



January 08, 2008

Patel Engineering Ltd

Buy

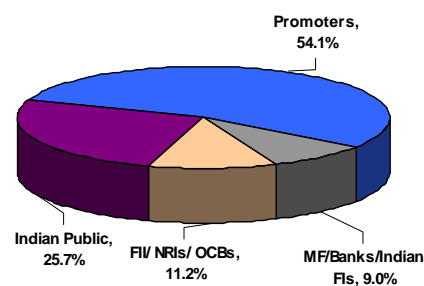
CMP: Rs 967

Target Price: Rs 1145

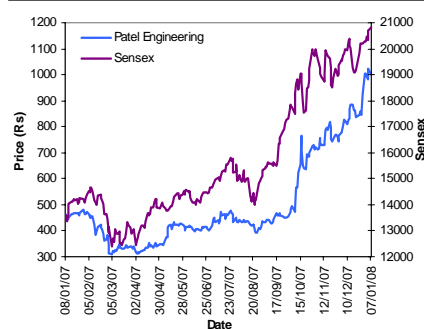
Key Data

Market Cap (Rs bn)	58.4
Market Cap (US\$ mn)	1424
52 WK High / Low	1070/292
Avg Daily Volume	73171
Face Value (Rs)	1
BSE Sensex	20873
Nifty	6288
BSE Code	531120
NSE Code	PATELENG
Reuters Code	PENG.BO
Bloomberg Code	PEC@IN

Shareholding Pattern (%)



Patel Engineering Vs BSE



Price Performance (%)

	Absolute	Relative
3 Months	110.7	91.7
6 Months	127.1	88.8
12 Months	117.8	64.4

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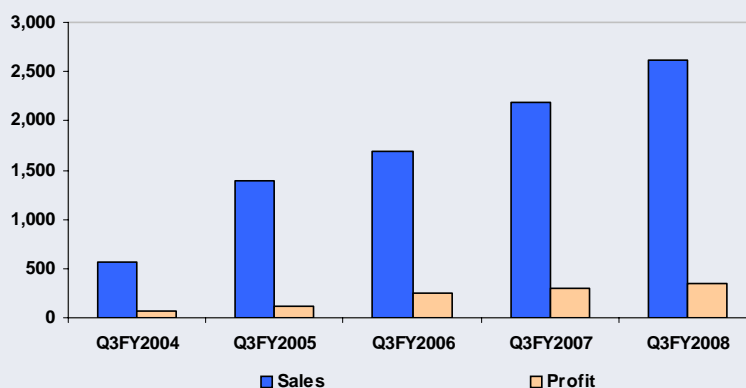
Q3FY2008 Result Update

Patel Engineering (PEL) has again managed to showcase a decent performance on the top line. The company reported a 33% YoY growth in sales and was in-line with our expectations, and 37% YoY growth in reported profit after tax. However profits without benefits of u/s 80IA stood at Rs 315mn.

Third Quarter (Q3FY2008)...good as it gets

PEL posted revenues worth Rs 3.7bn for Q3FY2008 as against Rs 2.8bn for Q3FY2007. The EBIDTA margins however faced some pressure and reported a reduction of 96bps YoY (from 16.6% in Q3FY2007 to 15.6% in Q3FY2008) on account of reduction of share of some high margin projects and adjustment in accounting policies.

Exhibit 1: Q3FY2008 ...revenues scaling new highs



Source: Company, FQ Research

Key Financials

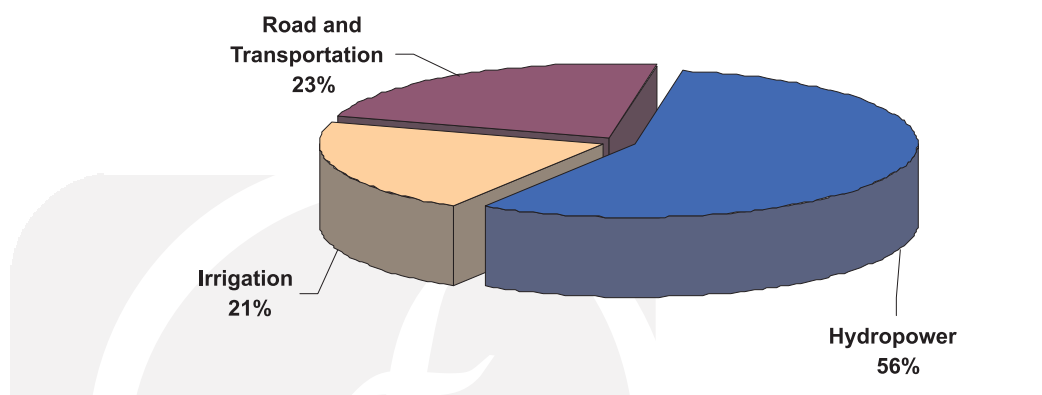
Y/E	March (Rs mn)	FY2007*	FY2008E	FY2009E	FY2010E
Net Sales		11,035	15,354	20,307	26,681
% chg		9.1	39.1	32.3	31.4
Net Profit		1,168	1,173	1,593	2,110
% chg		56.1	0.4	35.8	32.5
EPS (Rs)		19.6	19.7	26.7	35.4
EBITDA Margin (%)		13.7	14.2	14.9	15.1
P/E (x)		50.0	49.8	36.7	27.3
P/CEPS (x)		40.0	37.5	27.8	21.6
EV/EBIDTA		39.0	29.7	22.8	16.0
Book Value(Rs)		118.7	136.5	158.8	202.4
P/BV(x)		8.1	7.1	6.1	4.8
RoE (%)		16.5	14.4	16.8	17.5

Source: Company, FQ Research
*FY2007 figures according to press release

The company reported a PAT of Rs 411mn in Q3FY2008 as against Rs 299mn in Q3FY2007 (tax rate of 13%). PEL's PAT for Q3FY2008 stands at Rs 315mn with the effective tax rate of 33.5%.

Revenues for Q3FY2008 flowed from hydropower segment (56%), irrigation (21%) and transportation/others (23%). We expect the EBIDTA margins to stabilise around 17% for hydropower, 13% for irrigation and 9% for road projects in next two years. PEL has continued to bag orders in hydro power projects and capitalise its position in the Hydro power segment in India. We expect the revenue mix to be more biased towards hydropower segment thus pushing up the overall operating margins.

Exhibit 2: Revenue Mix Q3FY2008



Source: Company, FQ Research

For Q3FY2008 PEL's US subsidiaries have reported revenues of Rs 1.2bn and profit of Rs 45mn.

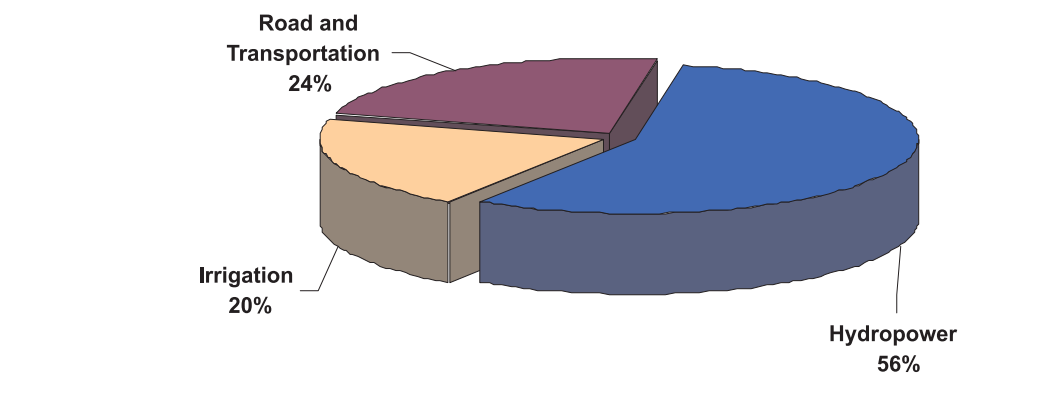
9 Months FY2008....On Track

The company has reported a 35% growth in revenues for 9mthsFY2008 at Rs 11bn as against Rs 8.4bn for 9mthFY2007. EBIDTA also showed improvement by 7bps (9mth FY08 EBIDTA : 14.2% via-avis 9mth FY07 EBIDTA : 14.1%) on account of change in revenue mix. The net profit (tax rate reported is 14%) stood at Rs 1bn for the present as against Rs 759mn for the same period last year, registering a growth of 44% YoY. However the net profit taking into account 33.5% tax rate is Rs 430mn.

Current order book Status.....

Current order book of PEL stands at Rs 55bn. The company is pre-qualified for Rs 60bn of projects.

Exhibit 3: Current Order Book



Source: Company, FQ Research

With the share of hydro power projects increasing in the overall order book we have revised our EBIDTA margins for FY2008E and FY2009E. We have also introduced FY2010E projections from this update.

Updates

New orders

The company has bagged an order in hydro power segment worth Rs 1.1bn from Government of Maharashtra in for civil works of Koyna Dam.

PEL has also signed a MOU with Arunachal Pradesh Government for hydro IPP for 100MW.

The company has also entered into a JV with Sotravic Ltee, a local construction company in Mauritius and has bagged an order worth Rs 656mn for construction of sewerage and water supply works. The order execution period is 24 months.

Revised estimates

PEL has been successful in adding up more hydro power projects which will benefit the company on EBIDTA margin front. We have thus revised our EBIDTA margins for FY2008E and FY2009E from 13.6% to 14.2% and 13.8% to 14.8% respectively. Thus our profit estimates to that extend have increased from 1.11bn to Rs 1.17bn for FY2008E and from Rs 1.44bn to Rs 1.59bn for FY2008E and FY2009E respectively. Thus the revised EPS stands at Rs 19.6 and Rs 26.7 for FY2008E and FY2009E.

We have introduced FY2010E estimates from this update and expect the company to showcase an excellent performance on account of execution of new projects in hydropower segments in FY2010E. We expect the company to report a top line of Rs 26bn in FY2010E registering a YoY growth of 32%. The EBIDTA margins will continue to improve and will grow by 89bps. We expect the company will require funds (which may be funded through debt) to fund its working capital and for capex on account of good order inflow. Thus, we expect interest and depreciation cost also to increase in the same proportion to the growth in sales. We expect PEL to report a PAT of Rs 2.1bn in FY2010E translating into an EPS of Rs 35.4. We have valued the core business at Rs 637 giving a P/E of 18x its FY2010E EPS, considering the overall re-rating in the infrastructure space.

Land Bank Updates...

We have valued the Phase 1 of PRIL on NPV basis (10 year lease model). We have revised the lease rentals for the Corporate Park and Corporate Tower in Jogeshwari, Mumbai. Thus, we arrive at a revised price Rs 220 per share for Phase I development.

We have also revised the Panvel property keeping in mind the new developments in this area and its repercussion on the property prices. Thus, we arrive at a revised price of Rs 217 per share for its remaining land bank.

We have also introduced the valuations for its recent BOOT project in hydro power in AP and its thermal power project in Gujarat (phase 1). We value both the projects on P/BV basis and arrive at a price of Rs 51 per share.

Valuation

Exhibit 4: Valuation Matrix (SOTP)

Segment	Valuation Parameter	Value Given	Share Price
Core Business	P/E (FY2010E)	18x	637
2 BOT	DCF		20
Phase 1 dev. PRIL	NPV		220
Land Bank	Value per share		217
Power Projects	P/BV	1.5x	51
Target Price			1145

Source: FQ Research

At the CMP of Rs 967 the stock discounts 36x FY2009E EPS of Rs 25.4 and 27x FY2010E EPS of Rs 35.4. **We upgrade our recommendation from Hold to Buy on the stock with a 12-month target price of Rs 1,145 which translates into annualized returns of 18.4%.**

Quarterly Financial highlights

Y/E March (Rs mn)	Q3FY2008 (3)	Q3FY2007 (3)	chg YoY (%)	FY2008 (9)	FY2007 (9)	chg YoY (%)
Net Sales	3789	2841	33.3	11329	8400	34.9
Expenditure	3197	2370	34.9	9719	7212	34.8
EBIDTA	592	471	25.6	1610	1187	35.6
<i>Margin (%)</i>	<i>15.6</i>	<i>16.6</i>		<i>14.2</i>	<i>14.1</i>	
Interest	44	41	6.3	136	100	36.3
EBDTA	548	430	27.4	1473	1087	35.5
Depreciation	104	97	7.1	304	270	12.6
Other Income	31	10	199.0	116	47	147.4
PBT	474	343	38.2	1286	864	48.8
Tax	64	45	42.7	190	105	81.0
PAT	411	299	37.6	1096	759	44.3
<i>Margin (%)</i>	<i>10.8</i>	<i>10.5</i>		<i>9.7</i>	<i>9.0</i>	
EPS	6.9	5.0		18.4	12.7	

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Ratings (Returns)

Buy > 15%

Hold 0-15%

Sell > -10%

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