

Gammon India

STOCK INFO.	BLOOMBERG
BSE SENSEX: 10,162	GMON IN
	REUTERS CODE
S&P CNX: 2,998	GAMM.BO

29 June 2006

Buy

Rs314

Previous Recommendation: Buy

Equity Shares (m)	86.7
52-Week Range	589/258
1,6,12 Rel. Perf. (%)	-23/-33/-25
M.Cap. (Rs b)	27.2
M.Cap. (US\$ b)	0.6

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	16,329	1,056	9.7	45.9	32.2	2.9	9.0	12.5	2.0	15.3
3/07E	21,262	1,589	18.3	88.2	17.1	2.6	14.9	14.5	1.4	11.2
3/08E	32,308	2,373	27.4	49.3	11.5	2.2	19.0	21.1	0.9	7.7

Period 12/04A is for 9 months; # 150month period Jan 05 - Mar 06

➤ **January-March 2006 Financial Performance impacted by AS-7:** During January-March 2006, Gammon reported revenues of Rs4.8b (up 70% YoY), EBIDTA margins of 7.4% (vs 10.9% YoY) and Net profit of Rs288m (vs Rs143m YoY). Robust order intake of Rs26b during July-December 2005 resulted in strong revenue growth during January-March 2006, while margin recognition was constrained by AS-7, as the projects did not reach the minimum threshold limit (15-20% completion) for margin recognition. Tax rates declined to 7.5% in FY06, vs 26.1% in CY04.

➤ **Current Order Book stands at Rs78-80b:** Gammon's existing order book stands at Rs78-80b, vs Rs68b in March 2006 and Rs37b in March 2005. Based on April-March 2006 revenues of Rs13.9b, current order book to bill ratio stands at 5.6x. Gammon continues to focus on large ticket size orders, with Top 10 projects accounting for 65% of the order book.

➤ **Utilization of GDR proceeds:** In February 2006, Gammon raised Rs4.4b through a GDR offer at Rs421/sh. The management stated that as at March 2006, Rs3.6b has been utilized for debt repayment and meeting working capital requirements and the balance Rs750m is invested in fixed deposits.

➤ **Recommend Buy:** We expect Gammon to report net profit of Rs1.6b for FY07 and Rs2.4b for FY08, respectively. At the CMP of Rs314, the stock quotes at reported PER of 17.1x FY07E and 11.5x FY08E. We value Gammon's 82.5% stake in Gammon Infrastructure at Rs15.9b (Rs184/share). Maintain **Buy**.

QUARTERLY PERFORMANCE

	(Rs Million)										
	CY04*				FY06 (Jan 05 - Mar 06)					Apr-Dec04	Jan-05-Mar-06
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	5Q		
Sales	3,378	2,887	2,627	3,262	2,806	2,862	2,891	3,350	4,069	8,775	14,851
Change (%)						-0.9	10.1	2.7	45.0		
EBITDA	312	317	358	285	306	340	447	486	353	959	1,932
Change (%)						7.6	24.9	70.5	15.5		
As of % Sales	9.2	11.0	13.6	8.7	10.9	11.9	15.5	14.5	8.7	10.9	13.0
Depreciation	52	52	54	58	61	66	63	84	97	165	371
Interest	70	90	98	94	98	102	102	114	55	282	471
Other Income	4	1	0	2	0	0	1	1	18	3	22
Extra-ordinary income	0	0	0	0	0	0	0	0	0	0	0
PBT	194	176	206	134	147	173	283	290	219	516	1,112
Tax	90	67	132	-65	4	19	36	80	-69	134	69
Effective Tax Rate (%)	46.2	38.1	64.2	-48.2	2.5	10.8	12.5	27.7	-31.5	26.1	6.2
Reported PAT	104	109	74	199	143	154	248	209	288	381	1,043
Adj PAT	104	109	74	199	143	154	248	209	288	381	1,043
Change (%)						41.7	234.9	5.3	101.3		

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

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January-March, 2006 Financial Performance impacted by AS-7

➤ **Revenues:** During January-March, 2006, Gammon reported revenues of Rs4.8b, up 70% YoY, vs our expectations of Rs4.4b. This 70% YoY growth compares with January-March 2005: (-)16.9%, April-June 2005: (-)0.9%, July-September 2005: 10.1% and October-December 2005: 2.7%. Robust order intake of Rs26b during July-December 2005 is the key driver for strong revenue growth during January-March 2006. Since a large proportion of the Top 10 projects of Gammon are EPC contracts, there is a time gap of ~3-6 months between award of the contract and actual construction, explaining the delay in terms of revenue recognition.

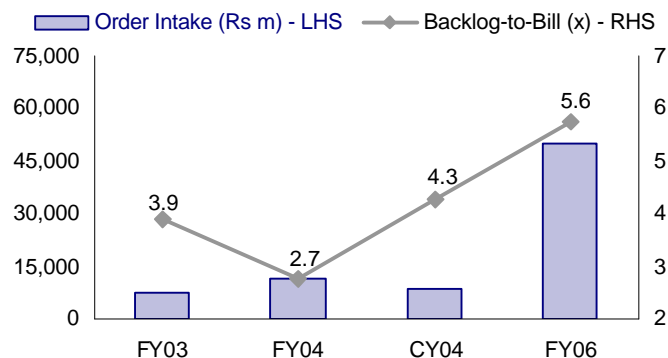
➤ **EBIDTA margins:** EBIDTA margins during Jan- Mar, 2006, stood at 7.4% (vs our expectation of 11.7%), down from 10.9% YoY. As per the Accounting Policy adopted (under Accounting Standard 7), Gammon accounts for margins post 15-20% project completion. Thus, while the robust order intake over the past two quarters have translated into strong revenue growth during Jan-Mar06, the company has not accounted margins on significant part of these revenues as the projects have not crossed the minimum threshold limit for margin recognition.

➤ **Net Profit:** Reported net profit stood at Rs288m (up 101% YoY). Reported numbers have been buoyed by tax write back of Rs69m in Jan-Mar 06. During FY06, tax rates for Gammon stood at 7.5%, vs 26.1% in CY04. Based on the decision of the Mumbai Income Tax Appellate Tribunal and the legal opinion obtained, the company has claimed 80IA benefits, resulting in lower tax rates.

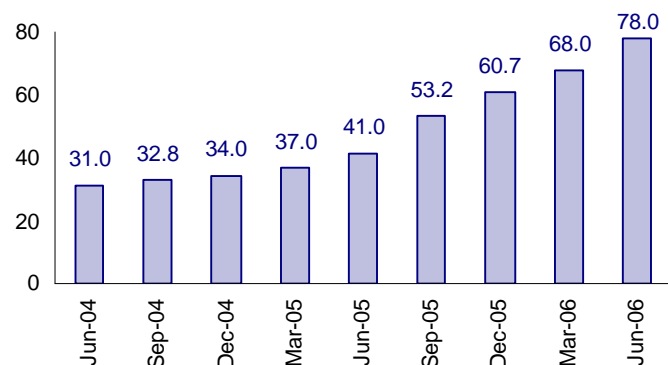
Order Book stands at Rs78-80b (June 2006)

Gammon's existing order book stands at Rs78-80b, vs Rs68b in Mar 06 and Rs61b in Dec 05. Based on Apr – Mar 06 revenues of Rs13.9b, current order book to bill ratio stands at 5.6x. Gammon continues to focus on large ticket size orders, with Top 10 projects as at March 2006 accounting for 65% of the order book.

TREND IN ORDER INTAKE (RS M) & ORDER BACKLOG TO BILL RATIO (X)



TREND IN QUARTERLY ORDER BACKLOG (RS B)



Source: Company/ Motilal Oswal Securities

Utilization of GDR proceeds

In Feb 2006, Gammon raised Rs4.4b through a GDR offer at Rs421/sh. The management stated that as at March 2006, Rs3.6b has been utilized for debt repayment and meeting working capital requirements and the balance Rs750m is invested in fixed deposits.

Recommend Buy

Over the next 12 months, we expect sizeable projects in nuclear and hydro power to be awarded. Gammon is one of the three construction companies in India (apart from L&T and HCC) which has the necessary pre-qualifications to bid for nuclear power projects and amongst the select few companies for hydro power.

We expect Gammon to report net profit of Rs1.6b for FY07 and Rs2.4b for FY08, respectively. At the CMP of Rs314, the stock quotes at reported PER of 17.1x FY07 and 11.5x FY08E. We value Gammon's 82.5% stake in Gammon Infrastructure at Rs15.9b (Rs184/share). Maintain **Buy**.

Gammon India: an investment profile

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 June 2006 was Rs68b. In addition, order intake for Gammon remained buoyant in 1QFY07, leading to an effective order book of Rs78b (5.6~x FY06 revenues)
- ✍ 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

- ✍ Change in accounting year from Dec to March. This entails that FY06 would now be a 15 month period from January 2005 – March 2006.
- ✍ 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.

Valuations and view

- ✍ Based on SOTP methodology, we arrive at a price target of Rs622/share
- ✍ At the CMP of Rs314, the stock quotes at reported PER of 17.1x FY07 and 11.5x FY08E. We value Gammon's 82.5% stake in Gammon Infrastructure at Rs15.9b (Rs184/share). 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 bidding stage
- ✍ BOT ventures could unlock sizable value

COMPARATIVE VALUATIONS

		GAMMON	HCC	NCC
P/E (x)	FY07E	17.1	14.3	13.5
	FY08E	11.5	11.0	8.6
P/E (x)*	FY07E	4.1	6.5	7.2
	FY08E	2.7	5.0	4.6
P/BV (x)	FY07E	2.6	1.9	2.3
	FY08E	2.2	1.7	1.9
ROE (%)	FY07E	14.9	16.9	18.6
	FY08E	19.0	16.3	24.5

* (adj for BoT and other investment)

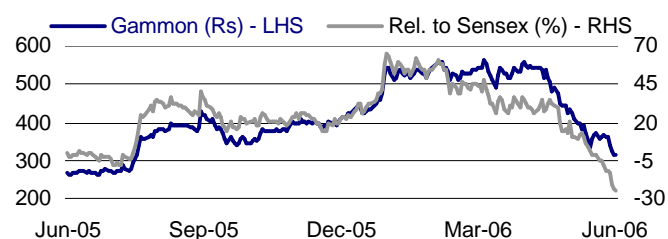
SHAREHOLDING PATTERN (%)

	MAR.06	DEC.05	MAR.05
Promoters	32.3	36.8	38.2
Domestic Institutions	10.9	9.0	3.6
FII's/FDIs	37.0	31.8	33.9
Others	19.8	22.4	24.3

EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
DEC-07	18.3	17.8	2.9
DEC-08	27.4	23.9	14.8

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E DECEMBER	2004	2004*	2006E#	2007E	2008E
Net Sales	11,238	8,775	16,329	21,262	32,308
Change (%)	53.8	4.1	116	62.8	52.0
Construction expenses	9,908	7,593	14,000	18,348	27,903
Office and site establishment ex	251	223	234	330	459
EBITDA	1,079	959	2,095	2,583	3,946
% of Net Sales	9.6	10.9	12.8	12.1	12.2
Depreciation	199	165	360	332	376
Interest	447	282	451	268	606
Other Income	6	3	4	4	4
PBT	438	516	1,288	1,987	2,967
Tax	252	134	232	397	593
Rate (%)	57.6	26.1	18.0	20.0	20.0
Reported PAT	186	381	1,056	1,589	2,373
Adjusted PAT	186	381	1,056	1,589	2,373
Change (%)	190.6	173.9	66.1	50.5	49.3

BALANCE SHEET					
(Rs Million)					
Y/E DECEMBER	2004	2004*	2006E#	2007E	2008E
Share Capital	125	152	173	173	173
Reserves	2,098	3,791	9,177	10,470	12,349
Net Worth	2,223	3,943	9,351	10,644	12,523
Loans	2,182	3,031	5,166	5,177	4,789
Deferred Tax Liability	320	366	366	366	366
Capital Employed	4,725	7,340	14,883	16,186	17,678
Gross Fixed Assets	4,142	4,505	5,195	6,033	6,833
Less: Depreciation	1,237	1,408	1,751	2,083	2,459
Net Fixed Assets	2,905	3,097	3,444	3,950	4,374
Capital WIP	48	128	188	150	150
Investments	805	896	1,547	4,544	6,044
Curr. Assets	5,913	8,258	15,019	16,148	20,149
Inventory	2,675	3,494	3,936	6,393	9,722
Debtors	1,718	2,335	2,326	3,778	5,745
Cash & Bank Balance	280	728	6,731	3,452	1,656
Loans & Advances	1,220	1,674	2,000	2,500	3,000
Other Current Assets	21	26	26	26	26
Current Liab. & Prov.	4,947	5,039	5,315	8,605	13,039
Creditors	2,287	3,030	3,077	5,027	7,645
Other Liabilities	2,594	1,918	2,147	3,487	5,303
Provisions	66	92	92	92	92
Net Current Assets	967	3,219	9,704	7,543	7,110
Application of Funds	4,725	7,340	14,883	16,186	17,678

E: M OSt Estimates; * Nine months ended Dec 2004,

#Fifteen months ended Mar 2006

RATIOS					
Y/E DECEMBER	2004	2004*	2006E#	2007E	2008E
Basic (Rs)					
Adjusted EPS	3.0	6.7	9.7	18.3	27.4
Growth (%)	118.0	124.7	45.9	88.2	49.3
Cash EPS	17.0	20.6	25.7	44.3	68.5
Book Value	35.6	51.8	107.8	122.7	144.4
DPS	0.5	0.5	15	3.0	5.0
Payout (incl. Div. Tax.)	19.2	115	14.0	16.4	18.3
Valuation (x)					
P/E (standalone)	105.7	47.0	32.2	17.1	11.5
Cash P/E	18.4	15.3	12.2	7.1	4.6
EV/EBITDA	27.0	23.1	15.3	11.2	7.7
EV/Sales	2.6	2.5	2.0	1.4	0.9
Price/Book Value	8.8	6.1	2.9	2.6	2.2
Dividend Yield (%)	0.2	0.2	0.5	10	16
Profitability Ratios (%)					
RoE	8.3	12.9	9.0	14.9	19.0
RoCE	20.0	17.6	12.5	14.5	21.1
Turnover Ratios					
Debtors (Days)	56	73	65	65	65
Creditors. (Days)	84	108	100	100	100
Leverage Ratio					
Debt/Equity (x)	10	0.8	0.6	0.5	0.4
CASH FLOW STATEMENT					
(Rs Million)					
Y/E DECEMBER	2004	2004*	2006E#	2007E	2008E
PBT before Extraordinary Items	438	516	1,288	1,987	2,967
Add : Depreciation	199	165	360	332	376
Interest	447	282	451	268	606
Less : Direct Taxes Paid	252	134	232	397	593
(Inc)/Dec in WC	-441	-1,804	-481	-1,119	-1,362
CF from Operations	392	-977	1,386	1,071	1,993
(Inc)/Dec in FA	-283	-436	-767	-800	-800
(Pur)/Sale of Investments	-36	-91	-651	-2,996	-1,500
CF from Investments	-319	-527	-1,418	-3,796	-2,300
(Inc)/Dec in Networth	146	1,429	4,500	0	0
(Inc)/Dec in Debt	299	849	2,135	11	-388
Less : Interest Paid	447	282	451	268	606
Dividend Paid	36	44	148	297	494
CF from Fin. Activity	-38	1,953	6,036	-554	-1,489
Inc/Dec of Cash	34	448	6,003	-3,280	-1,796
Add: Beginning Balance	246	280	728	6,731	3,452
Closing Balance	280	728	6,731	3,452	1,656

N O T E S



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1. Analyst ownership of the stock
2. Group/Directors ownership of the stock
3. Broking relationship with company covered
4. Investment Banking relationship with company covered

Gammon India

No
No
No
No

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