



# Patel Engineering

STOCK INFO. BLOOMBERG  
BSE SENSEX: 14,127 PEC IN  
REUTERS CODE  
S&P CNX: 4,171 PENG.BO

16 May 2007

Buy

Rs423

Previous Recommendation: Buy

Equity Shares (m)	59.7
52-Week Range	585/222
1,6,12 Rel. Perf. (%)	24/-5/-43
M.Cap. (Rs b)	25.2
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
3/07A	11,024	1,120	18.8	28.1	22.5	3.5	24.1	14.8	2.3	16.8
3/08E	14,302	1,134	19.0	1.2	22.3	3.3	14.5	14.9	1.8	13.2
3/09E	18,751	1,531	25.7	35.1	16.5	2.9	17.0	15.9	1.5	10.5

\*Consolidated

Real estate - value unlocking possibilities: Patel Engineering has transferred property developments rights for land bank of ~500 acres (FSI of 60m sq ft) to Patel Realty India (PRIL, 100% subsidiary). The management indicated that the entire land bank is in the physical possession of the company, and is unencumbered with proper title deeds registered. 98% of the projects are FDI compliant. In Phase 1, PRIL would commence construction of 0.75m sq ft commercial space in Jogeshwari (Mumbai) and 3-5m sq ft of commercial and residential development at Bangalore.

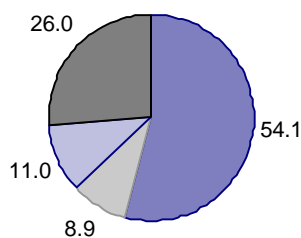
IPPs - avenues to deploy surplus cash balance: The company has announced plans to foray in to setting up thermal and hydro power projects on merchant basis. As these are long gestation projects, any meaningful equity commitment would commence post FY10 onwards. Also, these investments will allow the company to deploy cash surplus from construction business and real estate, towards assets which can possibly earn ~15%+ RoE.

Consolidated Order book at Rs50b, Book to bill ratio of 4.7x: Order book as at March 2007 stood at Rs50b, vs Rs39.4b in March 2006. Hydro power now accounts for 55% of the order book, vs 40% during Mar 06. Hydro power projects entail comparatively better margins (at 17-22%) vs Irrigation (10-15%) and Transportation (5-8%). The management has indicated that existing order book itself can drive 25% revenue CAGR till FY09.

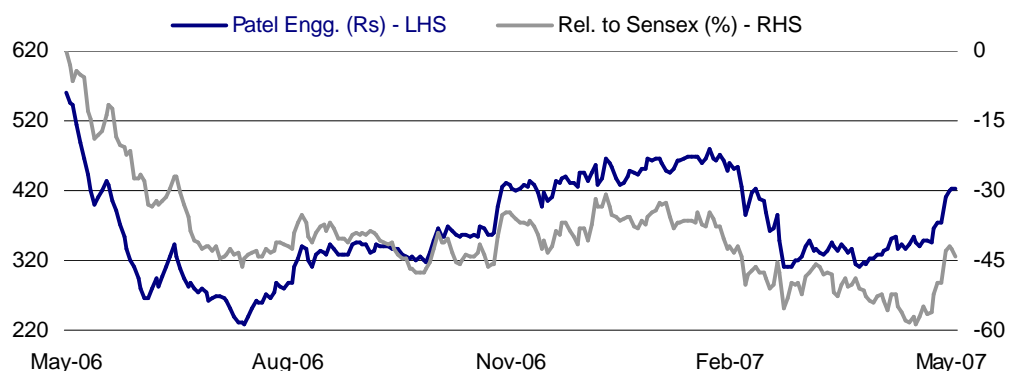
Valuation and View: We upgrade price target to Rs504/sh, from Rs406/sh earlier, largely driven by improved clarity on real estate assets. We value land bank of PRIL at Rs11.5b (Rs191/sh of Patel Engineering). Except for Jogeshwari (Mumbai) and Bangalore projects, for all other land banks, our valuation estimates largely factor in the value of raw land, as the development plans are yet to be approved. Maintain Buy.

SHAREHOLDING PATTERN (%)

Promoter Domestic Inst  
Foreign Others



STOCK PERFORMANCE (1 YEAR)



### Real estate: value unlocking possibilities

Patel Engineering has transferred property developments rights for land bank of ~500 acres to Patel Realty India (PRIL, 100% subsidiary). The management indicated that the entire land bank is in the physical possession of the company, and is unencumbered with proper title deeds registered. 98% of the projects are FDI compliant. The existing land bank of ~500 acres translates into an FSI of 60m sq ft.

#### LAND BANK DETAILS (ACRES)

CITY / STATE	ACRES	LOCATION
Hyderabad	200	Gachibowli, Samshabad, Maheshwaram, Sadashivpath, Kollur and Koyda
Chennai	200	Near Mahindra World City
Maharashtra	50	Jogeshwari (Mumbai), Panvel
Bangalore	50	Devanalli, Electronic City, Whitefield
<b>Total</b>	<b>500</b>	

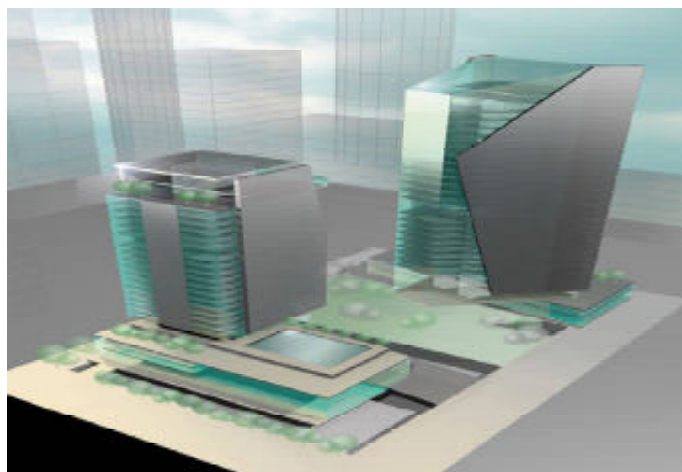
Source: Company

Mr. Pravin Malkani, an architect by profession, has been appointed as the President of PRIL. Real estate development has become a core business activity, and the company intends to further augment the existing land bank.

**Development plans:** In terms of the development plans, the management stated that in Phase 1, PRIL would commence construction of 0.75m sq ft commercial space in Jogeshwari (Mumbai) and 3-5m sq ft of commercial and residential development at Bangalore. In Bangalore, 55%

#### DEVELOPMENT PLANS

##### MUMBAI



Source: Company

of the development would be IT Parks / Commercial offices / Retail, etc, and 45% would be residential. Total FSI at Bangalore is 10m sq ft, and Phase 1 will entail development of 3-5m sq ft. The next phase would cover balance of Bangalore (~5-7m sq ft), Chennai land bank and Hyderabad land bank.

Construction at Jogeshwari (Mumbai) is expected to start from Oct 07, while construction at Bangalore is expected to start towards end FY08.

**Financing structure:** Patel Engineering has invested Rs2.5m as initial equity capital contribution towards PRIL. During FY08, equity investment by Patel Engineering is expected at Rs500m, which would be primarily utilized for financing the construction activities at Jogeshwari (Mumbai) and Bangalore. For the Bangalore project, the company has also indicated that they are in negotiations with various private equity players / FDI funding. The management has ruled out any plans for IPO / equity fund raising in PRIL, over the medium term.

PRIL is not looking at pre sale, and would start bookings post completion of 60-70% construction. Thus, the initial sale would commence from end FY09 onwards.

### IPPs: avenues to deploy surplus cash balance

Patel Engineering has announced plans to foray in to setting up of thermal power and hydro power projects on a merchant basis. As these are long gestation projects, any meaningful equity commitment would commence post FY10 onwards. Also, these investments will allow the company to deploy the cash surplus from construction business and real estate, towards assets which can possibly earn ~15%+ RoE.

**Thermal Power (1,200MW):** Patel Engineering has signed MoU with the Government of Gujarat to set up a 1200MW thermal power generation near Bhavnagar, at a planned investment of Rs50b. The project would be developed in three phases of 400 MW each and fuel will be based on imported coal. The management indicated that the project would be financed through 80:20 DER. The

company is in the process of land acquisition, tying up fuel linkages, environment approvals, etc, which is expected to take ~2 years. Thus, EPC contract is expected to be awarded during beginning FY10, post which the project will take 3 years for construction. The project is being set up on a merchant basis.

The company plans to rope in a technical JV partner, and a possible equity dilution of 30-40% in the joint venture. Assuming 60% equity stake in Phase 1 (400MW), equity commitment by Patel Engineering stands at Rs1.8b, which would be spread over FY10 till FY12. The equity infusion would be met largely through internal accruals.

**Hydro Power (~600MW):** Patel Engineering has submitted Request for Qualifications for hydro power projects, to be set up on merchant basis. It intends to set up hydro power projects on merchant basis, in states like Himachal Pradesh, Uttaranchal and North East India. As these projects are in nascent states, the management believes that any meaningful equity commitment will start post FY10 onwards. The projects would be executed through Patel Engineering Infrastructure P Ltd (100% subsidiary).

#### HYDRO POWER PROJECTS

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, Uttaranchal, etc

Source: Company

#### Impact of Sec 80 IA tax benefit withdrawal not provided

Patel Engineering has not provided for the impact of the withdrawal of tax benefits under Sec 80IA, as the management believes that based on the legal opinion, the matter is still sub-judice. The reported tax rate during FY07 stood at 10.6%. The management has indicated that cumulative liability till FY07, in terms of incremental cash outgo, stands at Rs270m. However in our earnings estimates, we factor in the impact from possible withdrawal of Sec 80IA tax benefits.

#### Guidance maintained

Management has guided for:

- ☞ Consolidated Revenue growth of 25% YoY over the next 2-3 years, based on the existing order book.
- ☞ EBIDTA margin improvement of 25-50bps YoY
- ☞ Order intake of Rs20b+ during FY08, which can add to the expected revenue growth of 25%. Patel Engineering is pre-qualified to bid for projects worth Rs60b in hydro space and Rs40b in irrigation and transportation.

As at March 2007, net worth stood at Rs7b, Debt at Rs5.6b (including mobilization advances) and cash balance at Rs1.6b. The company has utilized Rs2.7b out of the issue proceeds of Rs4.3b as: capex Rs380m, repayment of contractee advance Rs793m, investment in infrastructure / subsidiaries / joint venture projects Rs506m, working capital Rs820m and issue related expenses of Rs176m.

#### Consolidated Order book at Rs50b, Book to bill ratio of 4.7x

Patel's order book as at March 2007 stood at Rs50b, vs Rs39.4b in March 2006 and Rs47.6b in December 2006. The composition of the current order book stands as: Hydro: 55%, Irrigation: 25% and Transportation and others: 20%. This compares with (FY06 composition): Hydro 40%, Irrigation 38% and Transportation & Others 22%. Thus, there is a change in order book composition towards hydro power projects, which entails comparatively better margins (at 17-22%) vs Irrigation (10-15%) and Transportation (5-8%).

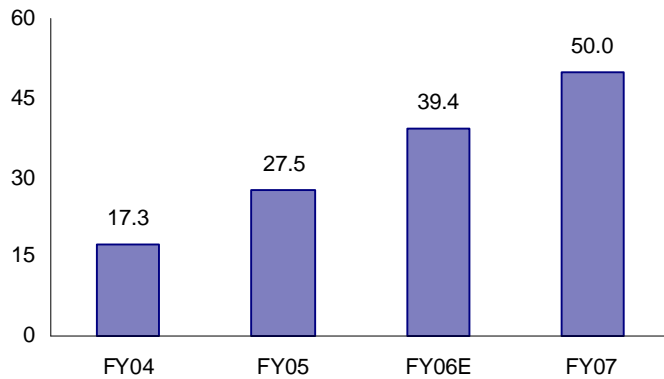
#### ORDER BOOK COMPOSITION

	FY07	FY06	EBIDTA MARGIN (%)
<b>Hydro Power</b>	<b>55</b>	<b>40</b>	<b>17-22</b>
Irrigation and Water Supply	25	22	10-15
Roads and Transport	20	38	5-8

Source: Company

Recently, Patel Engineering received order of Rs4b for construction of 434MW Rampur hydro power project in JV with Gammon. The order is to be executed over 54 month period. On the Urban Infrastructure side (specifically post acquisition of Michigan Engineers), the company received two orders from BMC totalling Rs3b.

## TREND IN ORDER BOOK (RS M)



Source: Company/ Motilal Oswal Securities

#### 4QFY07 Performance in line with expectations

During 4QFY07, Patel engineering reported revenues of Rs4b (up 31.5% YoY), EBIDTA Rs456m (up 69.2% YoY) and net profit of Rs340m (up 60% YoY). Reported revenues and PBT at Rs4b and Rs368m, were marginally better than our estimates of Rs3.9b and Rs331m respectively. EBIDTA margins improved by 260bps to 11.5% in 4QFY07 vs 8.9% in 4QFY06. The company has however not provided for the impact of the withdrawal of tax benefits under Sec 80IA, as the management believes that based on the legal opinion, the matter is still sub-judice. We estimate the tax impact during FY07 at Rs295m, and prior period arrears at Rs270m. Adjusted for this, FY07 net profit stands at Rs810m, vs reported Rs1.1b.

During 4QFY07, consolidated revenues increased to Rs4.9b (up 35% YoY), while net profit stood at Rs358m (up 53% YoY). EBIDTA margins increased 120bps YoY to 12.4% during 4QFY07, largely driven by contribution from Michigan Engineers and joint ventures (like Patel KNR, Patel Michigan and Patel L&T). During FY07, subsidiaries and joint ventures contributed Rs2.3b to revenues and Rs68m to net profit.

#### Valuation and view

We expect Patel Engineering to report consolidated net profit of Rs1.1b in FY08 (up 1.2% YoY) and Rs1.5b in FY09 (up 35.1% YoY). Our earnings estimate factor in the impact from possible withdrawal of Sec 80IA tax benefits.

We upgrade our price target to Rs504/sh, from Rs406/sh earlier, largely driven by improved clarity on real estate assets. We value the land bank of PRIL at Rs11.5b (Rs191/sh of Patel Engineering). For Jogeshwari (Mumbai) and Bangalore projects, we factor in the development profits given that construction is expected to commence during FY08, and development plans have been approved. For all other land banks, we do not factor in the development profits, and our valuation estimates largely factor in the value of the raw land, as the development plans are yet to be approved.

#### QUARTERLY PERFORMANCE (STANDALONE)

	(RS MILLION)									
	FY06				FY07				FY06	FY07
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
<b>Sales</b>	1,898	1,408	1,697	3,014	2,900	1,979	2,184	3,962	8,016	11,024
Change (%)	77.3	15.8	22.1	32.0	52.8	40.6	28.7	31.5	49.2	37.5
<b>EBITDA</b>	206	221	361	269	318	307	419	456	1,059	1,500
Change (%)	59.8	28.2	77.1	59.7	54.2	38.7	15.9	69.2	67.2	41.7
As of % Sales	10.9	15.7	21.3	8.9	11.0	15.5	19.2	11.5	13.2	13.6
Depreciation	60	71	72	63	65	66	70	72	266	273
Interest	51	23	60	72	46	-13	24	52	206	109
Other Income	37	15	46	101	26	20	11	35	200	91
Extra-ordinary income	0	0	0	2	0	0	0	0	2	0
<b>PBT</b>	133	142	276	237	233	274	335	368	789	1,210
Tax	20	16	25	23	33	24	44	28	85	129
Effective Tax Rate (%)	15.4	11.4	9.1	9.8	14.2	8.7	13.0	7.7	10.8	10.6
<b>Reported PAT</b>	113	126	251	214	200	250	292	340	704	1,081
<b>Adj PAT</b>	113	126	251	212	200	250	292	340	702	1,081
Change (%)	93.6	66.3	110.0	103.1	76.9	98.2	16.4	59.9	97.3	54.0

E: MOST Estimates

## LAND BANK VALUATION

	ACRES	RS M	VALUATION METHODOLOGY
Hyderabad	200	2,650	Land Bank
Jogeshwari (Mumbai)	20	1,991	NPV of Development Profits
Maharashtra	30	150	Land Bank
Chennai	200	2,400	Land Bank
Bangalore	50	4,277	NPV of Development Profits
<b>Total</b>		<b>11,467</b>	
<b>Rs/Sh</b>		<b>191</b>	

Source: Company

We value the core construction business at Rs280/sh (12x FY09E), Subsidiaries at Rs24/sh (10x FY09E), land bank at Rs191/sh and Investments at Rs10/sh (Book Value). At the CMP of Rs423, the stock trades at reported PER of 22.5x FY07, 22.3x FY08E and 16.5x FY09E. Adjusting for the value of Investment in BOT and Real Estate (Land Bank), the stock trades at a P/E of 11.8x FY07, 11.7x FY08 and 8.6x FY09E. Maintain **Buy**.

## PATEL ENGINEERING - 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	16,689	280	In line with peers
Subsidiaries	Construction	FY09E PER (x)	10	1,405	24	Discount to peers, given the lower profit size
BOT Projects / Investments	BOT Projects	FY07, Book Value	-	592	10	At Book value, as projects are yet to achieve financial closure
Land Bank		SOTP		11,467	191	
<b>Total</b>				<b>30,154</b>	<b>504</b>	

Source: Company/Motilal Oswal Securities

INCOME STATEMENT						RATIOS						
(Rs Million)												
Y/E MARCH	2005	2006	2007	2008E	2009E	Y/E MARCH	2005	2006	2007E	2008E	2009E	
<b>Net Sales</b>	<b>5,295</b>	<b>8,029</b>	<b>11,024</b>	<b>14,302</b>	<b>18,751</b>	<b>Basic (Rs)</b>						
Change (%)	-	51.6	37.3	29.7	31.1	<b>Adjusted EPS</b>	<b>8.1</b>	<b>14.4</b>	<b>18.4</b>	<b>18.0</b>	<b>23.3</b>	
Total Expenses	4,648	6,952	9,524	12,319	16,128	Growth (%)	-82.8	78.1	27.6	-2.3	29.4	
<b>EBITDA</b>	<b>647</b>	<b>1,077</b>	<b>1,500</b>	<b>1,984</b>	<b>2,622</b>	<b>Consolidated EPS</b>	<b>8.5</b>	<b>14.7</b>	<b>18.8</b>	<b>19.0</b>	<b>25.7</b>	
% of Net Sales	12.2	13.4	13.6	13.9	14.0	Growth (%)	-	71.5	28.1	12	35.1	
Depreciation	210	256	273	369	461	Cash EPS	12.4	19.6	23.0	24.2	31.0	
Interest	190	200	89	135	262	Book Value	26.6	38.9	120.6	127.1	147.5	
Other Operating Income	145	102	82	110	136	DPS	1.0	1.3	1.5	2.0	2.5	
Other Income	50	45	9	35	70	Payout (incl. Div. Tax.)	14.1	10.6	9.3	12.7	12.2	
<b>PBT</b>	<b>443</b>	<b>769</b>	<b>1,229</b>	<b>1,625</b>	<b>2,104</b>	<b>Valuation (x)</b>						
Extra-ordinary Items	-5	2	0	0	0	P/E (standalone)		29.3	22.9	23.5	18.1	
<b>PBT after Extra-ord. iter</b>	<b>438</b>	<b>770</b>	<b>1,229</b>	<b>1,625</b>	<b>2,104</b>	P/E (consolidated)		28.9	22.5	22.3	16.5	
Tax	48	46	129	551	713	Cash P/E		21.6	18.4	17.5	13.6	
Rate (%)	10.9	6.0	10.5	33.9	33.9	EV/EBITDA		21.6	16.8	13.2	10.5	
<b>Reported PAT</b>	<b>390</b>	<b>724</b>	<b>1,100</b>	<b>1,074</b>	<b>1,391</b>	EV/Sales		2.9	2.3	1.8	1.5	
Extra-ordinary Income (net of)	-5	2	0	0	0	Price/Book Value		10.9	3.5	3.3	2.9	
<b>Adjusted PAT</b>	<b>394</b>	<b>722</b>	<b>1,100</b>	<b>1,074</b>	<b>1,391</b>	Dividend Yield (%)		0.3	0.4	0.5	0.6	
Change (%)	72.0	83.2	52.2	-2.3	29.4	<b>Profitability Ratios (%)</b>						
<b>Consolidated PAT</b>	<b>416</b>	<b>733</b>	<b>1,120</b>	<b>1,134</b>	<b>1,531</b>	RoE		35.0	44.6	24.1	14.5	17.0
Change (%)	-	76.4	52.8	1.2	35.1	RoCE		12.9	15.9	14.8	14.9	15.9
E: MOST Estimates						<b>Turnover Ratios</b>						
<b>BALANCE SHEET</b>						<b>(Rs Million)</b>						
Y/E MARCH	2005	2006	2007E	2008E	2009E	Debtors (Days)	53	46	50	50	50	
Share Capital	49	50	60	60	60	Asset Turnover (x)	1.4	1.5	1.3	1.3	1.3	
Reserves	1,245	1,897	7,135	7,521	8,741	<b>Leverage Ratio</b>						
<b>Net Worth</b>	<b>1,294</b>	<b>1,947</b>	<b>7,195</b>	<b>7,580</b>	<b>8,801</b>	Debt/Equity (x)	0.9	1.3	0.3	0.3	0.5	
Loans	1,203	2,585	1,850	2,050	4,450	<b>CASH FLOW STATEMENT</b>						
Contractee Advances	1,854	1,770	1,102	2,145	2,813	<b>(Rs Million)</b>						
Deferred Tax Liability	144	122	122	122	122	Y/E MARCH	2005	2006	2007E	2008E	2009E	
<b>Capital Employed</b>	<b>4,495</b>	<b>6,424</b>	<b>10,269</b>	<b>11,897</b>	<b>16,185</b>	PBT before Extraordinary Item	<b>443</b>	<b>769</b>	<b>1,229</b>	<b>1,625</b>	<b>2,104</b>	
Gross Fixed Assets	2,491	2,590	3,086	3,986	4,986	Add : Depreciation	210	256	273	369	461	
Less: Depreciation	856	863	1,136	1,505	1,966	Interest	190	200	89	135	262	
<b>Net Fixed Assets</b>	<b>1,635</b>	<b>1,727</b>	<b>1,950</b>	<b>2,481</b>	<b>3,020</b>	Less : Direct Taxes Paid	48	46	129	551	713	
Capital WIP	41	46	50	50	50	(Inc)/Dec in WC	-393	-2,343	-1,697	-1,396	-2,202	
Investments	282	168	760	1,260	1,760	<b>CF from Operations</b>	<b>401</b>	<b>-1,164</b>	<b>-236</b>	<b>182</b>	<b>-88</b>	
<b>Curr. Assets</b>	<b>4,551</b>	<b>6,861</b>	<b>10,672</b>	<b>12,213</b>	<b>16,731</b>	Extra-ordinary Items	-5	2	0	0	0	
Inventory	1,428	2,854	3,926	5,094	6,678	<b>CF from Operations afte</b>	<b>396</b>	<b>-1,163</b>	<b>-236</b>	<b>182</b>	<b>-88</b>	
Debtors	768	1,022	1,510	1,959	2,569	(Inc)/Dec in FA	-428	-353	-500	-900	-1,000	
Cash & Bank Balance	917	520	1,850	1,051	2,098	(Pur)/Sale of Investments	-205	114	-592	-500	-500	
Loans & Advances	1,436	2,465	3,384	4,108	5,385	<b>CF from Investments</b>	<b>-634</b>	<b>-239</b>	<b>-1,092</b>	<b>-1,400</b>	<b>-1,500</b>	
Other Current Assets	1	1	1	1	1	(Inc)/Dec in Networth	13	-16	4,250	-553	0	
<b>Current Liab. &amp; Prov.</b>	<b>2,014</b>	<b>2,379</b>	<b>3,163</b>	<b>4,107</b>	<b>5,376</b>	(Inc)/Dec in Debt	1,067	1,298	-1,403	1,243	3,067	
Creditors	1,696	1,865	2,388	3,098	4,062	Less : Interest Paid	190	200	89	135	262	
Other Liabilities	281	490	673	873	1,144	Dividend Paid	55	77	102	136	170	
Provisions	36	25	102	136	170	<b>CF from Fin. Activity</b>	<b>836</b>	<b>1,006</b>	<b>2,657</b>	<b>419</b>	<b>2,635</b>	
<b>Net Current Assets</b>	<b>2,537</b>	<b>4,482</b>	<b>7,510</b>	<b>8,107</b>	<b>11,356</b>	<b>Inc/Dec of Cash</b>	<b>598</b>	<b>-396</b>	<b>1,329</b>	<b>-799</b>	<b>1,047</b>	
Misc. Exp	0	2	0	0	0	Add: Beginning Balance	319	917	520	1,850	1,051	
<b>Application of Funds</b>	<b>4,495</b>	<b>6,424</b>	<b>10,269</b>	<b>11,897</b>	<b>16,185</b>	<b>Closing Balance</b>	<b>917</b>	<b>521</b>	<b>1,849</b>	<b>1,051</b>	<b>2,098</b>	
E: MOST Estimates						E: MOST Estimates						

**N O T E S**



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<b>Disclosure of Interest Statement</b>	<b>Patel Engineering</b>
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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