Patel Engineering

Company Update

BUY

Price	**Rs343**
Target Price	**Rs418**
Investment Period	**12 Months**

Stock Info

Sector	Construction
Market Cap (Rs cr)	2,046
Beta	1.03
52 Week High / Low	1070/286
Avg Daily Volume	51324
Face Value (Rs)	1

BSE Sensex	13,964
Nifty	4,157

BSE Code	531120
NSE Code	PATELENG
Reuters Code	PENG.BO
Bloomberg Code	PEC IN

Shareholding Pattern (%)	
Promoters	52.3
MF / Banks / Indian FIs	11.0
FII / NRIs / OCBs	13.2
Indian Public / Others	23.5

Abs.	3m	1yr	3yr
Sensex (%)	(11.6)	(7.2)	91.1
Patel (%)	(38.8)	(64.8)	55.2

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'Making Constructive Strides'

Patel Engineering (PE) is a mid-sized infrastructure player with a strong presence in high-margin Hydropower Construction projects. With a burgeoning order book and access to leading-edge technology, Patel appears well placed to capitalise on the current infrastructure spending in the country. It is one of the few players with pre-qualifications in Hydro, Upstream Irrigation and other projects. It possesses in-house niche technologies like roller compacted concrete *(RCC) dam construction, microtunnelling, double lake water tapping, etc. We have valued PE on SOTP methodology wherein we have assigned its core construction business a PE of 10x FY2010E EPS of Rs25.5. For its Real Estate arm, we have arrived at NAV of Rs163/share.* ***We upgrade the stock from Neutral to Buy, with a Target Price of Rs418.***

- **Present in Niche high-Margin Segments:** PE's core competence is in the construction of Hydro Power Plants and Upstream Irrigation Projects. Hydro power projects are complex, require high technological expertise and fetch significantly high Margins. Benefits of Hydro and Upstream Irrigation projects is that the pass on of incremental costs is high compared to other segments. This helps PE maintain its Margins, which is a positive especially in the current high commodity price and interest rate regime.

- **Robust Order Book:** PE has a robust order book of Rs6,047cr (3.25x FY2008 Revenues). Importantly, there has been a change in the company's order book mix towards Hydro Power Projects, which command higher margins. It has been PE's policy to concentrate on high-Margin projects and enjoy optimum utilisation of resources. Currently, Hydro Projects contribute 59%, Transportation 24% and Irrigation 17% of the company's total order book.

- **Real Estate - The Dark Horse:** PE has a land bank of around 1,000 acres spread across Hyderabad (640 acres), Bangalore (106 acres), Chennai (230 acres) and Mumbai (26 acres). PE plans to develop its land bank in phases. In Phase I, it will develop 11% of the total land bank. In valuing PE's Real Estate venture, we have considered properties that would be developed in Phase I. For the balance land bank, we have assigned a discount to the prevailing market price. Our NAV for this segment works to Rs163/share.

Key Financials

Y/E March (Rs cr)	FY2007	FY2008	FY2009E	FY2010E
Net Sales	**1,296**	**1,860**	**2,371**	**2,916**
% chg	*27.7*	*43.5*	*27.5*	*23.0*
Net Profit*	**113.0**	**151.9**	**108.4**	**153.5**
% chg	*54.2*	*34.4*	*(28.6)*	*41.6*
FDEPS (Rs)	**18.9**	**25.4**	**18.0**	**25.5**
EBITDA Margin (%)	11.8	14.7	13.7	14.4
P/E (x)	18.1	13.5	19.0	13.4
RoE (%)	24.9	19.6	12.2	15.4
RoCE (%)	11.8	14.8	14.0	15.3
P/BV (x)	2.9	2.4	2.2	1.9
EV/Sales (x)	1.9	1.4	1.2	1.1
EV/EBITDA (x)	15.9	9.6	8.7	7.6

*Source: Company, Angel Research, Note: *We have assumed full tax rate for our estimates*

Company Background

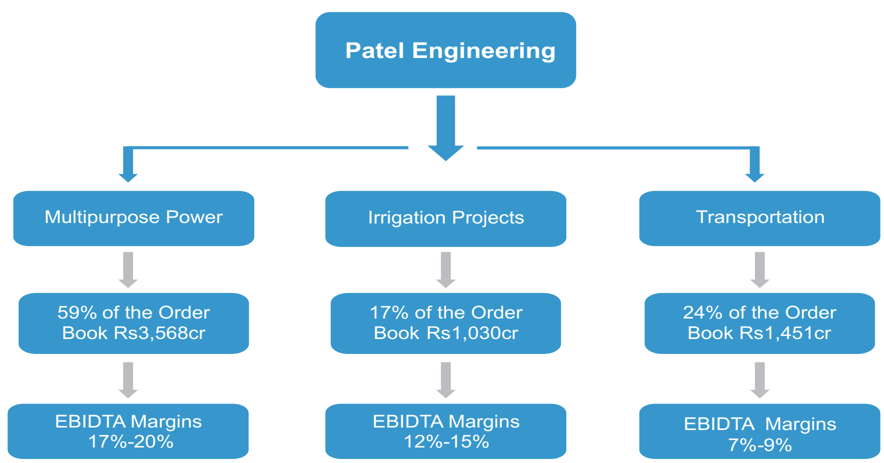
PE is a leading civil engineering and construction company and one of the few Indian construction companies with a presence in the US

PE is a leading civil engineering and construction company primarily engaged in the construction of hydro power projects, irrigation, water supply and transportation projects. Its core competency lies in the construction of hydro power plants. PE is one of the few Indian construction companies with a presence in the US. It has two US incorporated subsidiaries viz., ASI Constructors and Westcon Microtunnelling. These companies have given PE an added advantage in terms of access to use of sophisticated technology like RCC and microtunnelling, besides giving it a business presence in the technologically advanced US and European markets. The company has a land bank of around 1,000 acres, which it proposes to exploit in a phased manner. Phase I would involve development of 11% of the land bank.

Some of the technological milestones achieved by PE include:

- ✓ First construction company in Asia to execute Double Lake Tap works.
- ✓ Constructed largest underground cavern (Surge Chamber) in Asia.
- ✓ First Indian firm to execute microtunnelling projects using Tunnel Boring machine in India.
- ✓ Pioneer in the use of RCC technology for construction of dams in India.
- ✓ One of the few Indian companies with in-house expertise and technology to execute RCC dams and microtunnelling projects.
- ✓ Among the first few companies to have secured lift irrigation contracts.

Exhibit 1: Business Overview



Source: Company, Angel Research

Investment Arguments

Present in Niche high-Margin Segments

Patel has past experience and technical competence which are critical in winning contracts for Hydro Power Plant and Upstream Irrigation Projects

Traditionally, PE has been concentrating on niche segments to maintain its Margins and effectively use its resources. Its core competence lies in the construction of Hydro Power Plants and Upstream Irrigation projects. It has been involved in 22% of the total hydro power plants in India. Hydro power projects are complex, require high level of technological expertise and fetch significantly high Margins. Also, past experience and technical competence is critical in winning contracts for hydro power and upstream irrigation projects. It also effectively serves as an entry barrier restricting the number of bids to 4-5 in hydro power and 7-8 bidders in upstream irrigation. Further, the benefits of hydro projects and upstream irrigation projects are that the pass on of incremental costs is high compared to the other segments.

The pass on of incremental costs in Hydro projects is as high as 90% and in Irrigation projects it is in the range of 70-80%. Overall, this aids the company to maintain its Margins especially in the current high commodity prices and interest rate regime.

Hydro Power Segment: Emerging Opportunities

Hydropower is one of the lowest cost modes of power generation. India's hydro power potential is estimated at 1,48,701MW, which is primarily concentrated in the North and North Eastern regions due to the availability of ample hydel resources. As of March 2008, the total hydel power capacity in India stood at 32,443MW, with the Northern and Southern regions accounting for nearly 70%.

Exhibit 2: India's Hydropower Potential: Region-wise (MW)

Region	Potential Capacity	Existing Capacity	Capacity Under Construction	Capacity yet to be Developed
Northern	53,395	13,306	7,184	32,905
Western	8,928	5,784	400	2,744
Southern	16,458	9,101	1,055	6,302
Eastern	10,949	3,049	2,211	5,689
North Eastern	58,971	1,203	2,724	55,044
All India	**1,48,701**	**32,443**	**13,574**	**1,02,684**

Source: CEA, Angel Research

The government proposes to add around 14GW of hydel capacity in the Eleventh Five-year Plan period

In FY2006, India was faced with a load deficit of around 10%. Going ahead, in 2012, the deficit is expected to increase to around 27%. The government is attempting to tackle this issue by augmenting hydel capacities as there is substantial hydel potential in the country. Through its National Hydel Policy, the government targets to add 50GW hydel capacity. Further, home states are offered 12% of free power and giving them minority equity stake making hydel power projects attractive. Overall, the government proposes to add around 14GW of hydel capacity in the Eleventh Five-year Plan period. There are very few players in this segment, which along with huge opportunity would ensure that there would not be a price war leading to Margin pressures.

Hydro power is a very high-margin segment and contributes more than half of PE's total order book

Over the years, PE has been focusing on enhancing its strengths in technology, which along with experience would help it enjoy an edge over competition. PE is the second largest player after JP Associate. PE has contributed to a total of 7,000MW out of the country's total operating hydropower capacity of 32,443MW. Hydro power is a very high-margin segment and contributes more than half of PE's total order book.

Upstream Irrigation Projects - Competitive advantage

PE is also focusing on the high-margin Upstream Irrigation segment where currently there is low competition. PE intends to replicate its expertise in the hydro power projects in this sector as well. The contracting complexities in this segment are also similar to the Hydel power segment. Further, it enables the company to register better EBITDA Margins of 12-15% in comparison to the sub-10% Margins recorded in the downstream irrigation segment. PE competes with peers HCC and Gammon in the upstream irrigation works.

PE is well positioned to capture the large construction opportunities in these segments owing to its experience and possession of innovative technologies such as roller compacted concrete (RCC), micro tunneling and Double Lake Tap.

Embarked on growth path through Acquisitions and Joint Ventures

JVs have helped PE to build its expertise and execution capability and leverage its financial strength to win contracts

PE has grown its contracting business across segments through joint ventures (JVs) and acquisitions in India and abroad. JVs have helped it build its expertise and execution capability (JV with L&T) and leverage its financial strength to win contracts (JV with KNR Constructions). Over the years, PE has formed JVs across various verticals - in roads with KNR Constructions, irrigation with Soma, Hydel power with L&T, and urban infrastructure with Michigan Engineers.

PE has been consciously acquiring companies in India/abroad to strengthen its technological expertise as well as to diversify geographically. The main acquisitions include ASI RCC (Colorado, US, in November 1997), Westcon Microtunelling (California, US, in February 2002) and Michigan Engineers (India, in June 2006). These subsidiaries contributed a significant proportion to overall revenues of the company till FY2003. Since then, with the acceleration in infrastructure spending in India, the company's domestic contracting revenues and profits have raced ahead than those of its overseas subsidiaries.

Overseas Businesses

ASI Constructors, US, which is in the RCC business, is a 51% subsidiary of PE. The balance 49% is held by the employees. The company's business model is shifting to negotiated contracts from competitive bidding. The company clocked revenues of around Rs245cr in FY2008, recording EBIDTA and Net Margins of 14% and 4%, respectively. ASI recently bagged a US $280mn project (its share being 50%) in the US, involving rehabilitation of the Taum Sauck Upper Reservoir Dam, the largest RCC dam in Missouri, US. The project is a negotiated contract between Amren UE (which owns and operates the Taum Sauk Plant) and Ozark Constructors (a 50-50 joint venture between ASI and Fred Weber). Bagging this project proves that ASI Constructors is technically well-poised to capture the large dam rehabilitation opportunity in the US as it is for the first time that an Indian construction company has penetrated the most stringent and demanding Western market. PE's acquisitions have been driven by its strategy to self-equip, with the latest technologies in hydel power and urban infrastructure. The ASI RCC acquisition has enabled PE to adopt cost and time efficient RCC technology in hydel power contracting.

The acquisition of Westcon Microtunelling in 2002 has helped PE become one of the world's largest microtunnelling contractors and it has been propagating the use of non-invasive solutions for urban infrastructure needs.

Michigan Engineers

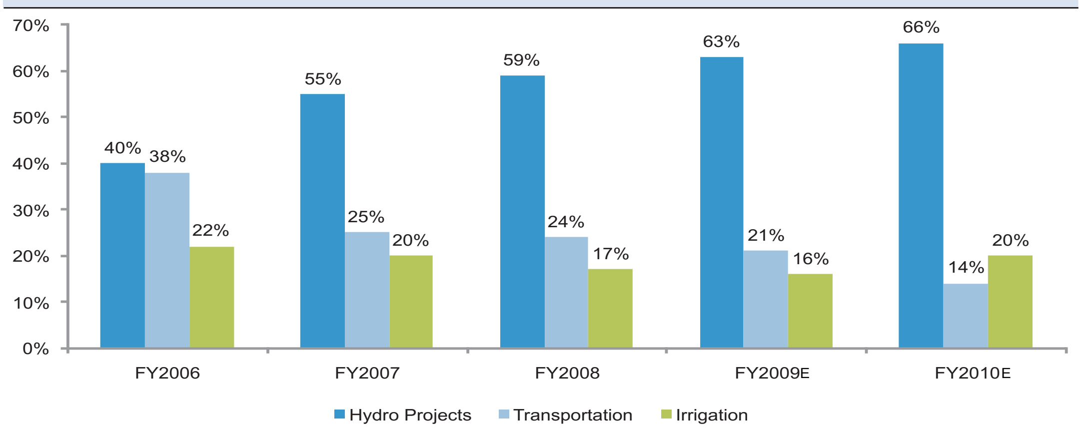
Michigan Engineers (51% subsidiary of PE), has scaled up its order book rapidly to the current Rs500cr. Revenues increased by 75% to Rs64.9cr (Rs37.1cr) in FY2008. This, along with healthy EBIDTA and Net Profit Margins at 14-15% and 8-9% in FY2008 respectively, is expected to translate into healthy Earnings growth going forward. Most equipment of Westcon, US, will be transferred to Michigan to enhance its Indian operations and accelerate growth going forward. With the acquisition of Michigan Engineers in July 2006, PE can now provide end-to-end solutions in sewer rehabilitation and urban infrastructure space. In addition, the company is the pioneer in Asia in adopting the Double Lake Tap technology, which enhances the capacity of hydel power projects without disrupting operations of the existing facility. We believe these technologies will enable PE continue to be the preferred contractor in its chosen area of specialisation.

Robust Order Book

PE's order book is at Rs6,047cr and importantly there has been a change in the order book mix towards hydro power projects, which command higher margins

PE has a robust order book of Rs6,047cr (3.25x FY2008 revenues). In FY2008, order book increased by 26%. Importantly, there has been a change in the order book mix towards hydro power projects, which command higher margins. It has been the company's policy to concentrate on high-margin projects and achieve optimum utilisation. This strategy has held it in good stead especially in the current high commodity prices and rising interest rates scenario. Currently, Hydro Projects contribute 59%, Transportation 24% and Irrigation 17% to the company's total order book.

Exhibit 3: Order Book Break-up



Source: Company, Angel Research

Exhibit 4: Order Book, Execution					(Rs cr)
Particulars	**FY2006**	**FY2007**	**FY2008**	**FY2009E**	**FY2010E**
Order Book	2,863	3,965	5,008	5,684	6,148
Intake	2,117	2,339	2,536	2,835	3,350
Execution	1,015	1,296	1,860	2,371	2,916
O/s Order Book	**3,965**	**5,008**	**5,684**	**6,148**	**6,582**

Source: Company, Angel Research

Real Estate: The Dark Horse

PRIL plans to develop this land bank in phases and the company is developing around 11% of the total land bank.

PE has ventured into the Real Estate sector by transferring the development rights of its historical land bank to Patel Realty India (PRIL), its 100% subsidiary. It has a land bank of around 1,000 acres spread across Hyderabad (640 acres), Bangalore (106 acres), Chennai (230 acres) and Mumbai (26 acres). PRIL plans to develop this land bank in phases and has accordingly announced plans for the Phase I development. Under Phase I, the company is developing around 11% of the total land bank.

For valuing PE's Real Estate venture, we have only considered properties to be developed in Phase I. For the remaining land bank, we have assigned discount to prevailing market prices.

- ✓ An IT SEZ Park at Gachibowli, in Hyderabad (2.7 mn sq.ft)
- ✓ A corporate park at Jogeshwari, in Mumbai (1.08 mn sq.ft)
- ✓ An Integrated Township at Electronic City near Bangalore (12.1 mn sq.ft)

IT SEZ in Hyderabad: PRIL is developing IT SEZ of around 2.7 mn sq.ft in Gachibowli, Hyderabad on an area of 7.5 acres. The development work is expected to start for the project in December 2008 and is expected to be completed in March 2012. We have estimated the construction cost at Rs1,700 per sq. ft. The company is expected to follow a lease-based model and we have assumed rentals of Rs40 per sq. ft./month. NPV of the project works out to Rs280cr and the value per share at Rs47.

Corporate Park in Mumbai: PRIL is developing Corporate Park of around 1.08 mn sq.ft in Jogeshwari, Mumbai. Around 0.08 mn sq.ft of area is constructed/near completion and leased at rentals of Rs104 per sq. ft. /month. The development work has also started for the balance 1.0 mn sq.ft project and is expected to complete by March 2011. We have estimated a construction cost of Rs2,100 per sq. ft. The NPV of the project works out to be Rs828cr and value per share of Rs137.

Integrated Township in Bangalore: PRIL is developing an Integrated Township of around 12.1 mn sq.ft at the Electronic City near Bangalore. It plans to develop a residential complex of 4mn sq ft, two SEZs of 25 acres each, a Hotel of 0.3mn sq ft, Retail/Mall of 1mn sq ft and Signature Villas. However, we have taken only the residential complex in our valuation as other projects are at a very nascent stage. The development work of the residential complex is expected to start for the project in April 2009 and is expected to complete in March 2014. We have assumed that the company would follow Sale based model and we have assumed sale rate of Rs2000 per sq. ft. We have estimated construction cost of Rs1,700 per sq. ft. The NPV of the project works out to be Rs52cr and value per share of Rs9.

Balance Land Bank: Given the lack of clarity on the remaining land bank, we have valued it at Rs748cr and Rs124/share. The valuation considered is at 60% discount to the prevailing market price in the respective areas as arrived at by DTZ, an independent valuer selected by PE.

Exhibit 5: Phase I Valuation

Location	Projects	Area (mn sq.ft.)	Expected Start	Expected Completion	Sale/Lease Model	NPV (Rs cr)	Value Per Share(Rs)
Hyderabad	IT SEZ Park at Gachibowli	2.7	Dec-08	Mar-12	Lease	280	47
Jogeshwari	Jogeshwari Corporate Park	0.08	0.04mn sq.ft completed & leased	0.04mn sq.ft completed by Sept -08	Lease	74	12
Jogeshwari	Jogeshwari Corporate Park	1.00	Jun-08	Mar-11	Lease	754	125
Bangalore	Integrated Township Bangalore	4.00	Apr-09	Mar-14	Sale	52	9

Source: Company, Angel Research

Exhibit 6: NAV Calculation

	Rs cr	Value Per Share (Rs)
Present Value of Phase I	1,160	-
Present Value of Phase I @ 80% Disc	232	39
Land Value @60% Disc	748	124
NAV (Rs)		**163**

Source: Company, Angel Research

BOT Projects: Runs out of steam

Patel has been a late entrant in the BOT segment compared to its peers. It bagged a couple of BOT projects in tie up with KNR Constructions. PE and KNR Constructions will jointly execute these projects.

Islam Nagar to Kadtal (NS-2/BOT/AP-7)

PE has been a late entrant in the BOT segment compared to its peers. It bagged a couple of BOT projects in tie up with KNR Constructions.

The project has been awarded by National Highway Authority of India (NHAI) on a Build-Operate-Transfer (BOT) annuity basis. The project is located on NH-7 in Andhra Pradesh under North-South Corridor, NHDP Phase II. The project is expected to be completed by March-2010. The project is on schedule and currently around 5% of the project is complete.

Exhibit 7: NS-2/BOT/AP-7

Particulars	Project Details
Length (km)	48
Concession Period (years)	20.5
Expected Date of Completion	March 2010
Project Costs (Rs cr)	600
Annuity Amount (Rs cr)	89
Equity Component (Rs cr)	120
Debt Component (Rs cr)	480
Company's Stake (%)	60
Company's Equity Commitment (Rs cr)	72
Company's Debt Commitment (Rs cr)	288

Source: Company, Angel Research

Andhra Pradesh, Karnataka Border

The project has been awarded by the NHAI on a BOT annuity basis. The project is expected to be completed by March-2009. The project is on schedule with 40% of the work completed.

Exhibit 8: Andhra Pradesh, Karnataka Border

Particulars	Project Details
Length (km)	67
Concession Period (years)	20.5
Expected Date of Completion	March 2009
Project Costs (Rs cr)(Net)	443
Annuity Amount (Rs cr)	66
Equity Component (Rs cr)	113
Debt Component (Rs cr)	330
Company's Stake (%)	60
Company's Equity Commitment (Rs cr)	68
Company's Debt Commitment (Rs cr)	198

Source: Company, Angel Research

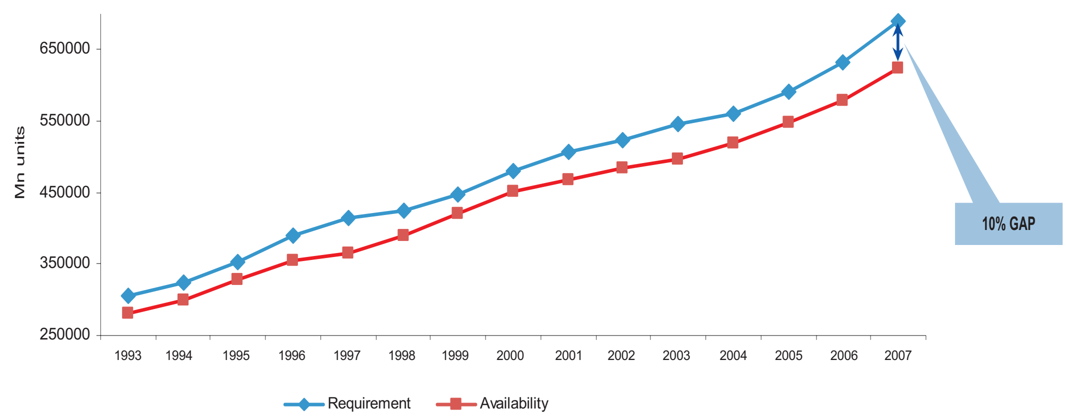
As per our DCF to Equity methodology, we do not see much value in these projects and have not assigned any value to them. However, we have estimated that the company would be investing funds to the tune of Rs140cr for these projects.

Plans on anvil to become Independent Power Producer

As per a CEA study, India needs to add on an average 14,000MW of power per year till 2022.

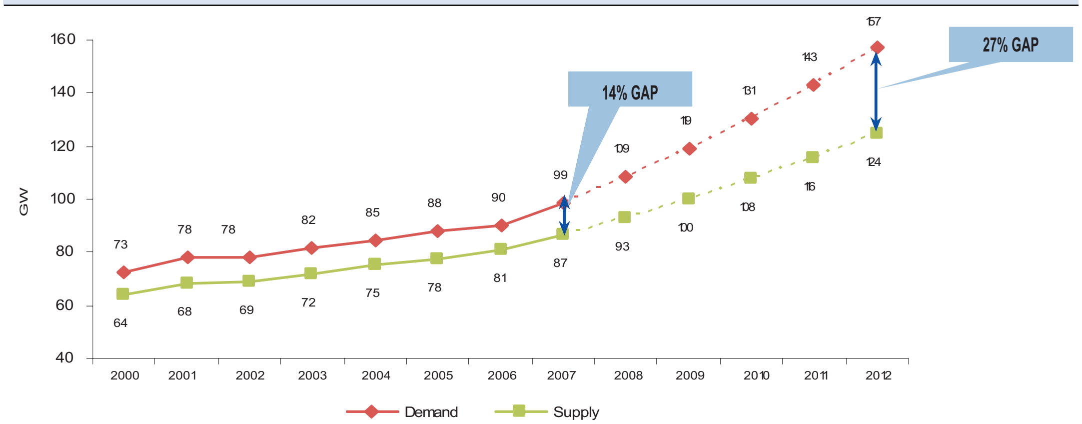
PE has long terms plans to be an independent power producer (IPP). The government has allocated substantial investments for the Power sector in the XI Plan, which provides opportunities galore for the company to cash in on. Further, as per a Central Electricity Authority (CEA) study, India needs to add on an average 14,000MW of power per year till 2022. CEA has assessed 82,200MW capacity addition during the XII Plan owing the to the widening demand-supply gap.

Exhibit 9: Energy Requirement v/s Availability



Source: Ministry of Power, Govt. of India

Exhibit 10: Peaking Demand –Supply Gap



Source: Ministry of Power, Govt. of India

MoU with Gujarat Government

PE is planning to set up a thermal and a hydro power plant of 1,200MW and 120MW, respectively in the next five years.

PE has signed an MoU with the Government of Gujarat to set up a thermal power plant of 1,200MW at an investment of Rs6,000cr. It will be a costal power plant on imported coal. The project would be executed over four phases and commissioned over the next five years. A special purpose vehicle (SPV) will execute the project. The project will be funded with a D/E ratio of 80:20. PE is currently scouting for land, tying up for coal linkages outside India and getting other clearances for the plant. PE is also looking for a strategic Equity Partner for equipment and operator. The power generated will be sold to power traders, captive consumers and state governments.

Hydro Power Plant at Haryana

The company is also setting up a 120MW Hydro Power Plant at Gongri, Arunachal Pradesh. The power potential has increased from the earlier 100MW to 120MW. The pre-feasibility report is complete and submitted to the concerned authorities. The construction activity is expected to commence from 2009. PE, with this plant, will be successful in emerging as an IPP in the long run. However, with these projects being at a nascent stage, we have not assigned any value to them. The projects are also pending financial closure.

Financial Outlook

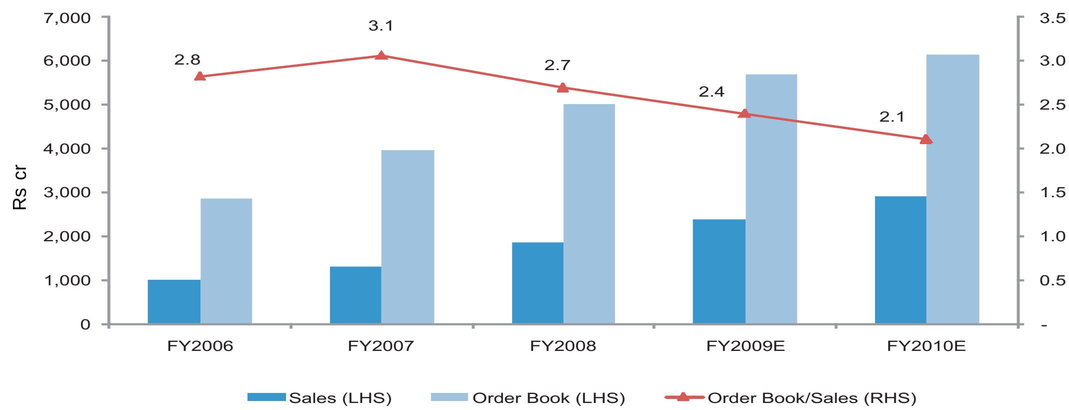
Drivers of Topline growth

We expect PE to post a 25% CAGR over FY2008-10E in Top-line on account of robust order book.

PE posted a healthy CAGR of 34% over FY2005-08 in Top-line to around Rs2,000cr. Going ahead, we expect PE to post a decent 25% CAGR over FY2008-10E in Top-line. The strong Sales growth would be on account of robust order book, which has risen from Rs2,863cr to Rs6,047cr over FY2005-08 and is expected to further increase to Rs6,582cr by FY2010. This would be even after achieving an estimated turnover of Rs2,916cr in FY2010. The Sales growth would mainly be driven by the Hydro Power segment, which is expected to contribute 45% and 53% to Topline in FY2009 and FY2010, respectively.

The company has increased its execution capabilities by doubling its Gross Block over the last four years. Going ahead, we expect PE to continue its capex program in line with its burgeoning order book. Further, employees are the backbone of any construction company. Accordingly, PE has been gradually increasing its personnel strength. Headcount has increased to 1,476 (78% of employees are technical staff) in FY2008 from 1,268 in FY2007. Notably, the company has also been successful in arresting its attrition level to the current 2%, which is much below the industry average of 10-12%.

Exhibit 11: Order Book to Sales



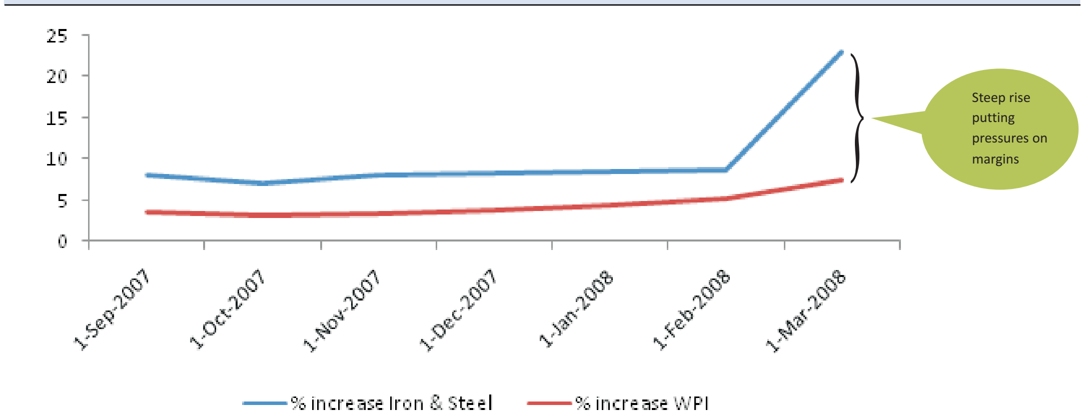
Source: Company, Angel Research

Threats to Margins...

Construction companies have witnessed pressure on the Margin front due to the spiraling commodity prices especially that of steel, which is a major cost component in the construction sector.

Recently, most of the construction companies have witnessed pressure on the Margin front due to the spiraling commodity prices especially that of steel, which is a major cost component in the construction sector. The rising interest rates have also impacted Margins of most infra companies. The rise in steel prices even exceeded the WPI resulting in contraction of Margins. The HRC steel prices, which are primarily used in pipeline projects, spiked by 26% YTD in CY2008. The reinforcement steel (wire rods, primarily used in structural work) prices also increased by 28%. Cement prices too increased by 3% YTD. On the fuel front, the diesel prices, which are regulated in India, rose by 7% YTD. It may be noted that while the construction contractors do have a built-in 75-80% cost escalation clause (either linked to the wholesale price index (WPI) or are Star rated contacts) in their contracts while bidding for the projects, clearly none had estimated such a sharp surge in the steel prices.

Exhibit 12: Commodity Price Movement v/s WPI



Source: Company, Angel Research

...defense levers

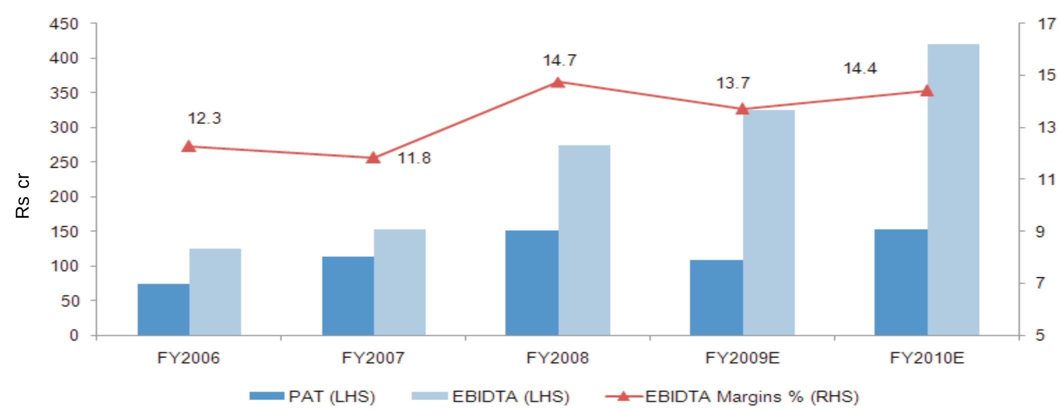
We believe that is PE is much better placed then industry peers as majority of it's current order book comes from Hydro Power and Upstream Irrigation segments (around 76% of Rs6,047cr) where the pass on of incremental costs is very high.

However, we believe that is PE is much better placed then industry peers as majority of it's current order book comes from Hydro Power and Upstream Irrigation segments (around 76% of Rs6,047cr) where the pass on of incremental costs is very high. The pass on of incremental costs in Hydro projects is as high as 90% and in Irrigation projects it is in the range of 70-80%. The pass on in the transportation segment is at a low of 50-60%. However, we estimate the company to face Margin pressures in FY2009 on account of roads segment and would clock EBIDTA Margins of 13.7%, a yoy decline of 100bp. This would be post considering the benefits of operating efficiencies enjoyed by the company. In FY2010E, we expect the commodity prices to cool off slightly owing to which we expect the company's Margins to increase by 70bp to 14.4%.

If the company is able to successfully raise funds by diluting stake then it would result in the company raising lower debt and hence lower interest cost than our estimates and higher Net Margins.

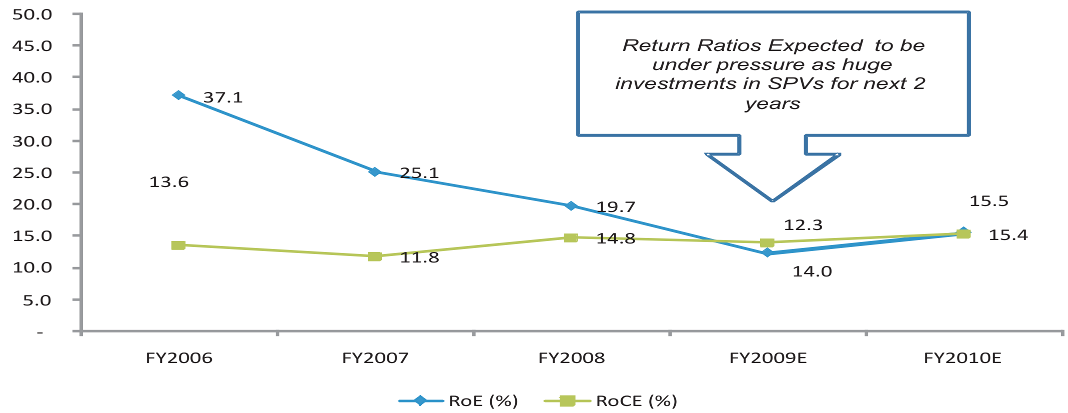
On the Net Profit front, FY2008 figures are not comparable with our estimated figures as the company continues to maintain its stance and claims to be entitled for section 80IA benefits whereas we have adopted a more conservative approach and factored in tax at a marginal rate. Our approach is on the basis that most of the industry peers of PE have started providing for full tax. At the PBT level, we expect PE to post a CAGR of 15% over FY2008-10, which would be somewhat muted compared to EBIDTA growth. This is because we expect the company to raise funds via debt as the current markets scenario is not conducive to raise money. Hence, we expect the company to raise around Rs500cr via debt. These funds would primarily be utilised to facilitate smooth sailing of PE's venture in the different segments including Real Estate and the BOT Projects. However, if the company is able to successfully raise funds by diluting stake at the subsidiary level, it would ease pressure on its cash flow. This would also result in the company raising lower debt and hence lower interest cost than our estimates and higher Net Margins.

Exhibit 13: Financial Indicators



Source: Company, Angel Research

Exhibit 14: Return Ratios



Source: Company, Angel Research

Concerns

Project risks: The construction business is fraught with project risks. For instance, any delays in project execution could lead to cost overruns and invocation of performance guarantees by the client. As for PE, most of its projects are running on schedule. However, one cannot ignore the inherent risks associated with the business.

High dependence on government expenditure: Majority of the projects are government contracts, which have inherent risks of delays in finance disbursals by the state governments. This could delay projects and exert pressure on the company's working capital.

Any decision against the company would not only dent its cash position but will also affect the stock sentiment on the bourses. Further, if the company is required to shell out Rs85cr, than our EPS estimates will be negatively impacted by 4-5%

Rising Raw Material prices: Rising raw material prices is another concern. A sharper-than-expected increase in the prices of these raw materials could impact PE's Margins. Though we have factored in the same in our Margin estimates for FY2009, for FY2010 we have assumed lower commodity prices. However, if the raw material prices continue to rule high it could pose a downside risk to our estimates.

Claiming of Section 80IA benefits: PE continues to claim benefits under Section 80 IA even though they were withdrawn in Budget 2008. According to the company, it fulfils all the required conditions under the clause of being an infrastructure developer. In February 2007 (prior to Budget 2008), the company had won the right to claim Sec 80 IA benefits in a court ruling. However, the matter is currently sub-judice pending the Mumbai High Court. The liability arising out of the same was estimated at Rs85cr in FY2008. We have assumed full tax rates going ahead. However, any decision against the company would not only dent its cash position but will also affect the stock sentiment on the bourses. Further, if the company is required to shell out Rs85cr, it will negatively impact our EPS estimates by 4-5%.

Slowdown in Real Estate: Current slowdown in the real estate cycle may hamper the project ramp ups in turn adversely impacting PE's revenue growth and hence cash flows. It could be more pronounced since majority of the company's projects in Phase I are being developed on lease basis, which are subject to upfront capital investments as opposed to sale basis wherein funding is largely met through customer advances. Hence, we have been conservative in our valuations for the company's Real Estate business. However, as the company's land-bank is at historical lower rates, we believe it will be able tide over the cyclicality in the housing sector even if it persists for a longer period than estimated.

Outlook and Valuation

The Infrastructure sector has embarked on a strong Public Private Partnership (PPP) mode transforming from the earlier public investment driven mode. Growing complexity in jobs has resulted in the domestic construction companies joining hands with the global leaders to better their pre-qualifications for bagging orders. Investment in infrastructure is expected to be in the range of US $500bn over the next 4-5 years, which would provide substantial opportunity to players in the segment. Further, the overseas market such as the Middle East continues to tick in strong order inflows for the domestic construction majors.

India is currently witnessing a slowdown in GDP growth. This is yet to trickle down significantly to the Infrastructure sector. Inflationary pressures are deteriorating government finances and political risks owing to the upcoming elections could lead to a significant slowdown in the government capex plans. Furthermore, Central and most State elections are scheduled for CY2008-09. Just before or during the elections there could be considerable slowdown in order inflows (CY2009). In the past too, during the May 2004 elections, most of the construction companies witnessed a slowdown in order inflow growth particularly in the last quarter preceding the elections (4QFY2004). However, the order inflow substantially picked up during 2HFY2005 leading to significant growth in order inflows for FY2005. General election in a year's time and with the state elections in Rajasthan and Madhya Pradesh round the corner are some of the factors that could hamper finalisation of orders in the sector. Furthermore, considering that the equity markets are currently not conducive for fund-raising, there is a possibility of slippages for project owners in achieving financial closures resulting in slowdown in order inflow.

Despite these constraints, India's medium-to-long-term growth story remains intact. We prefer companies that have an order book backlog sufficient to take care of revenue growth for the next few quarters. Also, players with a greater share of orders with price escalation clauses are relatively better placed. The interplay of these two forces - Revenue growth and Margin pressure - will lead to a dichotomy in performance among the players. Therefore, we prefer companies like PE as we believe that it's a very good play on India's construction industry as it is well placed on the Margin front. Additionally, we are also estimating robust growth over the next two years. Apart from being a pure construction play, PE also gives the flavours of Real Estate, BOT Projects and IPP, which can further unlock value for shareholders.

We expect the company to grow at a CAGR of 25% over the next two years and it would be one of the few players to stand tall on the Margin front especially in the prevailing high commodity price and rising interest rate regime. We have valued PE on SOTP methodology. We have assigned its core construction business a PE of 10x FY2010E EPS of Rs25.5. For the Real

Estate arm, we have arrived at an NAV of Rs163/share. In the recent past, the stock has witnessed a sharp fall due to weakness in the broader indices. Hence, we believe at current levels, PE is available at attractive valuations. At the CMP of Rs343, the stock is trading at 19x FY2009E and 13.4x FY2010E EPS of Rs18.0 and Rs25.5, respectively. However, after factoring the value of Real Estate, the stock is trading at 10x FY2009E and 7.1x FY2010E EPS of Rs18.0 and Rs25.5, respectively. **We upgrade the stock from Neutral to Buy, with a 12-month Target Price of Rs418.**

Exhibit 15: Comparative Valuation (FY2010E)

Particulars	Patel Engg	Simplex Infra	HCC	NCC	IVRCL Infra	*Gammon India
Promoter Holding (%)	52.3	49.4	47.0	22.5	9.6	31.1
Sales (Rs cr)	2,916	4,883	4,892	5,950	6,569	4,057
Net Profit (Rs cr)	153.5	244.8	166.7	263.6	343.8	173.4
FDEPS (Rs)	25.5	44.5	6.5	12.5	25.0	19.9
P/E (x)	13.4	10.2	14.2	11.8	12.4	11.8
Adj P/E (x)^	7.1	9.5	4.7	8.6	7.9	7.3
Order Book (Rs cr)	6,049	10,096	8,250	11,500	13,000	9,000
RoE (%)	15.4	21.5	14.0	16.5	15.2	14.2
RoCE (%)	15.3	19.9	11.5	16.1	17.5	17.9
P/BV (x)	1.9	1.8	3.7	2.6	2.5	2.8

*Source: Company, Angel Research, *Industry Estimates, Note: Price as on July 8, 2008; ^Adj P/E is after factoring investments , BOT Projects and Real Estate*

Profit & Loss Statement

Rs crore

Y/E March	FY2007	FY2008	FY2009E	FY2010E
Net Sales	**1,296**	**1,860**	**2,371**	**2,916**
% chg	*27.7*	*43.5*	*27.5*	*23.0*
Total Expenditure	1,142	1,586	2,046	2,496
EBIDTA	**153.3**	**274.0**	**325.0**	**420.4**
(% of Net Sales)	*11.8*	*14.7*	*13.7*	*14.4*
Other Income	21.4	3.7	20.0	35.0
Depreciation& Amortisation	34.9	62.7	75.0	90.0
Interest	9.7	29.5	95.2	121.8
PBT	**130.1**	**185.5**	**174.9**	**243.6**
(% of Net Sales)	*10.0*	*10.0*	*7.4*	*8.4*
Extraordinary Expense/(Inc.)	(0.3)	-	-	-
Tax	14.4	22.7	52.5	73.1
(% of PBT)	*11.1*	*12.2*	*30.0*	*30.0*
PAT	**116.0**	**162.8**	**122.4**	**170.5**
% chg	*53.3*	*34.0*	*(28.6)*	*41.6*
(% of Net Sales)	*9.0*	*8.8*	*5.2*	*5.8*
PAT after Minority Int.	**113.0**	**151.9**	**108.4**	**153.5**
% chg	*54.2*	*34.4*	*(28.6)*	*41.6*
(% of Net Sales)	*8.7*	*8.2*	*4.6*	*5.3*

Balance Sheet

Rs crore

Y/E March	FY2007	FY2008	FY2009E	FY2010E
SOURCES OF FUNDS				
Equity Share Capital	6.0	6.0	6.0	6.0
Reserves& Surplus	701.4	835.2	922.8	1,053.3
Shareholders Funds	**707.4**	**841.2**	**928.8**	**1,059.4**
Minority interest	8.0	18.0	33.2	49.8
Total Loans	491.2	773.9	956.6	1,258.0
Deffered Tax Liability	11.8	11.8	11.8	11.8
Total Liabilities	**1,218**	**1,645**	**1,930**	**2,379**
APPLICATION OF FUNDS				
Gross Block	391.6	621.6	771.6	921.6
Less: Acc. Depreciation	153.9	216.6	291.6	381.6
Net Block	**237.7**	**405.0**	**480.0**	**540.0**
Capital Work-in-Progress	15.9	95.9	145.9	195.9
Investments	**171.4**	**200.0**	**332.7**	**634.1**
Current Assets	1,128.2	1,542.4	2,019.3	2,557.4
Current liabilities	338.0	600.7	1,051.0	1,551.6
Net Current Assets	**790.1**	**941.6**	**968.3**	**1,005.9**
Mis. Exp. not written off	2.7	2.7	2.7	2.7
Total Assets	**1,218**	**1,645**	**1,930**	**2,379**

Cash Flow Statement

Rs crore

Y/E March	FY2007	FY2008	FY2009E	FY2010E
Profit Before Tax	130.4	185.5	174.9	243.6
Depreciation	34.9	62.7	75.0	90.0
Change in Working Capital	235.4	60.4	46.8	77.9
Direct Taxes paid	14.4	22.7	52.5	73.1
Cash Flow from Operations	**(84.5)**	**165.2**	**150.6**	**182.7**
Inc./ (Dec.) in Fixed Assets	45.5	310.0	200.0	200.0
Free Cash Flow	**(130.0)**	**(144.8)**	**(49.4)**	**(17.3)**
Inc./ (Dec.) in Investments	143.0	28.6	132.7	301.4
Issue of Equity	407.2	0.0	0.0	-
Inc./(Dec.) in loans	(64.2)	282.7	182.7	301.4
Dividend Paid (Incl. Tax)	(7.8)	(19.3)	(20.8)	(22.9)
Others & MI	2.0	(1.2)	-	-
Cash Flow from Financing	**190.2**	**236.0**	**29.2**	**(22.9)**
Inc./(Dec.) in Cash	60.2	91.2	(20.2)	(40.3)
Opening Cash balances	**44.5**	**104.7**	**195.9**	**175.7**
Closing Cash balances	**104.7**	**195.9**	**175.7**	**135.5**

Key Ratios

Y/E March	FY2007	FY2008	FY2009E	FY2010E
Per Share Data (Rs)				
EPS (fully diluted)	18.9	25.4	18.0	25.5
Cash EPS	24.8	35.9	30.5	40.5
DPS	1.3	2.8	3.0	3.3
Book Value	118.6	140.9	154.5	176.2
Operating Ratio (%)				
Raw Material / Sales (%)	22.3	23.5	23.8	23.0
Inventory (days)	119.5	125.5	131.7	138.3
Debtors (days)	85.4	95.4	105.4	115.4
Debt / Equity (x)	0.7	0.9	1.0	1.2
Returns (%)				
ROE	24.9	19.6	12.2	15.4
ROCE	11.8	14.8	14.0	15.3
Dividend Payout	6.9	11.0	16.6	12.9
Valuation Ratio (x)				
P/E	18.1	13.5	19.0	13.4
P/E (Cash EPS)	13.8	9.5	11.2	8.5
P/BV	2.9	2.4	2.2	1.9
EV / Sales	1.9	1.4	1.2	1.1
EV / EBITDA	15.9	9.6	8.7	7.6

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	Reduce (Downside upto 15%)	Sell (Downside > 15%)	

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