



Investor's Delight

19th January, 2011

Company	Patel Engineering Ltd.(PEL)
BSE Code	531120
Promoter's holding	45.5%
FV	Re.1
Equity Capital (Rs in mn)	69.8
Reserves (Rs in mn)	13,558
Book Value	Rs. 195
Market Capitalization (Rs in mn)	17,638
CMP	Rs. 252
Target Price	Rs. 312
Upside	24 %

A) About the company

1) Background

PEL operates as a civil engineering and construction company in India and abroad. The company, along with its various subsidiaries, offers its services to power, irrigation and water supply, infrastructure development, and transportation sectors.

2) Execution track record

In the past, the company has completed 40 hydropower projects, 175 km of tunneling projects and 78 dams in India. PEL's subsidiaries in the US — ASI RCC and Michigan Engineers, undertake and execute complex projects involving RCC and micro tunneling. It has completed 33 micro tunneling projects in India and the US.

3) Revenue profile

Majority of its revenues is accounted by hydropower segment (58%), followed by water and irrigation segment (28%) and balance (14%) from transportation and specialized projects. It has also forayed into real estate business, where it has land bank of over 1,100 acres located in Mumbai, Panvel, Bangalore, Mysore, Hyderabad and Chennai.

B) Investment Rationale

1) Strong order book

PEL has a strong order book of around Rs. 10.5bn (3.04x FY10 revenue). Hydropower-based projects constitute 50% of order book, water and irrigation account for 44% and rest 6% is from infrastructure and transportation. The company expects 60-70% growth in order book for FY11 on back of Rs. 20 bn orders, where it is pre-qualified, in addition to Rs.30 bn worth of internal orders (from power and real estate). The slow moving AP region accounts for ~18% of the company's order book with the biggest contribution from a single irrigation contract in the Pranahita project of Rs.35bn (PEL's share of Rs.15 bn) in the Telangana region

2) Foray in Real Estate - Huge value unlocking expected

- a) **Integrated township at Port Lois, Mauritius:** The Mauritius government has awarded ~56 acres of land to PEL for a lease rental of Rs. 20 mn per annum for 99 years. The company has no restrictions in terms of FSI, type of construction and time period. It is expected to generate Rs.40-60bn worth revenues from this project.
- b) **Commercial project at Mumbai:** The company is developing 1 million sq. ft. commercial project in Jogeshwari, Mumbai, from which it anticipates annual lease revenues of ~Rs. 1 bn. It has tied up with the anchor tenant for 1.5 lakh sq. ft. at Rs. 125 per sq. ft.
- c) **Residential project at Noida:** PEL's subsidiary has launched a residential project in Noida, Phase I of which comprises 1,600 units with a saleable area of 2.2 million sq. ft.
- d) **Integrated township at Bangalore:** PEL has also its Bangalore Electronic City township project. It has already sold close to 1,123 apartments in Smondoville phase (~10 acres). It has sold ~60% of the 239 apartments (Smondoville phase II of 5 acres). It has also been awarded the construction of Neomall in Bangalore to Dubai based Al Fara constructions. The mall is unique, as it will have horizontal (G+1) structure without any super-built up area, catering to premium products.

3) Diversification to mitigate concentration risk

To mitigate the risk of any segment specific slowdown, the company has forayed into other verticals like Power and Roads. The following is the description:

Power vertical

In its power vertical, PEL is in process of setting up thermal power plants with a total capacity of 2,650 mw in Tamil Nadu in two phases.

Foray in power transmission...

In this space, the company has bagged a project (BOOM basis) from REC Transmission Projects to establish 765 KV transmission system associated with Krishnapattanam Ultra Mega Power Plant in Consortium with M/s Simplex Infrastructure Ltd. and B S Transcomm Ltd. The estimated cost of the project is ~Rs.30 bn and is expected to be completed by March 2014 and the operation period would be 24 years.

Road and thermal power projects

It is also scaling up its asset ownership business in road and power sectors. The company's build-operate-transfer (BOT) road projects would provide steady annuity revenues. The company has two BOT road projects of which one, in Karnataka, is already operational with semi-annuity received. The other project, in Andhra Pradesh, is expected to follow soon.

C) Concerns

As per the media report - Hindustan Times, 24th December, 2010), the company has accepted the concealment of income of Rs. 2 bn. during searches conducted by the income tax (I-T) authorities.

D) Outlook and Valuation

At CMP, the stock trades at a P/E of 10.5x on H1FY11 annualized EPS. With due consideration to factors like a) good revenue visibility on account of strong order book, b) expected value unlocking from real estate business, we recommend a 'BUY' with a target price of Rs.312(13x at annualized H1FY11 EPS) for investors with a six months horizon.



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