

Patel Engineering Ltd.

Rs 103

Gearing Concerns are rising....

HOLD

KRChoksey
 wealth enhancement solutions


Target Price (Rs): 113

Potential Upside : 10%

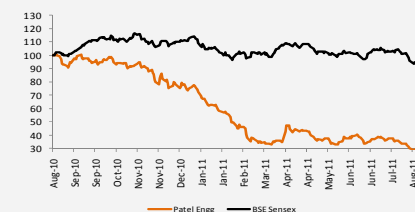
Previous TP (Rs): 186

| Market Data | 17 th Aug , 2011 |
|---------------------|-----------------------------|
| Shares outs (Cr) | 6.98 |
| Equity Cap (Rs. Cr) | 6.98 |
| Mkt Cap (Rs. Cr) | 719 |
| 52 Wk H/L (Rs) | 426/99.9 |
| Avg Vol (1yr avg) | 1,05,751 |
| Face Value (Rs) | 1.0 |
| Bloomberg Code | PEC. IN |

Market Info:

| | |
|--------|--------|
| SENSEX | 16,854 |
| NIFTY | 5,056 |

Price Performance



Share Holding pattern (%)

| Particulars | Jun-11 | Mar-11 | Chg |
|---------------|--------|--------|--------|
| Promoters | 45.62 | 45.62 | - |
| Institutions | 7.74 | 8.94 | (1.20) |
| FII | 8.31 | 8.69 | (0.38) |
| Public/Others | 38.33 | 36.75 | 1.58 |
| Total | 100.0 | 100.0 | |

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Patel Engineering Ltd (PEL) reported Q1FY12 standalone revenue of Rs 541 crore (up, 11.2% YoY) that is in-line with our expectation. Standalone EBITDA decreased by 6% to Rs 73.8 crore on YoY basis, primarily down due to increase in construction & other costs by 16%. EBITDA margins fell by 253 bps to 13.6% on YoY basis for Q1FY12. PAT stood at Rs 10.2 crore, a fall of 60% on a y-o-y basis and 72% sequentially. PEL reported lower PAT mainly on back of higher interest cost of Rs 48 cr, an increase of 64% on a y-o-y basis. Debt on the company's standalone balance sheet stood at Rs 2100 crore.

Order inflow muted to Rs 500 crore and not from PEL core area:

In Q1FY12, PEL won two order's worth Rs 500 crore, both were EPC road contracts that were awarded to PEL, one of them was a road contract in Pune worth Rs 350 crore and another a contract in Bihar worth Rs 150 crore. None of the new orders were from PEL core competency area of hydro. Current executable order book for PEL is Rs 6500 crore, as company's Kotli Bhel project (Rs 1500 cr) & Andhra Pradesh irrigation project (Rs 1500 cr) are not moving since many quarters. We expect the order book to gain momentum in FY12 as 2 internal power projects (Rs 2500 cr) of the company are expected to be awarded in the H2FY112.

Higher interest cost eats into the Profits of PEL:

PEL has a debt of ~Rs 2100 crore on its standalone balance sheet, debt increased by ~Rs 150 crore on a sequentially basis mainly to fund the gap in the working capital. The average interest cost for the company stood at 11.5% and is a risk to the company's profitability as RBI has signaled that the rate hike cycle is not yet over.

Valuation and outlook:

We have used SOTP method for PEL and revised target price is Rs 113 as against earlier target price of Rs 186. The interest cost for PEL increased dramatically in Q1FY12 that has eaten substantial profitability. After adjusting the increased interest cost on standalone financials we are getting EPS of Rs 10.8 & Rs 11.6 for FY12E & FY13E respectively. We have valued the standalone construction business at Rs 54 (5x to Rs 10.8 FY12E EPS), International subsidiaries value has been downgraded on account of muted growth to Rs 3 (2x to FY10 EPS), two BOT Road Projects are valued at Rs 10.4 (DCF), Real Estate is valued at Rs 45 for Bangalore, Noida and Jogeshwari projects on NAV basis. We recommend a "Hold" on PEL.

Key Financials

(Rs Crore)

| Particulars | FY09 | FY10 | FY11 | FY12E | FY13E |
|---------------|-------|-------|-------|-------|-------|
| Net sales | 1,784 | 2,425 | 2,554 | 2,746 | 2,966 |
| EBDITA | 264 | 380 | 351 | 338 | 365 |
| Net Profit | 174 | 131 | 100 | 75 | 81 |
| OPM | 14.8% | 15.7% | 13.7% | 12.3% | 12.3% |
| NPM | 9.8 | 5.4 | 3.9 | 2.7 | 2.7 |
| EPS (Rs) | 29.2 | 18.6 | 14.3 | 10.8 | 11.6 |
| P/E (X) | 3.5 | 5.5 | 7.2 | 9.5 | 8.9 |
| EV/EBIDTA (X) | 7.8 | 6.9 | 7.6 | 8.5 | 8.1 |

Source: Company, KRChoksey Research

Q1FY12 Result

(Rs. Crore)

| Particulars | Q1FY12 | Q4 FY11 | Q1 FY11 | Q-o-Q | Y-o-Y |
|-----------------------------------|--------------|--------------|--------------|----------|----------|
| Net Sales | 541.1 | 1,155.7 | 486.6 | -53.2% | 11.2% |
| Selling & Administrative Expenses | 37.9 | 57.6 | 37.7 | -34.3% | 0.4% |
| <i>% of sales</i> | <i>7.0%</i> | <i>5.0%</i> | <i>7.8%</i> | 202 bps | -75 bps |
| Construction & other costs | 429.4 | 1,008.0 | 370.2 | -57.4% | 16.0% |
| <i>% of sales</i> | <i>79.4%</i> | <i>87.2%</i> | <i>76.1%</i> | -786 bps | 328 bps |
| TOTAL EXPENDITURE | 467.3 | 1,065.7 | 407.9 | -56.2% | 14.5% |
| <i>% of sales</i> | <i>86.4%</i> | <i>92.2%</i> | <i>83.8%</i> | -585 bps | 253 bps |
| EBITDA | 73.8 | 90.1 | 78.7 | -18.0% | -6.2% |
| <i>EBITDAM</i> | <i>13.6%</i> | <i>7.8%</i> | <i>16.2%</i> | 585 bps | -253 bps |
| Interest | 48.0 | 39.0 | 29.3 | 23.2% | 64.2% |
| PBDT | 25.8 | 51.1 | 49.4 | -49.5% | -47.8% |
| Depreciation | 13.1 | 13.1 | 12.9 | -0.2% | 1.3% |
| Other Income | 1.6 | 2.0 | 1.9 | -22.3% | -16.9% |
| PBT | 14.3 | 40.0 | 38.4 | -64.3% | -62.8% |
| Tax | 4.1 | 2.9 | 12.8 | 42.5% | -68.2% |
| <i>Tax Rate</i> | <i>28.4%</i> | <i>7.1%</i> | <i>33.2%</i> | 2129 bps | -482 bps |
| Adjusted Profit After Eol | 10.2 | 37.2 | 25.7 | -72.5% | -60.1% |
| OPM(%) | 13.6% | 7.8% | 16.2% | 585 bps | -253 bps |
| NPM(%) | 1.9% | 3.2% | 5.3% | -132 bps | -338 bps |
| EPS | 1.47 | 5.32 | 3.68 | -72.5% | -60.1% |

Source: Company, KRChoksey Research

Patel Engineering- SOTP Valuation

We have used SOTP method for PEL and revised target price is Rs 113 as against earlier target price of Rs 186. We have valued the standalone construction business at Rs 54 (5x to Rs 10.8 FY12E EPS), International subsidiaries value has been downgraded on account of muted growth to Rs 3 (2x to FY10 EPS), two BOT Road Projects are valued at Rs 10.4 (DCF), Real Estate is valued at Rs 45 for Bangalore, Noida and Jogeshwari projects on NAV basis. We recommend a "Hold" on PEL.

| Component | Valuation Method | Rs / sh |
|--------------------------|------------------|---------|
| Standalone Cons business | 5x FY12E EPS | 54.0 |
| Michigan Eng. | 2x FY10 EPS | 2.0 |
| US Subsidiary | 2x FY10 EPS | 1.2 |
| Reality Projects | | 45.0 |
| Road BOT projects | DCF (CoE, 15%) | 10.5 |
| Total | | 112.7 |
| CMP | | 103.0 |
| Potential upside | | 9.4% |

Change in Estimates:

| Rs Crore | FY12E | | Change (%) | FY13E | | Change (%) |
|---------------|-------|-------|------------|-------|-------|------------|
| | Old | New | | Old | New | |
| Net Sales | 2,772 | 2,746 | -1% | 3,063 | 2,966 | -3% |
| EBITDA | 363 | 338 | -7% | 398 | 365 | -8% |
| Interest Cost | 193 | 225 | 16% | 202 | 241 | 19% |
| PAT | 114 | 75 | -34% | 129 | 81 | -37% |

We have assumed lower operating profit margin on account of lower execution of hydro projects compared to our previous estimates and net profit will be hit by higher interest cost.

Patel Engineering- Standalone P&L

(Rs Crore)

| Particulars | FY09 | FY10 | FY11 | FY12E | FY13E |
|---------------------|-------|-------|-------|-------|-------|
| Net sales | 1,784 | 2,425 | 2,554 | 2,746 | 2,966 |
| Growth | 34% | 36% | 5.3% | 7.5% | 8.0% |
| Cost of sales | 1,520 | 2,045 | 2,204 | 2,408 | 2,601 |
| EBDITA | 264 | 380 | 351 | 338 | 365 |
| EBDITAM | 14.8% | 15.7% | 13.7% | 12.3% | 12.3% |
| Depreciation | 44 | 50 | 53 | 51 | 55 |
| Gross Profit | 220 | 330 | 298 | 286 | 310 |
| GPM | 12.3% | 13.6% | 11.7% | 10.4% | 10.5% |
| Interest | 173 | 177 | 173 | 225 | 241 |
| Other Income | 151 | 49 | 7 | 51 | 52 |
| PBT | 198 | 202 | 132 | 112 | 121 |
| Tax | 23 | 71 | 32 | 37 | 40 |
| Net Profit | 174 | 131 | 100 | 75 | 81 |
| Extraordinary Items | 0 | 1 | 0 | 0 | 0 |
| Reported Net Profit | 174 | 130 | 100 | 75 | 81 |
| Growth | 18% | -25% | -23% | -25% | 8% |
| No of shares (mn) | 6.0 | 7.0 | 7.0 | 7.0 | 7.0 |
| EPS (Rs) | 29.2 | 18.6 | 14.3 | 10.8 | 11.6 |
| Growth | 18% | -36% | -23% | -25% | 8% |
| CEPS (Rs) | 36.5 | 25.8 | 21.9 | 18.2 | 19.5 |

Source: Company, KRChoksey Research

Patel Engineering- Standalone Balance Sheet

(Rs Crore)

| Particulars | FY09 | FY10 | FY11 | FY12E | FY13E |
|---------------------------------|--------------|--------------|--------------|--------------|--------------|
| Share Capital | 6 | 7 | 7 | 7 | 7 |
| Reserves Total | 973 | 1,279 | 1,378 | 1,353 | 1,358 |
| Total Shareholders Funds | 979 | 1,286 | 1,385 | 1,360 | 1,365 |
| Total Debt | 1,453 | 1,900 | 1,940 | 2,140 | 2,240 |
| Deferred tax | 10 | 7 | 0 | 0 | 0 |
| Total Liabilities | 2,442 | 3,193 | 3,325 | 3,500 | 3,605 |
| Gross Block | 486 | 531 | 551 | 571 | 591 |
| Less : Accumulated Depreciation | 169 | 217 | 270 | 322 | 376 |
| Net Block | 317 | 314 | 281 | 250 | 215 |
| CWIG | 23 | 17 | 0 | 0 | 0 |
| Investments | 290 | 453 | 476 | 476 | 476 |
| Inventories | 1,074 | 1,506 | 1,680 | 1,806 | 1,950 |
| Sundry Debtors | 462 | 603 | 651 | 685 | 748 |
| Cash and Bank | 155 | 85 | 86 | 61 | 124 |
| Loans and Advances | 716 | 951 | 1,022 | 1,181 | 1,127 |
| Total Current Assets | 2,407 | 3,145 | 3,438 | 3,732 | 3,949 |
| Current Liabilities | 587 | 689 | 819 | 903 | 975 |
| Provisions | 8 | 49 | 51 | 55 | 59 |
| Total Current Liabilities | 595 | 737 | 870 | 958 | 1,034 |
| Net Current Assets | 1,812 | 2,408 | 2,568 | 2,774 | 2,914 |
| Total Assets | 2,442 | 3,193 | 3,325 | 3,500 | 3,605 |

Source: Company, KRChoksey Research

Patel Engineering- Cash Flow Statement

(Rs Crore)

| Particulars | FY09 | FY10 | FY11 | FY12E | FY13E |
|---------------------------|-------|-------|-------|-------|-------|
| PBT | 198 | 202 | 132 | 112 | 121 |
| Add: depreciation | 44 | 50 | 53 | 51 | 55 |
| Add: Interest | 173 | 177 | 173 | 225 | 241 |
| Cash flow from operations | 415 | 429 | 358 | 389 | 417 |
| Change in working capital | 552 | 666 | 159 | 231 | 77 |
| Taxes | 23 | 71 | 32 | 37 | 40 |
| Miscellaneous expenses | 0 | 1 | 0 | 0 | 0 |
| Net cash from operations | (160) | (309) | 167 | 121 | 300 |
| Capital expenditure | (85) | (42) | (3) | (20) | (20) |
| Change in Investments | (145) | (164) | (23) | 0 | 0 |
| Net cash from investing | (230) | (205) | (25) | (20) | (20) |
| Increase/Decrease in debt | 568 | 447 | 40 | 200 | 100 |
| Dividends | (1) | (2) | (1) | (2) | (2) |
| Proceedings from equity | 2 | 337 | 0 | 0 | 0 |
| Interest | (173) | (177) | (173) | (225) | (241) |
| Others | (41) | (162) | (7) | (99) | (74) |
| Net cash from financing | 355 | 444 | (141) | (126) | (216) |
| Net Inc./ (Dec.) in Cash | (36) | (71) | 1 | (25) | 64 |
| Opening cash balance | 191 | 155 | 85 | 86 | 61 |
| Closing cash balance | 155 | 85 | 86 | 61 | 124 |

Source: Company, KRChoksey Research

Patel Engineering- Key Ratios

| Particulars | FY09 | FY10 | FY11 | FY12E | FY13E |
|-----------------------------|------|------|------|-------|-------|
| Valuation Ratios | | | | | |
| Market price (Rs) | 103 | 103 | 103 | 103 | 103 |
| EPS (Rs) | 29.2 | 18.6 | 14.3 | 10.8 | 11.6 |
| P/E (X) | 3.5 | 5.5 | 7.2 | 9.5 | 8.9 |
| P/CEPS (X) | 2.8 | 4.0 | 4.7 | 5.7 | 5.3 |
| P/BV (X) | 0.6 | 0.6 | 0.52 | 0.53 | 0.5 |
| M cap/Sales (X) | 0.3 | 0.3 | 0.3 | 0.3 | 0.2 |
| EV/EBIDTA (X) | 7.8 | 6.9 | 7.6 | 8.5 | 8.1 |
| EV/Sales (X) | 1.2 | 1.1 | 1.0 | 1.0 | 1.0 |
| Profitability Ratios | | | | | |
| EBIDTA margin (%) | 14.8 | 15.7 | 13.7 | 12.3 | 12.3 |
| PAT margin (%) | 9.8 | 5.4 | 3.9 | 2.7 | 2.7 |
| ROE (%) | 17.8 | 10.1 | 7.2 | 5.5 | 5.9 |
| ROCE (%) | 9.0 | 10.3 | 9.0 | 8.2 | 8.6 |
| Efficiency Ratios | | | | | |
| Asset turnover | 0.7 | 0.8 | 0.8 | 0.8 | 0.8 |
| Av collections days | 94 | 91 | 93 | 91 | 92 |
| Av payment days | 120 | 104 | 117 | 120 | 120 |
| Inventory turnover days | 220 | 227 | 240 | 240 | 240 |
| WC (Days) | 371 | 362 | 367 | 369 | 359 |
| Liquidity ratios | | | | | |
| Current ratio | 4.0 | 4.3 | 4.0 | 3.9 | 3.8 |
| Interest coverage | 1.3 | 1.9 | 1.7 | 1.3 | 1.3 |
| Debt/equity | 1.5 | 1.5 | 1.4 | 1.6 | 1.6 |

Source: Company, KRChoksey Research

| | | | |
|------------------|-----------------------------|--|------------------|
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Patel Engineering Ltd.

| Date | CMP | Target | Recommendation |
|-------------|-----|--------|----------------|
| 17-Aug-2011 | 103 | 113 | HOLD |
| 16-May 2011 | 152 | 186 | BUY |

Rating Legend

| Our Rating | Upside |
|------------|---------------|
| Buy | More than 15% |
| Hold | 5% - 10% |
| Reduce | Nil - 5% |
| Sell | Less than 0% |

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