

Gammon India

STOCK INFO.	BLOOMBERG
BSE SENSEX: 12,389	GMON IN
	REUTERS CODE
S&P CNX: 3,565	GAMM.BO

Equity Shares (m)	86.7
52-Week Range	589/276
1,6,12 Rel. Perf. (%)	-4/-35/-43
M.Cap. (Rs b)	33.8
M.Cap. (US\$ b)	0.7

5 October 2006

Buy

Rs390

Previous Recommendation: Buy

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	14,851	1,043	9.6	44.1	40.5	3.7	9.0	13.6	2.9	22.1
3/07E	21,522	1,182	13.6	41.8	28.6	3.3	11.5	14.0	1.6	17.0
3/08E	30,730	1,784	20.6	50.9	18.9	2.9	15.2	20.0	1.1	11.6

Period 12/04A is for 9 months; # 15 month period January 2005 - March 2006

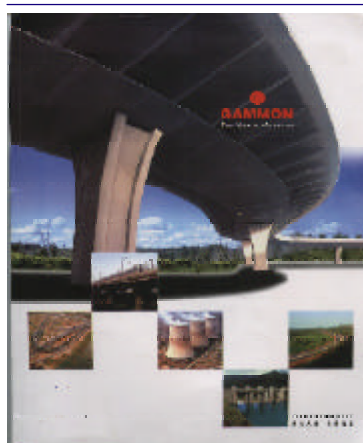
Annual report, FY06: key takeaways

Focus on Real Estate as core business activity: Chairman's statement states that property development and hydro carbons are showing exciting growth potential, in both of which Gammon is evaluating options and hopes to emerge as a key player in the near future. The company has also identified urban infrastructure, airports, water and waste water management, railways, power transmission and agricultural infrastructure as future growth drivers.

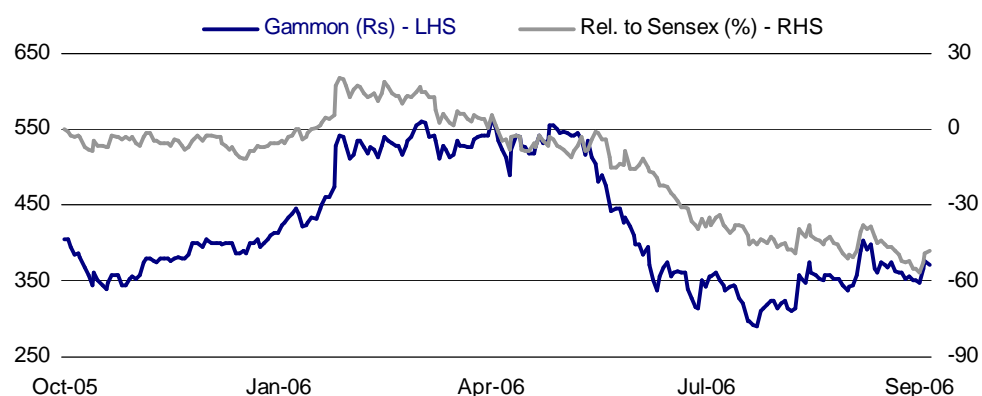
Increased contribution from subsidiary/ associate companies: During FY06, Gammon's consolidated profits stood at Rs1,446m, v/s standalone profits of Rs1,043m, resulting in net contribution of Rs403m. This compares with reported loss of Rs115m during CY04 by subsidiaries and associate companies.

Positive surprises from Associated Transrail and Gammon & Billimoria: (1) Associated Transrail Structures which is into power transmission towers (Gammon's stake 28.9%), reported FY06 revenues of ~Rs2.5b and net profit of Rs231m, and during FY07 we expect revenue growth of 50%+YoY (2) Gammon & Billimoria (Gammon's stake 50.9%) through Gammon and Billimoria Llc (49%), which is engaged in urban infrastructure projects in Middle East, contributed ~Rs100m to Gammon's consolidated profits in FY06; given the current order book at Rs6b+, we expect 25-30% growth rate in FY07.

Recommend Buy: Based on SOTP, we arrive at a price target of Rs425/sh; we value core business at Rs247/ share (12x FY08 P/E), Gammon Infrastructure at Rs135/share and other subsidiaries/investments at Rs42/sh. At CMP of Rs390, the stock trades at reported PER of 28.6x FY07 and 18.9x FY08E. Adjusting for the value of subsidiaries and investments, it trades at PER of 15.6x FY07 and 10.3x FY08E. Maintain **Buy**.



STOCK PERFORMANCE (1 YEAR)



Takeaways from Chairman's letter

Chairman's letter to shareholders indicates positive outlook in terms of infrastructure spending in the economy and also on Gammon's positioning to capitalize on the same. It also emphasizes increased focus on real estate as business activity, and states that other areas showing exciting potential are property development and hydrocarbons sector, where Gammon is evaluating options and hopes to emerge as key player in the near future. The company is also looking to consolidate on its recent foray in the international arena in markets in the Middle East, North Africa, etc. It concludes by stating *"I am optimistic and confident that in the current year and in the foreseeable future, your company will continue to maintain all round development and growth and meet the emerging challenges"*.

Robust order backlog, increased average project size

Gammon's order book as at March 2006 stood at Rs55.7b (spread over 55 project sites), vs Rs37.5b (73 project sites) in December 2004. Thus, the average size has nearly doubled to Rs1b from Rs510m. Order book composition stands as: Transport engineering (Roads & Bridges) 48%, Hydro & irrigation 19% and Pipelines 13%. Central government accounted for 64% of the order book, Andhra Pradesh (15%), Gujarat (3%), Overseas (6%), etc.

KEY PROJECTS UNDER EXECUTION AS AT MARCH 2006 (RS M)

Water Transmission System, Sultanate of Oman	6,425
Kalwakurthy Lift Irrigation System	6,310
Mumbai Nashik Expressway	6,210
NH 57, NHAI Road Project, Bihar	3,565
Prabati Hydro Electric Projects, Stage III	3,250
Gandikota Package, Andhra Pradesh Irrigation	2,940
Dahej – Uran Pipeline	1,960
NH 54, NHAI Road Project, Assam	1,790
NH 54, NHAI Road Project, Assam	1,710
Nuclear Building, Kalpakkam	1,560

Source: Company

Focus on new business segments

The management has listed the following sectors for future development and investment: urban infrastructure, airports, water and waste water management, railways, power transmission and agricultural infrastructure. Also, the Chairman's statement states that property development and hydro carbon sector are showing exciting growth potential. Further, the company is also looking to consolidate its recent foray in the international arena in markets in Middle East, North Africa, etc'. Gammon also intends to focus on Hydro & Thermal power projects on BOOT basis.

Real estate as a focused business activity

Realty development is emerging as a key focus area for the Gammon, though at nascent stages currently. As initial forays in the segment, Gammon has entered into contracts with Godrej Properties (Rs605m) for construction of 7 towers of 14 storeys each, in Bangalore and with Neelkanth Reality (Rs887m) for construction of 7 towers of 14 storeys, in Mumbai. Going forward, the company also intends to enhance its role as project developer. As we understand, the company already has certain land banks in metros, which can be monetized.

Increased contribution from subsidiary/associate companies

During FY06, Gammon's subsidiaries and associate companies have contributed to consolidated profits in a meaningful manner. Consolidated profits during FY06 stood at Rs1,446m, vs standalone profits of Rs1,043m, resulting in a net contribution of Rs403m. During CY04, the subsidiaries and associate companies reported net loss of Rs115m.

GAMMON INDIA: STANDALONE AND CONSOL. PERFORMANCE (RS M)

NET PROFIT	CY04	FY06
	(APR-DEC-04)	(JAN-MAR-06)
Standalone	381	1,043
Consolidated	266	1,446
Subsidiaries/ Associates	-115	403
EPS (Rs per Share)		
Standalone	6.7	12.0
Consolidated	4.7	16.7

Source: Company

The improved performance is being driven by:

- ✎ **Gammon Infrastructure (Gammon's stake - 82.5%):** During FY06, Gammon Infrastructure reported consolidated net profit of Rs216m. This is largely due to improved profitability of Rajahmundry Expressway (Rs179m) and Andhra Expressway (Rs153m). Vizag Seaports reported loss Rs128m and the SPV commenced operations in FY06.
- ✎ **Associated Transrail Structures Limited (Gammon's stake - 28.9%):** During FY06, Associated Transrail reported net profit of Rs231m, resulting in addition of Rs67m to Gammon's consolidated profitability. This company is engaged into setting up of power transmission networks. The management stated that FY06 revenues stood at Rs2.5b. During FY07, we expect the company to witness revenue growth of 50%+YoY, and also expect improvement in margins.
- ✎ **Gammon & Billimoria Limited (Gammon's stake - 50.9%):** Gammon and Billimoria has 49% stake in Gammon and Billimoria Llc, incorporated in Dubai. It is engaged in urban infrastructure projects in Middle East (commercial property, hotels, residential, car parks, etc). The management stated that Gammon's share of profits from this subsidiary stood at Rs100m in FY06. Given that the current order book of the company stands at Rs6b+, we expect 25-30% growth rate in FY07.

- ✎ **Expenditure on Contracts** at 84.3% during FY06 was lower by 200bp YoY and also lower than the historic levels. This was largely a result of lower sub contracting expenses to 32.6% in FY06, vs 40.5% in CY04, while employee costs, power expenses, etc increased. We also understand that during FY06, Gammon had received prior period claims, part of which have been netted off against expenditure on contracts. Thus EBITDA margins for the year improved to 13% in FY06, vs. 10.9% in CY04 and 9.6% in FY04.
- ✎ **Reasons for improvement in EBITDA margins during FY06:** We believe that the key reasons for improvement in EBITDA margins are: receipt of certain prior period claims by the company during FY06 and several projects reaching margin recognition threshold. As per the accounting policy adopted, Gammon accounts for margins on projects (Rs2.5b+) post 15% completion, and for other projects, post 25% completion.
- ✎ **Management's guidance factors in significant drop in margins:** For FY07, the management has guided for EBITDA margins of 9-9.5%, which factors in a 50bp impact from higher input costs. This compares with EBITDA margins of 13% during FY06. As several new projects are being commissioned in the current year, margins are expected to decline, as the accounting policy adopted will constrain margin recognition, on significant part of the revenues.

Financial performance and ratio analysis

During FY06, Gammon reported standalone revenues of Rs14.7b for 15 months period from January 2005 to March 2006. On adjusted basis, revenues grew by 2% YoY while EBITDA was up by 21% YoY to Rs1.9b and net profit for the year grew by 64% YoY to Rs1.04b (on adjusted basis).

COST ANALYSIS (RS M)

YEAR ENDED	FY03	FY04	CY04	FY06
Net Sales	7,308	11,238	8,775	14,851
YoY Growth (%)	-	53.8	4.1	1.5
Expenditure on Contracts	6,310	9,908	7,593	12,521
As a % to Sales	86.3	88.2	86.5	84.3
Establishment Expenses	192	251	222	397
As a % to Sales	2.6	2.2	2.5	2.7
EBITDA	807	1,079	959	1,932
EBITDA Margin (%)	11.0	9.6	10.9	13.0

Source: Company

BALANCE SHEET ANALYSIS (RS M)

YEAR ENDED	FY03	FY04	CY04	FY06
Net Worth	1,981	2,223	3,943	9,258
Borrowings	1,883	2,182	3,031	1,705
Gearing (x)	1.0	1.0	0.8	0.2
Fixed Assets (Gross)	3,808	4,142	4,505	5,420
Cash & Bank Balance	246	280	728	1,343
Debtors	1,498	1,718	2,335	2,380
Debtors (Days)	75	56	73	65
Inventory	1,831	2,675	3,494	4,706
Inventory (Days)	60	113	109	129
Creditors	1,846	2,287	3,030	2,530
Creditors (Days)	107	84	108	70
Loans & Advances	825	1,220	1,674	3,020
Net Working Capital	492	967	3,219	6,377
As a % to Sales	6.7	8.6	36.7	42.9

Source: Company

- ✎ **Increase in net worth:** Gammon's net worth as at March 2006 stands at Rs9.3b, up from Rs3.9b in December 2004. This is primarily through raising Rs4.5b from GDR issue of 10.6m additional shares at US\$9.47 (Rs426 per share) in December 2005.
- ✎ **Low gearing:** Significant part of the funds raised through GDR has been used for debt repayment. Thus, gearing is down from 0.8x in CY04 and 1x in FY04 to 0.2x in FY06. Debt as at March 2006 stands at Rs1.7b, of which non-convertible debenture comprise of Rs1b, and the balance is short term loans for durations of one year or less.
- ✎ **Significant addition to gross block:** During FY06, Gammon incurred capex of Rs915m, resulting in increase in gross block to Rs5.4b, up from Rs4.5b in CY04.
- ✎ **Increase in cash and bank balance:** Cash and bank balance has increased to Rs1.3b in FY 06 vs. Rs728m in CY04 mainly due to unutilized proceeds of the GDR proceeds deposited in fixed deposit (Rs911m) and current account (Rs360m) with the banks.
- ✎ **Increase in working capital:** During FY06, working capital requirement increased to 43%, up from 37% in December 2004. This is being driven by: (1) increased work in progress at Rs3.5b in March 2006, vs Rs2.4b in December 2004 (2) increased project advances at Rs1.6b vs Rs342m in December 2004 and (3) reduction in sundry creditors to Rs2.5b vs Rs3b in December

2004, as the company made prompt payments to be eligible for discounts, given the unutilized GDR proceeds.

- ✎ **Negative cash flow from operations:** During FY06, cash from operations stood at negative Rs636m, as compared to positive Rs202m in CY04. This is largely driven by the change in net working capital due to higher inventory levels, project advance and decrease in creditors, as the company made prompt payments to be eligible for discounts, given the unutilized GDR proceeds.

CASH FLOW STATEMENT (RS M)

	FY04	CY04	FY06
Cash Flow from Operations	640	202	-636
Cash Flow from Investing	-280	-506	-1,054
Cash Flow from Financing	-326	750	2,306
Net Increase in Cash & Equivalents	35	446	616

Source: Company

Recommend Buy

We expect Gammon to report net profit of Rs1.2b (up 42%) in FY07, and Rs1.8b (up 51% YoY) in FY08, respectively. Based on SOTP, we arrive at a price target of Rs425/sh; we value core business at Rs247/sh (12x FY08E P/E), Gammon Infrastructure at Rs135/sh and other investments at Rs42/sh. At CMP of Rs390, the stock trades at reported PER of 28.6x FY07E and 18.9x FY08E. Adjusting for the value of subsidiaries and investments, it quotes at PER of 15.6x FY07E and 10.3x FY08E. Maintain **Buy**.

INCOME STATEMENT					
(Rs Million)					
Y/E DECEMBER	2004	2004*	2006E#	2007E	2008E
Gross Revenues	11,197	8,666	16,592	21,437	30,600
Net Sales	11,238	8,775	14,851	21,522	30,730
Change (%)	53.8	4.1	1.5	81.2	42.8
Construction expenses	9,908	7,593	12,521	19,012	27,013
Office and site establishment ex	251	223	397	522	744
EBITDA	1,079	959	1,932	1,988	2,972
% of Net Sales	9.6	10.9	11.5	9.2	9.7
Depreciation	199	165	371	335	389
Interest	447	282	471	258	448
Other Income	6	3	21	13	14
PBT	438	516	1,112	1,408	2,149
Tax	252	134	69	225	365
Rate (%)	57.6	26.1	6.2	16.0	17.0
Reported PAT	186	381	1,043	1,182	1,784
Adjusted PAT	186	381	1,043	1,182	1,784
Change (%)	190.6	173.9	64.0	41.8	50.9

BALANCE SHEET					
(Rs Million)					
Y/E DECEMBER	2004	2004*	2006E#	2007E	2008E
Share Capital	125	152	173	173	173
Reserves	2,098	3,791	9,085	10,069	11,557
Net Worth	2,223	3,943	9,258	10,243	11,730
Loans	2,182	3,031	1,705	1,842	1,442
Deffered Tax Liability	320	366	345	345	345
Capital Employed	4,725	7,340	11,309	12,430	13,517
Gross Fixed Assets	4,142	4,505	5,420	6,143	7,143
Less: Depreciation	1,237	1,408	1,723	2,058	2,447
Net Fixed Assets	2,905	3,097	3,697	4,085	4,696
Capital WIP	48	128	73	150	150
Investments	805	896	1,162	1,158	1,158
Curr. Assets	5,913	8,258	11,469	15,087	18,952
Inventory	2,675	3,494	4,706	6,460	9,222
Debtors	1,718	2,335	2,380	3,818	5,449
Cash & Bank Balance	280	728	1,343	1,788	760
Loans & Advances	1,220	1,674	3,020	3,000	3,500
Other Current Assets	21	26	21	21	21
Current Liab. & Prov.	4,947	5,039	5,092	8,051	11,440
Creditors	2,287	3,030	2,530	4,111	5,868
Other Liabilities	2,594	1,918	2,440	3,818	5,449
Provisions	66	92	122	122	122
Net Current Assets	967	3,219	6,377	7,036	7,512
Application of Funds	4,725	7,340	11,309	12,430	13,517

E: MOST Estimates; * Nine months ended Dec 2004,

#Fifteen months ended Mar 2006

RATIOS					
Y/E DECEMBER	2004	2004*	2006E#	2007E	2008E
Basic (Rs)					
Adjusted EPS	3.0	6.7	9.6	13.6	20.6
Growth (%)	118.0	124.7	44.1	41.8	50.9
Cash EPS	17.0	20.6	24.0	32.7	50.3
Book Value	35.6	51.8	106.7	118.1	135.2
DPS	0.5	0.5	0.6	2.0	3.0
Payout (incl. Div. Tax.)	19.2	11.5	5.7	14.7	14.6
Valuation (x)					
P/E (standalone)		58.4	40.5	28.6	18.9
Cash P/E		18.9	16.2	11.9	7.7
EV/EBITDA		28.2	22.1	17.0	11.6
EV/Sales		3.1	2.9	1.6	1.1
Price/Book Value		7.5	3.7	3.3	2.9
Dividend Yield (%)		0.1	0.2	0.5	0.8
Profitability Ratios (%)					
RoE	8.3	12.9	9.0	11.5	15.2
RoCE	20.0	17.6	13.6	14.0	20.0
Turnover Ratios					
Debtors (Days)	56	73	65	65	65
Creditors. (Days)	84	108	70	70	70
Leverage Ratio					
Debt/Equity (x)	1.0	0.8	0.2	0.2	0.1

CASH FLOW STATEMENT					
(Rs Million)					
Y/E DECEMBER	2004	2004*	2006E#	2007E	2008E
PBT before Extraordinary Items	438	516	1,112	1,408	2,149
Add : Depreciation	199	165	371	335	389
Interest	447	282	471	258	448
Less : Direct Taxes Paid	252	134	69	225	365
(Inc)/Dec in WC	-441	-1,804	-2,543	-214	-1,504
CF from Operations	392	-977	-659	1,562	1,117
(Inc)/Dec in FA	-283	-436	-917	-800	-1,000
(Pur)/Sale of Investments	-36	-91	-266	4	0
CF from Investments	-319	-527	-1,182	-796	-1,000
(Inc)/Dec in Networth	146	1,429	4,312	0	0
(Inc)/Dec in Debt	299	849	-1,326	136	-400
Less : Interest Paid	447	282	471	258	448
Dividend Paid	36	44	60	198	297
CF from Fin. Activity	-38	1,953	2,455	-320	-1,145
Inc/Dec of Cash	34	448	615	445	-1,028
Add: Beginning Balance	246	280	728	1,343	1,788
Closing Balance	280	728	1,343	1,788	760



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Disclosure of Interest Statement	Gammon India
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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