

18 January 2008

BUY

Price **Rs 953** Target Price **Rs1219**

Sensex **19,701**

Price Performance

(%)	1M	3M	6M	12M
Absolute	10	34	105	105
Rel. to Sensex	7	27	62	47

Stock Details

Sector	Construction
Reuters	PEN.BO
Bloomberg	PEC@IN
Equity Capital (Rs mn)	60
Face Value	Rs1
52 Week H/L	1070/293
Market Cap	56.9
Daily Avg Volume (No of shares)	233063
Daily Avg Turnover (US\$)	4.8

Shareholding Pattern (%)

(31st Dec.'06)	
Promoters	54.1
FII	10.9
Institutions	10.8
Private Corp.	0.9
Public	23.3

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Patel Engineering Ltd.

Update

Further value unlocking likely

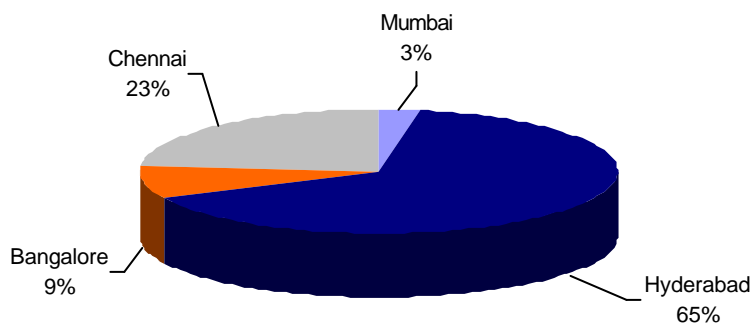
The company has continued its strong operating performance during FY08 especially the subsidiaries, which are showing improved profitability and growth. The company's has maintained a steady pace of orders inflow with an order intake of Rs15 bn during the current fiscal till now. We expect the growth momentum to continue in the core construction business and estimate the revenue to grow at a CAGR of 36% from FY07-FY10E to Rs27.8 billion and PAT to grow at a CAGR of 24% between FY07-FY10E to Rs2.1 billion

The company has also ventured into the high growth areas of real estate as well as power generation. The company plans to develop its historically acquired land bank of ~1000 acres through its 100% subsidiary PRIL. The company has signed an MoU with the Gujarat government to develop a imported coal based thermal power plant of 1200 MW capacity. It is currently in the process of identifying coal mines to secure linkages to the power plant. The company is also looking to develop a few hydro power IPPs and have put in bids for close to 600 MW projects. The company is planning to raise around USD 250-300 million through the QIP or FCCB route or a mix of both to fund these initiatives.

We believe that the company has in the recent past not only strengthened its focus in its core area of hydro power construction but has also ventured into the high growth areas like real estate and power generation. We also believe that despite the equity dilution, the real estate business and the power project will provide further room to create more value. We maintain our 'BUY' recommendation on the stock with a SoTP based target price of Rs1,219, an upside of 28% from the CMP of Rs953.

Real Estate to unlock value further – NAV Rs650 / share**Land bank in excess of 1000 acres**

The company has a strong land bank of over 1150 acres of which the company has decided to develop around 1000 acres. The company has finalized plans for development of only 12% of its total land bank. The company is developing the land bank through its 100% subsidiary Patel Realy (India) Ltd (PRIL). The land bank has been historically accumulated at a very low cost and is located in some of the key metros like Mumbai, Hyderabad, Bangalore and Chennai.

Spread of Land Bank

NAV at Rs650 per share

The company is looking at the option of funding some of the real estate projects through private equity at the project level. We believe that going ahead as the company firms up its development plans, there could be a substantial upside to the valuations currently being ascribed to its land bank. We have valued the land bank based on the NPV approach for the 1st Phase for which development plans are already finalised at Rs15.1 billion or Rs252 per share and the other land reserve at Rs397 per share based on the land value.

Key Assumptions in our NAV estimates

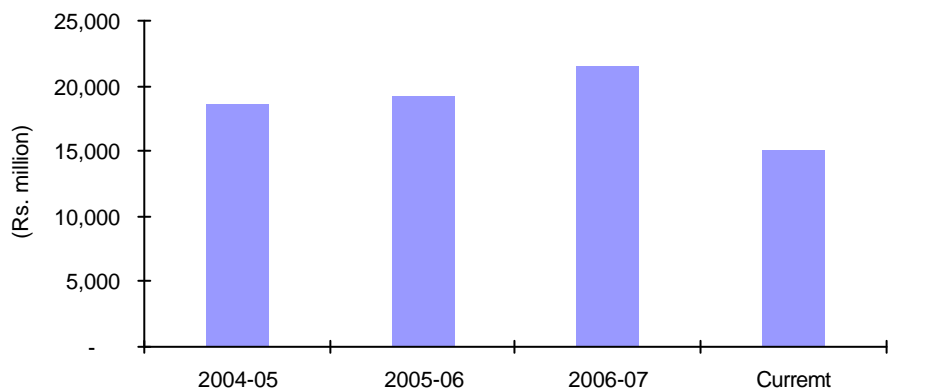
- For the 1st phase for which the development plans are already finalised, saleable area, development schedule etc. has been taken on the basis of indications given by the company.
- For other land bank, we have valued the land on the basis of the value of the land if sold as it is. NPV through development would be highly value accretive.
- Assumed a sell model for all the properties except Jogeshwari in Mumbai which the company is planning to lease out completely.
- Assumed a full tax rate of 33%. Cost of Equity of 15%.

We believe that the company's strong land reserves and a strategy to develop it in a phase wise manner will help the company emerge as a strong real estate player. We also believe that as the real estate subsidiary PRIL grows in size it will contribute strongly to the bottomline.

Construction business on firm footing

The company has a strong order backlog of Rs55 billion which is 4.5x TTM revenues. There has been an increased focus on the company's core strength viz. the high margin hydropower projects. The order intake has continued to be robust with an intake of orders worth Rs15 billion so far. The company is pre-qualified to bid for orders worth more than Rs100 billion in the hydropower segment. Patel is one of the strongest players in the hydropower segment and is set to benefit from the increased impetus of investment in the segment.

Year-wise order inflow



We expect the revenue to grow at a CAGR of 36% over a period of three years from FY07-10E to Rs27.8 billion. However, we expect the PAT to grow at a slower pace of 24% CAGR over the same period as we assume full tax rate. On a consolidated basis, we expect the company to register a growth of

Foray into Power Generation and eyeing coal mines

The company has signed a MoU with the Gujrat government to develop a 1,200 MW imported coal based thermal power plant to be developed in three phases of 400 MW each. This would entail an investment of over Rs50 billion over the next four years. The company is currently in the process of identifying the coal mines in order to establish the coal linkages for the power plant. The company's power plant would require 3-4 million tonnes of coal p.a. at full capacity and the company plans to secure linkages for next 20-30 years. The company is currently evaluating number of mines in Indonesia, South Africa and Mozambique. However, not much details are available regarding the

mines, the management expects to acquire mines in at least two countries in the next three to six months.

The company has also bidden for hydro power IPPs at various locations with a total capacity of 600 MW. Going forward, the company is planning to bid for larger hydropower projects of over 1000 MW. The company has already signed an MoU with the Arunachal Pradesh government to develop a 100 MW hydro power plant and is currently preparing the DPR for the same.

We believe that the company's expertise in construction of hydro power plants will provide the necessary synergies in development and operations of hydro power plants. Though, we have currently not valued the company's power projects, we feel that these initiatives would prove to be value accretive.

Improving performance of Subsidiaries

The company's subsidiaries in US as well as the microtunneling subsidiary in India has shown an improved performance in FY07 and in the current fiscal. This has resulted in the consolidated revenue growing at a faster pace of 35% and the PAT growing at 44.3% y-o-y for the nine months ended December, 2007. The company is planning to undertake a major capital expenditure programme in its US subsidiary Patel Engineering Inc as well as the microtunneling subsidiary in India. This would enable the company to take large orders of over USD 100 million in US.

Equity Dilution likely

The company is planning to raise around 250-300 million USD through a QIP or an FCCB route or a mix of both. This would result in an equity dilution of 15-20%. The main purpose of this exercise is to fund the company's plan to acquire coal mines. The funds will also be utilized for various other purposes viz. a) capex at the US subsidiary, b) Equipments for microtunneling business, c) Working capital requirements, d) Hydro power IPP.

Outlook and Valuation

The company has increased its focus on the high margin hydro power segment which is also its core strength. The company has also ventured into the high growth areas of real estate as well as power generation. We believe that the company will continue its growth momentum in the core construction business and estimate the revenue to grow at a CAGR of 36% over the period of FY07-10E and the PAT to grow at a CAGR of 24% over the same period. We also believe that as the company further firms up its plans for real estate business and as the company's power plans take more concrete shape it would be highly value accretive. We value the company based on a SoTP valuation assigning a value of Rs525 per share to the core construction business (15x FY10E), the real estate subsidiary at Rs650 per share (FY09E NAV), the foreign subsidiary at Rs26 per share and the BOT projects at Rs19 per share. We also believe that despite the equity dilution, the real estate business and the power project will provide further room for upside to our valuation going forward. We maintain our 'BUY' recommendation on the stock with a target price of Rs1,219, an upside of 28% from the CMP of Rs953.

SoTP Valuation

Segment	Basis	Multiple (x)	Value (Rsmn)	Value per share (Rs)	Justification
Construction business	FY09E, PE (x)	15.0	31,305	525	Rolling forward to FY10E. Assigning a multiple of 15 in line with peers like NCC, HCC and IVRCL
Foreign Subsidiaries	FY09E, PE (x)	12.0	1,575	26	Valued at a discount to Indian business because of lower margins
BOT projects (Annuity based)	P/BV	1.5	1,114	19	IRR at around 15-16% is reasonably risk free and thus premium over the expected investment
Real Estate division					
Phase-1	NPV		15,061	252	NPV of development, CoE -15%
Other land bank	Land value		23,700	397	Current land value if sold. NPV through development would be highly value accretive.
Total Fair value			72,754	1,219	

Income Statement

Y/E, Mar (Rs. m)	FY07	FY08E	FY09E	FY10E
Net Sales	11055	14900	20395	27820
Growth (%)	36.9	34.8	36.9	36.4
Expenses	9595	12814	17540	23925
Growth (%)	39.3	33.6	36.9	36.4
Raw Materials	2369	2533	3467	4729
% of sales	21.4	17.0	17.0	17.0
Labour charges	289	447	612	835
% of sales	2.6	3.0	3.0	3.0
Construction exps	6381	8940	12237	16692
% of sales	57.7	60.0	60.0	60.0
Admin exps	602	894	1224	1669
% of sales	5.4	6.0	6.0	6.0
(Profit)/loss on JV's	-46	0	0	0
% of sales	-0.4	0.0	0.0	0.0
EBIDTA	1460	2086	2855	3895
Growth (%)	22.7	42.9	36.9	36.4
EBIDTA %	13.2	14.0	14.0	14.0
Other income	95	90	90	90
Net interest exp	67	134	207	254
Depreciation	258	322	367	412
PBT	1231	1719	2371	3318
Current tax	129	567	782	1231
Deferred tax	0	0	0	0
Total Tax	129	567	782	1231
Effective tax rate (%)	10.5	33.0	33.0	37.1
Adjusted PAT	1101	1152	1589	2087
Growth (%)	52.0	4.6	37.9	31.4
Net Margin (%)	9.9	7.7	7.8	7.5
E/O items	0	0	0	0
Reported PAT	1101	1152	1589	2087

Balance Sheet

Y/E, Mar (Rs. m)	FY07	FY08E	FY09E	FY10E
Equity share capital	60	60	60	60
Stock option outstanding	0	0	0	0
Reserves & surplus	6972	7984	9398	11311
Networth	7032	8044	9458	11371
Deferred tax liability	108	108	108	108
Secured Loans	2734	2734	2734	2734
Unsecured Loans	511	511	511	511
Loan Funds	3245	3245	3245	3245
Total Liabilities	10385	11397	12811	14724
Gross Block	3083	3583	4083	4583
Less: Depreciation	1121	1443	1811	2223
Net block	1962	2139	2272	2360
Capital WIP	79	79	79	79
Investment	305	1805	2805	3805
Current Assets	12244	14663	17614	21999
Inventories	3898	5511	7264	9908
Sundry debtors	2639	2245	3073	4192
Cash & bank balance	2500	2824	1689	276
Loans & advances	3206	4082	5588	7622
Other assets	0	0	0	0
Current liabilities	4205	7289	9959	13519
Current liabilities	4199	7144	9778	13338
Provisions	6	145	180	180
Net current assets	8039	7374	7655	8480
Miscellaneous exp	0	0	0	0
Total Assets	10385	11397	12811	14724

Cash Flow

Y/E, Mar (Rs. m)	FY07	FY08E	FY09E	FY09E
Pre-tax profit	1231	1719	2371	3318
Depreciation	258	322	367	412
Interest Provided	67	134	207	254
Interest Paid	-85	-134	-207	-254
Others	-21	0	0	0
Chg in working cap	-2621	850	-1452	-2238
Tax paid	-260	-567	-782	-1231
Operating cash Inflow	-1431	2325	504	262
Capital expenditure	-515	-500	-500	-500
Free Cash Flow	-1947	1825	4	-238
Investments	-137	-1500	-1000	-1000
Equity Capital Raised	4250	0	0	0
Loans Taken / (Repaid)	96	0	0	0
Dividend (incl tax)	-105	0	-140	-175
Dividend Received	0	0	0	0
Issue Expenses	-177	0	0	0
Share Application money	0	0	0	0
Net chg in cash	1980	325	-1136	-1413
Opening cash position	520	2500	2824	1689
Closing cash position	2500	2824	1689	276

Key ratios

Y/E, Mar (Rs. m)	FY07	FY08E	FY09E	FY10E
Per Share Data (Rs)				
EPS	18.5	19.3	26.6	35.0
Cash EPS	22.4	24.7	32.8	41.9
EBITDA / Share	24.5	35.0	47.9	65.3
Book Value	117.9	134.8	158.5	190.6
Valuations (x)				
PER	51.6	49.4	35.8	27.2
Adjusted PER #	14.0	13.4	9.7	7.4
Price / CEPS	42.5	38.6	29.1	22.7
Price / BV	8.1	7.1	6.0	5.0
EV / Sales	5.2	3.8	2.9	2.2
EV / EBITDA	39.4	27.5	20.5	15.4
Adjusted EV / EBITDA #	11.1	7.6	5.9	4.7
EV/EBIT	47.9	32.5	23.5	17.2
Adjusted EV / EBIT #	13.4	9.0	6.8	5.3
Returns (%)				
RoCE	16.0	16.2	20.6	25.3
RoNW	24.5	15.3	18.2	20.0
RoC	0.0	0.0	0.0	0.0
Effeceincy ratio (x)				
Asset Turnover	1.5	1.4	1.7	2.0
Asset Turnover	1.5	1.6	2.2	2.8
Fixed Asset Turnover	3.9	4.5	5.3	6.4
Gearing Ratio (x)				
Net debt/ Equity	0.1	0.1	0.2	0.3
Total Debt/Equity	0.5	0.4	0.3	0.3

Price / EV adjusted for value assigned to businesses other than core construction business

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