

Patel Engineering

Healthy outlook

Presented below are key takeaways of our recent management meet with Patel Engineering (PEL).

Robust order book of Rs 72bn: PEL has an order book of Rs 72bn which is 3.3x FY09 consolidated revenues, providing strong revenue visibility. The company caters entirely to the government sector and does not work for private parties. Its order book is divided between the hydro (45%) and irrigation (40%) segments, with the balance comprising road and urban infrastructure projects. PEL expects an EBITDA margin of 14–15% with 20–25% revenue growth in FY10.

Election outcome to lend impetus to growth: In terms of state-wise budgetary outlays for the irrigation sector, the order of priority is Andhra Pradesh, Maharashtra, Madhya Pradesh, Karnataka and Gujarat. While the Andhra government has not paid its dues over the last four months because of the elections, the return of the Congress to power should bring stability on this front.

Government-sponsored infrastructure projects fall under three schemes: a) those fully funded by the Centre, b) 30:70 State-Centre funding; and c) 40:60 State-Centre funding. The central and state governments each account for 45% of PEL's order book, while the balance 10% comes from the state municipalities.

Real estate plans on a slow burner: The company's 1mn sq ft plot in Jogeshwari, Mumbai is being developed at a cost of ~Rs 2bn, which would be financed through debt. Of this, 80,000sq ft is ready for fit-outs and lease negotiations are underway. The second project in Bangalore is progressing slowly, with plans and approvals being put in place. Due to property oversupply in Hyderabad, the company intends to take up this project only once the market stabilises.

1,200MW power project being executed in four phases: PEL will extend its thermal power project development to 3–4 phases of 300MW each due to inadequate balance sheet muscle and a shortage of staff for super critical work. This implies that it would lose out on a potential cost benefit of 10–15% if the project was executed in two phases (600MW*2) instead of four.

Land acquisition is complete and environmental clearance expected by the year-end. The first phase would require an investment of Rs 12bn–14bn, including an equity component of Rs 3.5bn. PEL is scouting for a joint venture partner for the same who will take on a 49% interest. The company's contribution of Rs 1.8bn (51%) would start one year from now and would be spread over two years during phase-I of the project. This apart, PEL is in negotiations for the acquisition of coal mines in Indonesia to feed the power plant.

Financial highlights

(Rs mn)	FY08	FY09E	FY10E	FY11E
Revenue	13,245	16,291	20,038	24,847
Growth (%)	21.6	23.0	23.0	24.0
Adj net income	1,038	1,142	1,259	1,559
Growth (%)	24.1	10.1	10.2	23.9
FDEPS (Rs)	17.4	19.1	21.1	26.1
Growth (%)	24.1	10.1	10.2	23.9

Profitability and return ratios

(%)	FY08	FY09E	FY10E	FY11E
EBITDA margin	15.3	16.5	15.0	15.0
EBIT margin	12.8	14.1	12.7	12.8
Adj PAT margin	7.8	7.0	6.3	6.3
ROE	13.4	12.7	12.5	13.7
ROIC	12.2	9.0	7.9	12.4
ROCE	12.0	10.2	9.9	12.2

What's New? Target Rating Estimates

CMP	TARGET	RATING	RISK
Rs 353	Rs 309	HOLD	HIGH

BSE	NSE	BLOOMBERG
531120	PETELENG	PEC IN

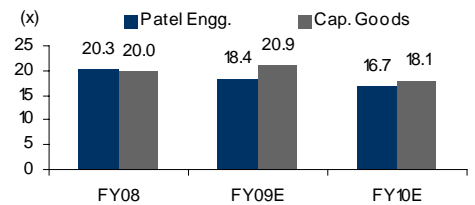
Company data

Market cap (Rs mn / US\$ mn)	21,060 / 445
Outstanding equity shares (mn)	60
Free float (%)	46.2
Dividend yield (%)	0.4
52-week high/low (Rs)	540 / 103
2-month average daily volume	478,464

Stock performance

Returns (%)	CMP	1-mth	3-mth	6-mth
Patel Eng	353	116.0	204.2	215.8
Sensex	13,913	22.8	56.3	60.0

P/E comparison



Valuation matrix

(x)	FY07	FY08	FY09E	FY10E
P/E @ CMP	25.2	20.3	18.4	16.7
P/E @ Target	22.0	17.8	16.1	14.6
EV/EBITDA @ CMP	18.2	12.7	9.6	8.6





Target price raised to Rs 309

Upgrading target multiple – maintain Hold

PEL is currently trading at 16.7x FY10E standalone earnings and 14.2x consolidated earnings. We are raising our target P/E multiple for the core construction business from 6x to 12x on FY10E due to an increase in the broader market multiple, while raising that for subsidiary companies from 4x to 6x. We have also introduced a value of Rs 14 for the Jogeshwari Tower real estate project, which gives us a fair value of Rs 17 for the real estate business. We thus arrive at a revised SOTP target price of Rs 309 for the company. We maintain our Hold rating on the stock.

Fig 1 - Valuation summary

Particulars	Business	Multiple (x)	Value (Rs mn)	Per share value (Rs)	
				New	Old
PEL Standalone	Core construction business	12x FY10E P/E	15,103	253	122
Real Estate	Real estate	NAV	1,005	17	3
BOT Projects	Roads	NAV	1,666	28	23
Value of Subsidiaries		6x FY10E P/E	681	11	8
Total			18,456	309	155

Source: RHH



Standalone financials

Profit and Loss statement

Y/E March (Rs mn)	FY08	FY09E	FY10E	FY11E
Revenues	13,245	16,291	20,038	24,847
Growth (%)	21.6	23.0	23.0	24.0
EBITDA	2,021	2,688	3,006	3,727
Growth (%)	43.1	33.0	11.8	24.0
Depreciation & amortisation	327	392	463	549
EBIT	1,694	2,296	2,542	3,178
Growth (%)	46.8	35.5	10.7	25.0
Interest	519	796	967	1,135
Other income	352	180	240	220
EBT	1,527	1,680	1,815	2,263
Income taxes	106	538	592	734
Effective tax rate (%)	6.9	32.0	32.6	32.4
Extraordinary items	-	-	-	-
Min into / inc from associates	-	-	36	30
Reported net income	1,421	1,142	1,259	1,559
Adjustments	(382)	-	-	-
Adjusted net income	1,038	1,142	1,259	1,559
Growth (%)	24.1	10.1	10.2	23.9
Shares outstanding (mn)	59.7	59.7	59.7	59.7
FDEPS (Rs) (adj)	17.4	19.1	21.1	26.1
Growth (%)	24.1	10.1	10.2	23.9
DPS (Rs)	1.5	1.5	1.5	1.5

Cash flow statement

Y/E March (Rs mn)	FY08	FY09E	FY10E	FY11E
Net income + Depreciation	1,748	1,535	1,722	2,108
Non-cash adjustments	21	-	(0)	(0)
Changes in working capital	(3,470)	(2,040)	(2,210)	(2,454)
Cash flow from operations	(1,701)	(506)	(487)	(346)
Capital expenditure	(1,284)	(1,256)	(1,000)	(1,000)
Change in investments	(1,137)	(900)	(400)	(400)
Other investing cash flow	-	-	-	-
Cash flow from investing	(2,422)	(2,156)	(1,400)	(1,400)
Issue of equity	(534)	(0)	-	-
Issue/repay debt	4,249	2,000	1,250	1,750
Dividends paid	(94)	(105)	(105)	(105)
Other financing cash flow	-	-	-	-
Change in cash & cash eq	(502)	(767)	(742)	(101)
Closing cash & cash eq	1,912	1,145	403	302

Economic Value Added (EVA) analysis

Y/E March	FY08	FY09E	FY10E	FY11E
WACC (%)	12.7	13.8	13.8	13.8
ROIC (%)	12.2	9.0	7.9	12.4
Invested capital (Rs mn)	15,042	19,682	23,465	27,633
EVA (Rs mn)	(77)	(956)	(1,387)	(389)
EVA spread (%)	(0.5)	(4.9)	(5.9)	(1.4)

Balance sheet

Y/E March (Rs mn)	FY08	FY09E	FY10E	FY11E
Cash and cash eq	1,912	1,146	403	302
Accounts receivable	3,586	4,463	5,490	6,807
Inventories	6,952	8,703	10,705	12,934
Other current assets	4,611	5,356	6,313	7,488
Investments	1,443	2,344	2,744	3,144
Gross fixed assets	4,165	5,415	6,415	7,415
Net fixed assets	2,897	3,754	4,291	4,742
CWIP	94	100	100	100
Intangible assets	-	-	-	-
Deferred tax assets, net	(104)	(154)	(174)	(194)
Other assets	11	60	80	100
Total assets	21,400	25,772	29,952	35,423
Accounts payable	3,447	4,145	5,098	6,322
Other current liabilities	636	765	940	1,166
Provisions	23	35	45	45
Debt funds	6,579	8,579	9,829	11,579
Other liabilities	2,274	2,769	3,406	4,224
Equity capital	60	60	60	60
Reserves & surplus	8,382	9,420	10,574	12,028
Shareholder's funds	8,442	9,480	10,634	12,088
Total liabilities	21,400	25,772	29,952	35,423
BVPS (Rs)	141.5	158.9	178.2	202.6

Financial ratios

Y/E March	FY08	FY09E	FY10E	FY11E
Profitability & Return ratios (%)				
EBITDA margin	15.3	16.5	15.0	15.0
EBIT margin	12.8	14.1	12.7	12.8
Net profit margin	7.8	7.0	6.3	6.3
ROE	13.4	12.7	12.5	13.7
ROCE	12.0	10.2	9.9	12.2
Working Capital & Liquidity ratios				
Receivables (days)	86	90	91	90
Inventory (days)	196	233	231	226
Payables (days)	102	113	110	109
Current ratio (x)	4.2	4.0	3.8	3.7
Quick ratio (x)	0.9	0.9	0.9	0.9
Turnover & Leverage ratios (x)				
Gross asset turnover	3.7	3.4	3.4	3.6
Total asset turnover	0.7	0.7	0.7	0.8
Interest coverage ratio	3.3	2.9	2.6	2.8
Adjusted debt/equity	0.8	0.9	0.9	1.0
Valuation ratios (x)				
EV/Sales	1.9	1.6	1.3	1.0
EV/EBITDA	12.7	9.6	8.6	6.9
P/E	20.3	18.4	16.7	13.5
P/BV	2.5	2.2	2.0	1.7



Quarterly trend

Particulars	Q3FY08	Q4FY08	Q1FY09	Q2FY09	Q3FY09
Revenue (Rs mn)	2,622	5,020	3,962	3,092	3,171
YoY growth (%)	20.1	26.7	20.0	31.1	21.0
QoQ growth (%)	11.2	91.5	(21.1)	(22.0)	2.6
EBITDA (Rs mn)	398	710	475	479	567
EBITDA margin (%)	15.2	14.1	12.0	15.5	17.9
Adj net income (Rs mn)	350	538	311	335	351
YoY growth (%)	20.1	58.4	17.9	3.2	0.2
QoQ growth (%)	8.0	53.5	(42.2)	7.7	4.8

DuPont analysis

(%)	FY07	FY08	FY09E	FY10E	FY11E
Tax burden (Net income/PBT)	70.8	68.0	68.0	69.3	68.9
Interest burden (PBT/EBIT)	102.5	90.1	73.2	71.4	71.2
EBIT margin (EBIT/Revenues)	10.6	12.8	14.1	12.7	12.8
Asset turnover (Revenues/Avg TA)	94.1	73.8	69.1	71.9	76.0
Leverage (Avg TA/Avg equity)	258.0	231.9	263.2	277.1	287.7
Return on equity	18.6	13.4	12.7	12.5	13.7

Company profile

Patel Engineering (PEL) is one of the oldest and largest construction companies in India, with a strong presence in the hydropower sector. It is one of the few players with pre-qualifications in hydro, irrigation and other projects. PEL possesses niche technologies (via subsidiaries) such as RCC dam construction, micro tunnelling and lake water tapping. It has also ventured into the real estate business and has a developable land bank of ~100mn sq ft in four Indian cities including Mumbai

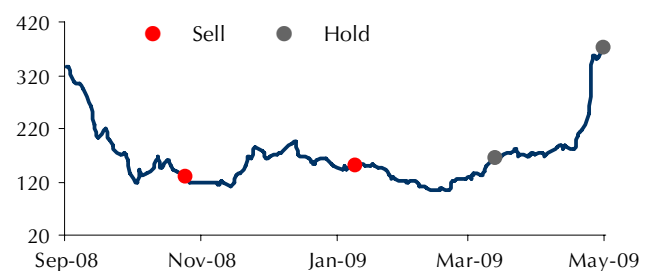
Shareholding pattern

(%)	Sep-08	Dec-08	Mar-09
Promoters	52.9	53.4	53.8
FIs	8.9	7.4	7.1
Banks & FIs	12.2	12.3	11.1
Public	26.0	26.9	28.0

Recommendation history

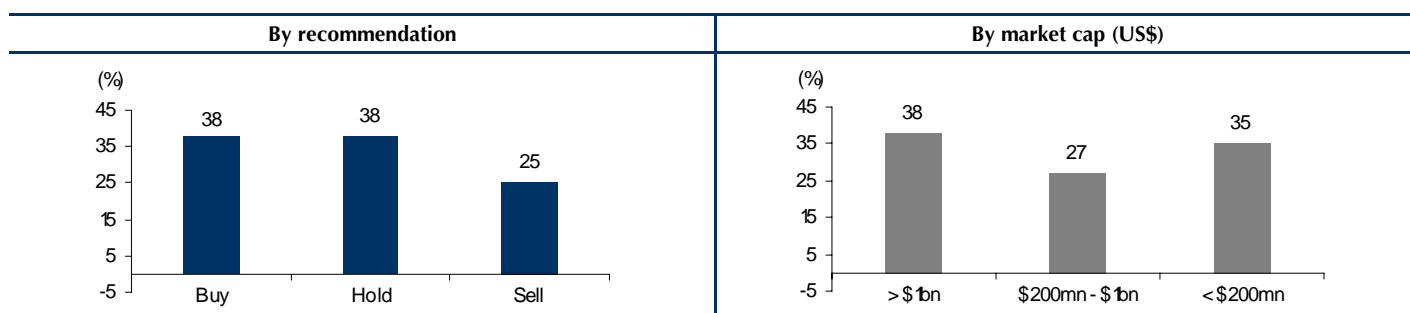
Date	Event	Reco price	Tgt price	Reco
18-Nov-08	Initiating Coverage	139	148	Sell
02-Feb-09	Results Review	147	155	Sell
06-Apr-09	Quarterly Preview	136	155	Hold
25-May-09	Company Update	353	309	Hold

Stock performance





Coverage Profile



Recommendation interpretation

Recommendation	Expected absolute returns (%) over 12 months
Buy	More than 15%
Hold	Between 15% and -5%
Sell	Less than -5%

Recommendation structure changed with effect from March 1, 2009

Expected absolute returns are based on share price at market close unless otherwise stated. Stock recommendations are based on absolute upside (downside) and have a 12-month horizon. Our target price represents the fair value of the stock based upon the analyst's discretion. We note that future price fluctuations could lead to a temporary mismatch between upside/downside for a stock and our recommendation.

Religare Capital Markets Ltd

4th Floor, GYS Infinity, Paranjpe 'B' Scheme, Subhash Road, Vile Parle (E), Mumbai 400 057.

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