

Patel Engineering (PATEN)

₹ 368

Rating matrix

Rating	: Strong Buy
Target	: ₹ 454
Target Period	: 12-15 months
Potential Upside	: 23%

Financial performance

	FY09	FY10	FY11E	FY12E
Net sales	2459.8	3190.9	3430.2	4195.2
EBITDA	395.3	508.7	537.8	665.1
Net profit	186.1	169.7	180.8	219.2

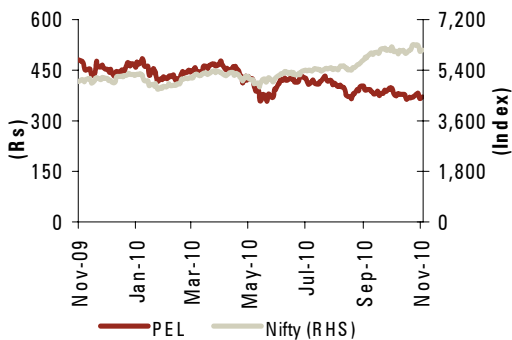
Valuation summary

	FY09	FY10	FY11E	FY12E
EPS (₹)	31.2	24.3	25.9	31.4
Adj PE(x)	8.6	10.7	10.0	8.3
Adj Target PE(x)	11.1	14.2	13.3	11.0
EV/EBITDA(x)	9.0	8.2	7.3	6.3
P/BV(x)	2.2	1.9	1.7	1.5
RoNW(%)	20.8	17.0	13.4	14.4
RoCE(%)	13.4	14.6	12.2	13.1

Stock data

MCap	₹ 2,570 crore
Debt	₹ 2,364 crore
Cash	₹ 392 crore
EV	₹ 4,541 crore
52 week H/L	₹ 484/358
Equity capital	₹ 7 crore
Face value	₹ 2.0
DII Holding (%)	3.7
FII Holding (%)	14.6

Price movement



Analyst's name

Deepak Purswani
deepak.purswani@icicisecurities.com

Bhupendra Tiwary
bhupendra.tiwary@icicisecurities.com

WHAT'S CHANGED...

PRICE TARGET	From ₹ 460 to ₹ 454
EPS (FY11E)	From ₹ 24.4 to ₹ 25.9
EPS (FY12E)	From ₹ 32.0 to ₹ 31.4
Rating	From Buy to Strong Buy

Building on power & real estate...

Patel Engineering Ltd (PEL) reported a strong set of Q2FY11 results with revenues witnessing 26% YoY growth to ₹ 766 crore. The EBITDA margin declined by ~350 bps YoY and ~170 bps QoQ to 15.2% due to lower share of revenues from the hydro segment. PAT grew at 7.2% YoY to ₹ 44 crore. Despite subdued order inflows, order book of ₹ 10,500 crore provides robust revenue visibility. The company's strong focus on the power and real estate segments ensures consolidated revenues CAGR of 14.7%. We recommend **STRONG BUY** on the stock.

Q2FY11 results above expectations; topline estimates upgraded

PEL reported a solid revenue growth of 26% in Q2FY11, above our estimates while EBITDA margins were in line at 15.2%. The company reported a net margin of 5.7% due to lower depreciation and interest charges.

Shifting focus on power and real estate verticals

With the subdued external order inflows, PEL is focussing on driving revenues from executing its captive orders, mainly in the power and real estate verticals. The company expects to secure ~₹ 3,000-4,000 crore of orders from the captive thermal and hydro power projects in FY11E.

Valuation

We have fine-tuned our earning estimates to incorporate H1FY11 in our estimates. At the CMP, PEL is trading at the adjusted P/E of 10x in FY11E and 8.3x in FY12E. With the strong performance in H1FY11, healthy order book and pick-up in execution of captive orders ensuring a strong earnings growth in FY10-12E, we recommend **STRONG BUY**, on the stock with a target price of ₹ 454/share.

Exhibit 1: Key financials (standalone)

Particulars	Q2FY11	Q2FY11E	Q2FY10	Q1FY11	YoY Gr (%)	QoQ Gr (%)
Net sales	765.9	646.0	608.0	702.3	26.0	9.1
EBITDA	116.1	99.0	113.6	118.5	2.2	-2.1
EBITDA Margin (%)	15.2	15.3	18.7	16.9		
Depreciation	26.2	26.4	31.6	25.6	-17.1	2.4
Interest	30.0	42.5	28.5	32.5	5.1	-7.8
PAT	43.6	23.7	40.7	40.1	7.2	8.8

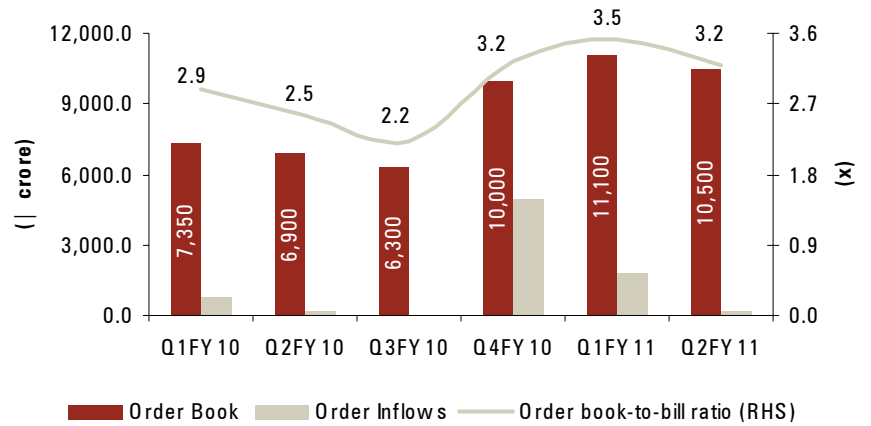
Source: Company, ICICIdirect.com Research

PEL is expected to secure ~₹ 3,000-4,000 crore of orders from its captive thermal and hydro power projects in FY11E

Subdued external order inflows; focus on captive orders execution

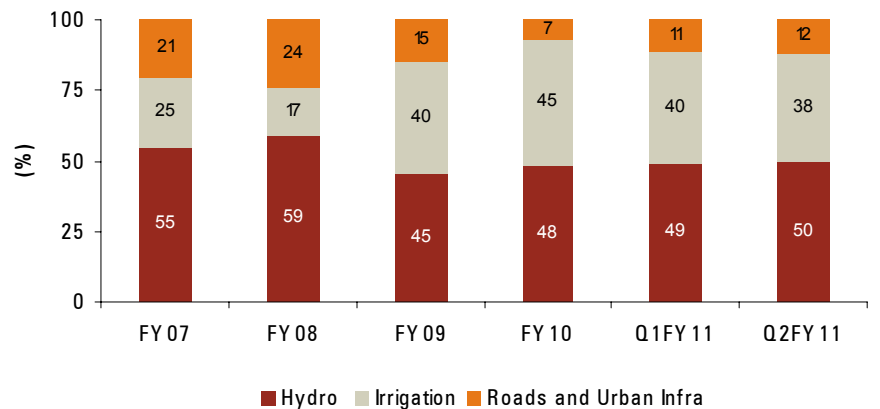
- PEL’s order book stands at ₹ 10,500 crore in Q2FY11 from ₹ 11,100 crore in Q1FY11. The management does not plan to bid aggressively for the low-margin new orders from external parties. PEL expects to receive orders worth ₹ 3,000-4,000 crore from its captive power projects in FY11E
- The order book includes ₹ 2,100 crore of contracts in which the company is L1 while ~₹ 200-250 crore of orders are from the company’s JVs
- The order book of ₹ 10,500 crore implies a TTM order book-to-bill ratio of 3.2x, providing strong revenue visibility
- The slow moving AP region accounts for ~18% of the company’s order book with the biggest contribution from a single irrigation contract in the Pranahita project of ₹ 3,500 crore (PEL’s share of ₹ 1,500 crore) in the Telangana region
- The hydro segment accounts for the largest share (50%) of the order book, followed by the irrigation (~38%) and roads and urban infra (~12%) segments

Exhibit 2: Order book of ₹ 10,500 crore provides strong revenue visibility



Source: Company, ICICIdirect.com Research

Exhibit 3: Hydro segment dominates order book with 50% share in Q2FY11



Source: Company, ICICIdirect.com Research

Power

- The company has invested ~₹ 250-300 crore in its power projects. The financial closure for phase I (1050 MW) is expected in December, 2010 or in January, 2011

Exhibit 4: Power project updates

Project	Capacity (MW)	Construction period (months)	Investment (₹ crore)	Status
Nagapattinam thermal power plant	2,650	36	5,000	Acquired land, secured coal linkages and approvals; to achieve FC by Dec 2010
West Kameng hydro power plant	140	48-60	1,000	Acquired land and approvals (except CEA); submitted revised DPR to be approved by June 2011

Source: Company, ICICIdirect.com Research

With the strong focus on developing its huge land bank (~1,100 acres), we expect significant value unlocking from real estate for the company

Huge value unlocking from real estate

- After the delay of one year, PEL started executing its real estate projects in December 2010 and recognised revenues of ₹ 50 crore from the real estate business for the first time in Q2FY11
- PEL plans to start development of its land bank in Hyderabad after settlement of the Telangana issue.
- The company is expected to make an investment of ~₹ 280 crore in its real estate business (through debt), majority of which is required for the commercial project in Mumbai (~₹ 200 crore)

Integrated township at Bangalore:

- PEL has sold all the 1,123 apartments in Smondoville phase I (~10 acres) for ₹ 240 crore
- For Smondoville phase II (~5 acres), the company has sold ~60% of the 239 apartments. The company expects revenues of ~₹ 200 crore from this project
- The company has awarded the construction of Neomall in Bangalore to Dubai based Al Fara constructions. It is a different type of mall with horizontal (G+1) structure without any super-built up area to cater to premium products. The company plans to invest ~₹ 150 crore in this project. PEL has already pre-leased ~65% of the area and expects to generate rental income of ~₹ 80-85 crore annually

Commercial property at Jogeshwari, Mumbai:

- Construction work has started on the commercial tower (10 lakh sq ft). The company plans to complete the construction in two years
- The company has tied up with the anchor tenant for 1.5 lakh sq ft at ₹ 125 psf. PEL is expected to generate post-tax income of ₹ 100 crore from this project

Integrated township at Port Lois, Mauritius:

- The Mauritius government has awarded ~56 acres of land to PEL for a lease rental of ₹ 2 crore per annum for 99 years
- There is no restriction for PEL in terms of FSI, type of construction and time period
- The company expects to generate ~₹ 4,000-6,000 crore of revenues over the years from this project

Other highlights

- PEL has completed both road BOT projects and will receive bonus on one of the projects for early completion. The company is already receiving annuity payments from KNT-1, Karnataka project and annuity from AP-7, Andhra Pradesh is expected to commence by the end of Nov 2010.

Valuations

As PEL reported a strong set of results in Q2FY11 above our estimates, we have increased our topline estimates marginally by 6% and 3% in FY11E and FY12E, respectively. However, with the high debt level and higher interest rates, we have increased our earning estimate for FY11E at 6% and reduced our FY12E earnings estimate by 2%.

At the CMP, the stock is trading at a P/E of 10x in FY11E 8.3x in FY12E (after adjusting for the subsidiaries valuation). With strong earnings growth in FY10-12E and value unlocking from the real estate and power verticals, we have upgraded our recommendation to **STRONG BUY** with an SOTP target price of ₹ 454/share.

Exhibit 5: SOTP Valuation - PEL

Entity	Value (₹ crore)	Per share (₹)	Comment
Construction business	2,410.7	345	11x FY12 Earning estimates
Road BOTs		8	
KNT - 1 Karnataka	25.7	4	Based on FCFE methodology. We have assumed COE of 13%
AP - 7 Andhra Pradesh	30.7	4	
Real Estate		65	
Corporate Tower, Jogeshwari	193.1	28	
Smondoville, Bangalore	29.7	4	Based on NPV methodology.
PAN Oasis, Noida	60.5	9	
Other Land Bank Value	171.4	25	Based on discounted market price
Power BOTs	250.0	36	1x P/BV
Fair Value		454	

Source: Company, ICICIdirect.com Research

Exhibit 6: Valuation metrics

	Sales (₹ crore)	Sales Gr (%)	EPS (₹)	EPS Gr (%)	Adj P/E (x)	P/BV (x)	RoNW (%)	RoCE (%)
FY09	2459.8	32.3	31.2	9.1	8.6	2.2	20.8	13.4
FY10	3190.9	29.7	24.3	-22.1	10.7	1.9	17.0	14.6
FY11E	3430.2	7.5	25.9	6.5	10.0	1.7	13.4	12.2
FY12E	4195.2	22.3	31.4	21.2	8.3	1.5	14.4	13.1

Source: Company, ICICIdirect.com Research

Our target price for PEL is ₹ 454/share. Real estate projects contribute ~14% of the target price, which is expected to increase, going forward

ICICIdirect.com coverage universe (Construction)

Simplex Infra				Sales (₹ Crore)	EPS (₹)	Adj PE (x)	P/BV(x)	RoNW (%)	RoCE (%)
Idirect Code	SIMCON CMP	468	FY09	4,662.7	23.2	19.9	2.5	13.9	14.7
Mcap (₹ crore)	2295 Target	549	FY10	4,443.5	24.7	18.7	2.4	13.1	12.8
	% Upside	17%	FY11E	5,183.0	28.9	16.0	2.1	13.9	14.2
			FY12E	6,406.5	38.7	11.9	1.8	16.1	16.8
Unity Infra				Sales (₹ Crore)	EPS (₹)	Adj PE (x)	P/BV(x)	RoNW (%)	RoCE (%)
Idirect Code	UNIINF CMP	106	FY09	1,130.8	10.4	10.2	1.7	18.0	18.8
Mcap (₹ crore)	822 Target	127	FY10	1,476.8	11.7	9.1	1.4	17.6	17.6
	% Upside	20%	FY11E	1,801.0	14.3	7.4	1.2	17.3	16.9
			FY12E	2,055.0	15.9	6.7	1.0	16.5	16.7
IVRCL Infra				Sales (₹ Crore)	EPS (₹)	Adj PE (x)	P/BV(x)	RoNW (%)	RoCE (%)
Idirect Code	IVRINF CMP	132	FY09	4,867.9	8.5	9.5	2.0	13.2	12.8
Mcap (₹ crore)	3535 Target	161	FY10	5,477.1	7.9	10.1	2.0	11.5	14.4
	% Upside	22%	FY11E	6,037.9	7.7	10.4	1.8	10.6	12.5
			FY12E	7,703.8	9.6	8.4	1.6	11.9	13.2
Nagarjuna Construction				Sales (₹ Crore)	EPS (₹)	Adj PE (x)	P/BV(x)	RoNW (%)	RoCE (%)
Idirect Code	NAGCON CMP	137	FY09	4,151.4	6.7	14.1	2.0	9.5	11.9
Mcap (₹ crore)	3747 Target	199	FY10	4,777.8	9.1	10.5	1.7	11.8	12.9
	% Upside	45%	FY11E	5,781.3	9.2	10.4	1.5	10.0	12.0
			FY12E	7,655.2	12.3	7.7	1.4	12.3	13.4
Patel Engineering				Sales (₹ Crore)	EPS (₹)	Adj PE (x)	P/BV(x)	RoNW (%)	RoCE (%)
Idirect Code	PATEN CMP	368	FY09	2,459.8	30.3	8.6	2.2	20.8	13.4
Mcap (₹ crore)	2570 Target	454	FY10	3,190.9	26.9	10.7	1.9	17.0	14.6
	% Upside	23%	FY11E	3,430.2	25.9	10.0	1.7	13.4	12.2
			FY12E	4,195.2	31.4	8.3	1.5	14.4	13.1
Hindustan Construction				Sales (₹ Crore)	EPS (₹)	Adj PE (x)	P/BV(x)	RoNW (%)	RoCE (%)
Idirect Code	HINCON CMP	57	FY09	3,313.7	1.7	8.2	3.2	12.5	10.5
Mcap (₹ crore)	3458 Target	74	FY10	3,644.2	1.6	9.4	2.5	6.5	9.5
	% Upside	30%	FY11E	4,234.4	1.7	7.4	2.4	6.7	8.7
			FY12E	5,514.2	2.3	5.5	2.2	8.5	10.3

Source: Company, ICICIdirect.com Research

RATING RATIONALE

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Strong Buy: 20% or more;
 Buy: Between 10% and 20%;
 Add: Up to 10%;
 Reduce: Up to -10%
 Sell: -10% or more;

Pankaj Pandey

Head – Research

pankaj.pandey@icicisecurities.com

**ICICIdirect.com Research Desk,
 ICICI Securities Limited,
 7th Floor , Akruiti Centre Point,
 MIDC Main Road, Marol Naka,
 Andheri (East)
 Mumbai – 400 093**

research@icicidirect.com

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