
Rating Rationale for Gayatri Projects Ltd's secured redeemable Non-Convertible Debentures Issue of ₹ 100 Crore with a tenor of 5 years

NCD Issue Rating: BWR A

Outlook : Stable

Brickwork Ratings has assigned '**BWR A (Pronounced BWR A)**' Rating for Gayatri Projects Ltd's ('GPL' or 'the Company') proposed Secured Redeemable Non Convertible Debentures (NCD) Issue of ₹ 100 Crore. Brickwork Ratings' 'BWR A' stands for an instrument that is considered to offer **Adequate** credit quality / safety in terms of timely servicing of principal and interest obligations.

The rating has, inter alia, factored GPL's experienced promoter and track record of the company in execution of various infrastructure projects, strong order book position, and strategic initiatives taken by the company to diversify into new verticals. The Rating has also factored the following important information shared by the Company's Management during discussions:

- a) The management of Gayatri Projects Ltd intends to, subject to necessary approval, raise equity of upto ₹ 300 Crore by way of rights issue to existing shareholders on or before June 2011 to strengthen the equity capital base of the Company. The promoters holding as on 30th September 2010 is 53.51% and the promoter group intends to subscribe to at least its portion of the proposed rights issue.
- b) In respect of the IJM-Gayatri Joint Venture the venture has incurred an excess expenditure over income amounting to about ₹ 135 Crore (₹ 54 Crore being the share of GPL on its 40% shareholding said to be due to several contractual failures on the part of NHAI and AP State Highway Authority, on 6 packages executed in the JV. The JV has raised claims for over ₹ 300 Crore which are under various stages of arbitration proceedings with appropriate authorities. The Committee of arbitrators has already awarded a claim of ₹ 12.42 Crore, for one of the packages out of the 6 packages. The management has also obtained independent legal opinion in this regard on the recoverability of their claims. The management is confident that it is unlikely that there would be any under recovery of the expense incurred.

However the rating is constrained by high working capital intensive nature of operations, impact of political unrest on projects located in Andhra Pradesh, and financial profile marked by high gearing, strained profitability margins and debt service coverage. It is also influenced by high level of contingent liabilities in form of performance guarantees given for projects bid by subsidiaries and JVs.

BWR has essentially relied upon the GPL's audited financial performance up to the financial year ending March 2010, quarterly unaudited published results up to June 2010, and information and clarification provided by the Company.

Background

GPL, founded in 1989, is a Hyderabad based company that operates in infrastructure sector. The company engages in the execution of various civil works, including concrete/masonry dams, canals, highways, bridges, aqueducts, ports, airport runways, and industrial facilities. It undertakes civil and engineering contracts of various state governments, central government, and other autonomous bodies/corporations. The Company has built world's largest masonry dam "Nagarjuna Sagar" in Andhra Pradesh.

The proceeds of the current issue are proposed to be utilized for:

- Augmenting medium to long term resources of the Company
- Replacement/Repayment of part of existing high cost short term loans
- Bidding for upcoming infra projects

Business Operations

GPL is a fast growing ISO 9001-2000 company in the infrastructure sector. The Company's business operations can be classified as under –

- Roads – national highways, state highways
- Irrigation – canals, dams
- Other infrastructure projects – airport runways, ports/harbors, railways, steel plants, industrial projects etc

The Company enters into contracts primarily through a competitive bidding process on a standalone basis as well as project specific joint ventures. The Company's bids for various projects are based on feasibility surveys conducted by a team of engineers that determines the availability of basic amenities near the site, availability of labor, distance from the sources of materials, and risk factors involved. Once the contract is awarded to the company, a project team is constituted to execute the work as per the terms of the contract. Each stage of the construction activity is closely monitored for quality and timely execution of work.

For better monitoring and maximizing the benefits, GPL has hived off its SPVs created for road projects into a subsidiary called Gayatri Infra Ventures Ltd (GIVL). The Company has 70.6% stake in GIVL while the remaining 29.4% has been diluted through equity participation to the extent of approx ₹ 200 Crore from AMP Capital (Australia). GPL, through its subsidiary, executes BOT road projects on annuity/toll basis. Out of total 7 contracts, the Company has 4 annuity contracts which are going to become operational during FY11. Annuity contracts have relatively low risk compared to tolling contracts as the developer, instead of charging tolls, gets periodic payments from the Government.

Another wholly subsidiary called Gayatri Energy Ventures Ltd (GEVL) has been created for executing projects under power sector. GEVL, through its subsidiary Thermal Powertech Corporation India Ltd (TPCIL) is developing a coal based power plant in Krishnapatnam,

Andhra Pradesh. The plant has been allotted 1,400 acres of land for this purpose while coal and water linkages have been tied up and various environmental clearances have been secured for the plant. GPL has also signed a power purchase agreement (PPA) with Power Trading Corporation (PTC) for selling 70% of power generated while remaining 30% would be sold on merchant basis. The project involves an outlay of approximately ₹ 6869 Crore to be funded through combination of debt and equity (75:25). TPCIL has been able to achieve Financial Closure for the power project; the debt has been arranged from various Indian Financial Institutions while Singapore based Sembcorp Industries Ltd has invested approx ₹ 1,100 Crore for a 49% stake in TPCIL as part of joint venture agreement with GEVL. GPL's management has consciously taken a decision to foray into the power sector in order to de-risk overall business model of the Company.

The Company also specializes in irrigation projects and has bagged contracts mainly from Andhra Pradesh State Government under the flagship irrigation programme called Jalayagnam. The Company has already executed works of ₹ 1025 Crore while works of ₹ 3028 Crore are under execution.

GPL has completed construction / maintenance/ widening of more than 644 Kms of highways, 1113 Kms of Irrigation projects along with several other projects of dams & reservoir and industrial buildings etc. The company had total orders of over ₹ 7000 Crore on hand as of June 2010. The sector-wise order book position is as under:

S. No	Particulars	Orders on hand (in ₹ Crore)	% Share
1	Roads	770.5	11.0%
2	Roads – BOT	1561.9	22.3%
3	Irrigation Division	3672.7	52.4%
4	Others	1000.2	14.3%
TOTAL		7005.4	100.0%

The order book to sales ratio is about 5 times, indicating good revenue visibility over the next 4-5 years. The projects are concentrated mainly in the southern states - Andhra Pradesh, Karnataka, and Tamil Nadu - which together account for 70% of the order book, the balance spread across other states - Maharashtra, Madhya Pradesh, Orissa, Uttar Pradesh and Assam.

The IJM-Gayatri Joint Venture has incurred expenditure over recognizable income amounting to ₹ 134.45 Crore said to have arisen due to contractual lapses on part of the employers (NHAI and Andhra Pradesh State Government) and the JV has raised claims for over ₹ 300 Crore on the employers for 6 packages executed by the JV which are under various stages of arbitration proceedings with appropriate authorities. Based on the legal opinion, the JV is confident of recovering its claims. At the minimum, the JV is confident that it will recover the entire expenses of about ₹ 134 Crore incurred by it. It has so far recovered an amount of ₹ 12.42 Crore

from one of the packages being executed in JV. Accordingly the expenditure has been treated as an advance payment and not considered as loss by the JV.

The Gayatri-ECI Joint Venture had incurred losses due to law and order problems in the state of Assam during FY09. Subsequently, the situation has improved and the JV has posted profit of ₹ 4.81 Crore and expects to recover the losses from these profits.

Andhra Pradesh has witnessed civil unrest for the formation of separate state of Telangana. Though the issue has subsided, however, resurfacing of such events could hamper progress of projects located in these regions.

Management

GPL was founded by Dr. T. Subbarami Reddy having vast experience in the construction industry. Mr. T. V. Sandeep Kumar Reddy is the Managing Director of the Company and is responsible for spearheading company's day to day business activities. The Board of Directors of the Company has an optimum combination of Executive, and Independent Directors and represents a mix of professionals having vast experience in construction & banking sectors.

Financial Performance

GPL's Sales has grown from ₹ 1004.6 Crore in FY09 to ₹ 1252.5 Crore in FY10 reflecting a y-o-y growth of 24.6%. PBITDA during the same period has grown by 31% from ₹ 116.9 Crore in FY09 to ₹ 152.7 Crore in FY10. Higher growth in PBITDA was mainly due to relatively lower growth in construction costs consisting of work expenditure, staff cost and administrative costs. Construction expenses account for approximately 88% of the company's Sales. PAT for the year FY10 was ₹ 53.3 Crore as against ₹ 41.2 Crore in FY09. The Net Profit Margin of the company for FY10 was 3.9% which fell from previous year figure of 4.1%. The NPM has declined in FY10 on account of increased work expenditure and higher levels of Interest & Financial charges. Increase in interest expenses has reflected in the Interest Coverage for the Company which stood at 2.76 times during FY10 and had declined from 3.17 times in FY09.

Net Fixed Assets of the Company increased from ₹ 160.6 Crore in FY09 to ₹ 166.15 Crore in FY10 due to purchase of additional machinery for execution of new projects awarded to the Company.

Current Ratio of the Company has also increased from 1.38 in FY09 to 1.56 in FY10. Increase in sundry debtors, cash and bank balances and loans & advances was the main reason for increase in Current ratio.

GPL, during the year FY10, had resorted to substantial borrowings in the nature of short term loans for working capital purpose and to meet project related expenses for the proposed thermal power project. Total debt increased from ₹ 360.75 Crore in FY09 to ₹ 608.56 Crore in FY10. Contingent liabilities, which are the performance guarantees given by the Company in the name

of joint ventures and subsidiaries, stood at ₹ 863.09 Crore in FY10 as compared to ₹ 579.76 Crore in FY09. Total debt to equity ratio (including working capital & FCCB) therefore increased from 1.98 in FY09 to 2.51 in FY10. The management of GPL intends to raise equity by way of rights issue before June 2011. Such a move would strengthen the equity capital base of the Company.

PBT for quarter ended June 2010 stood at ₹ 22.8 Crore as compared to ₹ 17.3 Crore for the corresponding quarter last year. PAT for quarter ended June 2010 was higher at ₹ 15.1 Crore than that of previous year at ₹ 12.0 Crore.

Key financials for the Company are as per the table below.

₹ in Crore	2010	2009	2008
Operating Income	1252.5	1004.6	752.4
Other Income	0.44	3.3	2.9
Total Income	1252.9	1007.9	755.3
Expenditure	1100.2	891.0	646.5
PBIDT	152.7	116.9	108.8
Depreciation	20.1	19.7	16.4
PBIT	132.7	97.2	92.4
Interest	55.4	36.9	33.7
Less: Interest income	3.8	3.1	2.5
Net Interest expense	51.7	33.8	31.2
PBT	81.0	63.4	61.2
PAT	53.3	41.6	40.0
Equity Paid Up	11.1	10.1	10.1
Net worth	280.4	215.7	179.3
Total Loans	608.6	360.7	310.2
Contingent Liabilities	878.4	596.2	825.9
Net Block including CWIP	166.1	160.7	162.9
Key Ratios			
Total Debt / Equity ratio (x)	2.51	1.98	2.22
Long Term Debt Equity ratio ¹ (x)	0.71	0.67	0.85
Interest cover (x)	2.75	3.17	3.23
DSCR ² (x)	0.59	1.18	1.19
Net worth (₹ Crore)	280.4	215.8	179.2
NPM (%)	3.9%	4.1%	5.2%

¹ Includes FCCBs outstanding amounting to ₹ 97.76 Crore.

² For the purpose of DSCR calculation, 25% of Incremental Net Working Capital has been considered. For FY10 the amount stood at ₹ 76.75 Crore. The Debt payable within one year includes current portion of long term debt and short term debt. This however excludes the debt in the nature of working capital loan that get renewed upon maturity.

₹ in Crore	2010	2009	2008
RoCE (%)	17.7%	17.6%	19.4%
Cash accrual to total debt (x)	0.11	0.16	0.17
Current Ratio (x)	1.56	1.38	1.38

Industry Outlook

The Indian economy has rebounded from the slowdown due to economic crisis and registered growth rate of 7.4% in 2009-10. Poor quality of infrastructure seriously limits India's growth potential in the medium term and the Government of India has put a comprehensive strategy for development of both rural and urban infrastructure which includes power, roads, railways, ports, airports, telecommunications, irrigation, drinking water, sanitation, storage, and warehousing. The Union Budget for 2010-11 has proposed to provide ₹ 1.73 lakh Crore for infrastructure development. Private participation in the several areas of infrastructure development had been limited; the Central Government has sought to evolve policies for private sector participation as a result of which both the Centre and the states have been able to attract private investment in areas such as power generation, telecommunications, roads, railways, airports, and ports.

The construction industry has grown at a CAGR of about 11 per cent (GDP) over the last five years ended March 2010. The trend is expected to continue over the next three years ending March 2013 with average growth rate at about 10%. The consistent growth will be driven by the investment momentum in the industrial and infrastructure segments. The government's emphasis on infrastructure through its various schemes under the Bharat Nirman Programme will continue to give impetus to the order booking opportunities of construction companies. The government has been increasingly awarding projects under roads, ports, airports, railways and power segments through the public-private partnership (PPP) model. Additionally, there has also been a rise in announcement of new projects by the corporate in the manufacturing sector. As investments in the manufacturing sector have gained traction, construction companies have observed a surge in orders relating to construction of pipeline infrastructure, industrial plants and material handling systems. A sharp rise in new investments point towards a gradual recovery in the capex cycle in the industrial space compared to last year.

The order backlog of construction companies continued to strengthen further during the June 2010 quarter. At the end of June 2010, the order books of the top nine construction companies were at least two times the sales generated in the last one year.

Although order books of the construction sector have shown a healthy uptrend, the same did not reflect in the bottom lines. Profits of the industry fell for due to a faster rise in wages, interest expenses and depreciation charges. Cost pressures are expected to rise for the industry as raw material costs are expected to sharply increase in the ensuing quarters of 2010-11. Steel prices have shown upward trend from early September. Wages and other expenses are also expected to remain on the higher side. Rising costs are expected to affect the margins of the industry.

Overall, the construction sector has a positive outlook keeping in view of the growing infrastructure demand. Policy measures taken by the Government to promote construction activity, economic growth, increased availability of finance for such sectors and increasing private sector participation in infrastructure development are the major drivers of growth for this sector.

Rating Outlook

GPL is an established player in infrastructure sector with strong execution capabilities. The Company is led by experienced promoters who have taken strategic decisions for diversification of the business. While the company has performed reasonably well and has strong order book which gives good revenue visibility for the next 4-5 years, its ability to adopt appropriate strategies for timely completion of projects, and ability to raise funds to finance projects would be vital for improving its performance.

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