

ENGINEERS INDIA

INR 916



Order book increases further to INR 48 bn

ACCUMULATE

Engineers India's (EIL's) Q3FY08 revenues and PAT were higher by 35.3% Y-o-Y and 26% Y-o-Y, respectively, supported by increase in engineering revenues.

Order intake for Q3FY08 of INR 10.0 bn resulted in the company increasing the order book further; we estimate current order book at INR 48 bn. Moreover, current order backlog stands at ~7.3 years of trailing twelve months' revenues.

EIL's employee count remained at 2,825, a modest increase compared to 2,750 in Q2FY08 end. We expect the company's rising employee strength (2,900 by FY08E end and 3,250 by FY09E end) to boost order execution.

Q3FY08 revenue of INR 1.8 bn was up 35.3% Y-o-Y. The company's conventional engineering and consultancy business (contributing 84% to the total topline) grew by 27% Y-o-Y due to impact of increased order book situation and higher headcount enabling order execution.

We maintain our FY08 and FY09 revenue (INR 6.9 bn and INR 11.1 bn) and profit (INR 1.9 bn and INR 2.3 bn) estimates. We are also introducing FY10E EPS at INR 49.8. EIL's expanding order book of INR 48 bn at 7.3x trailing 12-months' revenues provides significant earnings visibility over the next three years.

At INR 916, EIL is trading at 22.3x and 18.4x on FY08E and FY09E EPS, respectively. On an EV/EBITDA basis, the stock is trading at 16.1x and 12.3x our FY08E and FY09E earnings, respectively. Global firms—Technip, Jacobs, Fluor, McDermott—in similar business are trading at two-year forward EV/EBITDA and P/E of 10.7x and 18.9x, respectively. EIL's profits are expected to grow at two-year CAGR of 21.8%, which makes it an attractive story. However, EIL's valuations are comparable to global firms, leaving limited upside on the stock price. Hence, we maintain 'ACCUMULATE' recommendation on the stock.

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Bloomberg : ENGR IN

Market Data

52-week range (INR) : 1,314 / 430
Share in issue (mn) : 56.2
M cap (INR bn/USD mn) : 51.5 / 1,303.9
Avg. Daily Vol. BSE/NSE ('000) : 52.3

Share Holding Pattern (%)

Promoters : 90.4
MFs, FIs & Banks : 4.9
FII's : 0.4
Others : 4.3

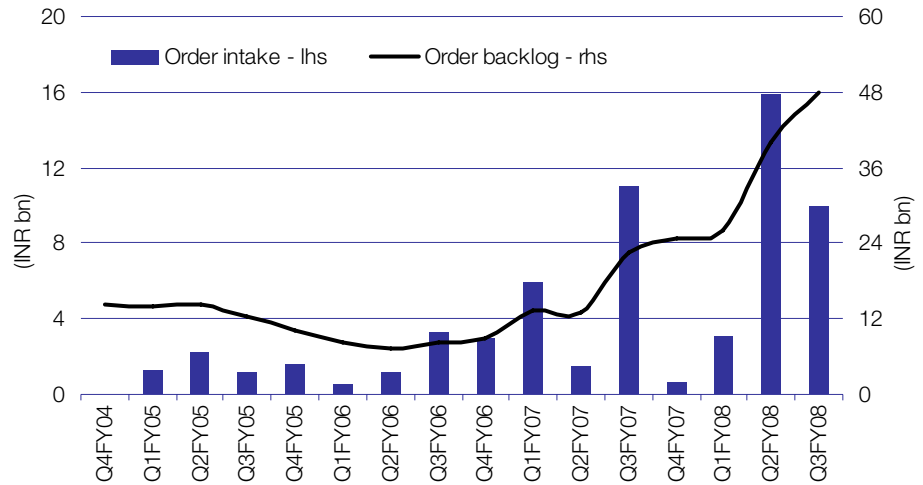
Financials

Year to March	Q3FY08	Q3FY07	Growth %	Q2FY08	Growth %	FY07	FY08E
Net revenue (INR mn)	1,775	1,312	35.3	1,670	6.3	5,711	6,910
EBITDA (INR mn)	487	354	37.3	469	3.8	1,306	1,662
Net profit (INR mn)	503	399	26.0	496	1.3	1,431	1,887
EPS (INR)	8.9	7.1	26.0	8.8	1.3	25.5	33.6
EPS growth (%)						3.2	31.8
P/E (x)						36.0	27.3

*** Order book bulging at INR 40 bn in Q2FY08**

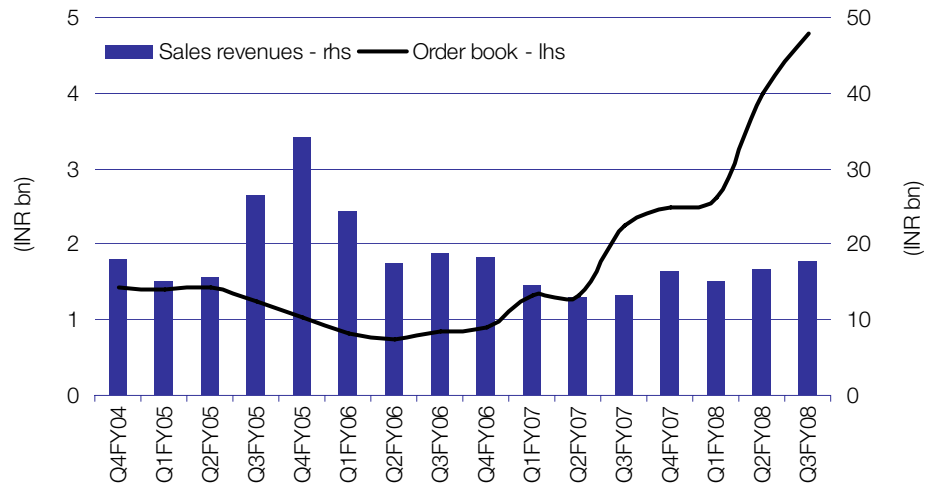
EIL's Q3FY08 order intake of INR 10.0 bn resulted in the company increasing its order book further; we estimate current order book at INR 48 bn. Moreover, current order backlog stands at ~7.3 years of trailing twelve months' revenues. LSTK order book remained same at ~INR 10 bn. In the quarter, EIL bagged INR 8.0 bn order of the upcoming Bhatinda refinery.

Chart 1: Order book becomes stronger



Source: Industry

Chart 2: Revenues not catching up with order backlog



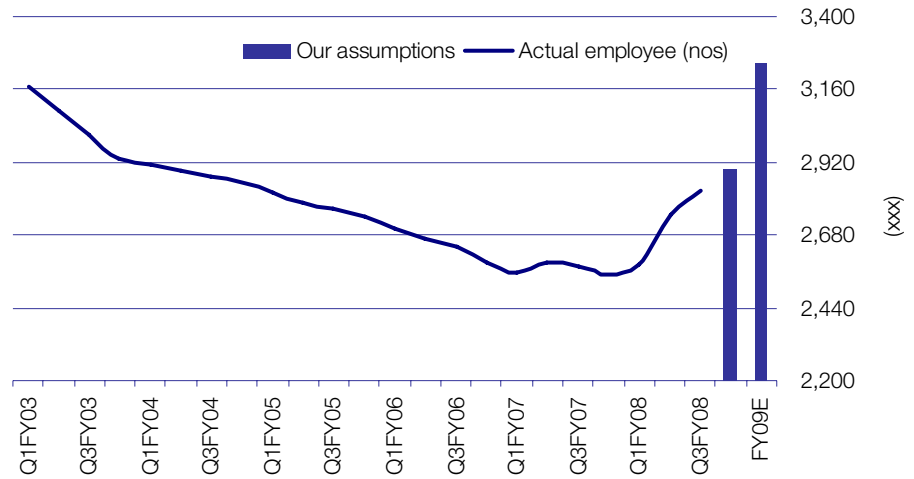
Source: Company

*** Employee strength increased in line with our estimates; to touch 3,250 by FY09E**

EIL's employee count was at ~2,825, a modest increase compared to ~2,750 in Q2FY08 end. We expect EIL's rising employee strength (~2,900 by FY08E end and 3,250 by FY09E end) to boost order execution. Consequently, we expect this to help record higher future revenue growth commensurate with EIL's expanding order book. This, we believe, is a key positive as it is likely to help the company capitalize on its order book.

However, we remain concerned on the pay revision (potentially next year) in line with the scheduled salary hikes for all public sector undertakings (PSU) from January 1, 2007, onwards. While adhoc advances have already been given to employees, we expect salary costs to increase further after the pay commission submits its reports around June 2007. Going forward, we continue with our view that employee expenses will dent margins.

Chart 3: Actual and projected employee strength



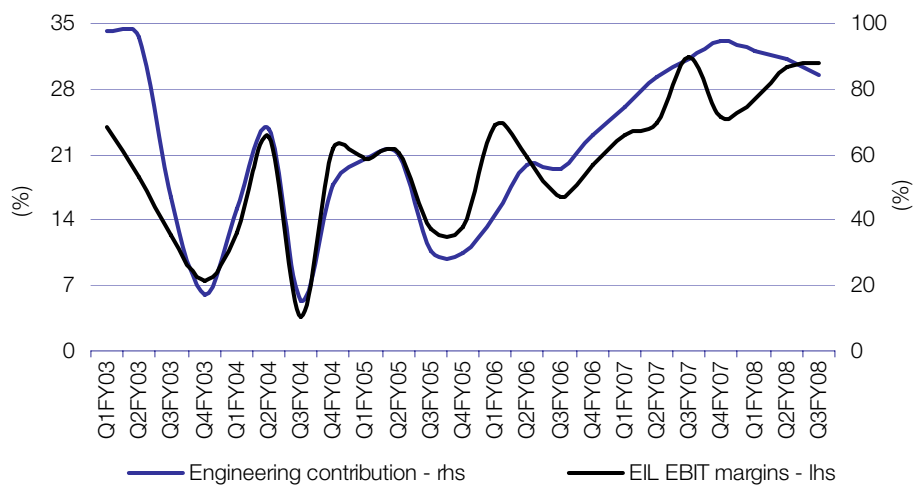
Source: Company, Edelweiss research

*** Revenues up 35.0% Y-o-Y due to higher conventional business revenues**

EIL's Q3FY08 revenue of INR 1.8 bn was up 35.3% Y-o-Y. The company's conventional engineering and consultancy business (contributing 84% to the total topline) grew by 27% Y-o-Y due to impact of increased order book and higher headcount enabling order execution. LSTK revenues doubled Y-o-Y in Q3FY08 due to impact of execution of IOC's HPDE/LDPE LSTK contract.

Additionally, engineering revenue per employee (INR mn/employee/year) at INR 2.21 mn remained flat sequentially (INR 2.25 mn in Q2FY08).

Chart 4: EBIT margins follow engineering contribution to revenues



Source: Company, Edelweiss research

* **Outlook and valuations: Maintaining FY08E; maintain 'ACCUMULATE'**

We maintain our FY08 and FY09 revenue (INR 6.9 bn and INR 11.1 bn) and profit (INR 1.9 bn and INR 2.3 bn) estimates. We are also introducing FY10E EPS at INR 49.8. EIL's expanding order book of INR 48 bn at 7.3x trailing 12-months' revenues provides significant earnings visibility over the next three years.

At INR 916, EIL is trading at 2.3x and 18.4x on FY08E and FY09E EPS, respectively. On an EV/EBITDA basis, the stock is trading at 16.1x and 12.3x our FY08E and FY09E earnings, respectively. Global firms—Technip, Jacobs, Fluor, McDermott—in similar business are trading at two-year forward EV/EBITDA and P/E of 10.7x and 18.9x, respectively. EIL's profits are expected to grow at two-year CAGR of 21.8%, which makes it an attractive story. However, EIL's valuations are comparable to global firms leaving limited upside on the stock price. Hence, we maintain 'ACCUMULATE' recommendation on the stock.

Financials Snapshot								(INR mn)
Year to March	Q3FY08	Q3FY07	Growth %	Q2FY08	Growth %	FY07	FY08E	FY09E
Net revenues	1,775	1,312	35.3	1,670	6.3	5,711	6,910	11,141
Construction material cost	67	65	2.4	35	92.0	326	300	1,200
Sub-contract payment	167	76	119.3	134	24.6	402	375	1,500
Employee expenses	781	527	48.1	787	(0.7)	2,478	3,335	4,882
COGS	1,015	669	51.8	956	6.2	3,206	4,010	7,582
Gross profit	760	643	18.1	714	6.4	2,505	2,900	3,559
Other expenses	273	289	(5.4)	245	11.4	1,199	1,238	1,295
Operating expenses	273	289	(5.4)	245	11.4	1,199	1,238	1,295
EBITDA	487	354	37.3	469	3.8	1,306	1,662	2,265
Depreciation	22	20	11.5	37	(39.7)	83	86	89
EBIT	464	334	38.9	432	7.5	1,223	1,577	2,176
Interest	-	-	NA	-	NA	1	-	-
Other income	288	227	26.8	299	(3.7)	823	1,202	1,261
Profit before tax	753	562	34.0	731	2.9	2,045	2,779	3,437
Current taxes	296	223	32.4	298	(0.8)	915	862	904
Deferred taxes	22	(37)	(158.2)	(57)	(137.9)	(276)	-	191
Tax	250	163	53.6	235	6.2	667	892	1,127
Adjusted net profit	503	399	26.0	496	1.3	1,378	1,887	2,310
Extra / Non-recurring items	-	-	NA	-	NA	53	-	-
Net profit	503	399	26.0	496	1.3	1,431	1,887	2,310
No. of shares (mn)	56	56	0.0	56	0.0	56.2	56.2	56.3
EPS (INR/share)	8.9	7.1	26.0	8.8	1.3	25.5	33.6	41.1
P/E (x)						36.0	27.3	22.3
as % of net revenues								
Direct costs	57.2	51.0		57.2		56.1	58.0	68.1
Gross profit	42.8	49.0		42.8		43.9	42.0	31.9
Employee expenses	44.0	40.2		47.1		43.4	48.3	43.8
SG&A	15.4	22.0		14.7		21.0	17.9	11.6
EBITDA	27.4	27.0		28.1		22.9	24.1	20.3
EBIT	26.2	25.5		25.9		21.4	22.8	19.5
Profit before tax	42.4	42.8		43.8		35.8	40.2	30.8
Net profit	28.3	30.4		29.7		25.1	27.3	20.7
Tax rate	42.2	33.1		32.9		31.3	31.0	31.9

Company Description

Incorporated in 1965, EIL was promoted by the GoI and the current government stake stands at 90.4%. EIL provides engineering services to players mainly in industries such as refining, petrochemicals, offshore oil & gas, pipelines, fertilizers, power, ports & terminals, and metallurgy. The company classifies its work into three specific areas: (1) lump sum turnkey contracts (LSTK), which extend to procurement and supply of equipment; (2) engineering, procurement, construction, and management (EPCM), where the equipment selection and commissioning is done by the client; and (3) project management control (PMC), where EIL's role is largely supervisory.

Investment Theme

Huge investment planned in the oil & gas space is expected to see huge capital expenditures in the next five-six years. This will double yearly investments in oil & gas projects. EIL will be a direct beneficiary of the same. It is the largest design engineering company in the country. Its capability in high-end engineering comes from its highly qualified manpower, unparalleled experience, and focus on research and development. Government ownership favors EIL as a preferred service provider for oil & gas companies, most of which are controlled by GoI.

Key Risks

Employee retention could be a key concern during periods of high growth. Higher number of resignations will stretch EIL's man power and could jeopardize EIL's revenue growth.

EIL's inexperience in executing projects for companies in the private sector could be a major challenge as EIL have mostly operated in a cost-plus environment and has not been successful in private projects due to stiff competition.

Financial Statements

Income statement					INR (mn)
Year to March	FY06	FY07	FY08E	FY09E	FY10E
Net revenues	7,905	5,711	6,910	11,141	19,228
Materials and equipments	865	327	300	1,200	4,500
Technical assistance / Sub contracts	2,290	402	375	1,500	5,000
Employee expenses	2,239	2,478	3,335	4,882	5,894
Cost of goods sold	5,395	3,207	4,010	7,582	15,394
Gross profit	2,510	2,503	2,900	3,559	3,834
Operating expenses	1,057	1,199	1,238	1,295	1,364
EBITDA	1,454	1,305	1,662	2,265	2,470
Depreciation & amortisation	95	83	86	89	93
EBIT	1,358	1,222	1,576	2,176	2,377
Other income	667	823	1,202	1,261	1,787
Interest	9	1	-	-	-
Provisions / Prior period expenses	8	(53)	-	-	-
Profit before tax	2,008	2,097	2,779	3,437	4,164
Current tax	813	915	862	904	1,141
Deferred tax	(217)	(276)	-	191	191
FBT	26	28	30	32	34
Tax	622	667	892	1,127	1,367
Profit after tax	1,386	1,430	1,887	2,310	2,798
Equity shares outstanding (mn)	56.2	56.2	56.2	56.2	56.2
EPS (INR)	24.7	25.5	33.6	41.1	49.8
Dividend per share (INR)	8.0	9.5	12.0	15.0	18.0
Dividend payout (%)	32.4	37.3	35.7	36.5	36.1

Common size metrics (% net sales)

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Cost of goods sold	68.2	56.2	58.0	68.1	80.1
Operating expenses	13.4	21.0	17.9	11.6	7.1
EBITDA	18.4	22.8	24.1	20.3	12.8
Depreciation & amortisation	1.2	1.5	1.2	0.8	0.5
Interest	0.1	0.0	-	-	-
Net profit	16.2	21.9	23.3	18.6	13.3

Growth metrics (%)

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Net revenues	(13.4)	(27.8)	21.0	61.2	72.6
EBITDA	19.6	(10.3)	27.4	36.3	9.1
PBT	20.7	4.4	32.5	23.7	21.2
Net profit	23.2	3.1	31.9	22.4	21.1
EPS	23.2	3.1	31.9	22.4	21.1

Balance sheet		(INR mn)				
As on 31st March	FY06	FY07	FY08E	FY09E	FY10E	
Common share capital	562	562	562	562	562	
Total equity capital	562	562	562	562	562	
Reserves & surplus	8,942	9,753	10,852	12,176	13,791	
Shareholder's equity (A)	9,503	10,315	11,413	12,737	14,352	
Capital employed (A+B+C)	9,503	10,315	11,413	12,737	14,352	
Accounts payable	1,671	844	1,006	1,824	3,443	
Other current liabilities	2,101	4,386	4,005	6,083	10,696	
Provisions	2,469	1,434	1,725	2,918	5,510	
Current liabilities & provisions (D)	6,242	6,663	6,737	10,825	19,649	
Total liabilities (A+B+C+D+E)	15,745	16,978	18,150	23,563	34,001	
Gross fixed assets	1,376	1,447	1,505	1,565	1,628	
Accumulated depreciation	989	1,064	1,149	1,239	1,331	
Net fixed assets	388	383	356	327	297	
Capital WIP	13	13	15	15	15	
Total fixed assets (A)	400	397	371	342	312	
Investments (B)	1,383	1,374	1,374	112	112	
Deferred tax asset (C)	549	824	824	633	442	
Inventories (including WIP)	151	161	173	279	481	
Accounts receivable	2,238	1,858	1,893	3,052	5,268	
Cash and cash equivalents	7,498	9,414	10,521	14,944	21,056	
Loans and advances	1,317	1,195	1,200	1,300	1,300	
Other current assets	2,139	1,749	1,794	2,900	5,030	
Current assets (D)	13,343	14,377	15,581	22,475	33,135	
Other assets including misc. expenditure (E)	70	7	0	0	0	
Total assets (A+B+C+D+E)	15,745	16,978	18,150	23,563	34,001	

Cash flow statement		(INR mn)				
Year to March	FY06	FY07	FY08E	FY09E	FY10E	
Op. CF before working capital changes	699	478	777	1,329	1,294	
(Incr)/Decr in working capital	442	1,304	(24)	1,617	4,276	
Cash flow from operations (A)	1,141	1,782	753	2,946	5,570	
Net purchase of fixed assets	(80)	(80)	(59)	(60)	(63)	
Net purchase of investments	656	832	1,202	2,523	1,787	
Cash flow from investing (B)	576	752	1,142	2,463	1,724	
Dividends paid	(512)	(618)	(788)	(985)	(1,183)	
Cash flow from financing (C)	(512)	(618)	(788)	(985)	(1,183)	
Net incr./(decr.) in cash (A+B+C)	1,205	1,916	1,107	4,423	6,112	

Valuation parameters						
Year to March	FY06	FY07	FY08E	FY09E	FY10E	
EPS (INR)	24.7	25.5	33.6	41.1	49.8	
EPS Y-o-Y growth (%)	23.2	3.1	31.9	22.4	21.1	
CEPS (INR)	26.4	26.9	35.1	42.7	51.5	
P/E (x)	37.1	36.0	27.3	22.3	18.4	
Book value per share (INR)	169.2	183.7	203.2	226.8	255.6	
P/BV (x)	5.4	5.0	4.5	4.0	3.6	
EV/Sales (x)	5.4	7.1	5.7	3.3	1.6	
EV/EBITDA (x)	29.3	31.2	23.8	16.1	12.3	

Liquidity ratios

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Current ratio	2.1	2.2	2.3	2.1	1.7
Quick ratio	2.1	2.1	2.3	2.1	1.7
Cash ratio	1.2	1.4	1.6	1.4	1.1
Receivable turnover (x)	2.9	2.8	3.7	4.5	4.6
Inventory turnover (x)	33.4	20.6	24.1	33.6	40.6
Payables turnover (x)	2.8	2.6	4.3	5.4	5.8
Receivables (days)	126.2	130.9	99.1	81.0	79.0
Inventory (days)	10.9	17.7	15.2	10.9	9.0
Payables (days)	128.5	143.1	84.2	68.1	62.4
Cash conversion cycle (days)	8.7	5.5	30.0	23.7	25.5

Operating ratios (x)

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Total asset turnover	0.5	0.3	0.4	0.5	0.7
Fixed asset turnover	19.9	14.8	18.7	32.7	61.7
Equity turnover	0.9	0.6	0.6	0.9	1.4

Profitability ratios (%)

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Gross profit margin	31.8	43.8	42.0	31.9	19.9
EBITDA margin	18.4	22.8	24.1	20.3	12.8
ROCE	15.4	14.4	17.4	19.1	20.7
ROE	15.3	14.4	17.4	19.1	20.7
ROA	8.7	8.7	10.7	11.1	9.7

Financial ratios

Year to March	FY06	FY07	FY08E	FY09E	FY10E
Total debt / Capital employed (%)	65.7	64.6	59.0	85.0	136.9
Interest coverage (x)	230.2	NA	NA	NA	NA

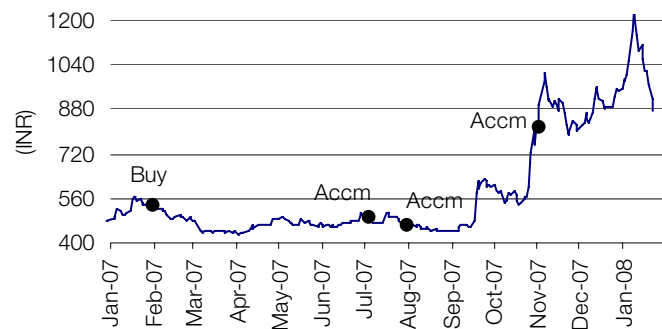
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Coverage group(s) of stocks by primary analyst(s): Oil & Gas, Petrochemicals

Bharat Petroleum Corporation, Cairn India, Chennai Petroleum Corp., Engineers India, Finolex Industries, Hindustan Petroleum Corporation, Indian Oil Corporation, Indraprastha Gas, ONGC, PSL, Reliance Industries

Engineers India



Date	Company	Title	Price (INR)	Recos
23-Jan-08	Finolex Industries	Volumes increase offsets margins decrease; <i>Result Update</i>	79	Reduce
23-Jan-08	Chennai	Lower throughput due to <i>Result Update</i>	290	Buy
17-Jan-08	Reliance Industries	Gas from MA-1 fields a positive; <i>Result Update</i>	2,996	Accum.
9-Jan-08	Oil & Gas	Increasing long-term Crude prices by 17%; <i>Sector Update</i>		

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	108	44	16	3	188

* 12 stocks under review / 5 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	103	66	19

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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