



Patel Engineering

STOCK INFO.	BLOOMBERG
BSE SENSEX: 14,131	PEC IN
	REUTERS CODE
S&P CNX: 4,084	PENG.BO

17 January 2007

Buy

Previous Recommendation: Buy

Rs466

Equity Shares (m)	59.7
52-Week Range	635/222
1,6,12 Rel. Perf. (%)	0/48/-36
M.Cap. (Rs b)	27.8
M.Cap. (US\$ b)	0.6

YEAR	NET SALES*	PAT*	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/06A	8,029	733	14.4	78.1	32.2	12.0	44.6	15.9	3.2	23.5
3/07E	10,944	1,073	17.6	22.1	26.4	3.9	23.2	13.5	2.5	18.8
3/08E	16,383	1,497	24.6	39.2	19.0	3.3	18.8	14.5	1.8	13.2

* Consolidated

- 3QFY07 performance in line with expectations:** During 3QFY07, Patel Engineering reported revenues of Rs2.2b (up 28.7% YoY), EBITDA of Rs419m (up 15.9% YoY) and net profit of Rs292m (up 16.4% YoY). Reported net profit at Rs292m is in line with our expectation of Rs298m. Consolidated revenues increased to Rs2.8b (up 22% YoY), while net profit stood at Rs295m (up 16% YoY). EBITDA margins were lower by 200bp, due to charge-off of mobilization expenses for new projects.
- Land bank monetization plans in final stages:** In the initial move towards monetizing the land bank, Patel Engineering has incorporated five wholly owned subsidiaries to develop existing land bank. The management stated that it has close to 500 acres spread in Bangalore, Hyderabad, Chennai and Maharashtra. Also, the company intends to develop significant part of its land bank in the next 3 years and the ground breaking ceremony is expected soon.
- Consolidated order book stands at Rs48b:** Order book as at December 2006 stood at Rs48b (v/s Rs39.4b as of March 2006) and Rs50b as at September 2006. Order book composition stands as: Hydro: ~50%, Irrigation: 20-22% and Transportation: 28%.
- Recommend Buy:** We expect Patel Engineering to report net profit of Rs1.1b for FY07 (up 46% YoY), Rs1.5b for FY08 (up 40% YoY) and Rs1.9b for FY09 (up 25% YoY). We arrive at price target of Rs531, and value the core construction business at Rs365/share (12x FY09E), US subsidiaries at Rs7/share (10x FY09E), land bank at Rs140/share and Investments at Rs17/share (book value). Adjusting for the value of investment in BOT and real estate (land bank), the stock trades at a 17.5x FY07E, 12.6x FY08E and 10.1x FY09E earnings. Maintain **Buy**.

QUARTERLY PERFORMANCE

	(RS MILLION)									
	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Sales	1,898	1,408	1,697	3,014	2,900	1,979	2,184	3,882	8,016	10,944
Change (%)	77.3	15.8	22.1	32.0	52.8	40.6	28.7	28.8	49.2	36.5
EBITDA	206	221	361	269	318	307	419	399	1,059	1,444
Change (%)	59.8	28.2	77.1	59.7	54.2	38.7	15.9	48.1	67.2	36.3
As of % Sales	10.9	15.7	21.3	8.9	11.0	15.5	19.2	10.3	13.2	13.2
Depreciation	60	71	72	63	65	66	70	77	266	278
Interest	51	23	60	72	46	-13	24	76	206	133
Other Income	37	15	46	101	26	20	11	114	200	171
Extra-ordinary income	0	0	0	2	0	0	0	0	2	0
PBT	133	142	276	237	233	274	335	361	789	1,203
Tax	20	16	25	23	33	24	44	50	85	150
Effective Tax Rate (%)	15.4	11.4	9.1	9.8	14.2	8.7	13.0	13.8	10.8	12.5
Reported PAT	113	126	251	214	200	250	292	311	704	1,053
Adj PAT	113	126	251	212	200	250	292	311	702	1,053
Change (%)	93.6	66.3	110.0	103.1	76.9	98.2	16.4	46.6	97.3	50.0

E: MOST Estimates

3QFY07 performance in line with expectations

During 3QFY07, Patel Engineering reported revenues of Rs2.2b (up 28.7% YoY), EBITDA of Rs419m (up 15.9% YoY) and net profit of Rs292m (up 16.4% YoY). Reported net profit at Rs292m is in line with our expectation of Rs298m. Consolidated revenues increased to Rs2.8b (up 22% YoY), and net profit after minority interest stood at Rs295m (up 16% YoY). Revenue composition from various segments was Hydro: 52%, Irrigation: 35% and Transportation: 11%.

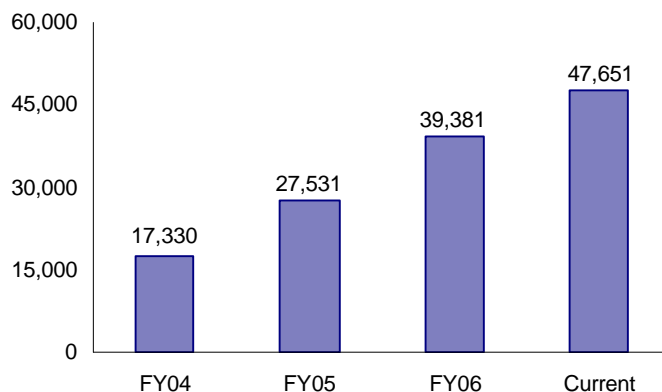
EBITDA margin impacted due to higher mobilization expenses

EBITDA margin for the quarter was lower by 200bp to 19.2% mainly due to charge-off of mobilization expenses for new projects, while revenues would start flowing in from subsequent quarters. As per the accounting policy adopted by Patel Engineering, mobilization expenses are charged to the P&L account, which impacts EBITDA margins during the ramp up phase. The management has, however, maintained its full year guidance of EBITDA margin improvement by 25-50bp (v/s 13.2% in FY06).

Consolidated order book at Rs48b, book to bill ratio of 4.4x

Patel's order book as at December, 2006 stood at Rs48b, v/s Rs50b in September 2006 and Rs39b in March 2006. The composition of the current order book stands as: Hydro: 50%, Irrigation: 20-22% and Transportation: 28%. The company has recently bagged orders from Brihanmumbai Municipal Corporation (Rs1.4b, micro tunneling) and NTPC (Rs3.6b) hydro project. The management has indicated that the company has submitted pre-qualification bids for projects worth Rs60b, and has had a success ratio of ~20%. The current order book includes Rs500m of Michigan Engineering (51% subsidiary), primarily for Urban Infrastructure projects.

TREND IN ORDER BOOK (RS M)



Source: Company/Motilal Oswal Securities

Key takeaways from the conference call

Guidance maintained

Management has guided for:

- ✍ Consolidated revenue growth of 25% YoY over the next 2-3 years
- ✍ EBITDA margin improvement of 25-50bp YoY
- ✍ Michigan Engineers expected to report revenues of Rs300-350m for FY07 and Rs600-650m for FY08 (v/s Rs180m for FY06)

Land bank monetization plans in final stages

In the initial move towards monetizing the land bank, Patel Engineering has incorporated five wholly-owned subsidiaries to develop the existing the land bank of the company. The reason for incorporating five SPVs is to develop land bank in each geography, through a separate SPV. This will enable the company to rope in strategic partners / joint developers for marketing.

The management stated that the company has close to 500 acres spread in Bangalore, Hyderabad, Chennai and Maharashtra. Also, the company intends to develop significant part of its land bank in next three years and the ground breaking ceremony is expected soon. The management indicated that the detailed development plan would be announced soon.

LAND BANK DETAILS (ACRES)

Hyderabad	354
Chennai	27
Maharashtra	90
Bangalore	30
Total	500

Source: Company/Motilal Oswal Securities

RFQs submitted for several IPP hydro projects

Patel Engineering has submitted Requests for Qualification (RFQs) for several hydro power projects with capacity ranging from 60-100MW, and the management seemed hopeful of bagging some of these projects. The projects would be executed through Patel Engineering Infrastructure P. Ltd (100% subsidiary). These hydro power projects are to be set up on merchant basis, and the management indicated tariffs in the range of Rs1.1-1.3/unit.

RFQS SUBMITTED

PROJECT	MW	STATE
Chanju I	25	Himachal Pradesh
Ropa	60	Himachal Pradesh
Chamba	126	Himachal Pradesh
Bajoli Holi	180	Himachal Pradesh
Various	200	Madhya Pradesh

Source: Company/Motilal Oswal Securities

SOTP VALUATION

PATEL ENGINEERING - EQUITY VALUATION	BUSINESS SEGMENT	METHOD	VALUATION (X)	VALUE (RS M)	VALUE (RS/SH)	RATIONALE
Patel Engineering Ltd.	Construction	FY09E PER (x)	12	21,904	367	In line with peers
Subsidiaries	Construction	FY09E PER (x)	10	441	7	Discount to peers, given the lower profit size
BOT Projects / Investments	BOT Projects	FY07, Book Value	-	992	17	At Book value, as projects are yet to achieve financial closure
Land Bank		SOTP		8,381	140	
Total				31,718	531	

Source: Company/Motilal Oswal Securities

Valuation and view

Given the strong order book position at Rs48b (4.4x FY07E revenue), we expect strong revenue and profit growth going forward. Also, the monetization of land bank could unlock significant value. Increased contribution from subsidiaries like Michigan Engineers and joint ventures with L&T, etc would also add significantly to consolidated profits.

We expect Patel Engineering to report net profit of Rs1.1b for FY07 (up 46% YoY), Rs1.5b in FY08 (up 40% YoY) and Rs1.9b in FY09 (up 25% YoY). At the CMP of Rs466, the stock trades at reported PER of 26.4x FY07E, 19x FY08E and 15.2x FY09E.

We arrive at price target of Rs531, and value the core construction business at Rs365/share (12x FY09E), US subsidiaries at Rs7/share (10x FY09E), land bank at Rs140/share and Investments at Rs17/share (book value). Adjusting for the value of investment in BOT and real estate (land bank), the stock trades at a 17.5x FY07E, 12.6x FY08E and 10.1x FY09E earnings. **Maintain Buy.**

Patel Engineering: an investment profile

Company description

Patel Engineering is one of the oldest and largest construction companies in India and has strong presence in Hydro power sector with a market share of 22%. It is one of the few players with pre-qualification in Hydro, Irrigation and other projects. It possesses niche technologies (via subsidiaries) like RCC Dam construction and Micro tunneling, Lake water tapping, etc in house. It has recently acquired Michigan engineers to leverage its skill in Micro tunneling to cater to urban infrastructure projects.

Key investment arguments

- Patel Engineering has expertise in hydro power, tunneling, irrigation, railways and roads segment.
- Order Book at end December, 2006 was Rs48b, 4.4x FY07E revenue.
- Real Estate could unlock significant value, Initiatives taken for developing IPP projects.

Key investment risks

- Retention of human resources given the increased traction in domestic construction and engineering sectors
- Infrastructure capex is highly cyclical.
- BOOT projects depress initial RoE .

Recent developments

- Formed five SPVs to monetize its land bank (~500 acre) over a period of three years.
- Acquisition of Michigan Engineers to bridge gaps in urban infrastructure portfolio.

Valuations and view

- Based on SOTP methodology, we arrive at a PT of Rs531/share.
- At the CMP of Rs466, the stock trades at reported PER of 26.4x FY07, 19x FY08E and 15.2x FY09E. Maintain **Buy**.

Sector view

- Increased government commitment towards infrastructure projects has led to several large projects taking off the ground.
- We notice a trend of margin expansion, driven by changing composition of order book and higher margins at bidding stage.

COMPARATIVE VALUATIONS

		PATEL ENG.	GAMMON	HCC
P/E (x)	FY07E	26.4	28.4	34.9
	FY08E	19.0	18.8	20.7
P/E (x)*	FY07E	17.1	12.5	20.6
	FY08E	12.3	8.3	12.2
P/BV (x)	FY07E	3.9	3.3	3.1
	FY08E	3.3	2.9	2.7
RoE (%)	FY07E	23.2	11.5	10.9
	FY08E	18.8	15.2	14.0

* adj for BoT and other investment

SHAREHOLDING PATTERN (%)

	DEC.06	SEP.06	DEC.05
Promoter	55.0	54.9	64.5
Domestic Inst	9.2	8.5	6.3
Foreign	9.5	7.4	4.4
Others	26.3	29.2	24.8

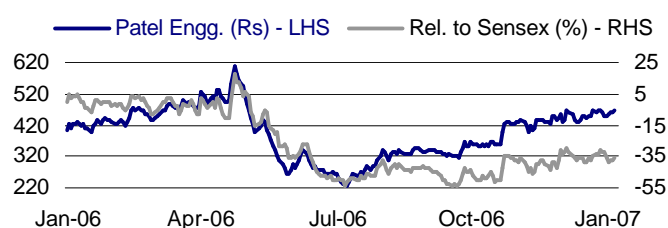
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	18.0	18.8	-4.1
FY08	25.1	25.8	-2.6

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
466	531	14.0	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Net Sales	5,295	8,029	10,944	16,383	20,684	
Change (%)	-	516	36.3	49.7	26.3	
Total Expenses	4,648	6,952	9,500	14,201	17,899	
EBITDA	647	1,077	1,444	2,182	2,785	
% of Net Sales	12.2	13.4	13.2	13.3	13.5	
Depreciation	210	256	278	399	499	
Interest	190	200	133	222	383	
Other Operating Income	145	102	136	191	253	
Other Income	50	45	35	35	70	
PBT	443	769	1,203	1,787	2,226	
Extra-ordinary Items	-5	2	0	0	0	
PBT after Extra-ord. iter	438	770	1,203	1,787	2,226	
Tax	48	46	150	322	401	
Rate (%)	10.9	6.0	12.5	18.0	18.0	
Reported PAT	390	724	1,053	1,465	1,825	
Extra-ordinary Income (net of tax)	-5	2	0	0	0	
Adjusted PAT	394	722	1,053	1,465	1,825	
Change (%)	72.0	83.2	45.7	39.2	24.6	

BALANCE SHEET		(Rs Million)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Share Capital	49	50	60	60	60	
Reserves	1,245	1,897	7,088	8,418	10,039	
Net Worth	1,294	1,947	7,148	8,477	10,098	
Loans	1,203	2,585	1,850	1,850	3,000	
Contractee Advances	1,854	1,770	2,189	3,277	4,137	
Deferred Tax Liability	144	122	122	122	122	
Capital Employed	4,495	6,424	11,308	13,726	17,357	
Gross Fixed Assets	2,491	2,590	3,086	3,986	4,986	
Less: Depreciation	856	863	1,141	1,539	2,038	
Net Fixed Assets	1,635	1,727	1,945	2,447	2,948	
Capital WIP	41	46	50	50	50	
Investments	282	168	1,160	1,910	3,160	
Curr. Assets	4,551	6,861	11,294	14,004	17,146	
Inventory	1,428	2,854	3,898	5,835	7,367	
Debtors	768	1,022	1,499	2,244	2,833	
Cash & Bank Balance	97	520	2,536	894	595	
Loans & Advances	1,436	2,465	3,360	5,029	6,350	
Other Current Assets	1	1	1	1	1	
Current Liab. & Prov.	2,014	2,379	3,140	4,684	5,947	
Creditors	1,696	1,865	2,371	3,549	4,481	
Other Liabilities	281	490	668	999	1,262	
Provisions	36	25	102	136	204	
Net Current Assets	2,537	4,482	8,153	9,319	11,199	
Misc. Exp	0	2	0	0	0	
Application of Funds	4,495	6,424	11,308	13,726	17,357	

E: MOST Estimates

RATIOS						
Y/E MARCH	2005	2006	2007E	2008E	2009E	
Basic (Rs)						
Adjusted EPS	8.1	14.4	17.6	24.6	30.6	
Growth (%)	-82.8	78.1	22.1	39.2	24.6	
Consolidated EPS	8.5	14.7	18.0	25.1	31.3	
Growth (%)	-	71.5	22.7	39.5	24.9	
Cash EPS	12.4	19.6	22.3	31.2	39.0	
Book Value	26.6	38.9	119.8	142.1	169.3	
DPS	10	13	15	2.0	3.0	
Payout (incl. Div. Tax.)	14.1	10.6	9.7	9.3	11.2	
Valuation (x)						
P/E (standalone)		32.2	26.4	19.0	15.2	
Cash P/E		23.8	20.9	14.9	12.0	
EV/EBITDA		23.5	18.8	13.2	10.8	
EV/Sales		3.2	2.5	1.8	1.5	
Price/Book Value		12.0	3.9	3.3	2.8	
Dividend Yield (%)		0.3	0.3	0.4	0.6	
Profitability Ratios (%)						
RoE	35.0	44.6	23.2	18.8	19.7	
RoCE	12.9	15.9	13.5	14.5	15.2	
Turnover Ratios						
Debtors (Days)	53	46	50	50	50	
Asset Turnover (x)	14	15	12	13	13	
Leverage Ratio						
Debt/Equity (x)	0.9	1.3	0.3	0.2	0.3	

CASH FLOW STATEMENT		(Rs Million)				
Y/E MARCH	2005	2006	2007E	2008E	2009E	
PBT before Extraordinary Item	443	769	1,203	1,787	2,226	
Add : Depreciation	210	256	278	399	499	
Interest	190	200	133	222	383	
Less : Direct Taxes Paid	48	46	150	322	401	
(Inc)/Dec in WC	-393	-2,343	-1,655	-2,808	-2,179	
CF from Operations	401	-1,164	-191	-722	528	
Extra-ordinary Items	-5	2	0	0	0	
CF from Operations after Extra-ordinary Items	396	-1,163	-191	-722	528	
(Inc)/Dec in FA	-428	-353	-500	-900	-1,000	
(Pur)/Sale of Investments	-205	114	-992	-750	-1,250	
CF from Investments	-634	-239	-1,492	-1,650	-2,250	
(Inc)/Dec in Networth	13	-16	4,250	0	0	
(Inc)/Dec in Debt	1,067	1,298	-316	1,088	2,010	
Less : Interest Paid	190	200	133	222	383	
Dividend Paid	55	77	102	136	204	
CF from Fin. Activity	836	1,006	3,698	730	1,423	
Inc/Dec of Cash	598	-396	2,015	-1,642	-299	
Add: Beginning Balance	319	917	520	2,536	894	
Closing Balance	917	521	2,535	894	595	



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Patel Engineering

1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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