

**Country: India**

**Sector: Infrastructure**

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## Key Data

Market cap	Rs14.6bn/US\$324.2 mn
Shares in issue (mn)	88.5
Diluted share (mn)	116.1
3-mon avg daily val (mn)	Rs52.8/US\$1.2
52-week range	Rs845/160
BSE Sensex (25/09/08)	13,547
Nifty (25/09/08)	4,111
Rs/US\$	45.0

## Shareholding Pattern (%)

	1Q FY08	1Q FY09
Promoters	31.1	31.1
FIs	32.8	26.0
MFs/FIs/Banks	14.4	16.8
Others	21.7	26.1

## Price Performance (%)

	1M	3M	12M
Absolute	(25.3)	(39.1)	(61.9)
Relative*	(19.0)	(34.4)	(42.0)

\* To the BSE Sensex

## Daily Performance



(As of 25 September 2008)

26 September 2008

Company Update

# Gammon India

Bloomberg: GMON IB

**Hold**

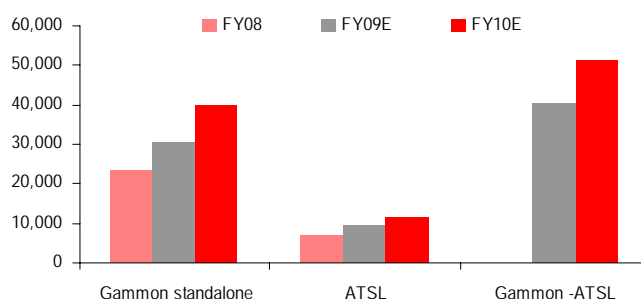
**Price: Rs165**

**Target Price (Mar 09): Rs215**

## Acquisitions overhang to overshadow EPS accretion of ATSL merger

- Healthy order book provides revenue visibility:** Gammon India (Gammon) is in the process of merging with Associated Transrail Structures (ATSL), which is in the business of manufacturing transmission towers and laying transmission lines (Refer to Appendix 1 for details on ATSL and the industry). Gammon has an order book of Rs90 bn, while ATSL has an order book of around Rs18 bn. On a consolidated basis, the Rs108 bn order book provides revenue visibility for FY09E-10E.
- ATSL to contribute 22-24% of consolidated revenue:** During FY08-10E, we expect standalone revenue CAGR of 30% each for Gammon and ATSL backed by their order books. On a consolidated basis, we anticipate Gammon's revenues to continue to contribute a lion's share and expect ATSL to contribute around 24% of revenues in FY09E and 22% in FY10E (see Exhibit 1).

**Exhibit 1: Revenue break-up of Gammon and ATSL (Rs mn)**



Source: Company, JM Financial

**Exhibit 2: Financial summary (Rs mn)**

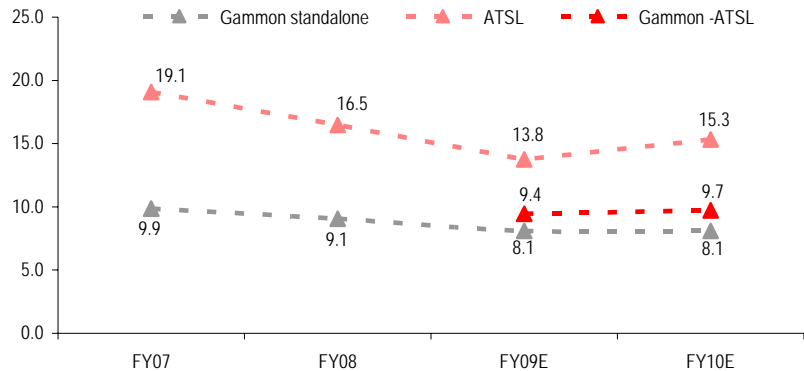
Y/E March	FY06	FY07	FY08	FY09E	FY10E
Income from operations	13,173	18,647	23,336	40,129	51,175
Growth (%)	-	42	25	72	28
EBITDA	1,615	1,840	2,116	3,791	4,973
EBITDA (%)	12.3	9.9	9.1	9.4	9.7
Net profit (adj)	885	950	942	1,599	2,249
EPS (Rs)	7.6	8.2	8.1	13.8	19.4
Acquisition adjusted EPS (Rs)	7.6	8.2	8.1	10.7	16.3
EPS growth (%)	-	7.3	(0.9)	69.9	40.6
ROCE (%)	15.3	8.6	12.0	18.6	19.0
RONW (%)	14.7	10.8	10.0	13.6	15.3
PE (x)	9.2	8.5	8.6	5.1	3.6
EV/EBITDA (x)	5.3	5.9	5.4	3.8	3.0
Acquisition adjusted PE (x)	9.2	8.5	8.6	6.6	4.3
Acquisition adjusted EV/EBITDA (x)	5.3	5.9	5.4	5.4	4.3

Source: Company, JM Financial. Note: Valuations as of 25 September 2008

\* Valuations exclude Rs85/share for Gammon's stake in GIPL and Rs10/share for treasury stock.

- ATSL merger will improve EBITDA margins:** Given its line of business, ATSL's EBITDA margins are significantly higher than that of Gammon's (see Exhibit 3). With the fixed-price contracts of Gammon's subsidiary company, Gammon Infrastructure Projects, accounting for 15-20% of its order book, we have factored in a margin decline of 100 bps for FY09E and FY10E vis-à-vis 9.1% in FY08. ATSL's margins are also expected to be impacted by the higher steel prices resulting in a margin decline in FY09E. EBITDA margins of the consolidated entity will be 130-160 bps higher than the standalone entity during FY09E-10E.

**Exhibit 3: EBITDA margin contribution**



Source: Company, JM Financial

- Dilution offset by positive EPS accretion:** Gammon's board has approved the merger of ATSL with the company at a swap ratio of two shares of Gammon for every one share of ATSL. Gammon owned 22% stake in ATSL, but it is opting to hold treasury stock rather than extinguish the shares received in the merger process. The merger transaction implies a 29% equity dilution and indicates that ATSL has been acquired at a reasonable PE of 8.6x FY09E earnings and 6.3x FY10E earnings (assumes Gammon's share price of Rs212/share, the date the merger ratio was announced). This compares favourably with the multiples of ATSL's peers like Jyoti Structures, KEC International and Kalpataru Power, which were then trading at a PE of 10-12x FY09E earnings and 8-10x FY10E earnings. Despite the equity dilution, the merger is expected to be EPS accretive to the tune of 25-30% in FY09E and FY10E, even after factoring in interest cost of Sofinter's 50% stake for €50 mn.
- Italian acquisitions to strain the financials:** Gammon has acquired stakes in three Italian companies for a total consideration of €97.5 mn. These acquisitions, which are primarily loss making companies (see Exhibit 4), have been funded entirely through debt. Gammon is looking to turn around these acquisitions during FY09E-10E. Given the acquired companies are not in the areas of Gammon's expertise, we believe the management will require at least a couple of years to make the entities significantly profitable. We estimate the companies would just about break-even and Gammon will have to service the debt raised to finance the acquisitions. ATSL has also acquired an Italian company, SAE Power Transmission Lines, which is in the similar line of business as that of ATSL. This company has been financed through optionally convertible preference shares issued to ATSL's promoters valued at Rs1.05 bn. Gammon's management indicated that these preference shares have been converted into equity and we have factored the same while estimating dilution from the merger.

**Exhibit 4: Financial details of Italian acquisitions (€ mn)**

	Sofinter	Franco Tossi	Sadelmi
Gammon's stake	50%	75%	50%
Acquisition cost	50	40	8
Turnover	527	90	120
PAT	(11)	(42)	(1)

Source: Company, JM Financial

- Maintaining a cautious stance despite seemingly low valuations:**  
 Gammon's recent acquisitions are likely to continue to strain the core business of the company. Additionally, if the acquisitions do not break-even during FY09E-FY10E, it will put further pressure on the financials. Hence, we continue to maintain our cautious stance on the company, and believe it will trade at a discount to its peers.

**Exhibit 5: Financial details of Italian acquisitions (€ mn)**

	Old	Revised	Basis
Core construction*	125	120	5.5x EV/EBITDA FY10E v/s 6.5x FY10E earlier
GIPL stake	100	85	Based on GIPL share price of Rs90/share
Treasury stock value	0	10	Valued at Rs205/share (target price of Gammon excluding treasury stock value)
ATSL stake	30	0	Factored this in merged core construction value
Target price	255	215	

Source: Company, JM Financial

## Appendix 1

Associated Transrail Structures (ATSL) is in the same line of business as Jyoti Structures, Kalpataru Power and KEC International, which are involved in tower manufacturing and laying transmission lines. ATSL has an installed capacity of 60,000 MT p.a. for tower manufacturing in Nagpur (Maharashtra) and Vadodra (Gujarat) and 38,000 MT p.a. for conductor manufacturing at Amboli (Silvassa).

Our Power Analyst, Abhishek Puri, in his report (*dated 11 September 2008 "Get ready for better times"*) highlights that the outlook for the Transmission & Distribution (T&D) sector remains positive. Projected power generation capacity addition is anticipated to be 2x 2007-08 addition at 18.4 GW by 2009-10, 19.3 GW in 2010-11 and 23.2 GW in 2011-12. During the past five year plan periods, order inflow picks up in the last three years of the plan. Effectively, similar to its peers, ATSL financials is also expected to benefit in the next couple of years on the back of strong order inflows in-line with the trend in previous five-year plans.

### Exhibit 6: Peer Comparison (FY08)

	ATSL	Jyoti Structures	KEC International	Kalpataru Power
Revenue CAGR (FY08-10E)	30	30	23	23
Turnover (Rs mn)	6,827	13,704	28,145	17,376
EBITDA margin (%)	16.5*	12.5	12.6	14.8
Adjusted PAT (Rs mn)	584	724	1,722	1,500
Tower Manufacturing Capacity (MT p.a.)	60,000	84,000	110,000	108,000

Source: Company, JM Financial

\* We expect ATSL's margins to come down in the range of 14-15% for FY09E & FY10E

## Financial Tables

Profit & loss statement						(Rs mn)
Y/E March	FY06	FY07	FY08	FY09E	FY10E	
Income from operations	13,173	18,647	23,336	40,129	51,175	
Growth (%)	-	42	25	72	28	
Other operational income	0	0	0	0	0	
EBITDA	1,615	1,840	2,116	3,791	4,973	
EBITDA (%)	12.3	9.9	9.1	9.4	9.7	
Growth (%)	-	14	15	79	31	
Other non operational income	21	19	45	40	35	
Depreciation & amortisation	310	352	462	583	683	
EBIT	1,326	1,507	1,699	3,249	4,325	
Interest income/expense	373	136	264	811	897	
Extraordinary income/expenses	14	(491)	(80)	0	0	
Pre tax profit	968	880	1,355	2,438	3,429	
Taxes	68	435	494	839	1,179	
Reported net profit	899	445	861	1,599	2,249	
Adjusted net profit	885	950	942	1,599	2,249	
Margin (%)	7	5	4	4	4	
Diluted share capital (mn)	232	232	232	232	232	
Diluted EPS (Rs)	7.6	8.2	8.1	13.8	19.4	
Growth (%)	-	7	(1)	70	41	

Source: Company, JM Financial

Balance sheet						(Rs mn)
Y/E March	FY06	FY07	FY08	FY09E	FY10E	
Share Capital	177	177	177	232	232	
Reserves & surplus	8,408	8,798	9,613	13,413	15,526	
Networth	8,585	8,975	9,790	13,645	15,758	
Total loan funds	1,706	3,715	3,771	6,819	8,019	
Deferred tax	345	379	372	580	730	
<b>Sources of funds</b>	<b>10,636</b>	<b>13,069</b>	<b>13,932</b>	<b>21,044</b>	<b>24,507</b>	
Intangibles	0	0	0	0	0	
Fixed assets	4,820	6,538	7,954	10,810	12,560	
Less: Depreciation/amortisation	1,723	2,051	2,536	3,209	3,891	
Net block	3,097	4,487	5,418	7,601	8,668	
Investments	1,162	1,504	1,608	1,792	1,892	
Current Assets	11,469	14,804	17,675	26,061	32,216	
Inventories	4,706	5,290	7,050	9,696	12,437	
Sundry Debtors	2,380	3,034	5,172	9,812	12,304	
Cash & bank balance	1,343	960	381	653	1,074	
Other current assets	3,041	5,521	5,073	5,900	6,400	
Current liabilities & provisions	5,092	7,727	10,768	14,411	18,269	
Current liabilities	5,033	6,628	9,111	14,041	17,750	
Provisions & others	60	1,099	1,657	369	519	
Net current assets	6,377	7,078	6,907	11,651	13,947	
Miscellaneous Expenditure	0	0	0	0	0	
<b>Application of funds</b>	<b>10,636</b>	<b>13,069</b>	<b>13,932</b>	<b>21,044</b>	<b>24,507</b>	

Source: Company, JM Financial

Cash flow statement						(Rs mn)
Y/E March	FY06	FY07	FY08	FY09E	FY10E	
PBIT	1,341	1,507	1,619	3,249	4,325	
Depreciation/amortisation	310	352	462	583	683	
Inc/dec in working capital changes	(2,047)	(1,674)	148	(3,183)	(2,025)	
Others	(102)	(233)	(1,081)	(2,111)	(948)	
Net cash from ops. (a)	(499)	(48)	1,148	(1,463)	2,035	
Inc/dec in investments	(266)	(343)	(104)	(185)	(100)	
Capex	(703)	(1,718)	(1,416)	(2,856)	(1,750)	
Others	22	259	287	40	35	
Cash flow from inv. (b)	(946)	(1,802)	(1,232)	(3,001)	(1,815)	
Inc/dec in capital	4,414	0	0	0	0	
Dividends paid + div. tax	0	(100)	(11)	(51)	(102)	
Inc/dec in loans	(1,325)	2,009	56	3,048	1,200	
Others	(596)	(443)	(539)	1,739	(897)	
Financing cash flow (c)	2,493	1,467	(495)	4,736	201	
Net inc/dec in cash (a+b+c)	1,048	(383)	(579)	272	421	
Opening cash balance	295	1,343	960	381	653	
closing cash balance	1,343	960	381	653	1,074	

Source: Company, JM Financial

Key ratios					
Y/E March	FY06	FY07	FY08	FY09E	FY10E
ROCE (%)	15.3	8.6	12.0	18.6	19.0
ROE (%)	14.7	10.8	10.0	13.6	15.3
Debt:equity (x)	0.2	0.4	0.4	0.5	0.5
EPS	7.6	8.2	8.1	13.8	19.4
Valuation (x)					
PER	9.2	8.5	8.6	5.1	3.6
PBV	0.7	0.7	0.6	0.6	0.5
P/sales	0.6	0.4	0.3	0.2	0.2
EV/EBITDA	5.3	5.9	5.4	3.8	3.0
Turnover ratios (no.)					
Debtor days	65	53	64	68	79
Inventory days	117	98	97	76	79
Creditor days	100	72	79	77	89

Source: Company, JM Financial

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