Batlivala & Karani

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INITIATING COVERAGE

LARGE CAP

Share Data

Market Cap.	Rs 136,252 mn (US$ 2,989 mn)
Price	Rs 2,426
Target Price	Rs 1,650
BSE Sensex	17,645
Reuters	ENGI.BO
Bloomberg	ENGR IN
6M avg. daily turnover (US$ mn)	4.3
52-week High / Low (Rs)	2,600 / 449
Issued Shares	56 mn

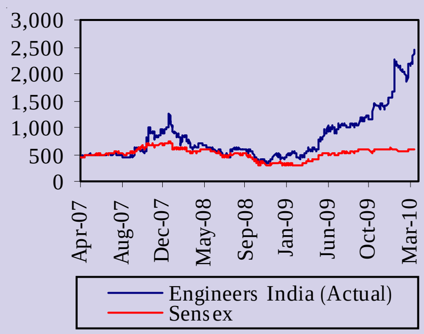
Valuation Ratios

Yr to 31 Mar	FY11E	FY12E
EPS (Rs)	89.3	104.1
+ / - (%)	16.0	16.6
PER (x)	27.2	23.3
Dividend / Yield (%)	1.1	1.2
EV / Sales (x)	4.7	3.6
EV / EBITDA (x)	20.2	16.7

Shareholding Pattern (%)

Promoters	90
FIIs	1
MFs	2
BFSI's	4
Public & Others	3

Relative Performance



Engineers India (SELL)

26 March 2010

Tougher times ahead...

Since its incorporation in 1965, Engineers India (EIL) has emerged a key player in establishment of PSUs refinery capacity by providing engineering and technical based consultancy services. Over the years, it has also developed expertise to cater to petrochemical and fertiliser projects, oil & gas platforms, pipelines, etc. The Government of India holds ~90.4% equity in the company.

Year to March	FY09	FY10E	FY11E	FY12E	CAGR (%)
P&L Data (Rs mn)					**FY09-12E**
Revenues	15,515	18,959	24,223	29,758	24.2
EBITDA	3,221	4,735	5,637	6,437	26.0
Adjusted Net Profit	3,497	4,324	5,016	5,846	18.7
Margins (%)					
EBITDA	20.8	25.0	23.3	21.6	–
Net Profit	22.5	22.8	20.7	19.6	–
Balance Sheet (Rs mn)					
Total Assets	29,086	27,816	36,083	45,213	15.8
Shareholders' Funds	14,104	10,399	13,638	17,510	7.5
Per Share Data (Rs)					
EPS	62.3	77.0	89.3	104.1	18.7
CEPS	64.2	79.2	91.6	106.5	18.4
Returns (%)					
RoCE	44.8	59.2	71.3	63.1	–
RoE	27.0	35.3	41.7	37.5	–

- The key concern for EIL is that India has surplus refining capacity and given the ongoing capex, this surplus is only going to increase. There is indeed a possibility that capex on new refinery projects, the mainstay of EIL's business, will slow down in the medium term.
- However, near-term top line growth will be driven by its Rs 65-70 bn book, which is enough work for at least 2.5 years (order book is at ~3.6x FY10E sales). We expect a top line CAGR of over 25% over FY10-12E.
- The EBITDA margin has peaked in FY10 and will witness a decline going forward due to changing sales mix and increasing competition from local as well as foreign companies. The bottom line growth will lag sales growth.
- The stock has moved up by ~40% in the last two months post the announcement of government divestment, a 2:1 bonus, a 1:1 sub-division and a Rs 100 per share special dividend, all on the same day. Our target price of Rs 1,650 is at 18.5x FY11E EPS which is higher than the last five years average P / E multiple.

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Analyst Declaration: We, Kunal Parekh & Pritam Lala, hereby certify that the views expressed in this report accurately reflect our personal views about the subject securities and issuers. We also certify that no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendation or view expressed in this report.

B&K Research is also available on Bloomberg <BNKI>, Thomson First Call & Investext.

Index .... Page No.

B&K Investment Ratings:

1. **BUY:** Potential upside of > +25% (absolute returns)
2. **OUTPERFORMER:** 0 to +25%
3. **UNDERPERFORMER:** 0 to -25%
4. **SELL:** Potential downside of < -25% (absolute returns)

Investment summary

EIL's current order book lends revenue visibility for the next 2.5 years

Current order book of Rs 65 bn to Rs 70 bn at 3.6x FY10E net sales

EIL has a strong order book of Rs 65 bn to Rs 70 bn, which is at ~3.6x FY10E sales. The company's current order book lends enough visibility for the next ~2.5 years assuming a CAGR of 25% on FY10E net sales of Rs 18.7 bn.

Potential opportunity in refinery sector

EIL is working towards setting up of about 33 MMTPA of refinery capacity that includes two grass-root refineries of 15 MMTPA (6 MMTPA Bina and 9 MMTPA Bhatinda refineries) and expansion in existing refineries to be completed by the end of 11th Five Year Plan. The private sector is expected to add another 24 MMTPA (Essar Oil 18 MMTPA and Nagarjuna Oil 6 MMTPA) which the company will bid for. In addition, there exist plans to set up three grass-roots refineries in Rajasthan, Kakinada and Ratnagiri by the state run companies (The company is currently doing a feasibility study for the HPCL Ratnagiri refinery). We expect EIL to secure at least two refinery orders out of the above state projects.

EIL has been a leader in setting up petrochemical plants

Petrochemical orders to contribute Rs 13 bn to Rs 17 bn to EIL's top line

EIL has executed six out of the seven major petrochemical complexes built in the country. Currently, the company is executing three grass-roots petrochemical projects for IOCL Panipat, ONGC Dahej and the Brahmaputra Assam cracker. The company would be offering Project Management Consultancy (PMC) services to all three projects. We believe these orders could contribute Rs 13 bn to Rs 17 bn to the top line. In addition, it would provide Lump-Sum Turnkey (LSTK) solutions for some units of IOCL's Naphtha cracker. However, EIL has recently lost out to L&T for Mangalore Petrochemicals' order to set up an aromatics complex at the Mangalore special economic zone.

EIL is actively looking at projects in the fertiliser…

Fertiliser and infrastructure space provides strong growth prospect

Gas-based fertiliser projects provide growth opportunities, as many of the existing fertiliser plants are expected to switchover from naphtha or fuel oil (FO) to natural gas. This would call for major plant modifications. According to the New Pricing Scheme (stage III), currently there are about 8 urea units (MFL, SPIC, ZIL, MCFL, GNFC, NFL-Nangal, NFL-Bhatinda, NFL-Panipat) in the country which are based on naphtha or FO/LSHS as feedstock. Out of this, GNFC and NFL-Panipat plants have already placed orders with L&T for ~Rs 30 bn to be executed in the next three years. EIL would be tendering its bids for the remaining six plants.

…and infrastructure sectors

EIL is examining other opportunities in view of some slowing down of growth expected in hydrocarbon projects. The company is planning to move into the infrastructure consultancy business where it expects to provide PMC services, third party inspection and quality assurance services. However, it is yet to secure/book substantial orders/revenues in this space.

- The company would operate as a verification/safety auditing agent for city gas distribution network and offer PMC services for building up country's strategic reserves for crude-oil storage.
- EIL has initiated water management consultancy business and is already working with Delhi Jal Board to expand in this area (bagged order worth ~Rs 1 bn).

- The company is now also looking at diversifying into several new areas including highways and bridges, IT, airports, mass rapid transport systems, ports and terminals, non-conventional and renewable energy sources, specialist materials and maintenance services, water and urban development projects, development of solar, gas and nuclear power consultancy business.

Healthy return rations; cash per share of ~Rs 310 on its books

Projects under execution will generate considerable cash flows with low fixed asset requirement and negative net working capital (excluding cash). Return ratios are therefore expected to remain at healthy levels going forward. EIL is a debt free company and would have Rs 17.4 bn cash on book at the end of FY10E translating to Rs 310 per share (after taking into the impact of Rs 100 per share special dividend).

Return ratios

(%)	FY07	FY08	FY09	FY10E	FY11E	FY12E
RoE	13.8	17.8	27.0	35.4	42.0	37.8
RoCE	22.1	29.5	44.8	59.5	71.7	63.7

Source: B&K Research

Investment concerns

Excess capacity in refinery set to increase; capex could slowdown in the medium term

During the last five years, India's refinery capacity has increased at a CAGR of 8.7% (which is higher than its last 29 year CAGR of 6.6%), while the consumption of petroleum products has increased at a CAGR of 4.9%. According to Ministry of Petroleum and Natural Gas, a total of 78 MMPTA of refinery capacity is expected to be added (CAGR of ~12.8%) by the end of 11th Five Year Plan. If we assume the consumption growth to remain at similar levels during the next three years, the gap between refinery capacity and consumption is expected to rise to 88 MMTPA (255 MMTPA is projected refinery capacity after expansion). Some slowdown in refinery capex in the medium term is possible.

Talent retention is a challenge

EIL has increased employee strength from 2,551 in 2007 to about 3,400 in FY09. Work is basically process driven. The company has put in place various training programs to ensure seamless dissemination of information/knowledge. However, given the PSU pay structure, retaining talent could be a challenging job for EIL.

Difficult to maintain margins at these levels in view of rising competition and changing sales mix

Margins in consultancy segment are expected to fall by 75 bps, while that in LSTK are expected to remain at around same levels

The 9MFY10 operating margins stood at 24.5% (consultancy segment PBIT margin at 39.4% and LSTK margin at 7.8%). The share of revenues from the consultancy and LSTK segments stood at 55% and 45%, respectively. (The Consultancy:LSTK mix in the order book is at ~45:55). However, margins would come under pressure in future, given the competition and changing sales mix. EIL faces competition from local players like Jai Corp & L&T as well as from foreign companies and their Indian subsidiaries (Foster Wheeler, Fluor Daniel, Lurgi India and Toyo India). In addition, expected growth slowdown in hydrocarbon projects would lead to an adverse sales mix. Consultancy segment share in revenue mix is expected to drop to 45% and LSTK share to increase to 55%, in the next couple of years. We expect consultancy margins to fall by ~75 bps by FY12E. However, we expect margins in turnkey projects to be maintained at ~8.2%.

Could be a bit difficult to secure orders in the fertiliser sector due to its inexperience and due to competition

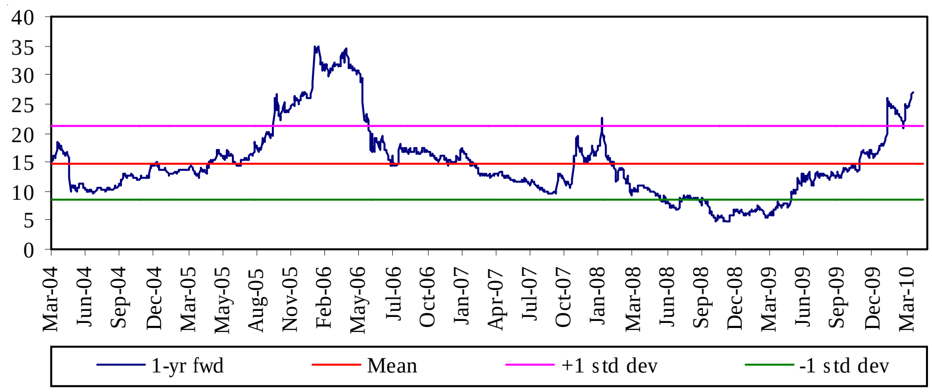
EIL to face competition mainly from L&T in fertilisers

Though there exists a potential opportunity in the fertiliser space, securing orders would pose a challenge in view of inexperience and competition. EIL had last executed a major fertiliser project order in 1981. In addition, competition from L&T and Projects and Development India Ltd. (existing PSU firm that specialises in providing consultancy to fertiliser industry) could make it tough for EIL to secure orders.

Valuations

EIL is a key player engaged in the setting up of public sector refineries. The execution of a 2.5 year order book should lead to decent profit growth in the next couple of years. The company has Rs 310 per share of cash on books (after excluding Rs 100 per share of special dividend announced recently). However, a possible slowdown in hydrocarbon projects combined with the recent 40% spurt in the stock price makes EIL expensive. At the current market price of Rs 2,426, EIL is trading at 27.2x FY11 P/E. We initiate coverage with a Sell rating. At our target price of Rs 1,650, the stock would trade at 18.5x FY11E EPS. The average P/E for the last five years, on one-year forward earnings is 14.8x.

1-year forward P/E



Source: B&K Research

Industry overview

India leads global growth in refining capacity

India's refining capacity grew at 6.2% CAGR between CY80 to CY08

India's refining capacity was about ~557,000 bpd in 1980 accounting for about ~1% of total world capacity. The world oil refining capacity grew at a CAGR of ~0.4% during the period from 1980 to 2008. Asia has seen the biggest surge in capacity over the past three decades, achieving an average growth rate of ~2.6% p.a. The growth in the world oil refining capacity was mainly led by China and India, which have shown strong growth of ~5.3% and ~6.2%, respectively. In contrast, the mature economies of Europe, North America, Japan and Australia have seen only marginal increase or a drop in their capacity.

Region-wise refining capacity

('000 bpd)	Capacity				CAGR (%)	Share (%)	
Region	**1980**	**1990**	**2000**	**2008**	**1980-08**	**1980**	**2008**
North America	21,982	19,195	19,937	21,035	(0.2)	28	24
S. & Cent. America	7,251	6,009	6,308	6,588	(0.3)	9	7
Europe & Eurasia	32,170	27,955	25,006	25,086	(0.9)	41	28
Middle East	3,528	5,244	6,390	7,592	2.8	4	9
Africa	2,102	2,804	2,879	3,228	1.5	3	4
+ China	1,805	2,892	5,407	7,732	5.3	2	9
+ India	557	1,122	2,219	2,992	6.2	1	3
Asia Pacific	12,364	13,449	21,641	25,098	2.6	16	28
Total World	**79,397**	**74,656**	**82,161**	**88,627**	**0.4**	**100**	**100**

Source: BP Statistical Review 2009

According to the World Oil Outlook 2009, released by OPEC, North America and Europe are expected to witness weak addition in refinery capacity, going forward. US and Canada are to be most impacted, driven by a combination of an ethanol supply surge, flattening demand growth with a decline in gasoline, as well as the continuing effects of dieselization in Europe that generates low-cost gasoline for US export. Europe too would witness flat demand and the impact of additional biofuels supply in the range of 1 mn bpd. In spite of increase in the capacity utilisation and sustained capacity addition, China is deficient in terms of refining capacity. This is due to the strong consumption growth in the economy. China is forced to import of petroleum products to meet domestic demand.

Global oil: Demand and Export 2008

(MMTPA)	Crude			Product		
	Imports	Exports	Balance	Imports	Exports	Balance
Total North America	524	176	(348)	187	122	(65)
S. & Cent. America	30	124	93	41	55	13
Total Europe & Eurasia	542	325	(217)	146	177	31
Middle East	11	895	884	10	106	96
Total Africa	43	371	328	31	37	7
China	179	4	(175)	39	15	(24)
India	128	0	(128)	22	34	12
Total Asia Pacific	820	79	(741)	313	231	(82)
Total World	**1,970**	**1,970**	**0**	**728**	**728**	**0**

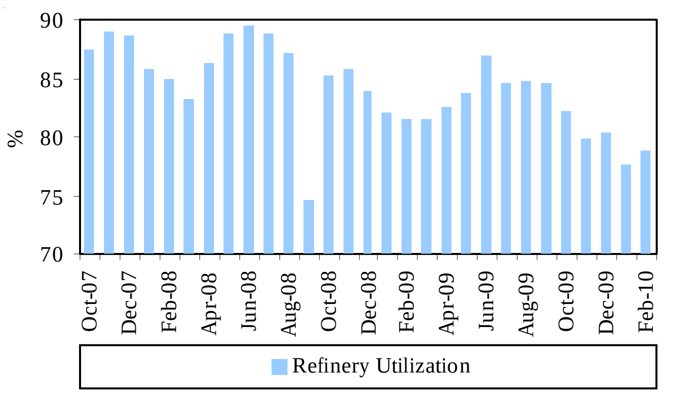
Source: BP Statistical Review 2009

Capacity utilisations and margins to remain under pressure

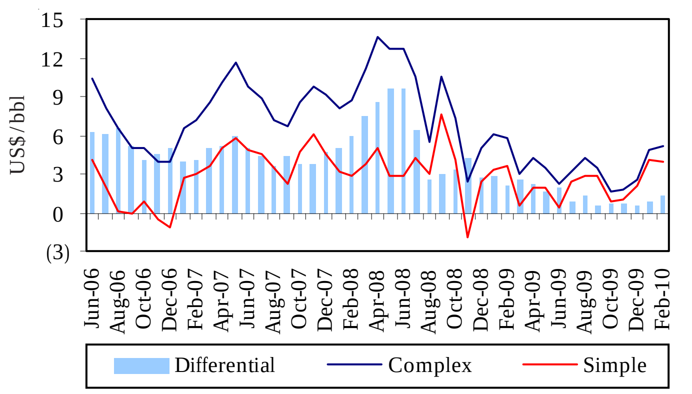
Asia Pacific region is a net importer of refinery products. Despite India's import of more then 75% of its crude requirements it is a net exporter of petroleum products. According to World Energy Outlook, as refining capacity for export increases, a growing share of trade in oil is expected to be in the form of refined products, notably from refineries in the Middle East and India.

Global refinery sector going through cyclical downtrend

U.S. refinery utilisation rate



Singapore refinery margins



Source: BP statistical review 2009; B&K Research

Since mid of 2008, the global refiners have faced a reversal of fortunes and with it some major challenges. Refining margins have collapsed, with naphtha, and at times gasoline, selling at spot prices below those for crude oil. As growth in global economy expected to remain sluggish, utilisation level of refineries are expected to remain on the lower side coupled with weakness in refining margins.

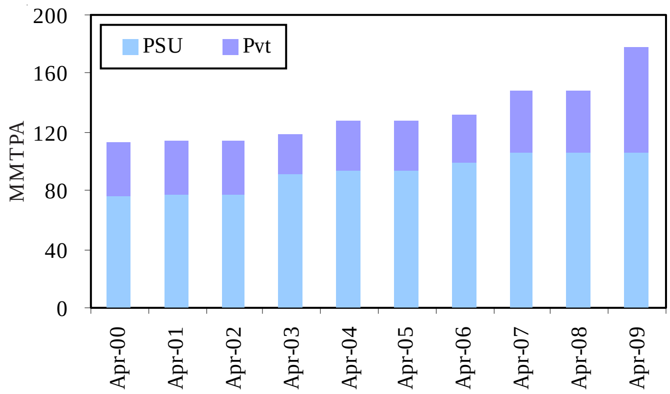
India's refining sector has witnessed a strong growth in capacity additions

Share of PSU refiners stand at ~60%

In order to meet the rising demand for petroleum products, not only has the refining capacity in the country increased over the years by the setting up of grass-root refineries, the existing refineries have been expanded, de-bottlenecked and modified by absorbing new process technologies. Over the last decade, India's refining capacity has grown at a CAGR of 5.2%

from ~113 MMTPA to ~178 MMTPA (PSU 105.5 MMTPA + Pvt 72.5 MMTPA). Public sector units (comprising of IOCL, BPCL, HPCL and ONGC) have dominated the Indian refinery sector with share of ~60% in March 2009. The net result has been a progressive development in refinery configurations (i.e. from low cost and simple refineries to highly integrated and complex configurations with linkages to petrochemicals) to maximise profitability. The country is not only self sufficient in refining capacity for its domestic consumption but also exports petroleum products substantially.

India's refining capacity



Source: MoP&NG; B&K Research

Capacity break-up FY09

Refineries	No	MMTPA	Share (%)
IOCL Group	10	60.2	34
BPCL Group	3	22.5	13
HPCL	2	13.0	7
ONGC/MRPL	2	9.8	6
PSU Total	**17**	**105.5**	**59**
RIL	2	62.0	35
ESSAR	1	10.5	6
Pvt Total	**3**	**72.5**	**41**
Total	**20**	**178.0**	**100**

Source: MoP&NG; B&K Research

Strong additions in refining capacity, led by PSUs

According to Ministry of Petroleum & Natural Gas, a total of ~78 MMPTA (including grass-root and expansion of existing refinery) capacities are expected to be added by the end of 11th Five Plan. Out of this, public sector units are expected to contribute about ~62%.

Capacity expansion of existing refineries

Company	Location	MMTPA
IOCL	Panipat, Haryana	3.0
IOCL	Haldia, West Bengal	1.5
HPCL	Mumbai, Maharashtra	2.4
HPCL	Visakhapatnam, Andhra Pradesh	2.5
CPCL	Manali, Tamil Nadu	1.6
BPCL	Kochi, Kerala	2.0
MRPL	Mangalore, Karnataka	5.3
ONGC	Tatipaka, Andhra Pradesh	0.1
EOL	Vadinar, Gujarat	5.5
Total		**23.9**

Grass-root refineries

Company	Location	MMTPA
IOCL	Paradip, Orissa	15
BORL	Bina, Madhya Pradesh	6
HMEL	Bhatinda, Punjab	9
EOL	Jamnagar, Gujarat	18
NOCL	Cuddalore, Tamil Nadu	6
Total		**54**

Source: MoP&NG

Public sector companies to witness investment of ~Rs 775 bn

Out of the above expansion, the public sector refineries are expected to invest Rs 775 bn by FY12 for adding about 44 MMTPA capacities.

Public sector outlays

Location	Company	Expansion type	MMTPA	Rs bn
Paradip	IOCL	Grass-root	15.0	298
Bina	BPCL	Grass-root	6.0	114
Bhatinda	HPCL	Grass-root	9.0	189
Mangalore	MRPL	Existing capacity expansion	3.2	124
Haldia	IOCL	Existing capacity expansion	1.5	29
Panipat	IOCL	Existing capacity expansion	3.0	10
Mumbai	HPCL	Existing capacity expansion	2.4	3
Vizag	HPCL	Existing capacity expansion	2.5	3
Chennai	CPCL	Existing capacity expansion	1.6	5
Total			**44.2**	**~775**

Source: Infraline; B&K Research

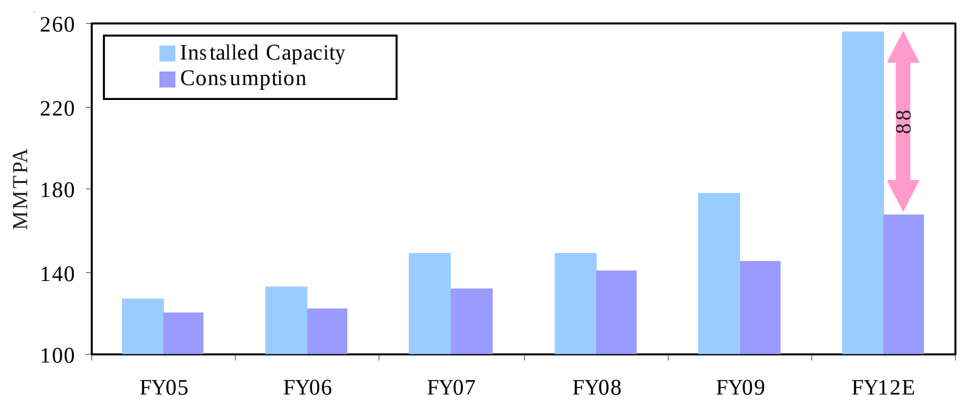
Capex on existing refinery upgradation to continue

Fall in output from productive oilfields and rising demand for petroleum products would call for processing of the heavier and sour grade crude oil. Concurrently, petroleum product specifications have been becoming more stringent in terms of emissions. Refineries would also need to increase their share of value-added products and maximise distillate yields through the setting up of secondary processing and cracking units. The investments required provide opportunity for EIL.

India's refining capacity and product demand gap to increase after expansion

During the last five years, India's refinery capacity has increased at a CAGR of 8.7% (which is higher than its last 29 year CAGR of 6.6%), while the consumption of petroleum products has increased at a CAGR of 4.9%. In the next three years, a total of 78 MMPTA of refinery capacity is expected to be added which will entail a CAGR of ~12.8%. If we assume the consumption growth to remain at similar levels during the next three years, considering the recovering global economy, the gap between refinery capacity and consumption is expected to rise to 88 MMTPA.

India's refining capacity and product demand (MMTPA)



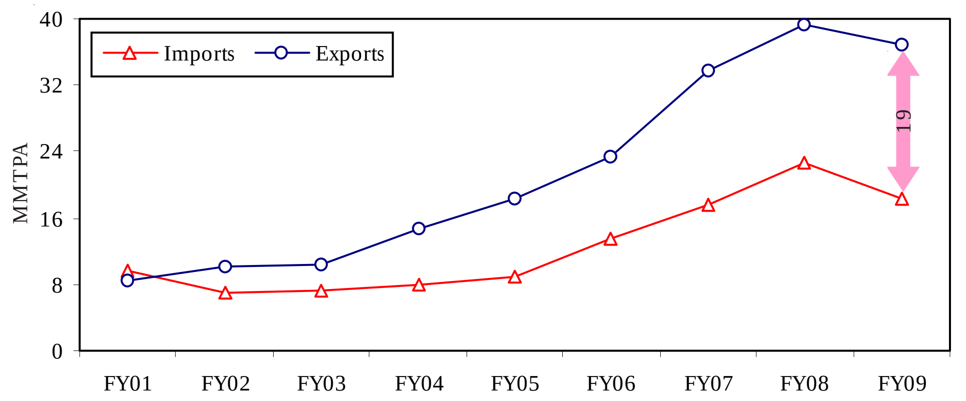
Source: MoP&NG, B&K Research (Note: Consumption includes refinery boiler fuel)

Surplus refining capacity is expected to be maintained in the long-term

India's net exports has increased to 19 MMTPA in FY09

Surplus refining capacity is expected to be maintained in view of India's cost competitiveness and strong demand for petroleum products in the domestic market as well as Asia Pacific region. Also, the Government of India's policy of differential custom duty on crude and refinery products discourages import of petroleum products in the country (basic custom duty on crude is at 5% while on petrol & diesel at 7.5% and other refined products at 10%). India's net export of petroleum products has progressively increased from FY01 to ~19 MMTPA in FY09.

India's import and export of petroleum products



Source: MoP&NG

Strategic location coupled with cost competitiveness to give Indian refiners an edge

India's proximity to Middle East and sustained demand within the Asia Pacific region gives the domestic refineries a reasonable freight advantage over competitors. (India is strategically located en-route of Middle East crude for East-Asian and Pacific rim markets). In addition, significantly lower cash operating costs mainly on account of cheaper power, labour and lower capital costs gives Indian refineries an edge over its competitors.

However, the key concerns towards India achieving the status of global refining hub are refinery complexity, product mix and quality as well as infrastructure. Investment in above mentioned areas should benefit EIL through order inflows.

However, plans to set up new grass-root refineries to be delayed in the medium term

Slowing down of growth in hydrocarbon projects a possibility

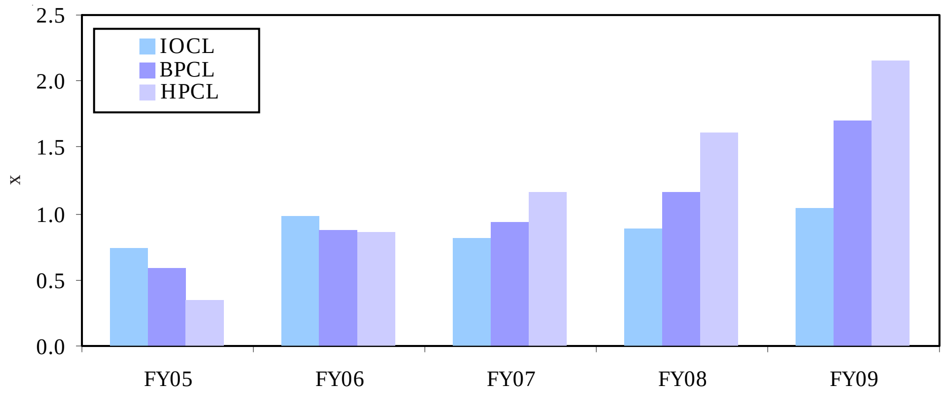
India, with an existing capacity of 178 MMPTA, is a net exporter of refinery products now. The country's investment in the refinery sector may slowdown in the long-term given the upcoming capacity (~78 MMTPA) and cautious outlook on global refinery utilisation levels. However, in the longer term, under-investment in crude oil refining can lead to shortages and consequently unacceptably high prices. Refining capacity is therefore expected to grow (in the long run) in line with domestic oil consumption (despite exports/self-sufficiency).

Ongoing expansion too may face deferment

Higher debt: equity ratio might lead to deferment in project financing

The increasing strain on finances due to mounting under-recoveries from under-pricing of key petroleum products like petrol, diesel, domestic and kerosene, the public sector refining companies would be forced to review their ongoing capex plans. In view of lower accruals (delayed government subsidy and continued under-recoveries) these companies would need to raise capital. However, debt equity ratio at 1.31:1 during FY09 (combined for all three companies) and under-pricing of refinery products would make fund raising a challenge.

Debt equity ratio



Source: Industry

Company background

Established over 40 years back by the GoI to help set up PSU refineries

Share of business from hydrocarbon space is >90%

EIL was primarily set-up (in 1965) to providing engineering and technical based consultancy services for the setting up of public sector refineries. Over the years, it has developed expertise to cater to the needs of petrochemicals, fertiliser, metal and infrastructure sectors. The company provides services in areas like engineering, procurement, project management, construction supervision, commissioning assistance, third-party inspection services and technical audits. However, more than 90% of business still comes from the hydrocarbon space. In addition, it has undertaken the role of project executor on turnkey basis from conception to commissioning (all the business here is in the hydrocarbon space). The Government of India holds 90.4% equity in EIL.

Brief snapshot on number of projects executed in various fields

+ 47 Petroleum Refinery Projects + 7 Petrochemical Complexes + 37 Pipeline Projects + 250 Offshore Platforms + 35 Oil & Gas Processing Projects + 26 Mining & Metallurgical Projects + 11 Ports & Terminals + 8 Fertiliser Projects + 16 Infrastructure Projects + 16 LSTK Projects

Source: Company

EIL has entered into strategic alliances with following entities to enhance its reach and tap business opportunities:

Strategic alliances

- VAI Industries UK Limited for Iron & Steel Plants
- Deutsche Montan Technologies GmbH, Germany for Coke Oven – By product Plants/ Gas Cleaning Systems
- IOCL (R&D) for Technology and Catalyst for DHT and Hydrotreater Projects in India
- Curtin University of Technology, Australia for Scientific Research Collaboration in the field of Oil & gas Processing
- IOCL for CFC Technology, Naphtha Isomerisation, Light Naphtha Hydrotreating
- Petron Scientech Inc. for MEG from sugarcane
- Stroytransgaz, Russia for oil and gas projects
- GAIL India Limited for overseas projects in LPG extraction & Pipeline transfer
- Jacobs Engg Co. for Sub dew point Sulphur Recovery

Source: Company

Most of the projects executed have been for PSUs, but have done private party work as well

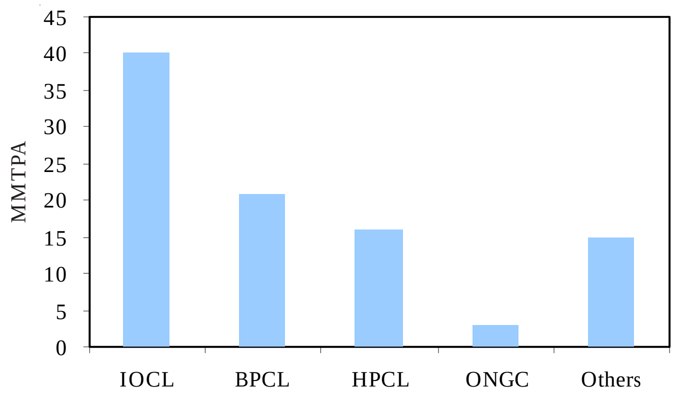
EIL has executed over 400 major projects since its inception. Though majority of the projects have been executed for PSUs, it has been catering to the requirement of domestic private sector companies (Essar Oil, Hindalco, etc.), and foreign companies (mainly in Algeria and Middle East region) also.

EIL is a key player towards establishing of India's refining sector

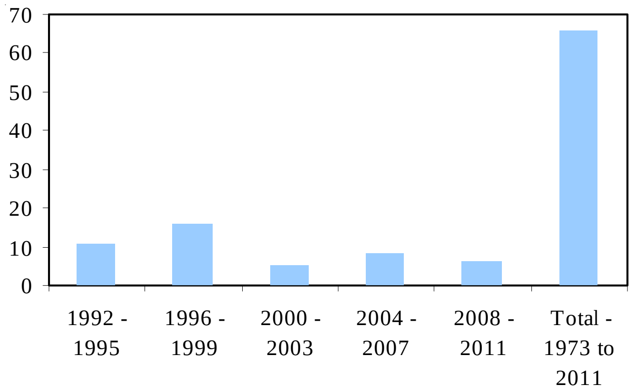
EIL has provided services for setting up of ~100 MMTPA refining capacity

Since taking up its first major project in (petroleum refining space) 1973, EIL has contributed towards setting up of more than 95 MMTPA of domestic refining capacity. These include 10 grass-root refineries and about ~26 capacity expansion-cum-modernisation projects. Apart from this, EIL has provided consultancy services in areas such as visbreaking, delayed coking, sulphur recovery, fluid catalytic cracking, MS and HSD quality upgradation – diesel hydro desulphurisation unit, naphtha reformer, kerosene hydro-desulphurisation and hydro-cracking, wax hydro-finishing and coke calcination. Though most of the projects have been executed for PSUs, it has been catering to the requirement of private sector companies as well. The company had provided its services for setting up of the Essar Oil Refinery at Gujarat in 2008.

EIL contribution towards setting up of refinery



Service provided (Count - Nos.)



Source: Company. Note: Services provided includes - Study, Process design, engineering, procurement, construction supervision, commissioning assistance, project management, others; when all the above parameters (except study) of services are provided in a project only then it is counted as one.

EIL has executed petrochemical projects too

In the past, EIL has provided its services towards implementation of petrochemical projects that includes aromatics, naphtha and gas crackers and downstream plants (as well as related facilities offsites and utilities, environmental protection systems, etc.).

List of petrochemical projects done by EIL

Year of completion	Project
1991	Haldia Petrochemical Complex – Haldia Petrochemicals Ltd.
1998	Petrochemicals Complex at Gandhar – IPCL
1998	Petrochemicals Complex at Auraiya – GAIL
1989	Maharashtra Gas Cracker Complex – IPCL
1985	Aromatics Complex at Mumbai – BPCL
1983	Aromatics Complex at Bongaigaon – Bongaigaon Refinery & Petrochemicals Ltd.
1979	Petrochemicals Complex at Vadodara – Olefins Naphtha Cracker & Downstream Plants - IPCL
1973	Aromatics Complex at Vadodara – IPCL

Source: Company

EIL has also done considerable work overseas – in Iran, the United Arab Emirates and Malaysia. Currently, the company is executing three grass-root petrochemical projects which are expected to be completed in the next two to three years.

Petrochemical projects where EIL is working

Project	Client	Ethylene capacity (MMTPA)	Project completion	PMC / LSTK	Produce	Cost of project (Rs bn)
Naphtha cracker and polymer complex*	Panipat (Haryana) – IOCL	0.8	Mar 2010	PMC	HDPE, LLDPE, MEG and PP.	144
Dahej Petrochemical Complex	ONGC Petro Additions	1.1	2012 end	PMC	HDPE, LLDPE, PP and Styrene Butadiene Rubber (SBR).	136
Assam Cracker	Brahmaputra Cracker & Polymer	0.2	1QCY12	PMC	HDPE, LLDPE and PP; boost development of plastic industry in the north east.	55

Source: Company. *EIL to provide turnkey services for some units.

Pipeline projects executed by EIL

India's petroleum, LPG and crude pipeline network stood at 17,576 km during FY09. In addition, there exists 7,220 km of natural gas pipeline. (GAIL). Out of this, EIL has executed close to ~14,000 km. The company provides services such as conceptual scheme, feasibility study, on site investigations and route survey, cathodic protection and telemetry, telecommunication and tele-supervisory control for pipeline projects besides other project services. The PSU pipeline network is expected to increase by 8,356 km in the next three years. Currently, the company is executing the following projects:

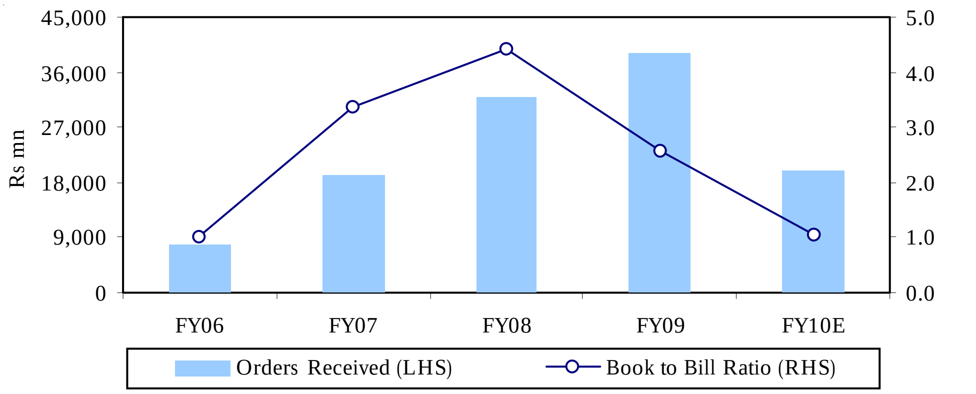
Project under execution

Pipeline	Fuel type	Km
Vadinar-Bina	Crude	935
Vijaipur-Dadri	Gas	498
Bina-Kota	Petroleum product	260
Mundra-Bhatinda	Crude	1,012
GASCO-Abu Dhabi	Gas	300
Total		**3,005**

Source: Company

Current order book of Rs 65 bn to Rs 70 bn at 3.6x FY10E net sales

New order received



Source: Company

EIL's book to bill ratio has remained at levels greater than 1 leading to a healthy order backlog. The company has a strong order book of Rs 65 bn to Rs 70 bn, which is at ~3.6x FY10E sales. The company's current order book lends enough visibility for the next ~2.5 years assuming a CAGR of 25% on FY10E net sales of Rs 18.7 bn.

Other areas

In addition, EIL has provided its services in the field of Oil & Gas, Fertiliser, Infrastructure, Power and Metallurgy projects.

Brief snapshot

Sector	Details: Service capabilities / rendered; Key Client
Oil & Gas Processing	• Crude Gathering Stations, Multistage Separation, Crude Desalting, Dehydration, Heavy Oil/Sour Oil Processing. It also has capabilities for implementing Gas Conditioning and Processing Plants including Gas Collection Systems, Compressor Stations, Solid/Liquid Dessicant Dehydration, Dewpoint Depression, Impurities and Acid gases removal and Cryogenic Natural Gas Liquids recovery such as LPG and Ethane/Propane recovery. • Key client: ONGC, GAIL Oil and Natural Gas Corporation. Ltd. and Gas Authority of India Ltd.
Oil & Gas Offshore	• In ocean engineering projects such as oil and gas platforms and fabrication yards and several submarine pipelines. • Key client: ONGC, GSPC. Has done work for offshore projects in Qatar, Vietnam and the North Sea.
Fertiliser	• Commissioning of fertiliser plants based on gas, naphtha and fuel oil. • Worked with renowned licencors/contractors on various assignments for ammonia, urea and phosphatic fertiliser plants, in India and abroad.
Infrastructure	• Diversified into areas such as airports, intelligent building & urban development, highways and bridges, water resources management, SEZ and Software Technology Park and Industrial Park. • Provide PMC, third party inspection and quality assurance services as independent engineer, etc. • Key client: Central/State government co-operations
Power	• Undertaken assignments for captive power plants in large process plants such as petroleum refineries, petrochemical complexes, etc. and has undertaken feasibility studies for refinery residue based power projects.
Metallurgy	• Can render services for metals such as zinc, lead, aluminium, copper, cadmium, silver, nickel, magnesium, titanium, etc. and also for sponge iron. • Also mine development and beneficiation plants. • The specialised services include studies for scaling up of Pilot Plant to Industrial Plant, process selection, optimisation of the process parameters, energy conservation, exploration, geostatistical ore reserve estimation, hydrogeological and geotechnical analysis, mine design and pit optimisation, etc. • Key client: NALCO, Hindustan Zinc Ltd., Hindustan Copper Ltd., RSMML, GMDC, etc.
Overseas	• EIL has worked in several countries of the West Asia, North Africa, Europe and South East Asia including Algeria, Bahrain, Iran, Iraq, Korea, Kuwait, Malaysia, Norway, Qatar, Saudi Arabia, UAE and Vietnam.

Source: Company

EIL to offer PMC services for building up country's strategic crude oil storage

As an energy security measure, the Union government has approved setting up of 15 mn MT underground strategic crude oil storages in the country in various phases. This storage will be over and above the existing storage capacity for crude oil and petroleum products at the various refineries. Crude oil from the (strategic storage) reserves will be released in the event of any short-term disruptions in supplies, a natural calamity or any unforeseen global event, leading to an abnormal increase in prices. In the first phase, a project for constructing a strategic storage of ~5.0 mn MT for crude oil is under implementation. This is expected to be constructed at three locations viz. Visakhapatnam in Andhra Pradesh, Mangalore in Karnataka, and Padur in Kerala by the end of 2012.

Strategic storage reserves

Location	Capacity (Mn MT)	Land (acre)	Project completion (%)			Project completion
			Mar 09	Dec 09	Dec 10E	
Visakhapatnam	1.33	68	32.7	44.2	63.2	Nov 11
Mangalore	1.5	100	10	17.5	28.2	Nov 12
Padur	2.5	160	5.4	12.4	15.2	Dec 12

Source: MoP&NG

EIL would provide project management consultancy (PMC) for execution of these projects by the Indian Strategic Petroleum Reserves, a special purpose vehicle created by the government for designing, building, operating and maintaining storage facilities.

JV and subsidiaries

JV

During FY09, EIL has entered into two JVs in order to increase its reach in providing services to diverse sectors and regions.

- **TEIL Projects Limited**
- A joint venture with M/s Tata Projects Limited was formed for pursuing projects on engineering procurement and construction basis (EPC Projects) in selected sectors such as oil & gas, fertilisers, steel, railways, power and infrastructure.
- **Tecnimont EIL Emirates Consultores E Services, LDA**
- A joint venture with M/s Tecnimont SPA, Italy was formed for pursuing EPC projects in UAE. For the purpose, a joint venture company was formed and registered with the Commercial Registry of Maderia Trade Zone, Portugal.

Subsidiary

Certification Engineers International Ltd. (CEIL) – CEIL, a wholly owned subsidiary of EIL, provides Certification as well as Third Party Inspection (TPI) services to various clients. During the year, CEIL secured a number of Certification & TPI assignments from ONGC, GSPL, GSPC, various State Governments and others.

EIL Asia Pacific Sdn. Bhd. (EILAP) – EIL AP is a wholly owned subsidiary of EIL incorporated in Malaysia. The principal activities of EIL AP are to provide technical services for projects in oil, gas and other industrial sectors. However, lately there have been constraints in operations due to changes in local regulations and slowdown in business environment leading to shrinkage of business for the company during the year. It has temporarily ceased its business operation since the FY07.

Key announcement – 10% divestment, sub-division of shares, bonus and special interim dividend

During January 2010, the Cabinet Committee on Economic Affairs has decided to disinvest 10% paid up equity capital of EIL, out of Government's shareholding, through follow on public issue. After this disinvestment Government shareholding in the company would come down from 90.4% to 80.40%.

Before the FPO (expected in Q1 FY11), the company would issue bonus (two shares for every one share) and sub-division of shares (one share of the FV of Rs 10 into two the FV of Rs 5 each). Also, the company would make payment of special interim dividend of Rs 100 per share (record date: 29 March 2010) of FV Rs 10 each.

Financial analysis

Income statement

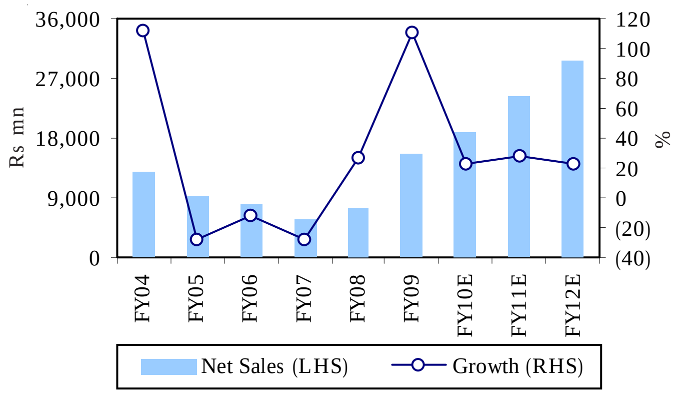
EIL is a key player engaged in the setting up of public sector refineries in India. The company has posted revenue, EBITDA and net profit CAGR of 4%, 28% and 33%, respectively, during FY04 to FY09.

Net sales and growth

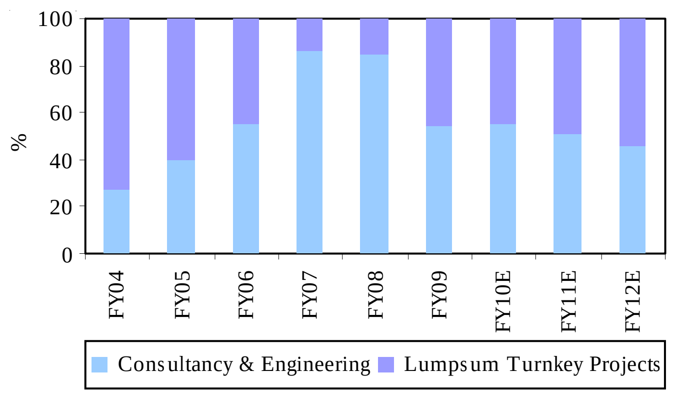
Revenue to post a CAGR of 25% during FY10-12E

We expect EIL to achieve a turnover of Rs 24.2 bn and Rs 29.8 bn during FY11 and FY12, respectively (CAGR 25.3% during FY10-12E). This is mainly on account of execution of the current order book, which is at ~3.6x FY10E sales. We expect the share of consultancy segment in total turnover to reduce from 55% in FY10E to 45% in FY12E.

Net sales and growth



Sales mix

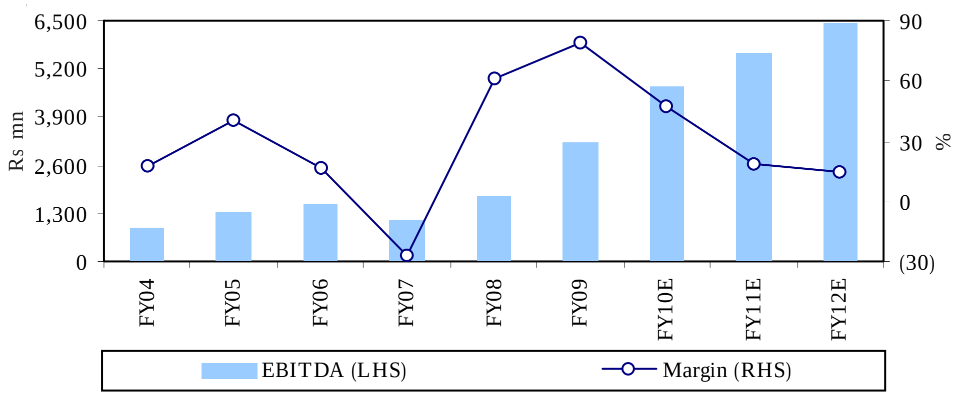


Source: B&K Research

EBITDA and margins

We expect the EBITDA margin to fall by 334 bps (from 25% to 21.6%) between FY10 and FY12, given the rising competition and changing sales mix (leading to a CAGR of 16.6% in EBITDA between FY10-12). We expect consultancy margins to fall by ~75 bps while margins in turnkey projects could be maintained at ~8.2% by FY12E.

EBITDA and growth



Source: B&K Research

Strong balance sheet...

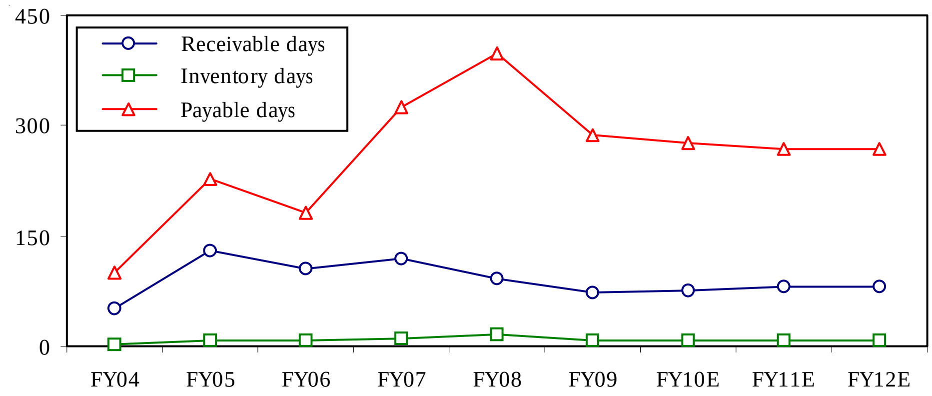
Projects under execution are expected to generate strong cash flows due to low asset requirement and negative working capital cycle. APIL is a debt free company and has Rs 17.4 bn cash on books at the end of FY10 translating to Rs 310 per share (after taking into the impact of special dividend of Rs 100 per share).

Negative net working capital cycle...

Net current assets remain negative

During FY05, EIL's net working capital stood at Rs 112 mn. During FY05 to FY09, the net working capital has been consistently negative and the quantum has steadily increased. It stood at (negative) Rs 8.4 bn during FY09.

Working capital scenario



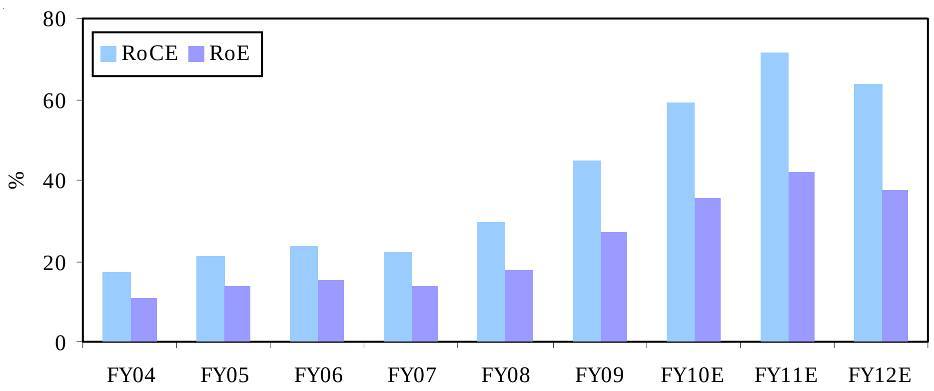
Source: B&K Research

We have assumed a bit of a tightening in the working capital cycle due to change in sales mix during FY10-12. Share of the LSTK segment is expected to increase from 45% in FY10 to 55% in FY12.

...resulting in healthy return ratios

Orders will continue to generate significant cash flows. Return ratios are therefore expected to remain at healthy levels going forward. Reduction of cash reserves by Rs 6.6 bn (due to special dividend of Rs 100 per share) would lead to further improvement in return ratios.

Return ratios



Source: B&K Research

Detailed financials

Income Statement

Yr end 31 Mar (Rs mn)	FY07	FY08	FY09	FY10E	FY11E	FY12E
Net sales	5,818	7,377	15,515	18,959	24,223	29,758
Operating expenses	(4,702)	(5,578)	(12,293)	(14,224)	(18,586)	(23,321)
Const Matl & Equip	(317)	(209)	(4,941)	(4,711)	(6,488)	(8,227)
Technical Assistance/Sub Contracts	(2,494)	(3,349)	(3,903)	(4,730)	(6,036)	(7,419)
Employee expenses	(411)	(562)	(1,912)	(3,091)	(3,773)	(4,780)
Other operating expenses	(1,480)	(1,457)	(1,538)	(1,693)	(2,289)	(2,895)
Operating profit/EBITDA	**1,117**	**1,799**	**3,221**	**4,735**	**5,637**	**6,437**
Depreciation	(84)	(105)	(110)	(122)	(129)	(137)
Other income	1,060	1,341	2,215	1,900	2,030	2,482
EBIT	**2,093**	**3,035**	**5,327**	**6,512**	**7,538**	**8,783**
Pre-tax profit	**2,093**	**3,035**	**5,327**	**6,512**	**7,538**	**8,783**
Tax (current + deferred)	(695)	(1,038)	(1,829)	(2,188)	(2,522)	(2,936)
Net profit	**1,398**	**1,997**	**3,497**	**4,324**	**5,016**	**5,846**
Adjusted net profit	**1,398**	**1,997**	**3,497**	**4,324**	**5,016**	**5,846**

Balance Sheet

Yr end 31 Mar (Rs mn)	FY07	FY08	FY09	FY10E	FY11E	FY12E
Current assets	**14,653**	**18,631**	**28,327**	**26,973**	**35,145**	**44,179**
Cash & bank	9,600	12,803	20,615	17,360	22,610	28,779
Debtors	1,916	1,864	3,090	3,965	5,319	6,535
Inventory	161	320	334	408	521	640
Loans & advances	1,213	1,829	2,231	2,726	3,483	4,279
Other current assets	1,763	1,815	2,057	2,514	3,212	3,946
Non-current assets	**1,777**	**1,906**	**759**	**843**	**938**	**1,034**
Investments	1,371	1,366	115	115	115	115
Fixed assets (Net block)	399	537	643	726	821	917
Gross block	1,451	1,618	1,711	1,813	1,922	2,037
Less: Depreciation	(1,066)	(1,116)	(1,128)	(1,137)	(1,151)	(1,171)
Add: Capital WIP	13	35	60	50	50	50
Other non-current assets	7	4	2	2	2	2
Total assets	**16,429**	**20,537**	**29,086**	**27,816**	**36,083**	**45,213**
Current liabilities	**6,679**	**9,687**	**16,151**	**18,761**	**23,991**	**29,481**
Creditors	4,199	6,097	9,656	10,726	13,734	17,060
Current liabilities	2,481	3,591	6,495	8,036	10,257	12,420
Non-current liabilities	(825)	(961)	(1,169)	(1,344)	(1,546)	(1,778)
Other non-current liabilities	(825)	(961)	(1,169)	(1,344)	(1,546)	(1,778)
Total liabilities	**5,854**	**8,727**	**14,982**	**17,417**	**22,446**	**27,703**
Total shareholders' funds	**10,575**	**11,811**	**14,104**	**10,399**	**13,638**	**17,510**
Paid-up capital	562	562	562	562	562	562
Reserves & surplus	10,014	11,249	13,542	9,837	13,076	16,948
Total equity & liabilities	**16,429**	**20,537**	**29,086**	**27,816**	**36,083**	**45,213**

Cash Flow

Yr end 31 Mar (Rs mn)	FY07	FY08	FY09	FY10E	FY11E	FY12E
Pre-tax profit	2,093	3,035	5,327	6,512	7,538	8,783
Depreciation	76	49	13	9	14	20
Chg in working capital	1,303	2,148	4,037	514	1,946	2,418
Total tax paid	(982)	(1,152)	(1,953)	(2,301)	(2,645)	(3,085)
Cash flow from operations (a)	**2,490**	**4,080**	**7,424**	**4,734**	**6,853**	**8,135**
Capital expenditure	(72)	(187)	(119)	(92)	(109)	(115)
Chg in investments	9	6	1,251	–	–	–
Other investing activities	53	(17)	14	–	–	–
Cash flow from investing (b)	**(10)**	**(199)**	**1,146**	**(92)**	**(109)**	**(115)**
Free cash flow (a+b)	**2,480**	**3,882**	**8,570**	**4,641**	**6,744**	**8,019**
Dividend (incl. tax)	(548)	(659)	(758)	(7,896)	(1,494)	(1,850)
Other financing activities	–	(20)	(1)	–	–	–
Cash flow from financing (c)	**(548)**	**(679)**	**(759)**	**(7,896)**	**(1,494)**	**(1,850)**
Net chg in cash (a+b+c)	**1,932**	**3,202**	**7,811**	**(3,255)**	**5,250**	**6,169**

Income Statement

Yr end 31 Mar (Rs mn)	FY09E	FY10E	FY11E	FY12E
Net sales	**15,515**	**18,959**	**24,223**	**29,758**
Growth (%)	*110.3*	*22.2*	*27.8*	*22.8*
Operating expenses	(12,293)	(14,224)	(18,586)	(23,321)
Operating profit	3,221	4,735	5,637	6,437
EBITDA	**3,221**	**4,735**	**5,637**	**6,437**
Growth (%)	*79.1*	*47.0*	*19.1*	*14.2*
Depreciation	(110)	(122)	(129)	(137)
Other income	2,215	1,900	2,030	2,482
EBIT	**5,327**	**6,512**	**7,538**	**8,783**
Pre-tax profit (before non-recurring items)	5,327	6,512	7,538	8,783
Pre-tax profit (after non-recurring items)	5,327	6,512	7,538	8,783
Tax (current + deferred)	(1,829)	(2,188)	(2,522)	(2,936)
Net profit	**3,497**	**4,324**	**5,016**	**5,846**
Prior period adjustments	14	0	0	0
Net income	3,511	4,324	5,016	5,846
Adjusted net profit	**3,497**	**4,324**	**5,016**	**5,846**
Growth (%)	*75.1*	*23.6*	*16.0*	*16.6*

Balance Sheet

Yr end 31 Mar (Rs mn)	FY09E	FY10E	FY11E	FY12E
Cash & marketable sec.	20,615	17,360	22,610	28,779
Other current assets	7,712	9,613	12,535	15,400
Investments	115	115	115	115
Net fixed assets	643	726	821	917
Other non-current assets	2	2	2	2
Total assets	**29,086**	**27,816**	**36,083**	**45,213**
Current liabilities	16,151	18,761	23,991	29,481
Other non-current liabilities	(1,169)	(1,344)	(1,546)	(1,778)
Total liabilities	**14,982**	**17,417**	**22,446**	**27,703**
Share capital	562	562	562	562
Reserves & surplus	13,542	9,837	13,076	16,948
Shareholders' funds	**14,104**	**10,399**	**13,638**	**17,510**
Total equity & liabilities	**29,086**	**27,816**	**36,083**	**45,213**
Capital employed	**12,935**	**9,055**	**12,092**	**15,732**

Cash Flow Statement

Yr end 31 Mar (Rs mn)	FY09E	FY10E	FY11E	FY12E
Pre-tax profit	5,327	6,512	7,538	8,783
Depreciation	13	9	14	20
Chg in working capital	4,037	514	1,946	2,418
Total tax paid	(1,953)	(2,301)	(2,645)	(3,085)
Cash flow from oper. (a)	**7,424**	**4,734**	**6,853**	**8,135**
Capital expenditure	(119)	(92)	(109)	(115)
Chg in investments	1,251	0	0	0
Other investing activities	14	0	0	0
Cash flow from inv. (b)	**1,146**	**(92)**	**(109)**	**(115)**
Free cash flow (a+b)	**8,570**	**4,641**	**6,744**	**8,019**
Dividend (incl. tax)	(758)	(7,896)	(1,494)	(1,850)
Other financing activities	(1)	0	0	0
Cash flow from fin. (c)	**(759)**	**(7,896)**	**(1,494)**	**(1,850)**
Net chg in cash (a+b+c)	**7,811**	**(3,255)**	**5,250**	**6,169**

Key Ratios

Yr end 31 Mar (%)	FY09E	FY10E	FY11E	FY12E
Adjusted EPS (Rs)	62.3	77.0	89.3	104.1
Growth	75.1	23.6	16.0	16.6
Book NAV/share (Rs)	251.2	185.2	242.9	311.8
Dividend payout ratio	34.8	185.7	35.4	33.8
EBITDA margin	20.8	25.0	23.3	21.6
EBIT margin	34.3	34.3	31.1	29.5
RoCE	44.8	59.2	71.3	63.1
Net debt/Equity	(146.2)	(166.9)	(165.8)	(164.4)

Valuations

Yr end 31 Mar (x)	FY09E	FY10E	FY11E	FY12E
PER	39.0	31.5	27.2	23.3
PCE	37.8	30.6	26.5	22.8
Price/Book	9.7	13.1	10.0	7.8
Yield (%)	0.8	5.0	1.1	1.2
EV/Net sales	7.5	6.3	4.7	3.6
EV/EBITDA	35.9	25.1	20.2	16.7

Du Pont Analysis – ROE

Yr end 31 Mar (x)	FY09E	FY10E	FY11E	FY12E
Net margin (%)	22.5	22.8	20.7	19.6
Asset turnover	0.6	0.7	0.8	0.7
Leverage factor	1.9	2.3	2.7	2.6
Return on equity (%)	27.0	35.3	41.7	37.5