GAYATRI PROJECTS

INR 375

Value in store

NOT RATED

December 10, 2007

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Recently, we met the management of Gayatri Projects (Gayatri) to understand the company's future plans. After a period of stagnant revenues and profits between FY02 and FY05, Gayatri has shown a robust revenue and profit growth in the past two years. The company has ventured into BOT projects, thereby moving up the value chain from being a mere contractor to owner of projects. The company also plans to enter the real estate development segment with a JV between its promoters and the DLF Group.

We expect Gayatri to perform well in the future, backed by a robust order book of INR 34 bn, which is executable over the next thirty months. However, lack of experience in executing such a high order book and BOT projects exposes the company to certain risks and its execution capability needs to be tested.

At CMP of INR 375, the stock is trading at competitive valuations—FY07 EV/EBITDA of 7.8x, and P/E of 15.9x. The stock is not under our coverage.

* On a high growth trajectory; strong topline and bottomline growth

Gayatri has registered a strong revenue and profit growth in the past two years, after a period of almost stagnant revenues and profits. Revenues increased by 23% in FY06 to INR 3.71 bn and 35% in FY07 to INR 5.02 bn; net profit increased by 92% in FY06 to INR 180 mn and by 31% in FY07 to INR 236 mn. The growth momentum continued in H1FY08 with revenues increasing from INR 1.83 bn in H1FY07 to INR 2.77 bn in H1FY08, a growth of 51%. The company expects this impressive performance to continue in the future, given the central and state governments' thrust on infrastructure spending. The company has guided for revenues of INR 7– 7.5 bn in FY08, INR 12–13 bn in FY09, and INR 16-17 bn in FY10.

Reuters	:	GAPR.BO
Bloomberg	:	GAYP IN

Market Data

52-week range (INR)	:	423 / 209
Share in issue (mn)	:	100.0
M cap (INR bn/USD mn)	:	37.5 / 948.2
Avg. Daily Vol. BSE ('000)	:	123.8

Share Holding Pattern (%)

Promoters	:	55.8
MFs, FIs & Banks	:	12.9
FIIs	:	6.5
Others	:	24.8

Financials

Year to March	FY04	FY05	FY06	FY07
Revenue	3,136	3,013	3,712	5,021
Rev. growth (%)	*(8.0)*	*(3.9)*	*23.2*	*35.3*
EBITDA (INR mn)	320	469	655	755
Net profit (Adjusted)	58	93	180	236
Shares outstanding (mn)	5.0	5.0	9.0	10.0
EPS (INR)	11.6	18.7	20.0	23.6
EPS growth (%)	*(19.3)*	*60.7*	*6.9*	*18.0*
P/E (x)	32.3	20.1	18.8	15.9
EV/ EBITDA	17.0	12.2	8.9	7.8
ROAE (%)	8.8	12.8	21.2	20.2
ROACE (%)	9.3	12.7	16.6	16.3

* Robust (INR 34 bn) order book provides income visibility

As at October 2007, Gayatri's order book stood at INR 34 bn, with cumulative order intake of ~ INR 14 bn in April-October 2007. Order book is at 5.73x TTM revenues and is executable over the next 30 months, which provides strong income visibility for the next two-three years. Irrigation contributed INR 6.5 bn, industrial projects INR 500 mn, and roads contributed the residue to the INR 14 bn order intake. The company has currently bid for six more projects worth INR 10 bn, outcome of which is likely to be known by March 2008. Order book break up of the company comprises roads and highways on contracts 38%, irrigation 27%, BOT roads and highways 33%, and others (mainly industrial structures) 2%. While 70% of the road projects are from National Highway Authority of India (NHAI), the rest are from state governments. All the irrigation projects are from state governments, mainly from Andhra Pradesh.

* Margins likely to dip due to changing project mix

The composition of Gayatri's executed projects is moving towards roads and highways from irrigation. This is mainly due to higher opportunities in the roads segment compared to irrigation. This shift is likely to result in declining EBITDA margins, since margins in the roads and highways segment are lower due to high competition. Margins in irrigation are 18-20%, in cash contract roads they are 10-12%, and in BOT roads margins are 12-14%.

* Scaling up the value chain: From a contractor to owner of projects

There has been a strategic shift in Gayatri's business model with the company venturing into the asset ownership space. As most of the roads and highway projects these days are in the form of BOT, the move was necessary to capitalize on the growth opportunities in this segment. Moreover, returns in these projects are also higher, which will result in higher profitability for Gayatri going forward.

The company currently has five BOT road projects in the pipeline—four annuities based and one toll based. All the five projects have already achieved financial closure. Revenue from the three projects for which construction has commenced is expected to start flowing from March 2010. The total cost of these projects is INR 22 bn. Gayatri has a share of 51% in each of the four annuity projects, while its share in the toll road project is 40%. The company has partnered Maytas Infra, NCC, and IDFC for these projects. The company is doing 100% of the contracting work for the two annuity projects won in JV with IDFC. Equity IRR on the Meerut-Muzaffarnagar project is 18%; on the remaining four projects, it is around 13-14%.

The company is looking to transfer the BOT projects to a separate company and may sell stake in that company to raise capital. It has given a mandate to E&Y. This process is likely to take about a year. The rationale behind this is that Gayatri does not want to raise further debt on its already stretched balance sheet, nor does it want to dilute equity. So it plans to raise capital through its subsidiary's balancesheet.

* Real estate plans with DLF: Gayatri's share expected to be 13% in INR 4 bn project

The promoters of Gayatri have entered into a 50:50 JV with DLF for an INR 4 bn project to develop residential and commercial space. In the initial phase, the project entails development of 1 mn sq ft. For this purpose, 1,500 acres have been acquired at a distance of 10 km from Shamshabad at INR 30 lakh per acre. The real estate stake of promoters will be shifted to a holding company with Gayatri getting around 13% of the share. The holding company will issue shares to Gayatri at par.

* Owning 100% of equipment and less subcontracting lead to high EBITDA margins

The company currently has gross fixed assets of INR 2.30 bn. It follows a strategy of owning 100% of the equipment instead of going in for the lease model. Moreover, it also subcontracts less (about 20% of the total value). The strategy of owning 100% of the equipment and lesser subcontracting enables it to achieve higher EBITDA margins—EBITDA margin for FY06 was 17.6%, while that for FY07 was 15.0%.

But the company also has to employ higher capital to finance the equipment, leading to higher interest burden. Further, the depreciation charge is also high. As a result, the benefit of higher EBIDTA margin does not percolate down to the PAT level and hence, PAT margin for the company is in line with other players in the industry at 4-5%. The company has guided for a PAT of INR 370-400 mn for FY08, INR 570–600 mn for FY09, and INR 800-900 mn for FY10.

The company's return ratios are slightly lower compared to other players due to higher capital employed. The average industry ROACE is around 20%, but for Gayatri it is around 16%.

* Taking the JV route to enhance financial and technical qualification

Gayatri has entered into JVs with some big players—Simplex Infrastructure, Nagarjuna Construction Company, IDFC, and Maytas Infra—to enhance its financial and technical qualification. This will enable it to bag more orders going forward, which will further enhance its already robust order book.

* No risk of retrospective tax liability

Gayatri has not availed of Section 80 IA benefits and has paid tax at normal rates. As a result, it does not face any risk of retrospective tax liability.

Other key highlights

* Debt of INR 3.80 bn including INR 1 bn FCCB

Gayatri currently has a debt of INR 3.80 bn. This includes mobilization advances of INR 700 mn and an FCCB of INR 1 bn issued in August 2007. The FCCB issue comprised unsubordinated and unsecured zero coupon bonds with a YTM of 3.75%, due for conversion in 2012. The initial conversion price of these bonds is set at INR 378.3 per share. The company has also brought down its total cost of debt to around 10% by replacing the high cost working capital loans at 13.5% with FCNR-B loans at 9.75% (including hedging cost).

* Moving into high value-added segment of roads

The company is entering into the high value-added segment of roads and hence, the value per km is increasing. Earlier, the company used to get INR 20–30 mn per km in road projects. However, in case of the Hyderabad outer ring road project, the total value is INR 9.34 bn for a total length of 25 km, which works out to around INR 370 mn per km.

* Cost overrun in past resulting in a loss of INR 540 mn

The Gayatri–IJM venture suffered a cost overrun of INR 1.30 bn on an INR 6 bn project. Gayatri's share in the project was 40%, thereby leading to a pre-tax loss of INR 540 mn and an after-tax loss of INR 380 mn. Gayatri has filed a claim for reimbursement of the increased costs citing delays in land acquisition by NHAI as the reason for the cost overrun. The matter is currently sub-judice and the company expects a judgment on the same within two-three years.

Key Risks

* Execution capability yet to be tested

The company's order book stands at INR 34 bn, to be executed over a period of 30 months. This translates in to an execution rate of INR 12 bn annually. This, when compared to its FY07 revenue of INR 5 bn, is very high and calls for high execution capability, which is yet to be tested. The company thus faces an execution risk, which could lead to project delays and consequent penalties and may adversely affect the company's financial performance.

* Moving into unfamiliar and risky territory

Gayatri has recently ventured into BOT projects. These projects are risky compared to the contracting business (its forte) and given the company's lack of experience in executing BOT projects, it is exposed to a significant risk.

* Equity dilution risk

The company's debt-equity ratio stood at 2.0 for FY07. Hence, it will be difficult for the company to raise additional debt beyond this point to finance its working capital needs as well as other long term funds. This could mean a potential equity dilution in the future. Gayatri has already made a FCCB issue of INR 1 bn in August 2007. Although the management has indicated that another round of equity dilution is one-two years away, the possibility of an equity dilution could not be completely ruled out considering the current high debt-equity ratio and the need for funds due to high order inflows.

* Outlook and valuations: Competitive

At a CMP of INR 375, the stock is trading at competitive valuations—FY07 EV/EBITDA of 7.8x, and P/E of 15.9x. The stock is not under our coverage.

Company Description

Gayatri was incorporated in 1989. The company currently has employee strength of over 1,100. It primarily undertakes civil construction in the road and irrigation segments. It now proposes to venture into urban infra and the water treatment segments (through a MoU with Ion Exchange) to diversify its operations and to improve margins. The company has completed projects worth about INR 250 bn and has projects worth INR 34 bn in hand. The company's m-cap is INR 375 cr.

Gayatri has entered the asset ownership space to benefit from the increased government spending on road projects, majority of which are on BOT basis, thereby moving up the value chain. The company accessed capital markets through a public issue in September 2006 at a price band of INR 275–295.

Financial Statements

Income statement

Year to March	FY04	FY05	FY06	FY07
Income from operations	3,136	3,013	3,712	5,021
Direct costs	2,696	2,422	2,922	4,076
Administrative expenses	119	121	135	190
Total operating expenses	2,815	2,543	3,057	4,266
EBITDA	320	469	655	755
Depreciation and amortisation	86	99	104	126
EBIT	235	371	551	629
Interest expenses	199	259	304	304
Other income	56	21	29	33
Profit before tax	91	133	276	358
Provision for tax	33	39	95	123
Tax related to previous year	-	-	1	-
Reported profit	58	93	180	236
Adjusted net profit	58	93	180	236
Shares outstanding	5.0	5.0	9.0	10.0
Dividend per share	-	2.5	1.7	2.3
Dividend payout (%)	-	13.4	8.6	9.9

Common size metrics- as % of net revenues

Year to March	FY04	FY05	FY06	FY07
Operating expenses	89.8	84.4	82.4	85.0
Depreciation	2.7	3.3	2.8	2.5
Interest expenditure	6.3	8.6	8.2	6.1
EBITDA margins	10.2	15.6	17.6	15.0
Net profit margins (Adjusted)	1.9	3.1	4.8	4.7

Growth metrics (%)

Year to March	FY04	FY05	FY06	FY07
Revenues	(8.0)	(3.9)	23.2	35.3
EBITDA	(17.1)	46.6	39.5	15.2
PBT	(15.0)	44.9	108.4	29.7
Net profit (Adjusted)	(19.3)	60.7	92.4	31.1
EPS (Adjusted)	(19.3)	60.7	6.9	18.0

Cash flow statement

Year to March	FY04	FY05	FY06	FY07
Net profit	58	93	180	236
Add: Depreciation	86	99	104	126
Add: E.O.adjustments	-	(0)	0	-
Add: Deferred tax	3	(7)	0	-
Gross cash flow	147	184	285	361
Less: Dividends	-	13	15	23
Less: Changes in W. C.	389	307	85	295
Operating cash flow	(242)	(135)	184	42
Less: Change in investments	(3)	-	3	369
Less: Capex	78	163	262	427
Free cash flow	(317)	(298)	(81)	(753)

Balance sheet (INR mn)

As on 31st March	FY04	FY05	FY06	FY07
Equity capital	50	50	90	100
Reserves & surplus	642	715	837	1,310
Shareholders funds	692	765	927	1,410
Secured loans	1,664	1,658	1,904	2,064
Unsecured loans	346	728	638	787
Borrowings	2,009	2,386	2,542	2,851
Sources of funds	2,701	3,151	3,469	4,261
Gross block	1,216	1,382	1,643	2,070
Depreciation	466	565	660	784
Net block	750	817	983	1,286
Capital work in progress	3	-	-	-
Total Fixed Assets	753	817	983	1,286
Investments	29	29	32	402
Inventories	156	203	218	218
Sundry debtors	792	969	1,046	1,302
Cash and equivalents	280	357	461	280
Loans and advances	1,197	1,348	1,430	1,560
Total current assets	2,425	2,877	3,156	3,360
Sundry creditors	363	416	504	563
Provisions	-	14	15	46
Total CL & provisions	363	431	520	609
Net current assets	2,062	2,446	2,636	2,751
Net Deferred tax	(142.6)	(141.4)	(183.0)	(178.0)
Uses of funds	2,701	3,151	3,469	4,260
Book value per share (BV)	138	153	103	141

Ratios

Year to March	FY04	FY05	FY06	FY07
ROAE (%)	8.8	12.8	21.2	20.2
ROACE (%)	9.3	12.7	16.6	16.3
Operating ROACE(%)	9.5	12.8	16.8	17.3
Current ratio	6.7	6.7	6.1	5.5
Debtors (Days)	92	117	103	95
Fixed assets t/o (x)	4.2	3.7	3.8	3.9
Average working capital t/o (x)	1.7	1.3	1.5	1.9
Debt/Equity	2.9	3.1	2.7	2.0

Valuations parameters

Year to March	FY04	FY05	FY06	FY07
EPS (INR)	11.6	18.7	20.0	23.6
Y-o-Y growth (%)	*(19.3)*	*60.7*	*6.9*	*18.0*
CEPS (INR)	28.8	38.4	31.5	36.1
P/E (x)	32.3	20.1	18.8	15.9
Price/BV(x)	2.7	2.4	3.6	2.7
EV/Sales (x)	1.7	1.9	1.6	1.2
EV/EBITDA (x)	17.0	12.2	8.9	7.8

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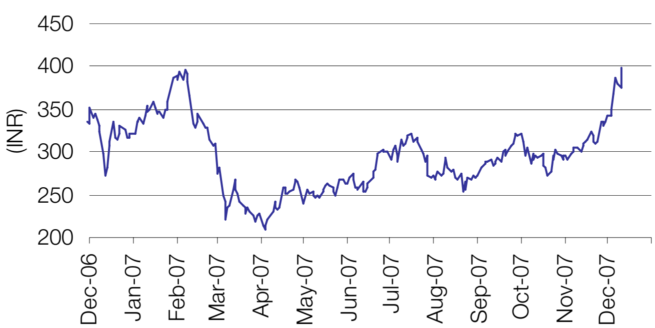
Coverage group(s) of stocks by primary analyst(s): *Construction:*

BL Kashyap & Sons, Gammon India, Hindustan Construction, IVRCL Infrastructures & Projects, JMC Projects (India), Madhucon Projects, Nagarjuna Construction, Patel Engineering and Simplex Infrastructures.

Gayatri Projects



Recent Research

Date	Company	Title	Price (INR)	Recos
07-Nov-07	B L Kashyap	Power packed performance; *Result Update*	1,413	Buy
25-Oct-07	Hindustan Construction	Lavasa gets going on; *Result Update*	198	Under *Review*
17-Oct-07	Patel Engineering	Real estate sweetener; *Result Update*	712	Under *Review*
15-Oct-07	C&C Construction	High margin play; *Event Update*	215	Not Rated

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	103	47	22	3	190

* 13 stocks under review / 2 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	96	65	29

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 20% over a 12-month period
Accumulate	appreciate up to 20% over a 12-month period
Reduce	depreciate up to 10% over a 12-month period
Sell	depreciate more than 10% over a 12-month period

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