



Gammon India

STOCK INFO.	BLOOMBERG
BSE Sensex: 14,516	GMON IN
	REUTERS CODE
S&P CNX: 4,215	GAMM.BO

5 February 2007

Buy

Previous Recommendation: Buy

Rs412

Equity Shares (m)	86.7
52-Week Range	589/276
1,6,12 Rel. Perf. (%)	-3/-2/-68
M.Cap. (Rs b)	35.7
M.Cap. (US\$ b)	0.8

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/06A	14,851	1,043	9.6	44.1	42.9	3.9	9.0	13.6	3.0	23.4
3/07E	21,493	1,179	13.6	41.4	30.3	3.5	11.5	13.6	1.7	18.2
3/08E	30,665	1,788	20.6	51.7	20.0	3.0	15.2	19.0	1.2	12.5

Period 12/04A is for 9 months; # 15 month period January 2005 - March 2006

- Strong 3QFY07 performance:** Gammon India reported revenues of Rs4.6b (up 37.5% YoY), EBITDA Rs515m (up 6% YoY) and net profit of Rs316m (up 50.9% YoY). Reported numbers were in line with our estimates: Revenue: Rs4.7b; EBITDA: Rs506m and net profit: Rs288m. EBITDA margin during 3QFY07 stood at 11.2% (v/s our expectation of 10.8%). Order book as at December 2006 stood at Rs75b, 3.5x FY07E revenues.
- Trade off between revenues and margins:** EBITDA margins of 11.2% in 3QFY07 were a positive surprise, and can be explained by the moderation in terms of QoQ revenue growth, as several projects crossed the margin recognition threshold. Revenue growth in 3QFY07 is at 37.5%, v/s 2QFY07 at 67.1% YoY and 1QFY07 at 93.5% YoY. During 1Q and 2Q, Gammon was unable to book margins on revenues of Rs750m-Rs800m, which impacted reported EBITDA.
- Key takeaways from our conference call:** (1) Guidance for revenue growth of 35% YoY to FY09 (50% CAGR expected as stretched target) and EBITDA margins of 9% for FY07 (9MFY07 – 8.3%); (2) GIPL submitted financial bids for four projects (Rs13.5b) and pre-qualified for financial bid submission for eight projects (Rs138b); current portfolio is at 11 projects of Rs48b; (3) Gammon has made initial forays into real estate.
- Recommend Buy:** We expect Gammon to report net profit of Rs1.2b (up 42%) in FY07, Rs1.8b in FY08 (up 52%) and Rs2.3b (up 31% YoY) in FY09. At the CMP of Rs412, the stock trades at reported PER of 30.3x FY07, 20x FY08E and 15.3x FY09E. We value Gammon's 82.5% stake in Gammon Infrastructure at Rs11.9b (Rs137/share), 50.9% stake in Gammon and Billimoria at Rs3.4b (Rs39/share) and 28.9% stake in Associated Transrail at Rs1.7b (Rs19/share) and stake in Sadbhav Engineering at Rs4/sh. Adjusting for the value of BOT and investments, the stock is trading at PER of 15.7x FY07, 10.3x FY08E and 7.9x FY09E. We maintain **Buy**.

QUARTERLY PERFORMANCE

	FY06 (JAN.05 - MARCH.06)					FY07				JAN-05- MAR-06	FY07E
	1Q	2Q	3Q	4Q	5Q	1Q	2Q	3Q	4QE		
	(Rs Million)										
Sales	2,806	2,862	2,891	3,350	4,767	5,539	4,830	4,607	6,518	16,677	21,493
Change (%)		-0.9	10.1	2.7	69.9	93.5	67.1	37.5	36.7		28.9
EBITDA	306	340	447	486	353	317	418	515	710	1,932	1,959
Change (%)		7.6	24.9	70.5	15.5	-6.9	-6.6	6.0	101.0		1.4
As of % Sales	10.9	11.9	15.5	14.5	7.4	5.7	8.6	11.2	10.9	11.6	9.1
Depreciation	61	66	63	84	97	83	103	102	100	371	389
Interest	98	102	102	114	55	52	18	53	51	471	174
Other Income	0	0	1	1	18	3	1	7	3	22	13
Extra-ordinary income	0	0	0	0	0	27	0	0	0	0	27
PBT	147	173	283	290	219	211	297	366	561	1,112	1,436
Tax	4	19	36	80	-69	25	36	50	119	69	230
Effective Tax Rate (%)	2.5	10.8	12.5	27.7	-31.5	11.9	12.0	13.7	21.2	6.2	16.0
Reported PAT	143	154	248	209	288	186	262	316	442	1,043	1,206
Adj PAT	143	154	248	209	288	159	262	316	442	1,029	1,179
Change (%)		41.7	234.9	5.3	101.3	3.5	5.7	50.9	61.4		14.6

E: MOST Estimates; * FY06 = 15 months from Jan 2005 - Dec 2004

Strong 3QFY07 performance

During 3QFY07, Gammon India reported revenues of Rs4.6b (up 37.5% YoY), EBITDA Rs515m (up 6% YoY) and net profit of Rs316m (up 50.9% YoY). Reported numbers were in line with our estimates: Revenue: Rs4.7b; EBITDA: Rs506m and net profit: Rs288m. 3QFY07 EBITDA margin stood at 11.2% (v/s our expectation of 10.8%).

Revenues during 9MFY07 are at Rs15b (up 65% YoY), whilst management has guided for FY07 revenues of Rs20b-Rs21b. This implies revenue growth of ~37% in 4QFY07, which seems reasonable. Further, management has always maintained that the optimistic revenue target for FY07 is Rs25b.

QUARTERLY REVENUE (RS M) AND YOY GROWTH (%)

	JUN-05	SEP-05	DEC-05	MAR-06	JUN-06	SEP-06	DEC-06
Revenue	2,862	2,891	3,350	4,069	4,185	3,793	4,607
YoY Gr.	-0.9	10.1	2.7	45.0	93.5	67.1	37.5

Source: Company

Trade off between revenues and margins

EBITDA margins of 11.2% during 3QFY07 were a positive surprise, and can be explained by the moderation in terms of QoQ revenue growth, as several projects crossed the margin recognition threshold. Revenue growth during 3QFY07 stands at 37.5%, compared with 2QFY07 at 67.1% YoY and 1QFY07 at 93.5% YoY. Thus, during 1Q and 2Q, the company was not being able to book margins on revenues of Rs750m-Rs800m, which impacted reported EBITDA. This is because, as per the accounting methodology adopted, Gammon accounts for margins on projects with size exceeding Rs2.5b, post 15% completion and for other projects, post 25% completion. As these projects enter the margin recognition threshold, we expect EBITDA margins to improve going forward.

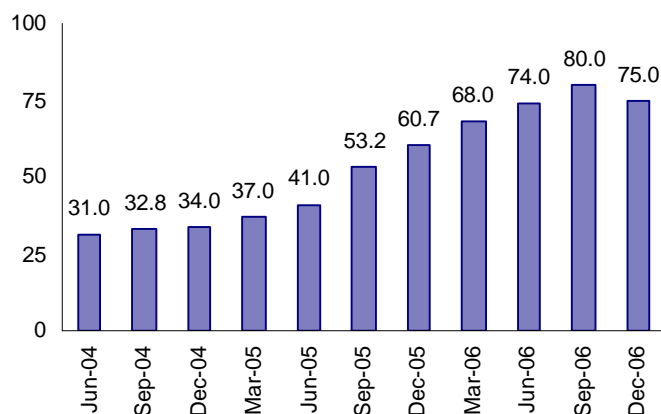
Order book stands at Rs75b

Gammon's order book as at December 2006 stood at ~Rs75b, v/s Rs80b in September 2006 and Rs74b in June 2006. During 9MFY07, order intake for the company was ~Rs20b. BOT projects comprise 17% of the current order

backlog of the company. In terms of the order book composition, transport projects and the power sector account for ~35% each of the order book, while other segments such as Irrigation, Pipelines, Transmission, Railways etc. account for the rest, none of which account for more than 10%. We expect the order book to grow rapidly over the next 12 months on the back of strong project pipeline comprising roads, hydropower etc.

The company is also L1 in projects worth Rs6b, thus taking the effective order book at Rs81b. The current order book also does not include the potential value of the Mumbai Container Port (construction contract ~Rs3.5-4b), which would also accrue to Gammon India.

TREND IN QUARTERLY ORDER BACKLOG (RS B)



Source: Company

Key takeaways from the conference call

Guidance maintained

Management has provided guidance for:

- ✍ Revenue growth of 35% YoY to FY09 (50% YoY growth as a stretched target)
- ✍ EBITDA margin of 9% for FY07 (9MFY07 - 8.3%)
- ✍ Capex of Rs1.5b for FY07 and Rs1b+ for FY08

Fund raising options for GIPL

The recent SEBI order has barred Gammon India from accessing the capital market for a period of one year and divesting and/or selling its stake in Gammon Infrastructure projects limited for a three-year period, post IPO. This is pertaining to irregularities in the rights issue of Gammon

India during 2001. As we understand, Gammon Infra can still tap the equity markets through a public offering. The company has appealed against the SEBI order to the Securities Appellate Tribunal.

SEBI's order states: (1) Gammon India shall not access capital market directly or indirectly for a period of one year from the date of this order; and (2) Gammon India and promoters shall not divest, transfer, sell or alienate in any way their shareholding in Gammon Infrastructure Projects Ltd. for a period of 3 years from the date of the allotment in the public issue of GIPL.

The management indicated Gammon Infrastructure is working on a capital raising plan, and the IPO should occur over the next 3-4 months. Apart from the IPO, other fund raising options available to Gammon Infra include private equity, securitization of operational projects etc.

Status of BOT portfolio (GIPL)

The Gammon India led consortium has emerged as an L1 bidder for the Rs12b offshore container terminal at the Mumbai Port Trust. Gammon India has quoted a revenue sharing ratio of 35.1%, while the L&T consortium was at 31.1%. Gammon Infra will have 50% stake in the project, with Dragados SPL, Spain controlling the remaining 50%. A letter of intent (LoI) is expected over the next 2-3 months. The project also entails land area of 35 hectares, which would be utilized for construction of a container stock yard.

Gammon Infra has also submitted financial bids for another four projects totaling Rs13.5b, and is pre-qualified for submitting financial bids for eight projects totaling Rs138b. We also believe that the Gammon consortium (comprising Gammon Infra, Larsen and Toubro, Siemens AG and Bharat

Earth Movers) stands a fair chance of bagging some of the large urban infrastructure projects, particularly in the Mass Rapid Transit systems.

Increased contribution from subsidiaries

During FY06, Gammon's subsidiaries and associate companies have contributed to consolidated profits in a meaningful manner. Consolidated profits during FY06 stood at Rs1,446m, v/s standalone profits of Rs1,043m, resulting in a net contribution of Rs403m. During CY04, the subsidiaries and associate companies reported net losses of Rs115m.

GAMMON INDIA:STANDALONE AND CONSOLIDATED PERFORMANCE (RSM)

	CY04 (APR – DEC 04)	FY06 (JAN – MAR 06)
Net Profit		
Standalone	381	1,043
Consolidated	266	1,446
Subsidiaries	-115	403
EPS (Rs per share)		
Standalone	6.7	12.0
Consolidated	4.7	16.7

Source: Company

The improved performance is being driven by:

- ✍ **Gammon Infrastructure (Gammon's stake: 82.5%):** During FY06, Gammon Infrastructure reported consolidated net profit of Rs216m. This is largely due to improved profitability of Rajahmundry Expressway (Rs179m), Andhra Expressway (Rs153m) and Vizag Seaports (loss Rs128m – commenced operations in FY06). During FY07, management has guided for revenues of Rs1.25b and net profit of Rs300m.
- ✍ **Associated Transrail Structures Limited (Gammon's stake: 28.9%):** During FY06, Associated

GAMMON INFRA'S BOT PORTFOLIO

	PROJECTS (NOS)	VALUE (RS M)	REMARKS
Already Operational	4	8,551	Rajahmundry Expressway, Andhra Expressway, Vizag Port and Cochin Bridge
Under Implementation	5	26,830	Mumbai Nashik Expressway, Sikkim Hydro, Punjab Biomass, Kosi River Bridge, Gorakhpur Bypass
Recently Awarded	2	13,000	Adityapur SEZ, Mumbai Offshore Container Terminal
Financial Bids Submitted	4	13,500	

Source: Company

Transrail reported net profit of Rs231m, resulting in addition of Rs67m to Gammon's consolidated profitability. This company is engaged into setting up of power transmission networks. The management stated that FY06 revenues stood at Rs2.5b. During FY07, management has guided for revenues of Rs4.5b, and net profit of Rs400m. The current order backlog stands at Rs8.5b, and based on this, management expects strong revenue growth during FY08 as well.

✎ **Gammon & Billimoria Limited (Gammon's stake: 50.9%):** Gammon and Billimoria has a 49% stake in Gammon and Billimoria Llc, incorporated in Dubai. This company is engaged in urban infrastructure projects in Middle East (commercial property, hotels, residential, car parks etc). Management stated that Gammon's share of profits from this subsidiary stood at Rs100m in FY06. Given that the current order book of the company stands at Rs5b+, we expect 25-30% YoY growth rate during FY07.

Valuation and view

Gammon India has strong order backlog of Rs75b as of December 2006, translating into 3.5x FY07E revenue of

Rs21.5b. We expect Gammon India to report revenues of Rs21.5b in FY07, Rs30.6b in FY08; Rs41.3b in FY09; and net profit of Rs1.2b (up 42%) in FY07, Rs1.8b in FY08 (up 52%) and Rs2.3b (up 31% YoY) in FY09.

As per the accounting policy adopted, Gammon accounts for margins on projects (size Rs2.5b+) post 15% threshold completion stage; and thus during April-December 2006, the company could not book margins on revenues of Rs1.0b. Thus, a strong surge in revenues during FY07 (up 55% YoY) has led to constraint in terms of margin recognition, on a part of the incremental revenues.

Attractive valuations

At the CMP of Rs412, the stock trades at reported PER of 30.3x FY07, 20x FY08E and 15.3x FY09E. We value Gammon's 82.5% stake in Gammon Infrastructure at Rs11.9b (Rs137/share), 50.9% stake in Gammon and Billimoria at Rs3.4b (Rs39/share) and 28.9% stake in Associated Transrail at Rs1.7b (Rs19/share) and stake in Sadbhav Engineering at Rs4/sh. Adjusting for the value of BOT and investments, the stock is trading at PER of 15.7x FY07, 10.3x FY08E and 7.9x FY09E. We maintain **Buy**.

SOTP VALUATION

	BUSINESS SEGMENT	METHOD	VALUATION (X)	VALUE (RS M)	VALUE (RS/SH)	RATIONALE
Gammon Standalone	Construction	FY09E PER (x)	12	28,026	323	At par to industry average
Gammon Infrastructure	BOT	SOTP		11,847	137	Refer Working Below; 20% holding company discount
Sadbhav Engineering	Construction	Market Price (Rs/sh)	353	388	4	Discount of 25% to CMP
Associated Transrail Structures	Power Transmission Towers	FY09E PER (x)	12	1,672	19	
Gammon and Billimoria Ltd	Construction in Middle East	FY09E PER (x)	12	3,375	39	
Total				45,308	522	

Ignoring the value of Real Estate; transmission company and Punjab HEP 100MW

Gammon India: an investment profile

Company description

Established in 1919, Gammon India is one of the oldest and largest construction companies in India and is amongst the Top 5 contractors to NHAI. The company possesses pre-qualification skills across most sectors. It is one of the leaders in the BOT space with a history of successful execution. The company is headed by Mr. Abhijit Rajan, who has been the managing director since 1991.

Key investment arguments

- ✍ Possesses pre-qualifications and proven execution capabilities across sectors; will gain from large ticket sized orders in hydro and nuclear sectors
- ✍ Order book at end-December, 2006 was Rs75b. In addition, order intake for Gammon during 9MFY07 remained buoyant at ~Rs20b.
- ✍ Early mover advantage and consistent performance track-record in BOT space

Key investment risks

- ✍ Increased competition may put pressure on operating margins
- ✍ BOT projects depress initial RoE
- ✍ Liabilities associated with delays/ other failures in international projects

Recent developments

- ✍ GIPL-led consortium has been awarded to Mumbai port container terminal
- ✍ To fund growth through investments in BOOT/BOT projects, Gammon Infrastructure Projects (82.5% subsidiary of Gammon India) has announced fund raising plans through IPO.

Valuation and view

- ✍ Based on SOTP methodology, we arrive at a PT of Rs522/share
- ✍ At the CMP of Rs412, the stock trades at reported PER of 30.3x FY07, 20x FY08E and 15.3x FY09E. Maintain **Buy**.

Sector view

- ✍ Increased government commitment towards infrastructure projects has led to several large projects taking off the ground
- ✍ We notice a trend of margin expansion, driven by changing composition of order book and higher margins at the bidding stage
- ✍ BOT ventures could unlock sizable value

COMPARATIVE VALUATIONS

		GAMMON	HCC	NCC
P/E (x)	FY07E	30.3	37.6	24.0
	FY08E	20.0	22.3	15.8
Adj. P/E (x)	FY07E	15.8	13.6	19.0
	FY08E	10.4	8.1	12.5
P/BV (x)	FY07E	3.5	3.8	2.0
	FY08E	3.0	2.5	1.7
RoE (%)	FY07E	11.5	10.5	17.8
	FY08E	15.2	13.9	23.1

SHAREHOLDING PATTERN (%)

	DEC.06	SEP.06	DEC.05
Promoter	31.1	31.1	36.8
Domestic Inst	15.7	15.9	9.0
Foreign	38.3	37.3	31.8
Others	14.9	15.7	22.4

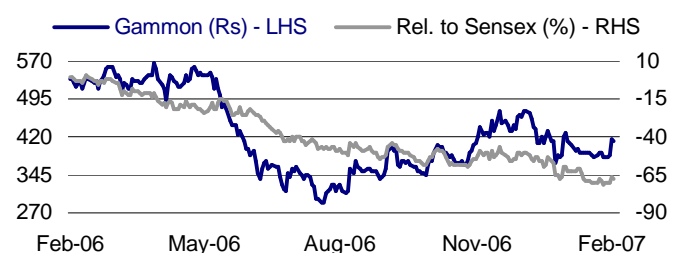
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	13.6	13.2	3.3
FY08	20.6	18.7	10.3

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
412	522	26.7	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT						RATIOS					
(Rs Million)											
Y/E MARCH	2004*	2006E#	2007E	2008E	2009E	Y/E MARCH	2004*	2006E#	2007E	2008E	2009E
Gross Revenues	8,666	16,592	21,437	30,600	41,250	Basic (Rs)					
Net Sales	8,775	14,851	21,493	30,665	41,315	Adjusted EPS	6.7	9.6	13.6	20.6	26.9
Change (%)	4.1	15	80.9	42.7	34.7	Growth (%)	24.7	44.1	414	517	30.6
Construction Expenses	7,593	12,521	19,012	27,013	36,365	Cash EPS	20.6	24.0	32.0	48.9	65.5
Office and Site Est. Exps	223	397	522	744	1,089	Book Value	51.8	106.7	118.4	135.5	157.9
EBITDA	959	1,932	1,959	2,907	3,860	DPS	0.5	0.6	2.0	3.0	4.0
% of Net Sales	10.9	11.5	9.1	9.5	9.3	Payout (incl. Div. Tax.)	11.5	5.7	14.4	14.6	14.9
Depreciation	165	371	389	451	514	Valuation (x)					
Interest	282	471	174	316	514	P/E (standalone)		42.9	30.3	20.0	15.3
Other Income	3	21	40	14	15	Cash P/E		17.2	12.9	8.4	6.3
PBT	516	1,112	1,436	2,155	2,848	EV/EBITDA		23.4	18.2	12.5	9.5
Tax	134	69	230	366	513	EV/Sales		3.0	1.7	1.2	0.9
Rate (%)	26.1	6.2	16.0	17.0	18.0	Price/Book Value		3.9	3.5	3.0	2.6
Reported PAT	381	1,043	1,206	1,788	2,335	Dividend Yield (%)		0.1	0.5	0.7	1.0
Extra-ordinary Income (net of ex)	0	0	27	0	0	Profitability Ratios (%)					
Adjusted PAT	381	1,043	1,179	1,788	2,335	RoE	12.9	9.0	11.5	15.2	17.0
Change (%)	173.9	64.0	414	51.7	30.6	RoCE	17.6	13.6	13.6	19.0	22.8
BALANCE SHEET	(Rs Million)					Turnover Ratios					
Y/E MARCH	2004*	2006E#	2007E	2008E	2009E	Debtors (Days)	73	65	65	65	65
Share Capital	152	173	173	173	173	Creditors. (Days)	108	70	70	70	70
Reserves	3,791	9,085	10,093	11,585	13,524	Leverage Ratio					
Net Worth	3,943	9,258	10,266	11,758	13,698	Debt/Equity (x)	0.8	0.2	0.2	0.1	0.1
Loans	3,031	1,705	1,842	1,442	1,942	CASH FLOW STATEMENT	(Rs Million)				
Deferred Tax Liability	366	345	345	345	345	Y/E MARCH	2004*	2006E#	2007E	2008E	2009E
Capital Employed	7,340	11,309	12,453	13,545	15,985	PBT before Extraordinary Items	516	1,112	1,436	2,155	2,848
Gross Fixed Assets	4,505	5,420	6,223	7,223	8,223	Add : Depreciation	165	371	389	451	514
Less: Depreciation	1,408	1,723	2,112	2,563	3,077	Interest	282	471	174	316	514
Net Fixed Assets	3,097	3,697	4,111	4,660	5,146	Less : Direct Taxes Paid	134	69	230	366	513
Capital WIP	128	73	70	70	70	(Inc)/Dec in WC	-1,804	-2,543	-214	-1,504	-1,667
Investments	896	1,162	1,158	1,158	1,158	CF from Operations	-977	-659	1,555	1,051	1,696
Curr. Assets	8,258	11,469	15,164	19,097	24,989	(Inc)/Dec in FA	-436	-97	-800	-1,000	-1,000
Inventory	3,494	4,706	6,460	9,222	12,432	(Pur)/Sale of Investments	-91	-266	4	0	0
Debtors	2,335	2,380	3,818	5,449	7,346	CF from Investments	-527	-1,182	-796	-1,000	-1,000
Cash & Bank Balance	728	1,343	1,866	904	1,191	(Inc)/Dec in Networth	1,429	4,312	27	0	0
Loans & Advances	1,674	3,020	3,000	3,500	4,000	(Inc)/Dec in Debt	849	-1,326	136	-400	500
Other Current Assets	26	21	21	21	21	Less : Interest Paid	282	471	174	316	514
Current Liab. & Prov.	5,039	5,092	8,051	11,440	15,379	Dividend Paid	44	60	198	297	396
Creditors	3,030	2,530	4,111	5,868	7,911	CF from Fin. Activity	1,953	2,455	-209	-1,012	-409
Other Liabilities	1,918	2,440	3,818	5,449	7,346	Inc/Dec of Cash	448	615	523	-961	287
Provisions	92	122	122	122	122	Add: Beginning Balance	280	728	1,343	1,866	904
Net Current Assets	3,219	6,377	7,114	7,657	9,611	Closing Balance	728	1,343	1,866	904	1,191
Application of Funds	7,340	11,309	12,453	13,545	15,985						

E: MOSt Estimates; * Nine months ended Dec 2004,

#Fifteen months ended Mar 2006

N O T E S



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1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No
4. Investment Banking relationship with company covered	No

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