



Patel Engineering

STOCK INFO.	BLOOMBERG
BSE SENSEX: 14,936	PEC IN
	REUTERS CODE
S&P CNX: 4,346	PENG.BO

1 August 2007

Buy

Previous Recommendation: Buy

Rs431

Equity Shares (m)	59.7
52-Week Range	490/261
1,6,12 Rel. Perf. (%)	1/-10/23
M.Cap. (Rs b)	25.7
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	23.0	3.6	24.1	14.8	2.3	17.2
3/08E	14,302	1,134	19.0	1.2	22.7	3.4	14.5	14.9	1.9	13.5
3/09E	18,751	1,531	25.7	35.1	16.8	2.9	17.0	15.9	1.5	10.7

*Consolidated

- 1QFY08 Performance lower than expectations:** During 1QFY08, Patel Engineering reported standalone revenues of Rs3.3b (up 13.8% YoY), EBIDTA of Rs358m (up 12.6% YoY) and net profit of Rs264m (up 32.1% YoY). The reported revenues are lower than estimates of Rs3.7b, while the EBIDTA margins at 10.9% are in line with estimates. On a consolidated basis, the company reported revenues of Rs4.2b (up 33% YoY), EBIDTA of Rs462m (up 33% YoY) and net profit after minority interest of Rs270m (up 33.6% YoY).
- Progress on real estate development:** Patel Engineering has transferred its existing land bank of ~500 acres (60mn sq ft) in Bangalore, Chennai, Hyderabad and Mumbai to Patel Realty India (PRIL, 100% subsidiary). The company plans to incorporate SPVs for development of the land bank and may induct financial investors or developers in the same. Phase 1 includes development of 0.75m sq ft commercial space in Jogeshwari (construction to start from Oct 07) and 3-5m sq of commercial and residential development at Bangalore (construction to start from end FY08).
- Consolidated Order Book stands at Rs50b+:** Patel Engg has an order book of Rs50b+ representing 3.8x FY07 revenues of Rs13.3b. The company has recently won its first order of US\$153m (its stake at 50%) from Algeria (Africa) for design and construction of Mehouane Dam, in consortium with As-Ka Insaat Construction Company. Order book composition stands as: Hydro: 65%, Irrigation: 18% and Transportation: 17%.
- Recommend Buy:** We expect Patel Engineering to report net profit of Rs1.1b for FY08 (up 1.2% YoY) and Rs1.5b in FY08 (up 35.1% YoY). We arrive at price target of Rs574/sh, and value the core construction business at Rs350/sh (15x FY09E), Subsidiaries at Rs24/sh (10x FY09E), Land Bank at Rs191/sh and Investments at Rs10/sh (Book Value). Adjusting for the value of Investment in BOT and Real Estate (Land Bank), the stock trades at a P/E of 11x FY07, 10.9x FY08 and 8x FY09E. We maintain **Buy**.

QUARTERLY PERFORMANCE (STANDALONE)

	(RS MILLION)								FY07	FY08E
	FY07				FY08E					
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE		
Sales	2,900	1,979	2,184	3,962	3,301	2,523	2,839	5,640	11,024	14,302
Change (%)	52.8	40.6	28.7	31.5	13.8	27.5	30.0	42.3	37.5	29.7
EBITDA	318	307	419	456	358	404	554	668	1,500	1,984
Change (%)	54.2	38.7	15.9	69.2	12.6	31.4	32.1	46.5	41.7	32.2
As of % Sales	11.0	15.5	19.2	11.5	10.9	16.0	19.5	11.8	13.6	13.9
Depreciation	65	66	70	72	66	85	95	122	273	369
Interest	46	-13	24	52	27	35	40	33	109	135
Other Income	26	20	11	35	35	30	45	35	91	145
Extra-ordinary income	0	0	0	0	0	0	0	0	0	0
PBT	233	274	335	368	300	314	464	548	1,210	1,625
Tax	33	24	44	28	37	119	176	220	129	551
Effective Tax Rate (%)	14.2	8.7	13.0	7.7	12.2	37.9	37.9	40.1	10.6	33.9
Reported PAT	200	250	292	340	264	195	288	328	1,081	1,074
Adj PAT	200	250	292	340	264	195	288	328	1,081	1,074
Change (%)	76.9	98.2	16.4	59.9	32.1	-22.2	-1.3	-3.4	54.0	-0.6

E: MOST Estimates

1QFY08 Performance lower than expectations

During 1QFY08, Patel Engineering reported standalone revenues of Rs3.3b (up 13.8% YoY), EBIDTA of Rs358m (up 12.6% YoY) and net profit of Rs264m (up 32.1% YoY). The reported revenues are lower than estimates of Rs3.7b, while the EBIDTA margins at 10.9% are in line with estimates. On a consolidated basis, the company reported revenues of Rs4.2b (up 33% YoY), EBIDTA of Rs462m (up 33% YoY) and net profit after minority interest of Rs270m (up 33.6% YoY). Consolidated earnings include forex gain of Rs12.9m on account of payment / restatement of liabilities for fixed assets. Adjusted for this, net profit for 1QFY08 stood at Rs260m, up 28% YoY. During 3QFY07, revenue composition from various segments was Hydro: 50%, Irrigation: 33% and Transportation: 8%.

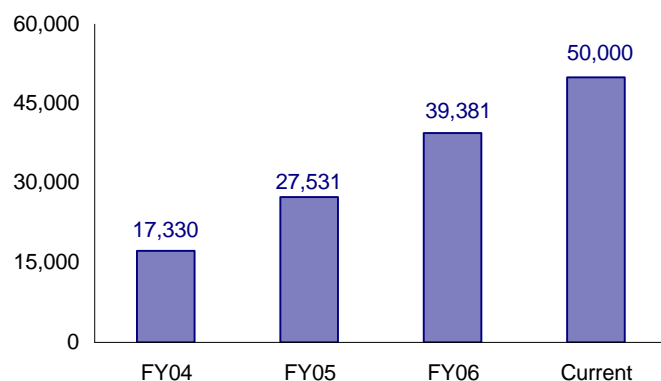
EBIDTA margin for standalone business stood at 10.9% in 1QFY08 vs 11% in 1QFY07. On a consolidated basis, EBIDTA margin for the company stood at 11.1% in 1QFY08. This is despite the higher mobilization done by the company for two projects of Rs15b. As per the accounting policy adopted by Patel Engineering, mobilization expenses are charged to the P&L account, which impacts EBIDTA margins during the ramp up phase.

Consolidated Order book at Rs48b, Book to bill ratio of 3.8x

Patel's order book as at June, 2007 stood at Rs50b, vs Rs40b in June 06 representing a book to bill ratio of 3.8x FY07 revenues of Rs13.3b. The composition of the current order book stands as: Hydro: 65%, Irrigation: 18% and Transportation: 17%. It is pre-qualified to bid for projects of Rs60b. The company has recently won its first order of US\$153m (its stake at 50%) from Algeria (Africa) for design and construction of Mehouane Dam, in consortium with As-Ka Insaat Construction Company. It plans to further increase its presence in African market given the higher margin profile and has bid for projects of US\$100-

150m. It is also looking at acquiring a local construction company in Africa. Patel Engineering has also floated a 100% subsidiary to tap new markets in Mauritius.

TREND IN ORDER BOOK (RS M)



Source: Company/Motilal Oswal Securities

Key takeaways from the Conference Call:

Management has guided for:

- ✍ Consolidated Revenue growth of 25% YoY over the next 2-3 years
- ✍ EBIDTA margin improvement of 25-50bps YoY
- ✍ Capex of Rs600-800m in FY08
- ✍ Michigan Engineers expected to report revenues of Rs300-350m for FY07 and Rs600-650m for FY08 (vs Rs180m for FY06)

Progress on Real estate development

Patel Engineering has transferred its existing land bank of ~500 acres (60mn sq ft) in Bangalore, Chennai, Hyderabad and Mumbai to Patel Realty India (PRIL, 100% subsidiary). The company plans to incorporate SPVs for development of the land bank and may induct financial investors or developers in the same. Phase 1 includes development of 0.75m sq ft commercial space in Jogeshwari (construction to start from Oct 07) and 3-5m sq of commercial and residential development at Bangalore (construction to start from end FY08) in Phase 1.

SUMMARY OF VALUATION OF LAND BANK (RS M)

LAND BANK	ACRES	RS M
Hyderabad	200	2,650
Mumbai	20	1,991
Maharashtra	30	150
Chennai	200	2,400
Bangalore	50	4,277
Total		11,467
Rs/Sh		191

Source: Company/Motilal Oswal Securities

Valuation and view

Given the strong order book position of Rs50b (3.8x FY07 revenue), we expect strong revenue and profit growth going forward. Also, the monetization of land bank could unlock significant value. Increased contribution from subsidiaries

like Michigan Engineers and Joint Ventures with L&T, etc would also add significantly to consolidated profits.

We expect Patel Engineering to report net profit of Rs1.1b for FY08 (up 1.2% YoY) and Rs1.5b in FY09 (up 35.1% YoY).

We arrive at price target of Rs574/sh, and value the core construction business at Rs350/sh (15x FY09E), Subsidiaries at Rs24/sh (10x FY09E), Land Bank at Rs191/sh and BOT projects/ Investments at Rs10/sh (Book Value). Adjusting for the value of Investment in BOT and Real Estate (Land Bank), the stock trades at a P/E of 11x FY07, 10.9x FY08 and 8x FY09E. We 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)	15	20,862	350	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	
Total				34,326	574	

Source: Company/Motilal Oswal Securities

Patel Engineering: an investment profile

Company description

Patel Engineering is one of the oldest and largest construction companies in India and has strong presence in Hydro power sector with a market share of 22%. It is one of the few players with pre-qualification in Hydro, Irrigation and other projects. It possesses niche technologies (via subsidiaries) like RCC Dam construction and Micro tunneling, Lake water tapping, etc in house. It has recently acquired Michigan engineers to leverage its skill in Micro tunneling to cater to urban infrastructure projects.

Key investment arguments

- Patel Engineering has expertise in hydro power, tunneling, irrigation, railways and roads segment
- Order Book at end June, 2007 was Rs50b, 3.8x FY07 revenue
- Real Estate could unlock significant value, Initiatives taken for developing IPP projects.

Key investment risks

- Retention of human resources given the increased traction in domestic construction and engineering sectors
- Infrastructure capex is highly cyclical
- BOOT projects depress initial RoE.

COMPARATIVE VALUATIONS

		PATEL	GAMMON	HCC
P/E (x)	FY07E	24.0	27.8	30.2
	FY08E	16.7	18.6	17.7
P/E (x)*	FY07E	11.5	10.3	11.8
	FY08E	8.0	6.9	6.9
P/BV (x)	FY07E	2.9	2.6	2.6
	FY08E	2.5	2.4	1.7
RoE (%)	FY07E	18.5	9.4	8.6
	FY08E	16.1	12.7	11.9

SHAREHOLDING PATTERN (%)

	JUN-07	MAR-07	JUN-06
Promoter	54.2	54.1	53.5
Domestic Inst	9.0	8.9	6.7
Foreign	11.2	11.0	10.0
Others	25.8	26.0	29.8

Recent developments

- Transferred entire land bank of 500 acre to Patel Realty Limited, a 100% subsidiary.

Valuation and view

- Based on SOTP methodology, we arrive at a PT of Rs574/share
- Adjusting for the value of Investment in BOT and Real Estate (Land Bank), the stock trades at a P/E of 11x FY07, 10.9x FY08 and 8x FY09E.

Sector view

- Increased government commitment towards infrastructure projects has led to several large projects taking off the ground
- We notice a trend of margin expansion, driven by changing composition of order book and higher margins at bidding stage.

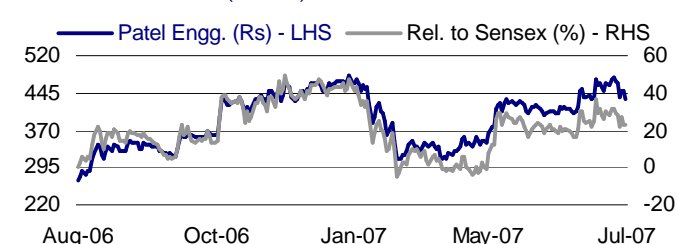
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	19.0	19.0	-
FY09	25.7	24.2	6.2

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
431	574	33.2	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007	2008E	2009E
Net Sales	5,295	8,029	11,024	14,302	18,751
Change (%)	-	516	37.3	29.7	311
Total Expenses	4,648	6,952	9,524	12,319	16,128
EBITDA	647	1,077	1,500	1,984	2,622
% of Net Sales	12.2	13.4	13.6	13.9	14.0
Depreciation	210	256	273	369	461
Interest	190	200	89	135	262
Other Operating Income	145	102	82	110	136
Other Income	50	45	9	35	70
PBT	443	769	1,229	1,625	2,104
Extra-ordinary Items	-5	2	0	0	0
PBT after Extra-ord. iter	438	770	1,229	1,625	2,104
Tax	48	46	129	551	713
Rate (%)	10.9	6.0	10.5	33.9	33.9
Reported PAT	390	724	1,100	1,074	1,391
Extra-ordinary Income (net of i	-5	2	0	0	0
Adjusted PAT	394	722	1,100	1,074	1,391
Change (%)	72.0	83.2	52.2	-2.3	29.4
Consolidated PAT	416	733	1,120	1,134	1,531
Change (%)	-	76.4	52.8	12	35.1

E: MOST Estimates

BALANCE SHEET					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Share Capital	49	50	60	60	60
Reserves	1,245	1,897	7,135	7,521	8,741
Net Worth	1,294	1,947	7,195	7,580	8,801
Loans	1,203	2,585	1,850	2,050	4,450
Contractee Advances	1,854	1,770	1,102	2,145	2,813
Deferred Tax Liability	144	122	122	122	122
Capital Employed	4,495	6,424	10,269	11,897	16,185
Gross Fixed Assets	2,491	2,590	3,086	3,986	4,986
Less: Depreciation	856	863	1,136	1,505	1,966
Net Fixed Assets	1,635	1,727	1,950	2,481	3,020
Capital WIP	41	46	50	50	50
Investments	282	168	760	1,260	1,760
Curr. Assets	4,551	6,861	10,672	12,213	16,731
Inventory	1,428	2,854	3,926	5,094	6,678
Debtors	768	1,022	1,510	1,959	2,569
Cash & Bank Balance	917	520	1,850	1,051	2,098
Loans & Advances	1,436	2,465	3,384	4,108	5,385
Other Current Assets	1	1	1	1	1
Current Liab. & Prov.	2,014	2,379	3,163	4,107	5,376
Creditors	1,696	1,865	2,388	3,098	4,062
Other Liabilities	281	490	673	873	1,144
Provisions	36	25	102	136	170
Net Current Assets	2,537	4,482	7,510	8,107	11,356
Misc. Exp	0	2	0	0	0
Application of Funds	4,495	6,424	10,269	11,897	16,185

E: MOST Estimates

RATIOS					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Basic (Rs)					
Adjusted EPS	8.1	14.4	18.4	18.0	23.3
Growth (%)	-82.8	78.1	27.6	-2.3	29.4
Consolidated EPS	8.5	14.7	18.8	19.0	25.7
Growth (%)	-	71.5	28.1	12	35.1
Cash EPS	12.4	19.6	23.0	24.2	31.0
Book Value	26.6	38.9	120.6	127.1	147.5
DPS	10	13	15	2.0	2.5
Payout (incl. Div. Tax.)	14.1	10.6	9.3	12.7	12.2
Valuation (x)					
P/E (standalone)		29.8	23.4	23.9	18.5
P/E (consolidated)		29.4	23.0	22.7	16.8
Cash P/E		22.0	18.7	17.8	13.9
EV/EBITDA		21.9	17.2	13.5	10.7
EV/Sales		2.9	2.3	1.9	1.5
Price/Book Value		11.1	3.6	3.4	2.9
Dividend Yield (%)		0.3	0.3	0.5	0.6
Profitability Ratios (%)					
RoE	35.0	44.6	24.1	14.5	17.0
RoCE	12.9	15.9	14.8	14.9	15.9
Turnover Ratios					
Debtors (Days)	53	46	50	50	50
Asset Turnover (x)	1.4	1.5	1.3	1.3	1.3
Leverage Ratio					
Debt/Equity (x)	0.9	1.3	0.3	0.3	0.5

CASH FLOW STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
PBT before Extraordinary Item	443	769	1,229	1,625	2,104
Add : Depreciation	210	256	273	369	461
Interest	190	200	89	135	262
Less : Direct Taxes Paid	48	46	129	551	713
(Inc)/Dec in WC	-393	-2,343	-1,697	-1,396	-2,202
CF from Operations	401	-1,164	-236	182	-88
Extra-ordinary Items	-5	2	0	0	0
CF from Operations afte	396	-1,163	-236	182	-88
(Inc)/Dec in FA	-428	-353	-500	-900	-1,000
(Pur)/Sale of Investments	-205	114	-592	-500	-500
CF from Investments	-634	-239	-1,092	-1,400	-1,500
(Inc)/Dec in Networth	13	-16	4,250	-553	0
(Inc)/Dec in Debt	1,067	1,298	-1,403	1,243	3,067
Less : Interest Paid	190	200	89	135	262
Dividend Paid	55	77	102	136	170
CF from Fin. Activity	836	1,006	2,657	419	2,635
Inc/Dec of Cash	598	-396	1,329	-799	1,047
Add: Beginning Balance	319	917	520	1,850	1,051
Closing Balance	917	521	1,849	1,051	2,098

E: MOST Estimates



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Disclosure of Interest Statement	Patel Engineering
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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