Equity | India | Construction & Eng

RBS The Royal Bank of Scotland

9 February 2010

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Gammon India

Margins on the decline

Core business margins have declined sharply over the past two quarters. That EBITDA margins have regressed to pre-ATSL merger levels is worrying, particularly given the ongoing high interest burden. Subsidiaries are also not yet out of the woods, in our view. We stay at Sell with a new target price of Rs185.8.

Sell

Target price
Rs185.80 (from Rs165.03)

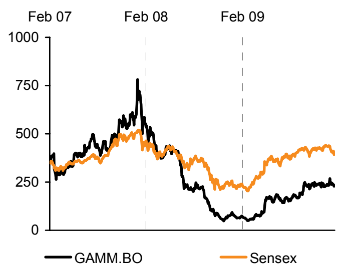
Price
Rs231.00

Short term (0-60 days)
n/a

Market view
Underweight

Price performance

	(1M)	(3M)	(12M)
Price (Rs)	229.4	217.9	63.35
Absolute (%)	0.7	6.0	264.6
Rel market (%)	10.8	7.5	112.8
Rel sector (%)	10.2	5.6	132.2



Market capitalisation
Rs31.34bn (US$668.81m)

Average (12M) daily turnover
Rs80.79m (US$1.70m)

RIC: GAMM.BO, GMON IN
Priced Rs231.00 at close 5 Feb 2010.
Source: Bloomberg

Key forecasts

	FY08A	FY09A	FY10F	FY11F	FY12F
Revenue (Rsm)	23,449	36,579	43,894	50,478	58,050
EBITDA (Rsm)	2,245	3,345	4,609	5,073	5,689
Reported net profit (Rsm)	861.3	1,405	1,928	2,028	2,183
Normalised net profit (Rsm)[1]	941.5	937.0	1,928	2,028	2,183
Normalised EPS (Rs)	10.90	6.91	14.20 ▼	14.90 ▼	16.10 ▼
Dividend per share (Rs)	0.51	0.48	0.50	0.60	0.60
Dividend yield (%)	0.22	0.21	0.22	0.26	0.26
Normalised PE (x)	21.30	33.40	16.20	15.50	14.40
EV/EBITDA (x)	15.50	12.10	7.18	7.55	6.64
Price/book value (x)	1.63	1.98	1.49	1.36	1.25
ROIC (%)	8.09	11.20	10.30	12.40	10.70

Use of ▲ ▼ indicates that the line item has changed by at least 5%.
year to Mar, fully diluted
1. Post-goodwill amortisation and pre-exceptional items
Accounting standard: Local GAAP
Source: Company data, RBS forecasts

EBITDA margin has regressed to pre-ATSL merger levels

Including ATSL (former Associated Transrail Structures Limited), Gammon posted a 7% yoy increase in lfl sales in 3QFY10 to Rs10.2bn and an EBITDA margin of 9.8% (down 100bp qoq). We are concerned about the sequential decline in the EBITDA margin, from 11.6% in 1Q to 10.8% in 2Q and 9.8% in 3Q. The regression to the pre-ATSL merger EBITDA margin level is eroding the benefits of the merger, which we had considered to be EPS-accretive for Gammon shareholders, and is even more of a concern in the light of the continued high interest burden of 3.3% of net sales in 3QFY10.

Subsidiaries continue to weigh heavily upon group earnings

Our analysis of the limited information made available for the consolidated entity suggests the Italian subsidiaries are not yet in the black. Gammon reported a consolidated EBITDA margin of 9.9% (standalone 10.7%) for 9MFY10, but consolidated EBITDA is propped up by the 40% EBITDA margin of subsidiary Gammon Infrastructure Projects Ltd (GIPL) and, hence, is not meaningful. Taking a disaggregated view of the construction business (parent and Italian subsidiaries) and the infrastructure development business (GIPL), we believe the Italian subsidiaries remain in the red, which is a significant negative for Gammon.

Dilution factored in and subsidiary value re-examined; we stay at Sell

Our estimates are broadly unchanged, but we have incorporated the recent QIP (qualified institutional placement). Consequently, our FY11F EPS falls 9.4% to Rs14.90. We value the standalone entity at 11x FY11F EPS, at the lower end of our valuation range for the sector, given Gammon's sliding EBITDA margin, low ROE and sluggish order-book growth. We mark to market our valuations for GIPL and Sadbhav and continue to value the Italian subsidiaries on a 20% discount to peer Alstom's 2009 EV/sales. We arrive at a new SOTP-based TP of Rs185.8 (vs Rs165.03). Given 20% downside potential from current levels, we reiterate Sell.

This note should be read along with our sector report (*Order execution needs to improve, 9 February 2010*) for a better understanding of the investment argument.
Important disclosures can be found in the Disclosures Appendix.

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Sliding margins a cause for concern

The slide in the core business margin from 11.6% in 1Q to 10.8% in 2Q and 9.8% in 3Q is a cause for concern, especially given the high interest cost. Continued losses at the Italian subsidiaries and sluggish order-book growth make us wary. We reiterate our Sell rating.

3QFY10 result – EBITDA margin drops for second consecutive quarter

On an lfl basis, Gammon posted a mixed operating performance in 3QFY10, with sales up 7% yoy to Rs10.2bn and EBITDA margin at 9.8% (down 100bp qoq), resulting in PAT of Rs209m (up 5% yoy from a low base of Rs199m in 3QFY09). Excluding extraordinary items, adjusted PAT was Rs371m (up 106% yoy). We reiterate our concern about the shrinking EBITDA margin, which seems to be regressing to pre-ATSL merger levels. Interest costs fell 11% qoq, but at 3.3% of net sales they remain a strain on profitability. EPS for the quarter was Rs2.70 on fully diluted 135.7m shares after the QIP in December 2009.

For 9MFY10 (including ATSL in both periods), Gammon reported a 16% yoy increase in net sales to Rs28bn and EBITDA margin of 10.7% (up 200bp yoy), resulting in PAT of Rs900m (down 21% yoy). Adjusted EPS for 9MFY10 was Rs7.20.

Gammon also revealed its unaudited consolidated results summary for 9MFY10, claiming a 9.9% EBITDA margin. This figure must be viewed in the context of EBITDA margins of 10.7% for the parent and 40% for GIPL. We reiterate that GIPL, which develops and owns infrastructure assets, has a completely different model, whereby an EBITDA margin of 40% or higher is essential to justify the high up-front costs of developing infrastructure assets. We must take a disaggregated view of the EBITDA margins of all of Gammon's subsidiaries and not rely solely on the consolidated number. A rough back-of-the-envelope calculation suggests that all of Gammon's subsidiaries combined, except GIPL, made an EBITDA margin of 2.7% and a net loss of Rs137m. We remain concerned about the lack of profits in the international operations.

Table 1 : Gammon 9MFY10 consolidated sales, pro forma breakdown

(Rsm)	Gammon	Gammon cons	GIPL cons	Other subsidiaries
Net sales	28,212	44,410	2,502	13,696
EBITDA	3,017	4,384	993	374
EBITDA margin	10.7%	9.9%	39.7%	2.7%
Reported PAT	900	920	207	(137)
PAT margin	3.2%	2.1%	8%	-1%

Source: Company data, RBS forecasts

Table 2 : Gammon 3QFY10 results and comparison with pro forma statements

Gammon + ATSL pro forma basis	3QFY09	3QFY10	yoy	9MFY09	9MFY10	yoy
(Rsm)	3 M	3 M				
Net operational income	9,467	10,156	7%	24,307	28,212	16%
Growth (%)						
Expenditure						
Raw material	4894	4,735	-3%	12461	12,198	-2%
Change in stocks	233	(936)		-1536	(1,532)	
% of net sales		37.4%		45%	38%	
Other expenses on contracts	2839	4,536	60%	8989	12,209	36%
% of net sales		44.7%		37.0%	43.3%	
Personnel expenses	506	572	13%	1600	1,853	16%
% of net sales		5.6%		6.6%	6.6%	
Administrative & other expenses	289	249	-14%	673	467	-31%
% of net sales		2.5%		2.8%	1.7%	
Miscellaneous exp. w-o				0	0	
Total expenditure	8761	9,157	5%	22,185	25,195	14%
EBITDA	707	999	41%	2,121	3,017	42%
EBITDA margin (%)	7.5%	9.8%		8.7%	10.7%	
EBITDA growth (%)						
Share in profit/ (loss) of JVs		0		0	0	
Total EBITDA margin (%)		0%				
Depreciation	158	175	11%	455	518	14%
% of gross block						
EBIT	549	824	50%	1,667	2,499	50%
Net interest	248	338	36%	650	1,085	67%
Net interest as % of sales		3.3%				
Non-operating income	8	5		52	5	
PBT	308	490	59%	1,069	1,418	33%
PBT margin %	3.3%	4.8%				
Tax-total	128	119	-7%	487	438	-10%
Tax rate (%) - total	41.5%	24.3%				
Profit after tax	180	371	106%	582	980	69%
Extraordinary income	19	0		555	162	
Extraordinary expenditure	0	162		0	242	
Excess/ (short) tax prov for earlier years	0	0		0	0	
Other no tax impact items	0	0		0	0	
Reported profit	199	209	5%	1,136	900	-21%
Number of shares (fully diluted)	136	136		136	136	
EPS	1.3	2.7		4.3	7.2	

Source: Company data, RBS proforma estimates

Forecasts unchanged: EPS lowered 9%, building in the impact of the recent QIP

We leave our FY10-12 sales and profitability forecasts unchanged, but build in the dilution arising from the recent QIP of 12.8m shares. This results in a 9% cut in our FY11 EPS forecast. We view the successful fund-raising via QIP as positive, but believe more may be required to ease the strain on the consolidated balance sheet. In our coverage universe, Gammon delivers the lowest EPS CAGR for FY10-12F, at just 6%.

Table 3 : Our new vs old estimates

	FY10F old	FY10F new	Change	FY11F old	FY11F new	Change
Sales Rsm	43,894	43,894	0%	50,478	50,478	0%
EBITDA Rsm	4,609	4,609	0%	5,073	5,073	0%
EBITDA margin	10.5%	10.5%	0 bps	10.1%	10.1%	0 bps
Adj. EPS	15.7	14.22	-9.5%	16.5	14.95	-9.4%

Source: RBS forecasts

Revisiting subsidiary valuation; Sell, with a Rs185.80 target price

We value Gammon's Italian subsidiaries Sadelmi, Franco Tosi and Sofinter at a 20% discount to power equipment giant Alstom's 2009 EV/sales (based on Bloomberg consensus sales estimate), due to their smaller scale of operations and lower profitability. We retain our 15% holding-company discount. This takes the overall discount for the Italian subsidiaries to 32% on a weighted average basis. We value the Italian subsidiaries at -Rs64.60/Gammon share. We value Gammon's 76% stake in GIPL at a 15% discount to the prevailing market price of Rs24 (after the 5:1 split). This results in a value of Rs82.60/Gammon share. We value Gammon's 3.5% stake in Sadbhav Engineering at a 15% discount to the market price, translating into a value of Rs3.40/ Gammon share.

Table 4 : SOTP target price

	Gammon India	GIPL	Sadbhav Engineering	Italian acquisitions
Basis of valuation	**11 x FY11F EPS**	**Market value**	**Market value**	**Comparative EV/sales**
Comparative company				Alstom
Premium/(discount)				-20%
Reasons for premium/(discount)				Discount for smaller size of operations
Base no. definition	**FY11F EPS**	**Market price (Rs)**	**Market price (Rs)**	**CY09F sales (€m)**
Base no.	14.9	24.0	1218	537
Multiple	11			0.60
Holding		76.0%	3.5%	
Holding company discount		15%	15%	15%
Value/share	164.4	82.6	3.4	-64.6
Target price – Gammon India (Rs)	185.8			

Prices as of 5 February 2010
Source: Company data, RBS forecasts

Forecasts and assumptions

Table 5 : Gammon – order status, sales and expenses assumptions

(Rsm)	FY09A	FY10F	FY11F	FY12F
Order inflow	88,749	35,000	50,000	50,000
Change	278%	-61%	43%	0%
Order book, year-end	129,670	120,776	120,297	112,247
Change	67%	-7%	0%	-7%
Order book to average sales	4.3	3.0	2.5	2.1
Net sales	36,579	43,894	50,478	58,050
Growth	56%	20%	15%	15%
Raw materials and other construction expenses as net sales	85%	83%	83%	83%
Labour and personal expenses as net sales	5%	6%	6%	6%
EBITDA	3345	4609	5073	5689
EBITDA margin	9.1%	10.5%	10.1%	9.8%
Net interest expenses as net sales	2.9%	2.6%	2.8%	3.0%
Pre-tax profit margin	4.5%	6.5%	5.9%	5.5%

Source: Company data, RBS forecasts

Table 6 : Sensitivity of target price to GIPL valuation

	-20%	Base case	20%	30%	50%
GIPL value/share (Rs)	19	24	29	31	36
Value/Gammon share (Rs)	66	83	99	107	124
SOTP (Rs)	169.3	185.8	202.3	210.6	227.1

Source: RBS

Income statement

Rsm	FY08A	FY09A	FY10F	FY11F	FY12F
Revenue	23449	36579	43894	50478	58050
Cost of sales	-21204	-33234	-39285	-45405	-52361
Operating costs	n/a	n/a	n/a	n/a	n/a
EBITDA	**2245**	**3345**	**4609**	**5073**	**5689**
DDA & Impairment (ex gw)	-462.1	-639.5	-640.4	-699.8	-772.2
EBITA	**1783**	**2705**	**3969**	**4373**	**4917**
Goodwill (amort/impaired)	n/a	n/a	n/a	n/a	n/a
EBIT	**1783**	**2705**	**3969**	**4373**	**4917**
Net interest	-264.1	-1053	-1144	-1403	-1717
Associates (pre-tax)	-112.8	-40.9	0.00	0.00	0.00
Forex gain / (loss)	n/a	n/a	n/a	n/a	n/a
Exceptionals (pre-tax)	n/a	n/a	n/a	n/a	n/a
Other pre-tax items	46.0	22.2	11.1	11.1	11.1
Reported PTP	**1452**	**1634**	**2836**	**2982**	**3211**
Taxation	-510.2	-696.9	-907.5	-954.2	-1027
Minority interests	n/a	n/a	n/a	n/a	n/a
Exceptionals (post-tax)	-80.2	467.8	0.00	0.00	0.00
Other post-tax items	0.00	0.00	0.00	0.00	0.00
Reported net profit	**861.3**	**1405**	**1928**	**2028**	**2183**
Normalised Items Excl. GW	-80.2	467.8	0.00	0.00	0.00
Normalised net profit	**941.5**	**937.0**	**1928**	**2028**	**2183**

Source: Company data, RBS forecasts year to Mar

Balance sheet

Rsm	FY08A	FY09A	FY10F	FY11F	FY12F
Cash & market secs (1)	380.9	513.6	9481	6748	9007
Other current assets	17294	32524	32484	36873	39858
Tangible fixed assets	7915	9834	10194	10994	11722
Intang assets (incl gw)	n/a	n/a	n/a	n/a	n/a
Oth non-curr assets	1608	2206	2206	2206	2206
Total assets	**27197**	**45078**	**54365**	**56820**	**62793**
Short term debt (2)	n/a	n/a	n/a	n/a	n/a
Trade & oth current liab	9043	18744	20406	18309	20313
Long term debt (3)	3771	9723	11223	13723	15473
Oth non-current liab	2097	804.9	1664	1784	1916
Total liabilities	**14911**	**29271**	**33293**	**33816**	**37702**
Total equity (incl min)	12287	15806	21072	23005	25092
Total liab & sh equity	**27197**	**45078**	**54365**	**56820**	**62793**
Net debt	3390	9209	1742	6975	6465

Source: Company data, RBS forecasts year ended Mar

Cash flow statement

Rsm	FY08A	FY09A	FY10F	FY11F	FY12F
EBITDA	2245	3345	4609	5073	5689
Change in working capital	-2647	-6292	2977	-5199	276.6
Net interest (pd) / rec	-218.1	-1030	-1133	-1391	-1706
Taxes paid	-517.7	-625.2	-850.8	-894.6	-963.2
Other oper cash items	2046	-174.0	-473.1	-1227	-1190
Cash flow from ops (1)	**907.9**	**-4777**	**5130**	**-3638**	**2106**
Capex (2)	-1362	-2559	-1000	-1500	-1500
Disposals/(acquisitions)	0.00	0.00	0.00	0.00	0.00
Other investing cash flow	-130.1	484.4	4427	0.00	-1.00
Cash flow from invest (3)	**-1492**	**-2075**	**3427**	**-1500**	**-1501**
Incr / (decr) in equity	0.00	58.3	39.5	0.00	0.00
Incr / (decr) in debt	55.7	5952	1500	2500	1750
Ordinary dividend paid	-50.7	-76.0	-79.3	-95.2	-95.2
Preferred dividends (4)	n/a	1050	-1050	0.00	0.00
Other financing cash flow	0.00	0.00	0.00	0.00	0.00
Cash flow from fin (5)	**5.00**	**6984**	**410.2**	**2405**	**1655**
Forex & disc ops (6)	n/a	n/a	n/a	n/a	n/a
Inc/(decr) cash (1+3+5+6)	**-579.0**	**132.7**	**8967**	**-2733**	**2260**
Equity FCF (1+2+4)	-453.9	-6286	3080	-5138	605.9

Lines in bold can be derived from the immediately preceding lines. year to Mar
Source: Company data, RBS forecasts

Standard ratios	Gammon India					IVRCL Infra & Projects			Nagarjuna Construction		
Performance	**FY08A**	**FY09A**	**FY10F**	**FY11F**	**FY12F**	**FY10F**	**FY11F**	**FY12F**	**FY10F**	**FY11F**	**FY12F**
Sales growth (%)	25.7	56.0	20.0	15.0	15.0	15.1	24.5	27.4	13.0	27.0	25.0
EBITDA growth (%)	30.4	49.0	37.8	10.1	12.1	28.8	21.9	25.6	25.5	25.7	21.2
EBIT growth (%)	30.2	51.8	46.7	10.2	12.4	29.0	22.3	26.5	29.2	27.3	21.4
Normalised EPS growth (%)	0.57	-36.4	105.8	5.14	7.67	5.05	30.8	32.7	25.6	37.7	28.7
EBITDA margin (%)	9.57	9.14	10.5	10.1	9.80	9.71	9.50	9.36	10.0	9.90	9.60
EBIT margin (%)	7.60	7.40	9.04	8.66	8.47	8.64	8.49	8.42	8.83	8.85	8.59
Net profit margin (%)	4.02	2.56	4.39	4.02	3.76	4.24	4.46	4.64	4.12	4.47	4.60
Return on avg assets (%)	4.42	4.53	5.41	5.32	5.56	6.60	7.10	7.73	5.51	6.12	6.46
Return on avg equity (%)	7.92	6.93	10.8	9.20	9.08	12.3	14.0	16.3	9.93	11.5	13.3
ROIC (%)	8.09	11.2	10.3	12.4	10.7	10.3	11.2	13.0	9.86	10.8	11.5
ROIC - WACC (%)	-4.50	-1.40	-2.28	-0.19	-1.93	-2.25	-1.39	0.40	-3.79	-2.88	-2.19
					year to Mar			year to Mar			year to Mar
Valuation											
EV/sales (x)	1.48	1.11	0.75	0.76	0.65	0.99	0.79	0.62	1.08	0.89	0.76
EV/EBITDA (x)	15.5	12.1	7.18	7.55	6.64	10.2	8.32	6.58	10.8	8.98	7.95
EV/EBITDA @ tgt price (x)	12.7	10.3	5.85	6.34	5.57	12.2	9.97	7.90	12.1	10.0	8.79
EV/EBIT (x)	19.5	15.0	8.34	8.76	7.69	11.4	9.31	7.31	12.2	10.0	8.88
EV/invested capital (x)	2.16	1.59	1.41	1.25	1.17	1.57	1.44	1.32	1.54	1.42	1.29
Price/book value (x)	1.63	1.98	1.49	1.36	1.25	2.06	1.79	1.58	1.82	1.65	1.48
Equity FCF yield (%)	-2.27	-20.1	9.83	-16.4	1.93	3.28	5.78	8.38	5.92	0.72	1.89
Normalised PE (x)	21.3	33.4	16.2	15.5	14.4	17.9	13.7	10.3	20.8	15.1	11.7
Norm PE @tgt price (x)	17.1	26.9	13.1	12.4	11.5	22.7	17.3	13.1	23.9	17.4	13.5
Dividend yield (%)	0.22	0.21	0.22	0.26	0.26	0.45	0.55	0.65	0.84	0.97	1.30
					year to Mar			year to Mar			year to Mar

Per share data	FY08A	FY09A	FY10F	FY11F	FY12F
Tot adj dil sh, ave (m)	86.8	135.7	135.7	135.7	135.7
Reported EPS (INR)	9.93	10.4	14.2	14.9	16.1
Normalised EPS (INR)	10.9	6.91	14.2	14.9	16.1
Dividend per share (INR)	0.51	0.48	0.50	0.60	0.60
Equity FCF per share (INR)	-5.23	-46.3	22.7	-37.9	4.47
Book value per sh (INR)	141.6	116.5	155.3	169.6	185.0
					year to Mar

Solvency	FY08A	FY09A	FY10F	FY11F	FY12F
Net debt to equity (%)	27.6	58.3	8.27	30.3	25.8
Net debt to tot ass (%)	12.5	20.4	3.20	12.3	10.3
Net debt to EBITDA	1.51	2.75	0.38	1.37	1.14
Current ratio (x)	1.95	1.76	2.06	2.38	2.41
Operating CF int cov (x)	7.54	-3.03	6.28	-0.97	2.80
Dividend cover (x)	18.6	12.3	24.3	21.3	22.9
					year to Mar

Priced as follows: GAMM.BO - Rs231.00; IVRC.BO - Rs311.00; NGCN.BO - Rs154.70
Source: Company data, RBS forecasts

Valuation methodology – SOTP target price

	Gammon India	GIPL	Sadbhav Engineering	Italian acquisitions
Basis of valuation	**11 x FY11F EPS**	**Market value**	**Market value**	**Comparative EV/sales**
Comparative company				Alstom
Premium/(discount)				-20%
Reasons for premium/(discount)				Discount for smaller size of operations
Base no. definition	**FY11F EPS**	**Market price (Rs)**	**Market price (Rs)**	**CY09F sales (€m)**
Base no.	14.9	24.0	1218	537
Multiple	11			0.60
Holding		76.0%	3.5%	
Holding company discount		15%	15%	15%
Value/share	164.4	82.6	3.4	-64.6
Target price – Gammon India (Rs)	185.8			

Source: Company data, RBS forecasts

Company description — Sell

Gammon is one of the oldest construction companies in India, with a substantial exposure to transport engineering. It has gained good ground in BOT projects involving PPP via its subsidiary GIPL, especially in its core area of transport engineering. It has won the second-largest number of contracts for four laning the Golden Quadrangle and is the highest beneficiary in value terms from NHDP annuity projects. However, Gammon's ROE and profits are low, due to significant dependence upon transport engineering, which is low-margin. Gammon acquired three Italian companies - Franco Tosi, a turbine maker; Sofinter, a boiler maker; and Sadelmi, which is into power plant EPC projects, in FY09. Since the merger with Associated Transrail Structures Limited, Gammon has emerged as an integrated player in the power sector.

Price relative to country

Strategic analysis — Average SWOT company score: 2

Strengths — 3

Gammon's capability in complex transport engineering projects such as bridges and tunnels has helped establish it in the PPP space. It now plans to augment existing strength in power sector civil contracts (nuclear and hydro) via acquisition of power equipment makers to emerge as an EPC player.

Weaknesses — 2

Long gestation period for projects limits growth prospects for Gammon despite a decent order-book-to-sales ratio. Mishaps at project sites (eg Delhi Metro, Hyderabad, etc) may lead to loss of bids.

Opportunities — 3

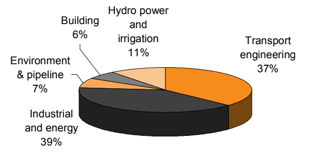
We believe the government of India's aggressive infrastructure plans (for example, the plan to harness 50,000MW of hydro power by FY17) provide Gammon with good growth prospects.

Threats — 1

Competition is rapidly catching up in Gammon's mainstay area of transport engineering, thereby affecting profitability. Delays in turning around international subsidiaries could be burdensome.

Scoring range is 1-5 (high score is good)

Orderbook by number of projects



Source: Company data (FY09)

Market data

Headquarters
Gammon House, Veer Savarkar Marg, Prabhadevi, Mumbai 400025

Website
www.gammonindia.com

Shares in issue
135.7m

Freefloat
74%

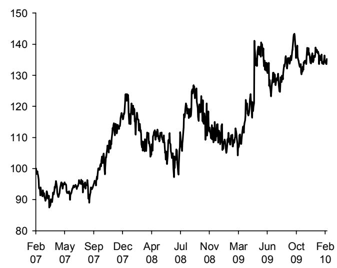
Majority shareholders
Warhol Ltd (7%), Humid Investments & Traders Pvt Ltd (4%), Copthall Mauritius (4%)

Country view — Underweight

Valuations have run ahead of regional counterparts, while the market also looks expensive relative to where it traded in the past. Another concern is the market seems to believe that policy reform will act as a catalyst for a never-ending re-rating of risky assets. Meanwhile, it appears that monetary policy might turn sooner than the market is anticipating, due to possible rising inflationary pressure. Recent statements from the central bank (RBI) suggest it may be steering the country down a tighter policy path going forward.

The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.

Country rel to Asia Pacific



Competitive position — Average competitive score: 2-

Supplier power — 3-

Suppliers of key raw materials have significant bargaining power. However, companies are well covered through price-escalation clauses, and the same are passed on to the customers.

Barriers to entry — 2+

In the transport engineering segment, especially road projects, barriers to entry are relatively low. However, in sectors such as energy and hydro power, higher barriers to entry exist.

Customer power — 1-

Customer power is weak, as order books of all the quality construction companies are full and customers must agree to the escalation clauses.

Substitute products — 3+

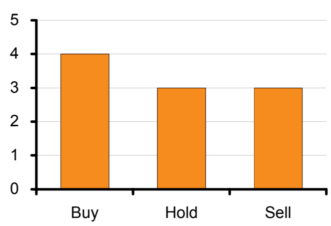
Substitutes are limited as the industry works on a cost-plus basis and design primarily comes from the customers.

Rivalry — 2-

Despite overlap in the kinds of projects undertaken, rivalry is largely subdued due to heavy investment in infrastructure and companies' healthy order books.

Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse

Broker recommendations



Source: Bloomberg

Recommendation structure

Absolute performance, short term (trading) recommendation: A Trading Buy recommendation implies upside of 5% or more and a Trading Sell indicates downside of 5% or more. The trading recommendation time horizon is 0-60 days. For Australian coverage, a Trading Buy recommendation implies upside of 5% or more from the suggested entry price range, and a Trading Sell recommendation implies downside of 5% or more from the suggested entry price range. The trading recommendation time horizon is 0-60 days.

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%. For UK Mid/Small Cap Analysis a Buy/Sell implies upside/downside of 10% or more, an Add/Reduce 5-10% and a Hold less than 5%. For UK-based Investment Funds research the recommendation structure is not based on upside/downside to the target price. Rather it is the subjective view of the analyst based on an assessment of the resources and track record of the fund management company. For listed property trusts (LPT) or real estate investment trusts (REIT) the recommendation is based upon the target price plus the dividend yield, ie total return.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Sector relative to market: The sector view relative to the market is the responsibility of the strategy team. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

Distribution of recommendations

The tables below show the distribution of recommendations (both long term and trading). The first column displays the distribution of recommendations globally and the second column shows the distribution for the region. Numbers in brackets show the percentage for each category where there is an investment banking relationship.

Long term recommendations (as at 09 Feb 2010)

	Global total (IB%)	Asia Pacific total (IB%)
Buy	659 (10)	436 (1)
Add	0 (0)	0 (0)
Hold	385 (4)	215 (0)
Reduce	0 (0)	0 (0)
Sell	96 (0)	57 (0)
Total (IB%)	1140 (7)	708 (0)

Source: ABN AMRO

Trading recommendations (as at 09 Feb 2010)

	Global total (IB%)	Asia Pacific total (IB%)
Trading Buy	3 (0)	3 (0)
Trading Sell	0 (0)	0 (0)
Total (IB%)	3 (0)	3 (0)

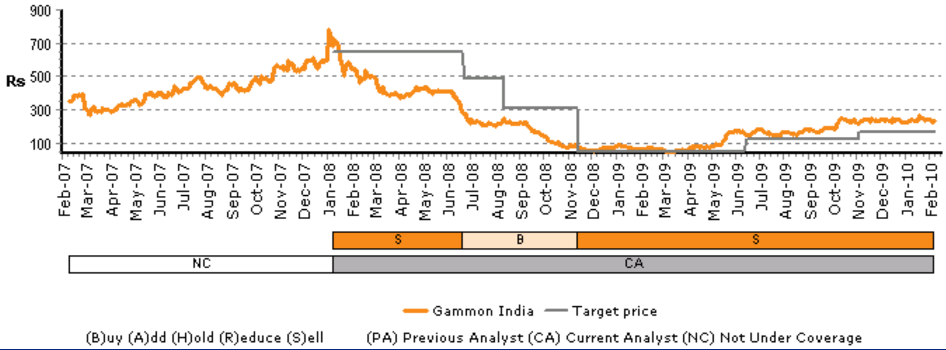
Source: ABN AMRO

Valuation and risks to target price

Gammon India (RIC: GAMM.BO, Rec: Sell, CP: Rs231.00, TP: Rs185.80): Key risks to our SOTP-based target price are: 1) a faster turnaround at the international subsidiaries were they to gain a foothold in the domestic power sector; and 2) a halt to the decline in standalone EBITDA margin and a return to the 1QFY10 level.

Gammon India coverage data

Stock performance, recommendations and coverage (as at 8 Feb 2010)



Pramod Amthe started covering this stock on 7 Jan 08

Source: RBS

Trading recommendation history (as at 09 Feb 2010)

Date	Rec	Analyst
	n/a	

Source: ABN AMRO

Regulatory disclosures

Subject companies: **GAMM.BO**

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