almost in every project. In addition, considering the high financial stake involved through private investments, delay in payments may also put severe pressure on contractors to meet the performance commitments. In spite of all odds, we keep on experimenting with different strategies and manage to maintain an impressive record.

We are headed for an inflationary period, which would mean a rise in the cost of capital. To what extent would this impact your ongoing projects, as well as bidding for future projects?

The currently inflationary scenario may affect the demand as the double dip recession is expected in the developed world. Due to higher inflation, almost hovering in double digits, the central bank has undertaken anti-recessionary measures and has consistently increased the key interest rates. This increase in interest would certainly impact the cost of on-going project as well as the future bidding strategies, because the infrastructure sector has long gestation period, and many other social implications associated with it.

What is your order book position as of today? To what extent, percentage-wise, has it grown?

C & C Constructions is sitting pretty on an order book position of Rs3600-crores against Rs2612.90-crores in FY'10.This gives us figure of approx 38 percent increase.

What would you say are the demand drivers that have seen a growth in your orders/revenue?

Roads, highways and bridges will continue to be a major demand driver for C & C Constructions. Allocation of 46 percent, or Rs1.73-lakh crores of the total plan outlay for the infrastructure sector was one bench marking proportion. NHDP is likely to generate orders worth $55-billion over the next five years. Maintenance of national and state highways and other roads are likely to create demand for maintenance projects. Other demand drivers are urban infrastructure development, urban transportation projects, water supply and sanitation projects along with benchmarking projects of DFCC and DMIC.

It is already known that in the XII Five Year Plan, the government would substantially increase the expenditure outlay. Gazing ahead, what are the likely key risk factors that could impact your performance in the coming months?

The revised XI Five year plan (2007-2012) has projected Rs20.5-trillion spend for Infrastructure development in India, a growth of around 127 percent over the comparative X plan period. The World Bank is exploring to invest in an $11-billion debt fund the Indian government will roll out by next year as part of a massive push to its infrastructure sector. This means an ultimate huge opportunity for C & C Constructions.

But, this opportunity would surface real challenges of the sector viz. lack of availability of capital required for implementation of projects, hurdles in implementation, such as land availability for roads, adverse bidding mechanism, lack of equipment availability, delay in environmental and forest clearances, and political issues. But, as mentioned earlier, we are geared up to fight all odds as I firmly believe on our aim of a healthy robust growth in execution capability, profitability and intrinsic value of the company.