

Patel Engineering

Performance Highlights

Y/E March (₹ cr)	3QFY11	3QFY10	2QFY11	% chg (yoy)	% chg (qoq)
Net sales	434.6	633.0	765.9	(31.3)	(43.3)
Operating profit	58.0	119.2	116.1	(51.3)	(50.0)
Net profit after MI	8.8	44.4	43.6	(80.2)	(79.9)

Source: Company, Angel Research

For 3QFY2011, Patel Engineering (PEL) posted disappointing numbers on consolidated and standalone basis. Going ahead as well, we believe recovery to the growth path will take time as the order inflow concerns loom large. Hence, we are downgrading our earnings estimates for FY2011 and FY2012 by 50–60%. Further, the company has not provided for the recent IT raid (which would accrue in the next few months), thereby increasing the tax rate going ahead; and the hedging loss incurred due to project cancellations, which we believe would materialise and impact the company's financials. **Hence, we are downgrading the stock to Neutral from Buy, given the pressure on C&EPC's earnings, muted order inflow, uncertainty over tax outflow and hedging loss.**

Disappointing results: For 3QFY2011, PEL posted a decline of 31.3% yoy and 43.3% qoq in net sales. The disappointment was on both the domestic and international fronts as revenue witnessed a major slowdown mainly on account of extreme weather conditions. EBITDA margin came in at 13.4% (adjusting the hedging loss under total operating expenses). The dismal top-line performance resulted into an 80.2% yoy decline in the bottom line.

Outlook and valuation: PEL's core C&EPC business is currently facing headwinds with its large projects facing delays and disappointing order inflow. Further, the longer gestation nature of its order book, macro headwinds and increasing debt levels put the company's growth visibility for the next few quarters under doubt. Hence, we are downgrading the stock to Neutral with a revised fair value of ₹220/share (earlier ₹353/share).

Key financials (Consolidated)

Y/E March (₹ cr)	FY2009	FY2010	FY2011E	FY2012E
Net sales (incl op. income)	2,460	3,191	2,428	2,776
% chg	32.6	29.7	(23.9)	14.3
Adj. net profit	139.2	198.2	110.8	97.9
% chg	(8.1)	42.4	(44.1)	(11.7)
FDEPS (₹)	19.9	28.4	15.9	14.0
EBITDA margin (%)	15.8	15.9	15.1	15.2
P/E (x)	20.9	14.7	26.3	29.8
RoAE (%)	14.9	16.7	7.9	6.6
RoACE (%)	11.0	12.5	7.2	7.3
P/BV (x)	2.9	2.1	2.0	1.9
EV/Sales (x)	1.8	1.5	2.2	2.2
EV/EBITDA (x)	11.2	9.5	14.4	14.6

Source: Company, Angel Research

NEUTRAL

CMP	₹200
Target Price	-

Investment Period	-
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Stock Info

Sector	Infrastructure
Market Cap (₹ cr)	2,913
Beta	1.1
52 Week High / Low	500/181
Avg. Daily Volume	37,483
Face Value (₹)	1
BSE Sensex	17,729
Nifty	5,310
Reuters Code	PENG.BO
Bloomberg Code	PEC@IN

Shareholding Pattern (%)

Promoters	45.5
MF / Banks / Indian Fls	11.3
FII / NRIs / OCBs	15.3
Indian Public / Others	27.8

Abs. (%)	3m	1yr	3yr
Sensex	(13.9)	9.8	6.6
Patel	(46.2)	(53.5)	(67.6)

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Exhibit 1: Quarterly performance (Consolidated)

Y/E March (₹ cr)	3QFY11	3QFY10	2QFY11	% Chg (yoy)	% Chg (qoq)	9MFY11	9MFY10	% Chg
Net Sales	434.6	633.0	765.9	(31.3)	(43.3)	1902.8	1884.0	1.0
Total Expenditure*	376.6	513.8	649.8	(26.7)	(42.1)	1610.2	1545.6	4.2
Operating Profit	58.0	119.2	116.1	(51.3)	(50.0)	292.6	338.4	(13.5)
OPM (%)	13.4	18.8	15.2	-	-	15.4	18.0	-
Interest*	36.2	24.2	30.0	49.5	21.0	98.7	81.2	21.6
Depreciation	18.6	32.3	26.2	(42.5)	(29.1)	70.4	95.5	(26.3)
Non Operating Income	7.1	7.0	5.2	-	37.6	14.8	23.0	(35.6)
Nonrecurring items	0.0	0.0	0.0	-	-	0.0	0.0	-
Profit Before tax	10.3	69.6	65.1	(85.2)	(84.2)	138.4	184.8	(25.1)
Tax	2.7	21.3	19.7	(87.6)	(86.6)	41.2	54.3	(24.1)
Net Profit before MI	7.6	48.3	45.3	(84.2)	(83.1)	97.2	130.6	(25.6)
PAT (%)	1.8	7.6	5.9	-	-	5.1	6.9	-
Minority Interest (MI)	(1.1)	4.0	1.7	(128.6)	(165.7)	4.7	9.2	(48.3)
Net Profit after MI	8.8	44.4	43.6	(80.2)	(79.9)	92.4	121.4	(23.8)
Adj. PAT (%)	2.0	7.0	5.7	-	-	4.9	6.4	-
Adj. FDEPS	1.3	6.3	6.2	(80.2)	(79.9)	13.2	17.4	(23.8)

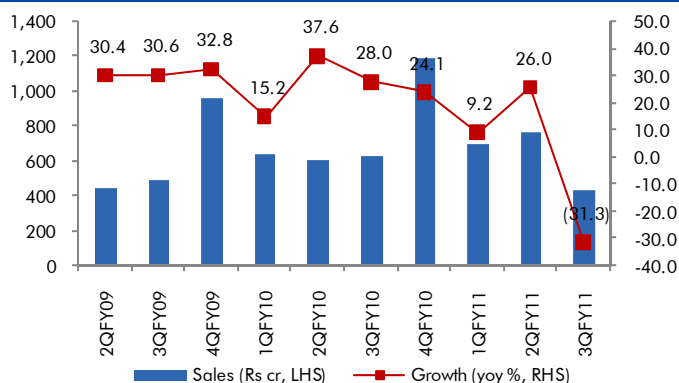
Source: Company, Angel Research; Note: *The reported numbers include ₹50cr as hedging loss in interest cost, which has been credited to the top line as well. We have considered the same as normal cost and have included it in the total operating expenditure. Therefore, we have excluded the same from interest cost. The company has claimed it will be receiving the same from the client in the next 6–8 months, but we do not expect the same.

Top line a complete white wash

PEL posted a decline of 31.3% yoy and 43.3% qoq in net sales during the quarter. This was due to 1) flash floods that affected two of the company's hydro projects (namely Teesta low dam and Parbati), leading to revenue loss of ₹60cr; 2) heavy snowfall in the US, which affected the company's international operations; 3) cancellation of Loharinagpala hydro electric project (4x150 MW) from NTPC; and 4) delay in the execution of Pranahita Chevella irrigation project. Management has indicated that its hydro projects (Teesta low dam and Parbati) have started contributing to the revenue and things are back on track. The total cost for the projects is ~₹1,050cr.

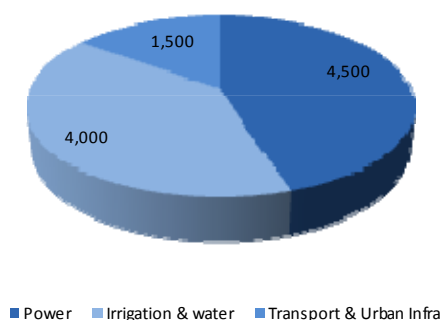
On the order book front, PEL disappointed with order inflow at a mere ₹1,200cr for 9MFY2011; and the current order book stands at ₹10,000cr (4.1x FY2011E revenue) – including L1 for projects worth ₹1,200cr. However, management has indicated that captive orders would ensure robust order inflow for FY2012. Of the total order book, hydro projects constitute 45%, irrigation project contribute 40% and the remaining constitute 15%.

Exhibit 2: Expect sales to drop on qoq basis



Source: Company, Angel Research

Exhibit 3: Order book break-up (₹10,000 cr)



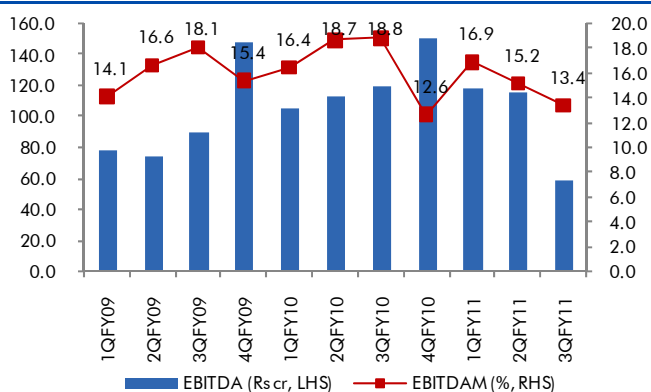
Source: Company, Angel Research

Bottom line declines by staggering 80.2%

During the quarter, operating margin came in at 13.4% (18.8%) adjusting for the hedging loss, below our estimates, mainly on account of lower revenue growth. The reported numbers include ₹50cr as hedging loss in interest cost, which has been credited to the top line as well. We have considered the same as normal cost and included it in the total operating expenditure. Therefore, we are excluding the same from interest cost. The company has claimed that it will be receiving the same from the client in the next 6–8 months, but we do not expect this to happen.

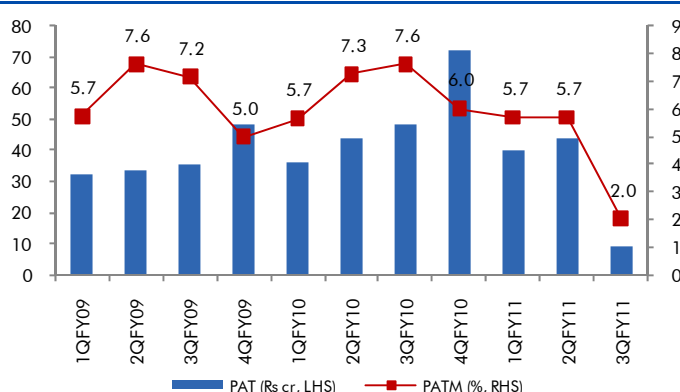
On the bottom-line front, PEL posted a staggering decline of 80.2% due to dismal top-line performance. Going ahead as well, we believe recovery to the growth path will take time, as the order inflow concerns loom large.

Exhibit 4: Expect EBITDAM to be under pressure



Source: Company, Angel Research

Exhibit 5: PATM take a plunge



Source: Company, Angel Research

Project updates

PEL has invested equity of ₹250cr in its power ventures, which we have valued at 1x. Land for the first phase (1,050MW plant in Nagapatnam district, Tamil Nadu) has been acquired and coal linkages are also in place from the Mahanadi coal fields. Management had earlier expected financial closure by December 2010 and construction work was likely to start in 2QFY2012. However, pending final clearance from the Tamil Nadu government to commence construction activity, the project has witnessed delays and can only be expected in 2HFY2012.

In real estate, management indicated that the progress is satisfactory with Smondoville-1 completely sold out (total 1,123 apartments), which also implies that the project does not require cash and would be self funded. During 3QFY2011, PEL booked ₹13.5cr from real estate from its Smondoville Bangalore project and PAT of ₹38lakhs. Phase II and III of Smondoville are 80% sold; and the company has recently launched Phase IV, which has witnessed good response. PEL's Noida project is completely sold out. In Mumbai, PEL has roped in an anchor tenant for Corporate Tower at ₹120–130/sq. ft. and completion is likely to be in 18 months.

Outlook and valuation

PEL's core C&EPC business is currently facing headwinds with its large projects facing delays and disappointing order inflow. Further, the longer gestation nature of its order book, macro headwinds and increasing debt levels put the company's growth visibility for the next few quarters under doubt. Hence, we are downgrading our earnings estimates for FY2011 and FY2012 by 50–60%.

Exhibit 6: Change in estimates

	FY2011			FY2012		
	Earlier estimates	Revised estimates	Variation (%)	Earlier estimates	Revised estimates	Variation (%)
Revenue (₹ cr)	3,693	2,428	(34)	4,297	2,776	(35)
EBITDA margin (%)	16.1	15.1	(7)	15.8	15.2	(3.8)
PAT (₹ cr)	215	111	(48)	228	98	(57)

Source: Company, Angel Research

Further, PEL has not provided for the recent IT raid (which would accrue in the next few months), thereby increasing the tax rate going ahead; and the hedging loss incurred due to project cancellations, which we believe would materialise and impact its financials (though we have not factored these developments due to uncertainty). **Hence, we are downgrading the stock to Neutral from Buy with a revised fair value of ₹220/share (₹353/share), given the pressure on C&EPC's earnings, muted order inflow, uncertainty over tax outflow and hedging loss.**

Our SOTP fair value of ₹220 is based on a target P/E of 8x (lower than its historical average and peers to factor in the uncertainty of IT raid and claims with clients) FY2012E EPS of ₹14.0 and valuing the company's investments in real estate, power and road at ₹107.5/share.

Exhibit 7: Derivation of SOTP-based fair value for PEL (FY2012E)

Business segment	Methodology	Remarks	₹ cr	₹/share	% to TP
Core Construction	P/E	8x FY2012E Earnings	1,370	112.1	51.0
Real Estate	NAV	30% Discount	392	56.1	25.5
BOT Assets	BV	1.0x P/BV	109	15.7	7.1
Power Venture	BV	1.0x P/BV	250	35.8	16.3
Total			2,121	219.6	100.0
CMP (₹)				200.0	
Upside (%)				9.8	

Source: Company, Angel Research

Exhibit 8: Key assumptions

(₹ cr)	FY2007	FY2008	FY2009	FY2010	FY2011E	FY2012E
Order inflow	2,333	2,536	3,976	5,881	2,500	7,000
Revenue	1,301	1,853	2,460	3,191	2,428	2,776
Order backlog (Y/E)	5008	5684	7200	10000	10,072	14,296
Order book-to-sales ratio (x)	3.9	3.1	2.9	3.1	4.1	5.2

Source: Company, Angel Research

Exhibit 9: Angel EPS forecast v/s consensus

	Angel forecast	Bloomberg consensus	Variation (%)
FY2011E	15.9	25.3	59.6
FY2012E	14.0	29.3	109.1

Source: Company, Angel Research

Exhibit 10: Recommendation summary

Company	CMP	TP	Rating	Top line (₹ cr)				EPS (₹)				Adj. P/E			OB/ Sales(x)
				FY10	FY11E	FY12E	CAGR (%)	FY10	FY11E	FY12E	CAGR (%)	FY10	FY11E	FY12E	
CCCL	53	63	Buy	1,976	2,377	2,838	19.8	5.0	4.8	6.3	12.6	10.7	11.0	8.4	1.9
HCC	34	-	Neutral	3,629	4,146	4,990	17.3	1.3	1.3	1.6	9.8	-	-	-	4.0
IRB Infra	171	264	Buy	1,705	2,460	3,707	47.5	11.6	14.2	15.4	15.1	2.8	2.3	2.2	-
IVRCL	67	129	Buy	5,492	6,031	7,668	18.2	7.8	7.7	9.5	10.1	4.2	4.2	3.4	3.9
JP Assoc.	82	131	Buy	10,355	13,438	16,873	27.6	4.7	5.2	6.7	20.2	17.6	15.7	12.2	-
Punj Lloyd	71	-	Neutral	10,448	8,129	10,048	(1.9)	(10.9)	(1.0)	4.1	-	-	-	17.3	3.4
NCC	98	164	Buy	4,778	5,365	6,430	16.0	7.8	7.7	9.0	7.3	5.3	5.4	4.6	3.2
Sadbhav	99	156	Buy	1,257	1,766	2,330	36.2	3.9	7.4	8.7	49.1	7.6	4.0	3.4	4.1
Simplex In.	325	521	Buy	4,564	5,258	6,168	16.2	25.6	30.3	37.2	20.6	12.7	10.7	8.7	2.6
PEL	200	-	Neutral	3,191	2,428	2,776	(6.7)	28.4	15.9	14.0	(29.7)	3.3	5.8	6.6	4.1
Madhucon	88	144	Buy	1,388	1,690	2,105	23.2	6.2	7.2	9.0	20.6	1.1	1.0	0.8	2.5
L&T	1,556	1,964	Buy	37,035	44,267	56,039	23.0	47.3	53.9	67.8	19.7	22.7	19.9	15.9	2.6
ITNL	223	285	Buy	2,403	3,204	4,690	39.7	17.7	20.4	22.6	12.8	12.6	10.9	9.9	8.9

Source: Company, Angel Research

Exhibit 11: SOTP break up

Company	Core Const.		Real Estate		Road BOT		Invst. in subsidiaries		Others		Total ₹
	₹	% to TP	₹	% to TP	₹	% to TP	₹	% to TP	₹	% to TP	
CCCL	63	100	-	-	-	-	-	-	-	-	63
HCC	16	32	23	47	11	21	-	-	-	-	50
IRB Infra	125	48	-	-	134	51	5	2	-	-	264
IVRCL	95	74	-	-	-	-	34	26	-	-	129
JP Assoc.	57	44	36	27	-	-	-	-	38	29	131
Punj Lloyd	91	100	-	-	-	-	-	-	-	-	91
NCC	108	66	7	4	27	16	-	-	23	14	164
Sadbhav	87	56	-	-	69	44	-	-	-	-	156
Simplex In.	521	100	-	-	-	-	-	-	-	-	521
PEL	112	51	56	26	16	7	-	-	36	16	220
Madhucon	63	44	4	3	52	36	-	-	25	18	144
L&T	1,491	76	-	-	-	-	473	24	-	-	1,964
ITNL	103	36	-	-	135	47	-	-	47	16	285

Source: Company, Angel Research

Profit & loss statement (Consolidated)

Y/E March (₹ cr)	FY2007	FY2008	FY2009	FY2010	FY2011E	FY2012E
Net Sales	1,301	1,853	2,460	3,191	2,428	2,776
Other operating income	0	2	-	-	-	-
Total operating income	1,301	1,855	2,460	3,191	2,428	2,776
% chg	26.9	42.6	32.6	29.7	(23.9)	14.3
Total Expenditure	1,145	1,557	2,070	2,682	2,062	2,354
Net Raw Materials	289	455	427	398	321	569
Other Mfg costs	808	935	1,471	2,011	1,583	1,651
Personnel	44	112	128	136	150	129
Other	4	55	44	138	8	5
EBITDA	157	299	390	509	366	422
% chg	25.4	90.8	30.5	30.5	(28.0)	15.1
(% of Net Sales)	12.0	16.1	15.8	15.9	15.1	15.2
Depreciation & Amortisation	35	63	120	109	95	95
EBIT	122	236	270	400	271	327
% chg	30.3	94.0	14.5	47.9	(32.1)	20.4
(% of Net Sales)	9.4	12.7	11.0	12.5	11.2	11.8
Interest & other Charges	10	61	137	192	196	270
Other Income (incl Ass/JV pft)	16	41	62	98	99	100
(% of PBT)	12.4	18.9	31.9	32.0	56.7	63.7
Recurring PBT	128	216	196	305	174	157
% chg	58.4	69.1	(9.5)	55.8	(43.0)	(10.0)
Extraordinary Expense/(Inc.)	(0)	-	(41)	-	-	-
PBT (reported)	128	216	237	305	174	157
Tax	14	23	44	93	57	52
(% of PBT)	11.3	10.7	18.4	30.5	33.0	33.0
PAT (reported)	114	193	193	212	117	105
Less: Minority interest (MI)	2.7	10.9	12.9	13.9	5.7	7.0
Prior period items	-	-	-	-	-	-
PAT after MI (reported)	111	182	181	198	111	98
ADJ. PAT	112	151	139	198	111	98
% chg	52.6	35.4	(8.1)	42.4	(44.1)	(11.7)
(% of Net Sales)	8.6	8.2	5.7	6.2	4.6	3.5
Basic EPS (₹) (Reported)	18.6	30.5	30.2	30.2	15.9	14.0
Fully Diluted EPS (₹) (Diluted)	16.0	21.7	19.9	28.4	15.9	14.0
% chg	52.6	35.4	(8.1)	42.4	(44.1)	(11.7)

Balance sheet (Consolidated)

Y/E March (₹ cr)	FY2007	FY2008	FY2009	FY2010	FY2011E	FY2012E
SOURCES OF FUNDS						
Equity Share Capital	6.0	6.0	6.0	7.0	7.0	7.0
Preference Capital	-	-	-	-	-	-
Reserves & Surplus	701	840	1,011	1,356	1,438	1,516
Shareholder's Funds	707	846	1,017	1,363	1,445	1,523
Minority Interest	7	41	22	62	62	62
Total Loans	491	1,194	1,747	2,138	2,476	3,356
Deferred Tax Liability	12	15	15	11	11	11
Total Liabilities	1,218	2,096	2,800	3,574	3,994	4,952
APPLICATION OF FUNDS						
Gross Block	357	615	804	861	961	1,086
Less: Acc. Depreciation	114	180	303	306	401	496
Net Block	242	435	500	555	560	590
Capital Work-in-Progress	11	235	70	204	254	304
Investments	171	36	50	70	481	997
Current Assets	1,150	2,045	2,865	3,758	3,909	4,507
Inventories	446	824	1,110	1,803	1,893	2,177
Sundry Debtors	303	462	583	696	765	880
Cash	105	288	295	232	121	95
Loans & Advances	296	471	878	1,026	1,129	1,355
Other	-	-	-	-	-	-
Current liabilities	360	658	692	1,020	1,217	1,454
Net Current Assets	790	1,387	2,174	2,738	2,692	3,054
Misc. Exp. not written off	3	2	6	7	7	7
Total Assets	1,218	2,096	2,800	3,574	3,994	4,952

Cash flow statement (Consolidated)

Y/E March (₹ cr)	FY2007	FY2008	FY2009	FY2010	FY2011E	FY2012E
Profit before tax (excluding MI)	131.6	185.5	237.0	291.1	168.2	149.5
Depreciation	34.9	62.7	119.6	109.0	94.8	94.8
Change in Working Capital	302.0	396.0	662.6	626.9	65.0	388.1
Less: Other income	15.9	40.8	62.5	97.6	98.6	99.7
Direct taxes paid	29.7	45.2	76.0	108.4	57.4	51.7
Cash Flow from Operations	(181.1)	(233.8)	(444.5)	(432.8)	42.0	(295.1)
(Inc.)/ Dec. in Fixed Assets	(78.8)	(482.3)	(15.1)	(295.0)	(150.0)	(175.0)
(Inc.)/ Dec. in Investments	6.6	(1.8)	(51.0)	21.0	(411.4)	(516.1)
Other income	15.9	40.8	62.5	97.6	98.6	99.7
Cash Flow from Investing	(56.3)	(443.3)	(3.6)	(176.4)	(462.8)	(591.4)
Issue of Equity	425.0	-	-	344.3	-	-
Inc./ (Dec.) in loans	29.2	703.0	535.7	391.2	338.3	879.6
Dividend Paid (Incl. Tax)	9.2	8.1	5.9	22.8	17.8	19.6
Others	(147.0)	165.0	(75.0)	(165.8)	(10.9)	-
Cash Flow from Financing	298.0	860.0	454.7	546.9	309.7	860.1
Inc./ (Dec.) in Cash	60.7	182.9	6.7	(62.3)	(111.1)	(26.5)
Opening Cash balances	44.5	105.1	288.1	294.8	232.5	121.4
Closing Cash balances	105.1	288.1	294.8	232.5	121.4	94.9

Key ratios

Y/E March	FY2007	FY2008	FY2009	FY2010	FY2011E	FY2012E
Valuation Ratio (x)						
P/E (on FDEPS)	26.0	19.2	20.9	14.7	26.3	29.8
P/CEPS	19.9	13.6	11.3	9.5	14.2	15.1
P/BV	4.1	3.4	2.9	2.1	2.0	1.9
Dividend yield (%)	0.3	0.4	0.4	0.5	0.5	0.6
EV/Sales	2.5	2.1	1.8	1.5	2.2	2.2
EV/EBITDA	21.1	12.8	11.2	9.5	14.4	14.6
EV / Total Assets	2.7	1.8	1.6	1.3	1.3	1.2
Order Book to Sales	3.9	3.1	2.9	3.1	4.1	5.2
Per Share Data (₹)						
EPS (Basic)	18.6	30.5	30.2	30.2	15.9	14.0
EPS (fully diluted)	16.0	21.7	19.9	28.4	15.9	14.0
Cash EPS	21.0	30.6	37.0	44.0	29.4	27.6
DPS	1.3	1.5	1.7	2.0	2.2	2.4
Book Value	101.3	121.1	145.6	195.0	206.8	218.0
DuPont Analysis						
EBIT margin	9.4	12.7	11.0	12.5	11.2	11.8
Tax retention ratio	0.9	0.9	0.8	0.7	0.7	0.7
Asset turnover (x)	1.2	1.3	1.1	1.1	0.7	0.6
ROIC (Post-tax)	9.7	14.4	10.2	9.5	5.0	5.0
Cost of Debt (Post Tax)	1.7	6.4	7.6	6.9	5.7	6.2
Leverage (x)	0.5	0.8	1.3	1.4	1.5	1.9
Operating ROE	14.0	21.1	13.5	13.2	4.1	2.8
Returns (%)						
ROACE (Pre-tax)	10.0	14.2	11.0	12.5	7.2	7.3
Angel ROIC (Pre-tax)	10.9	16.2	12.5	13.7	7.5	7.5
ROAE	15.8	19.5	14.9	16.7	7.9	6.6
Turnover ratios (x)						
Asset Turnover (Gross Block)	3.6	3.8	3.5	3.8	2.7	2.7
Inventory / Sales (days)	125	125	144	167	278	268
Receivables (days)	85	75	77	73	110	108
Payables (days)	90	100	99	95	161	169
WC cycle (ex-cash) (days)	192.3	175.5	220.9	250.8	381.6	363.6
Solvency ratios (x)						
Net debt to equity	0.5	1.1	1.4	1.4	1.6	2.1
Net debt to EBITDA	2.5	3.0	3.7	3.7	6.4	7.7
Interest Coverage	12.6	3.9	2.0	2.1	1.4	1.2

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Disclosure of Interest Statement

	Patel Engg.
1. Analyst ownership of the stock	No
2. Angel and its Group companies ownership of the stock	Yes
3. Angel and its Group companies' Directors ownership of the stock	No
4. Broking relationship with company covered	No

Note: We have not considered any Exposure below ₹1 lakh for Angel, its Group companies and Directors.

Ratings (Returns):

Buy (> 15%)

Reduce (-5% to 15%)

Accumulate (5% to 15%)

Sell (< -15%)

Neutral (-5 to 5%)